Appendix

Consultation Paper on Review of Connected Transaction Rules

Questions 1 – 3

We agree that with this proposal. Subject to our comments in this paper, we have no comments on Appendix I to the Consultation Paper.

We believe the Exchange should in due course publish the corresponding changes to other parts of the Listing Rules.

Question 4

We agree there is no need to extend the definition of connected person to key management personnel of an issuer's controlling shareholder / holding company.

Question 5

We are in favour of implementing the proposals in paragraphs 90(a) and 90(b) together.

In our view, even if X is a substantial shareholder holding 10% or more in the listed issuer's subsidiary (S), by definition the listed issuer, as the holding company, will always have dominant influence in S.

Taking Hong Kong company law as a standard, if the listed issuer is a holding company of S by virtue of holding 51% or more of S's capital or voting power, by normal operation of law it will be the only shareholder of S who can pass an ordinary resolution single-handedly. In the absence of unusual circumstances (e.g. unusual provisions in the articles or a shareholders' agreement), X's "influence" over S chiefly consists of its ability to block special resolutions. This is a type of negative control rather than an ability positively to direct S's affairs according to X's own wishes.

If the listed issuer is a holding company by virtue of its control over the composition of S's board, X is likewise highly unlikely to have dominance over the affairs of S to such an extent that it will "trump" the listed issuer, the directors appointed by whom will be obliged to act in the interests of S. The risks of channeling of benefits from S to X without the scrutiny of the listed issuer is minimal.

Accordingly, we believe it is not necessary to impose independent shareholders' approval on transactions between persons connected only at the subsidiary level with the issuer group. Further, we also believe the risk of any abuse between persons connected at the subsidiary level and subsidiaries (other than the subsidiary which the connected person is connected at) is minimal and therefore there would not be of much value to require issuers to make announcements covering transactions between such parties.

Question 6

We have no objection in principle to the proposals. However, in practice, