

Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please make your comments by replying to questions below against proposed changes discussed in the Consultation Paper at the hyperlink: http://www.hkex.com.hk/consul/paper/cp200910ct_e.pdf.

Where there is insufficient space provided for your comments, please attach additional pages.

A. Transactions with persons connected with an issuer only by virtue of their relationship with the issuer's subsidiaries

1. Do you think that the definition of connected person should exclude persons connected by virtue of their relationship with an issuer's subsidiaries?

Yes

No

Please provide reasons for your views.

We agree with this proposal principally for the reasons set out in paragraph 18 of the Consultation Paper. Some of our clients have found the application of the connected transaction rules unduly burdensome – in particular, the requirement to monitor and report on transactions between (i) a subsidiary of a listed issuer and (ii) a substantial shareholder (or its associates) of that subsidiary, and also the expectation that it should put in place a framework agreement for continuing connected transactions.

In our view, a more efficient and less burdensome way to regulate such transactions at the subsidiary level would be to capture only those transactions where there is a real risk of undue influence being exerted against the interests of the listed group. This is possible only in transactions between (i) the non wholly-owned subsidiary of a listed issuer and (ii) its own directors or its substantial shareholder. In other words, if a separate, unrelated transaction takes place between the listed issuer itself or another of its subsidiaries and the connected person at the subsidiary level, this should not be caught by Chapter 14A because the possibility of the connected person being able to exert influence over another member of the listed issuer’s group, to the detriment of the independent shareholders of the listed issuer, is remote.

To deal with this potential issue, we would suggest such transactions should still need to be on normal commercial terms and in the ordinary and usual course of business of the relevant subsidiary of the listed issuer (i.e. they must be conducted on an arm’s length basis). In addition, such transactions could be required, in each case, to be subject to (i) the approval of the independent non-executive directors of the listed issuer before such transactions can be entered into; (ii) annual review by the independent non-executive directors of the listed issuer under Rule 14A.37; and (iii) annual review by the auditors of the listed issuer under Rule 14A.38.

In addition, as per our answer to question 3 below, we would suggest that the “insignificant subsidiary exemption” should work in parallel to our proposals above i.e. our suggested framework described above should be triggered only if the relevant subsidiary is not “insignificant”.

2. If your answer to question 1 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

The proposed draft Rule amendments would implement the proposal in the manner outlined in the Consultation Paper, but not our alternative suggestion outlined above in response to question 1. We have not provided the relevant drafting but would be happy to discuss this issue further with you if the concept is approved in principle.

3. On the basis that the definition of connected person will continue to include person connected at the subsidiary level, do you agree with the proposal to introduce an “insignificant subsidiary exemption” for connected transactions?

Yes

No

Please provide reasons for your views.

Listed issuers may from time to time enter into arrangements with third parties which give rise to connected transaction issues e.g. where the third party becomes a substantial shareholder of a joint venture entity. We believe it makes sense to apply a type of “de minimis” test to such arrangements, provided the relevant entities are insignificant from the listed issuer’s perspective (and regardless of the conclusion reached in response to question 1 above). On the basis that such entities are insignificant from the listed issuer’s perspective, there should be minimal risk of such entities being able to influence the relevant listed issuer.

4. Based on your experience, do you think that the “insignificant subsidiary exemption” would be used by you (or for market practitioners, your clients)?

Yes

No

Please describe the circumstances and refer to Option 1 or 2.

The “insignificant subsidiary exemption” may be used in the situation where a listed issuer wishes to establish or expand its operations in an overseas jurisdiction where – for legal or practical reasons – it makes sense to do so in partnership with a local, or more locally-established, entity. The exemption might also be used in certain financing structures e.g. structured finance transactions that use newly-incorporated companies and provide mutual benefits for the listed issuer and the counterparty, such as tax savings or taking liabilities off balance sheet. These transactions may be de minimis in the context of the listed issuer’s group as a whole but, under the current drafting of Chapter 14A of the Listing Rules, could unintentionally create new connected persons of the listed issuer with onerous ongoing monitoring and compliance obligations which should not be necessary given that the relevant entities are unlikely to be able to exert undue influence over the listed issuer.

5. If your answer to question 3 is “Yes”, do you agree with

(a) the proposed materiality threshold under (i) Option 1 or (ii) Option 2?

Yes (*please choose one of the following options*)

Option 1

Option 2

No

Please provide reasons for your views.

There should be an element of smoothing out fluctuations, hence the preference for Option 2.

More importantly, however, we believe the exemption should also be applicable to newly-created and newly-acquired subsidiaries which have a substantial shareholder. If a subsidiary is insignificant in the context of the listed issuer's group as a whole, it would be insignificant from the outset and the listed issuer should not have to wait for a "seasoning period" to elapse for one or more years before being able to rely on the new exemption. If this were the case, a listed issuer would potentially end up in the strange position of having to treat a substantial shareholder of its subsidiary and all of its associates as connected persons - with the corresponding onerous ongoing monitoring and compliance obligations until the relevant "seasoning period" has elapsed - before being able to rely on the "insignificant subsidiary exemption".

A more sensible approach would be to allow the listed issuer to apply the assets test at the outset (which it would need to do anyway for notifiable transaction purposes). If the assets ratio as calculated on Day 1 against the most recent annual or interim financial results of the listed issuer is less than 5% or 10% (depending on whether Option 1 or Option 2 is preferred), the insignificant exemption would be applicable – subject to annual testing against the assets ratio and the revenue ratio (see the response to (b) below) to make sure the relevant entity still meets the "insignificant subsidiary exemption".

We would like to make two additional points in the context of the proposed insignificant subsidiary exemption:

1. The "insignificant subsidiary exemption" should also be available for transactions between the listed issuer and the insignificant subsidiary itself. It is not currently clear from the Consultation Paper and the draft Rule amendments therein whether such transactions would benefit from the proposed exemption under Rule 14A.31(9) (possibly not, given the italicised heading in the draft Rule amendments).

2. A listed issuer should be able to rely on Rule 14A.41 if the relevant subsidiary has previously satisfied the "insignificant" test but does not in the future e.g. because one or more of the percentage ratios exceeds the minimum threshold for the exemption in any given year. In this case, the listed issuer should only need to comply with the applicable reporting, disclosure and independent shareholders' approval requirements of Chapter 14A if there is a variation or renewal of the relevant agreement during the time the entity does not meet the "insignificant subsidiary exemption".

- (b) the proposed bases for assessing the significance of a subsidiary, i.e. the asset ratio, revenue ratio and the profits ratio?

Yes

No. The significance of a subsidiary should be determined by (*please specify*): Just the assets ratio and perhaps the revenue ratio as well.

Please provide reasons for your views.

The profits ratio is possibly subject to the most fluctuation from year to year and is therefore not used in calculating the de minimis exemption under Rules 14A.31 to 34. The same logic should be applied to the “insignificant subsidiary exemption”.

We note, however, that the UK Listing Rules apply the assets ratio and the profits ratio for the purpose of the UK insignificant subsidiary exemption, although there is no revenue test under Chapters 10 and 11 of the UK Listing Rules.

Please also refer to our response to question 5(a) above.

- (c) the proposed additional safeguard to require the consideration ratio be less than 10% if an “insignificant” subsidiary concerned is itself a party to the transaction or its securities/assets are the subject of the transaction?

Yes

No

Please provide reasons for your views.

We agree that this additional safeguard is sensible because the transaction would otherwise be exempt from the reporting, announcement and independent shareholders’ approval requirements of Chapter 14A.

- (d) the proposed mechanism for applying the exemption to continuing connected transactions described in paragraph 27 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

If the relevant continuing connected transaction is exempt because it satisfies the requirements under Rule 14A.31(9), it should be exempt from all of the requirements - including the requirement for the agreement not to exceed three years. This would be consistent with the existing position under Chapter 14A of the Listing Rules, where the requirement under Rule 14A.35(1) to have a written agreement with a term not exceeding three years only applies to transactions not falling under Rule 14A.33.

However, for continuing connected transactions, we agree that the listed issuer should be required to assess the situation annually to make sure the requirements in Rule 14A.31(9) are still met.

Please see our suggested drafting amendments to Rule 14A.33(4).

6. If your answers to question 5 are “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

Please see our responses to question 5 above and our suggested drafting amendments.

7. If you agree with Option 2, do you think that the definition of “major subsidiary” under Rule 13.25 should be amended to align with that in the “insignificant subsidiary exemption” if adopted?

Yes

No

Please provide reasons for your views.

We do not have a strong view on this question. We can see there is some logic to having the same threshold apply in the two situations. However, they are dealing with two different scenarios. It is arguable that the disclosure threshold for an insolvency or winding up event should, in fact, be lower than for a connected transaction where the connected person is connected with an insignificant subsidiary of the listed issuer.

B. De minimis thresholds that trigger disclosure or shareholders' approval requirement for connected transactions

8. (a) For the exemption from independent shareholders' approval requirement, do you support the proposal to revise the percentage threshold to 5%? If your answer is "No", please specify the percentage threshold that you consider appropriate.

Yes

No. The percentage threshold should be *(please specify)*: _____

Please provide reasons for your views.

We believe the current 2.5%/HK\$10 million threshold is too small and catches too many transactions that are, in substance, immaterial to the relevant listed issuer.

We also believe the de minimis threshold should be applicable to an issue of new securities by a listed issuer to a connected person (i.e. delete the italicised Note below Rules 14A.31(2) and 14A.32). There are already sufficient protections in place to ensure that this Rule would not be abused e.g. the requirement to obtain shareholder approval for a non-preemptive placing of shares, the general mandate requirement, the thresholds under the Takeover Code for making a mandatory bid, the public float requirement under the Listing Rules and the Part XV SFO disclosure of interests regime.

- (b) For the exemption from all reporting, announcement and independent shareholders' requirements, do you support the proposal to revise the percentage threshold to 1%? If your answer is "No", please specify the percentage threshold that you consider appropriate.

Yes

No. The percentage threshold should be *(please specify)*: _____

Please provide reasons for your views.

Please see our response to question 8(a) above.

9. If your answer to question 8 is “Yes”, do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is “No”, please provide reasons and alternative views.

Please see our suggested drafting amendments. The proposal to use “each or all” instead of just “each” is repetitive. In this context, “each” and “all” mean the same thing.

In addition, we have suggested some drafting to clarify that the de minimis exemption should still apply in the following situation: where (by way of example) two of the percentage ratios are less than 1% and two of the percentage ratios are equal to or more than 1%, as long as all of them are less than 5%. It is currently unclear from the drafting of Rules 14A.31(2), 14A.32, 14A.33(3) and 14A.34 whether the de minimis exemption would be available in these circumstances (although we understand the Stock Exchange takes a sensible interpretation of the Rules in this instance). However, the opportunity should be taken to remove this potential uncertainty.

10. Do you agree that a percentage threshold is sufficient to assess whether a connected transaction is eligible for the de minimis exemptions?

Yes

No

Please provide reasons for your views.

The monetary threshold in paragraph (b) of each of the de minimis tests is disproportionately low for larger issuers. Moreover, the value of the consideration for the relevant listed issuer on a particular transaction is tested by reference to its total market capitalisation under the consideration ratio. The monetary threshold effectively renders useless the second limb of the de minimis test under paragraph (b). Just having the percentage ratios, therefore, is a much fairer and more proportionate way of testing whether a connected transaction is material or immaterial to the listed issuer.

11. Do you believe that an absolute monetary cap should also be imposed, irrespective of the percentage threshold test for de minimis exemptions? If your answer is yes, please specify the monetary cap that you consider appropriate for fully exempt connected

transactions (the monetary cap for connected transactions exempt from independent shareholders' approval would be adjusted proportionately).

Yes. The monetary cap for fully exempt connected transactions should be:

- HK\$100 million
- HK\$200 million
- HK\$500 million
- HK\$1,000 million
- Other monetary cap (*please specify*): HK\$ _____

No

C. Transactions that are revenue in nature and in the ordinary and usual course of business

12. Do you agree that the connected transaction Rules should govern revenue transactions with connected persons?

Yes

No

Please provide reasons for your views.

We believe the regime for regulating revenue transactions that are in the ordinary and usual course of business of a listed issuer should be made less burdensome to the listed issuer (while, of course, still complying with the principle set out in Rule 14A.01). Currently, such transactions are usually made the subject of “framework agreements”, which usually provide that the transactions must be on market terms. These could be problematic especially where the connected person is effectively a third party which has a small shareholding in a listed company or a subsidiary of listco.

The key protections for independent shareholders are that such transactions are (i) in the ordinary and usual course of business of the listed issuer, (ii) on normal commercial terms, and (iii) subject to the disclosure and annual review requirements. Provided these safeguards are in place through (in the case of (i) and (ii)) their being provided for under the Listing Rules as part of a definition of “revenue transactions”, we believe the regime for regulating revenue transactions in Chapter 14A can be significantly improved. By way of example, see UK Listing Rule 11.1.5(1) and 11.1.5A.

Notwithstanding the above proposal, we acknowledge that this would not ease the administrative burden for certain listed issuers whose ongoing monitoring and reporting requirements are already onerous; for example, where a listed issuer has a substantial shareholder which has a very large number of subsidiaries and associates. Hence, we are also in favour of the proposed exemption for revenue transactions with a passive investor.

Proposed exemption for revenue transactions with associates of a passive investor

13. Do you agree with the proposed exemption for revenue transactions with associates of a substantial shareholder who is a passive investor in the issuer group?

Yes

No

Please provide reasons for your views.

We agree with the proposal, subject to the following observations or questions that arise out of paragraphs 57 to 61 of the Consultation Paper and the draft rule amendments for Rule 14A.33(4) which are set out in Appendix I of the Consultation Paper:

1. We believe the passive investor exemption should be applicable to the substantial shareholder itself, as well as to associates of the substantial shareholder. We do not agree with the statement in the second point of paragraph 59 of the Consultation Paper that "Given the substantial shareholder is a passive investor, it is not expected to conduct transactions with the issuer directly". A substantial shareholder could be a "passive investor" in the listed issuer and still conceivably conduct ordinary course of business transactions with an issuer (or its subsidiary) on an arm's length basis e.g. if the listed issuer is a banking company and the substantial shareholder wishes to enter into an ordinary course banking transaction such as a loan, foreign exchange or trade finance transaction.

2. Is the proposed wording in Rule 14A.33(4)(b) intended to be a two-limb test or are paragraphs (i) to (vi) intended to be the definition of a "passive investor"?

3. With regard to the draft rule amendments and new Rule 14A.33(4), do you intend to define "sovereign fund"? Sovereign funds potentially come in a number of different forms and the degree of independence from the relevant Government/State could differ from entity to entity. For example, would any or all of the Hong Kong Exchange Fund, China Investment Corporation, Temasek, Government of Singapore Investment Corporation and UK Financial Investments be regarded as "sovereign funds"?

4. How wide is a "wide spread of investments" in new Rule 14A.33(4)? Certain sovereign funds like Temasek and GIC have been around for several decades, whereas other sovereign funds like CIC and the Kuwaiti Investment Corporation are relatively new. In other words, would a newly-created sovereign fund be excluded from reliance on the new exemption or would it be able to seek a specific waiver from the Stock Exchange on the basis that it intends to have a wide spread of investments in due course?

5. Does the independence test in paragraph (vi) of proposed Rule 14A.33(4) add anything that is not already covered by paragraphs (i) to (v), in particular paragraphs (iv) and (v)? In other words, what does "independent" mean in this context?

14. Do you think that the proposed exemption should also require the substantial shareholder be a passive investor in the relevant associate, for example, it is not involved in the management of the relevant associate?

Yes

No

Please provide reasons for your views.

No – please refer to point 1 in response to question 13 above.

Even putting that argument to one side, it should not matter whether the substantial shareholder is a passive investor in the relevant associate; what is important is whether they have any (real) influence over the listed issuer other than a 10-30% shareholding interest which, in itself, does not provide a great degree of control or influence over the listed issuer.

15. If your answer to question 13 is “Yes”,

(a) do you agree that the passive investor must be a sovereign fund or an authorised unit trust or mutual fund?

Yes

No

Please provide reasons for your views.

Not necessarily – please see the answer to question 15(b) below.

(b) do you think that the exemption should be made available to other passive investors? If so, which?

Yes. The exemption should be made available to *(please specify)*:

No

Please provide reasons for your views.

Consistent with the rationale behind the connected transaction rules, the general principle should be whether the passive investor is in a position to exercise influence over the listed issuer. It should not matter, therefore, if the substantial shareholder is a sovereign fund, mutual fund, unit trust, investment trust, limited liability company or other form of legal entity. As long as it is truly a passive investor, in accordance with the tests set out in paragraphs (iii), (iv) and (v) - and possibly paragraph (ii) - of new Rule 14A.33(4), then this should be sufficient.

In addition, there are other "tests" within new Rule 14A.33(4) which would need to be satisfied before the exemption can be relied upon, namely that the transaction is (i) of a revenue nature; (ii) in the ordinary and usual course of business of the listed issuer and (iii) on normal commercial terms.

(c) do you agree that the passive investor must not have representative on the board of directors of the issuer and its subsidiaries?

Yes

No

Please provide reasons for your views.

We believe this exemption should still be available if the passive investor has a non-executive director on the board of directors of the listed issuer. It is possible that an investor with a 10+% interest in a listed issuer would have a representative on the board of directors, but this should not preclude the application of the exemption. In this scenario, the interests of independent shareholders would be safeguarded anyway by general company law principles, which are applied to Hong Kong listed companies through paragraph 4(1) of Appendix 3 to the Listing Rules, whereby directors must abstain from voting on matters in which they have a material interest.

A potential difficulty could also arise if a subsidiary of the listed issuer and a subsidiary/associate of the passive investor enter into an unrelated joint venture arrangement where (i) the joint venture entity is a subsidiary of the listed issuer and (ii) both parties have at least one representative on the board of directors of the joint venture entity. Although this entity and the relevant directors are unlikely to have any influence over the decisions of the listed issuer higher up the chain, the (unintended?) result of the current drafting would be that the "passive investor" exemption would not be applicable if the passive investor has a representative on the board of directors of a listed issuer's subsidiary.

One possible solution to this potential difficulty is to clarify in the new Rules that the requirement not to have a representative on the board of directors of the "listed issuer" means the company/entity whose securities are listed on the Main Board (i.e. the Rule 1.01 definition of "listed issuer") and not the Rule 14.04(6) definition of "listed issuer" which includes its subsidiaries unless the context otherwise requires.

(d) do you agree with other proposed conditions set out in paragraph 59 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

Please see our response to question 13 above.

16. If your answer to question 13 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

Please see the answer to question 13 above and our suggested amendments to Rule 14A.33(4).

Proposed modification of the exemption for provision of consumer goods or consumer services

17. Do you agree with the proposed changes to expand the exemption for acquisition of consumer goods or services described in paragraph 66 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

We agree with the proposed changes for the reasons set out in paragraphs 65 and 66 of the Consultation Paper.

18. If your answer to question 17 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

19. Can you think of any other suggestions to improve the regulation of revenue transactions with connected persons?

Yes

No

If your answer is "Yes", please elaborate your views.

D. Definition of associate

(1) Definition of associate in Rule 1.01 (for non-PRC issuer) and Rule 19A.04 (for PRC issuer)

20. Do you support the proposal to carve out from the definition of associate the following entities?

(i) The holding company of the investee company or a fellow subsidiary of this holding company described in paragraph 68(e) of the Consultation Paper.

Yes

No

(ii) A company controlled by the investee company (not being a subsidiary of the investee company) described in paragraph 68(f) of the Consultation Paper and this company's subsidiary, holding company and fellow subsidiary.

Yes

No

Please provide reasons for your views.

We agree with the proposals for the reasons set out in paragraph 69 of the Consultation Paper.

21. If your answer to question 20 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

(2) Extended definition of associate in Rule 14A.11(4)

22. Do you agree with the proposed extension of the definition of associate to a company in which a connected person's relative has a majority control as described in paragraph 74 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

We agree with the proposal for the reasons set out in paragraphs 73 and 74 of the Consultation Paper.

23. If your answer to question 22 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

E. Definition of connected person

(1) Non wholly-owned subsidiary

24. Do you agree with the proposed exemption for (i) transactions between a connected subsidiary and any of its own subsidiaries; and (ii) transactions between any subsidiaries of the connected subsidiary?

Yes

No

Please provide reasons for your views.

We agree with the proposed exemption because, as suggested in paragraph 79 of the Consultation Paper, the possible scope for abuse by the connected person in this situation (i.e. what is effectively an intra-group transaction) is small, if not non-existent.

25. If your answer to question 24 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

We have proposed a couple of minor drafting amendments to Note 1(a) to Rule 14A.11(5). This Note is intended to clarify the Rule but there are currently four negatives in this sentence, which make it quite difficult to understand.

26. Do you agree that a non wholly-owned subsidiary should not be regarded as a connected person in the circumstances described in paragraphs 81(a) and (b) of the Consultation Paper?

Yes

No

Please provide reasons for your views.

We agree that the connected transaction rules should not apply in such situations, where they indirectly or inadvertently bring persons within the definition of "connected person" and it is unlikely that the spirit and intent of the connected transaction rules would be breached.

27. If your answer to question 26 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

(2) Promoter of a PRC issuer

28. Do you support the proposal to delete "promoter" of a PRC issuer from the definition of connected person?

Yes

No

Please provide reasons for your views.

We agree with the proposal for the reasons set out in paragraphs 85 and 86 of the Consultation Paper.

29. If your answer to question 28 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

(3) PRC Governmental Body

30. Do you support the proposal to apply those provisions for PRC Governmental Body in Chapter 19A to connected persons of non-PRC issuers?

Yes

No

Please provide reasons for your views.

We agree with the proposal for the reason set out in paragraph 90 of the Consultation Paper.

31. If your answer to question 30 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

(4) Management shareholder of a GEM issuer

32. Do you support the proposal to delete "management shareholder" from the definition of connected person in the GEM Rules?

Yes

No

Please provide reasons for your views.

We agree with the proposal for the reasons set out in paragraphs 94 and 95 of the Consultation Paper.

33. If your answer to question 32 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

F. Other changes to the connected transaction Rules

(1) Exemption for small transaction involving issue of new securities by subsidiary

34. Do you agree with the proposal to remove the restriction on applying the de minimis exemptions to an issue of securities by the issuer's subsidiary?

Yes

No

Please provide reasons for your views.

We agree with this proposal for the reason set out in paragraph 98 of the Consultation Paper. However, please also see our response to question 8(a) above, which states that the de minimis exemption should be applicable to an issue of securities by the listed issuer as well.

35. If your answer to question 34 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

Please see our suggested drafting amendments.

(2) Exemption for financial assistance provided on a pro-rata basis

36. Do you agree with the proposal to clarify that the exemption under Rule 14A.65(3)(b)(i) will apply where the commonly held entity is also a connected person?

Yes

No

Please provide reasons for your views.

We agree with the proposal for the reason set out in paragraph 102 of the Consultation Paper.

37. If your answer to question 36 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

(3) Transactions with third parties involving joint investments with connected persons

38. Do you agree with the proposal to extend the exemption under Note 3 to Rule 14A.13(1)(b)(i) to disposal transactions mentioned in paragraph 108 of the Consultation Paper?

Yes

No

Please provide reasons for your views.

We agree with the proposal for the reason set out in paragraph 108 of the Consultation Paper.

39. If your answer to question 38 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

Please see our suggested minor amendments to new Note 4 to Rule 14A.13(1)(b)(i).

(4) Annual review of continuing connected transactions

40. Do you agree with the proposed Rule amendments to clarify that the annual review requirements apply to continuing connected transactions that are subject to reporting and disclosure requirements in Chapter 14A?

Yes

No

Please provide reasons for your views.

We agree that it would be helpful to clarify this point.

41. If your answer to question 40 is "Yes", do you agree that the proposed draft Rule amendments in Appendix I to the Consultation Paper will implement our proposal?

Yes

No

If your answer is "No", please provide reasons and alternative views.

42. Are there any other comments you would like to make?

Yes

 No

If your answer is “Yes”, please elaborate your views.

There are five points we would like to make in relation to the connected transaction rules:

1. We believe (and understand from practical experience) that parts (b) and (c) of the definition of “subsidiary” in Rule 1.01 inadvertently bring certain entities within the ambit of the connected transaction rules that should not do so. More specifically, you may be aware that *SIC 12 Consolidation – Special Purpose Entities* addresses the situation when a special purpose entity (“SPE”) should be consolidated by a reporting enterprise under the consolidation principles in IAS 27. We understand the Interpretation sets out various examples which may indicate a relationship in which an entity should consolidate an SPE e.g. the reporting entity has the rights to obtain the majority of the benefits of the SPE and therefore may be exposed to risks incident to the activities of the SPE. On the basis that the purpose of the connected transaction rules is to safeguard against third parties exercising control or influence over the listed issuer or its subsidiaries, it would seem sensible to exclude from the definition of “connected person” those “subsidiaries” that are only brought within the ambit of Chapter 14A by virtue of a risk-based test. We propose that an amendment could be implemented by way of a separate, narrower definition of “subsidiary” in Rule 14A.10 which is used specifically for the purposes of Chapter 14A.

2. In FAQ46 that was published on 28 November 2008, the HKSE explained that for continuing connected transactions listed issuers are required to compute the assets ratio, revenue ratio and consideration ratio using the annual cap as the numerators. This is illogical. The annual cap is effectively a monetary cap on the consideration payable or receivable by the listed issuer. In a situation where the listed issuer is incurring expenditure, e.g. on leasing a property from a connected person, the revenue test should not be applicable because the payment of rent does not have an impact on the listed issuer’s revenue arising from its principal activities. Consistent with rule 14.07, listed issuers should only need to consider the percentage ratios to the extent they are applicable. FAQ46 should be amended to ensure that the impact of a transaction on a listed issuer is properly assessed by comparing like with like.

3. We believe it would be helpful, particularly in the current economic environment, to clarify how the profits ratio should be calculated in respect of loss-making companies. We acknowledge the provision under Rule 14.20 that the Stock Exchange may disregard a calculation and substitute other relevant indicators of size and the Stock Exchange’s helpful guidance on this point in FAQ53 from 2004. However, we believe it would be more helpful if the Stock Exchange were to re-introduce in the Listing Rules earlier guidance for loss-making companies as otherwise such companies may find it difficult to plan for corporate transactions for the benefit of shareholders when these may become very substantial acquisitions or disposals regardless of how small they are.

4. With regard to Rules 14A.72 to 14A.79, and as set out in more detailed in our response to Issue 14 in the January 2008 consultation exercise, we believe the concept of a general property acquisition mandate should be extended to include public auctions in other industries and other jurisdictions, not just Hong Kong. As previously stated, there appears to be no reason for limiting the application of such mandates to property companies and no basis for treating property development companies more favourably than companies in other industries which also participate in public auction processes.

5. On a more general level, it would be helpful if the Stock Exchange clarified when the percentage ratios will be applied on a forward-looking basis (particularly for notifiable transaction purposes). In our experience, the numerator for the percentage ratios has occasionally been applied on a forward-looking basis; for example, in a loan transaction, future revenue from interest earned has been applied against the historical revenue of a listed issuer – which does not seem logical. This situation arises more often where the relevant transaction is a contractual arrangement rather than an acquisition or a disposal of an asset or a company. In these cases, it is not clear how the percentage ratios should be calculated because, for example, it is difficult to identify the “revenue attributable to the asset”. In our view, for certain contractual arrangements which do not involve the acquisition/disposal of tangible assets, it is possible that the revenue and profits ratios are not applicable – because there are no (identifiable) revenue and profits attributable to the relevant “asset” at the time the transaction is entered into. Whilst Chapter 14A can be applied relatively easily in relation to transactions involving the acquisition/disposal of tangible assets, it can be very difficult to apply to transactions which do not involve the acquisition/disposal of a tangible asset (e.g. a transaction involving a mere contractual right).

Note: An interest of a connected person of the listed issuer ~~(other than at the level of its subsidiaries)~~ as defined in rules 14A.11(1) to (4) in the company which is held through the listed issuer is to be excluded from the 10% referred to in this rule.

- (b) to a listed issuer by;
 - (i) a connected person; or
 - (ii) a company in which both the listed issuer and a connected person are shareholders and where any connected person(s) of the listed issuer ~~(other than at the level of its subsidiaries)~~ as defined under rules 14A.11(1) to (4) is/are (individually or together) entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting of such company.

Note: An interest of a connected person of the listed issuer ~~(other than at the level of its subsidiaries)~~ as defined in rules 14A.11(1) to (4) in the company which is held through the listed issuer is to be excluded from the 10% referred to in this rule.

...”

- (ii) If the proposed “insignificant subsidiary exemption” to the connected transaction Rules is adopted

**“Connected transactions
~~(other than those involving financial assistance or the granting of options)~~
exempt from the reporting, announcement and
independent shareholders’ approval requirements**

14A.31 The following connected transactions will be exempt from all the reporting, announcement and independent shareholders’ approval requirements contained in this Chapter:

...

Transactions with persons connected at the level of subsidiaries

(9) a connected transaction on normal commercial terms where

(S)

- (a) the transaction is a connected transaction only because it involves a person who is a connected person of the listed issuer by virtue of its/his relationship with the issuer’s subsidiary or subsidiaries;

Question
5(a)

∴ (i) a connected person ⁴¹ of the listed issuer as defined under rule 14A.11(5); or //
(ii)

(b) ~~the relevant subsidiary has, or the relevant subsidiaries have in aggregate, contributed less than 5% of the issuer's total assets, profits and revenue in the financial year immediately preceding the transaction]~~ 10% of the issuer's total assets, profits [and revenue] in each of the 3 financial years immediately preceding the transaction]. For this purpose, 100% of the subsidiary's or subsidiaries' total assets, profits and revenue will be used to calculate the relevant percentage ratios; and

(c) if any relevant subsidiary (or any of its subsidiaries) is a party to the transaction or if the securities or assets of the relevant subsidiary (or any of its subsidiaries) are the subject of the transaction, the consideration ratio is less than 10%.

...

**Continuing connected transactions
exempt from the reporting, annual review, announcement and
independent shareholders' approval requirements**

14A.33 The following continuing connected transactions will be exempt from the reporting, annual review, announcement and independent shareholders' approval requirements of this Chapter:

...

Question 5 (d) Transactions with persons connected at the level of subsidiaries

(4) ~~a continuing connected transaction that meets the requirements in rule 14A.31(9) and the following requirements:~~ , provided that

(a) ~~the period for the agreement must not exceed 3 years, except in special circumstances described in rule 14A.35(1); and~~

(b) ~~the listed issuer must reassess the situation annually based on its latest published audited financial information. If the transaction no longer meets the requirements in rule 14A.31(9), the listed issuer must disclose the facts in its annual report and comply with the reporting requirements for the transaction. Upon any variation or renewal of the agreement, the listed issuer must comply with all applicable requirements of this Chapter for the transaction effected after such variation or renewal."~~

2. Draft Rule amendments relating to the de minimis exemptions - [Chapter 2: Parts B and F(1)]

**“Connected transactions
(other than those involving financial assistance or the granting of options)
exempt from the reporting, announcement and
independent shareholders’ approval requirements**

14A.31 The following connected transactions will be exempt from all the reporting, announcement and independent shareholders’ approval requirements contained in this Chapter:

...

De minimis transactions

Question
9

(2) a connected transaction on normal commercial terms where ~~each or all of the percentage ratios (other than the profits ratio) is/are:~~

STET (a) ~~each of the percentage ratios (other than the profits ratio) is less than 0.1% 1%; or~~

STET (b) ~~each of the percentage ratios (other than the profits ratio) is equal to or more than 0.1% 1% but less than 2.5% 5% and the total consideration is less than HK\$1,000,000;~~

[Note: This exemption does not apply to the issue of new securities by a listed issuer (other than its subsidiaries) to a connected person, which is governed by rule 14A.31(3).] — Not very clear. See Rider 43

...

(attached) as an alternative.

**Connected transactions (other than those involving financial assistance,
the granting of options or Qualified Property Acquisitions under a General Property
Acquisition Mandate) exempt from
the independent shareholders’ approval requirements**

14A.32 A connected transaction on normal commercial terms where ~~each or all of the percentage ratios (other than the profits ratio) is/are:~~

STET (1) ~~each of the percentage ratios (other than the profits ratio) is less than 2.5% 5%; or~~

STET (2) ~~each of the percentage ratios (other than the profits ratio) is equal to or more than 2.5% 5% but less than 25% and the total consideration is less than HK\$10,000,000~~

is only subject to the reporting and announcement requirements set out in rules 14A.45 to 14A.47 and is exempt from the independent shareholders’ approval requirements of this Chapter.

[Note: This exemption does not apply to the issue of new securities by a listed issuer (other than its subsidiaries) to a connected person, which is governed by rule 14A.31(3).]

**Continuing connected transactions
exempt from the reporting, annual review, announcement and
independent shareholders' approval requirements**

14A.33 The following continuing connected transactions will be exempt from the reporting, annual review, announcement and independent shareholders' approval requirements of this Chapter:

...

De minimis transactions

(3) a continuing connected transaction on normal commercial terms where ~~each or all of the percentage ratios (other than the profits ratio) is/are:~~

STET (a) ~~each of the percentage ratios (other than the profits ratio) is on an annual basis less than 0.1% 1%; or~~

STET (b) ~~each of the percentage ratios (other than the profits ratio) is on an annual basis equal to or more than 0.1% 1% but less than 2.5% 5% and the annual consideration is less than HK\$1,000,000.~~

all of them are

**Continuing connected transactions
exempt from the independent shareholders' approval requirements**

14A.34 A continuing connected transaction on normal commercial terms where each or all of the percentage ratios (other than the profits ratio) is/are:

(1) on an annual basis less than 2.5% 5%; or

(2) on an annual basis equal to or more than 2.5% 5% but less than 25% and the annual consideration is less than HK\$10,000,000

any of the ...
percentage ratios (other than
the profits ratio) is
...

Financial assistance

Exempt from reporting, announcement and independent shareholders' approval requirements

14A.65 The following connected transactions are exempt from the reporting, announcement and independent shareholders' approval requirements of this Chapter:—

(1) ...

**Continuing connected transactions
exempt from the reporting, annual review, announcement and
independent shareholders' approval requirements**

14A.33 The following continuing connected transactions will be exempt from the reporting, annual review, announcement and independent shareholders' approval requirements of this Chapter:

Consumer goods or consumer services

- (1) the provision of consumer goods or consumer services as set out in rule 14A.31(7);

Sharing of administrative services

- (2) ...; and

De minimis transactions

- (3) ...

- (b) ...; and

Transactions with ~~associates of a~~ passive investor

- (4) a connected transaction of a revenue nature in the ordinary and usual course of the listed issuer's business and on normal commercial terms where

- (a) the transaction is a connected transaction only because it involves an associate (the "Relevant Associate") of a substantial shareholder of the listed issuer; and

- ~~(b)~~ the substantial shareholder is a passive investor in the listed issuer and meets the following criteria:

- (i) it is a sovereign fund, or a unit trust or mutual fund authorised by the Commission or an appropriate overseas authority;

- (ii) it has a wide spread of investments other than the securities of the listed issuer ~~and the Relevant Associate~~;

- (iii) it ~~and the Relevant Associate are~~ connected persons only because it is a substantial shareholder of the listed issuer;

- (iv) it is not a controlling shareholder of the listed issuer; and

- (v) it does not have any representative on the board of directors of the listed issuer, and is not involved in the management of the listed issuer;

between a listed issuer and a passive investor or any of its associates which is or its associates business of

Question 13

holding an executive position

~~and~~
(vi) ~~it is independent of the directors, chief executive, controlling shareholder(s) and any other substantial shareholder(s) of the listed issuer.~~

4. Draft Rule amendments relating to the definition of associate – [Chapter 2: Part D(1)]

“1.01 Throughout this book, the following terms, save where the context otherwise requires, have the following meanings:

...

“associate”

(a) in relation to an individual means:—

- (i) his spouse;
- (ii) any child or step-child, natural or adopted, under the age of 18 years of such individual or of his spouse (together with (a)(i) above, the “family interests”);
- (iii) the trustees, acting in their capacity as such trustees, of any trust of which he or any of his family interests is a beneficiary or, in the case of a discretionary trust, is (to his knowledge) a discretionary object ~~and any company (“trustee controlled company”) in the equity capital of which the trustees, acting in their capacity as such trustees, are directly or indirectly interested so as to exercise or control the exercise of 30% (or such other amount as may from time to time be specified in the Takeovers Code as being the level for triggering a mandatory general offer) or more of the voting power at general meetings, or to control the composition of a majority of the board of directors and any other company which is its subsidiary (together, the “trustee interests”); and~~
- (iv) ~~a holding company of a trustee controlled company or a subsidiary of any such holding company; and [Repealed [insert date]]~~
- (v) any company in the equity capital of which he, his family interests, and/or any of the trustees referred to in (a)(iii) above, acting in their capacity as such trustees, ~~and/or any trustee interests taken together~~

*Carve out for
employee share schemes?*

See UKLR

Appx 1

*“associate” definition
para (2)*

wholly-owned subsidiary; and

Question 25

Notes: 1 *It follows that a non wholly-owned subsidiary is not a connected person where:*

- (a) *no connected person(s) of the listed issuer (other than at the level of its subsidiaries) as defined under rules 14A.11(1) to (4), is/are (individually or together) entitled to exercise, or control the exercise of, 10% or more of the voting power at any general meeting of such non wholly-owned subsidiary; and*
- (b) *the non wholly-owned subsidiary is not an associate of a connected person of the listed issuer (other than at the level of its subsidiaries) as defined referred to in rules 14A.11(1), (2) or (3).*

2 *An interest of a connected person of the listed issuer (other than at the level of its subsidiaries) in the subsidiary which is held through the listed issuer is to be excluded from the 10% referred to in this rule.*

(6) any subsidiary of a non wholly-owned subsidiary referred to in rule 14A.11(5).

Note: If the subsidiaries are connected persons only by virtue of being the subsidiaries of a non wholly-owned subsidiary referred to in rule 14A.11(5), transactions among these subsidiaries or between the non wholly-owned subsidiary and any of these subsidiaries will not be regarded as connected transactions.

7. Draft Rule amendments relating to promoter of PRC issuer - [Chapter 2: Part E(2)]

“1.01 Throughout this book, the following terms, save where the context otherwise requires, have the following meanings:

...

“associate” (a) in relation to an individual means:—

...

Notes (1) *This definition is modified in the context of connected transactions by virtue of rules 14A.11 and 14A.12.*

(2) *In the case of a PRC issuer, its promoters,*

shareholder) immediately prior to the acquisition;

(iii) it is proposed that the substantial shareholder will remain a director, chief executive or controlling shareholder of the company being acquired (or an associate of such director, chief executive or controlling shareholder) following the acquisition; and

(iv) following the acquisition, the only reason why he is still a controller is that he remains a director, chief executive or controlling shareholder of the company being acquired (or an associate of such director, chief executive or controlling shareholder), as the case may be. Where he remains a controlling shareholder, there must not be any increase in his interest in such company as a result of the acquisition.

4 For a disposal of interest in a company, this rule does not apply if the disposal falls within this rule only because the substantial shareholder of the company being disposed of is a director, chief executive or controlling shareholder of this company (or an associate of such director, chief executive or controlling shareholder) immediately prior to the disposal.

Question 39

an

transaction

General rules

Categories

14A.16 The categories of connected transactions are:

- (1) connected transactions exempt from the reporting, announcement and independent shareholders' approval requirements (see rule 14A.31);
- (2) connected transactions exempt from the independent shareholders' approval requirements (see rule 14A.32);
- (3) continuing connected transactions exempt from the reporting, annual review, announcement and independent shareholders' approval requirements (see rule 14A.33);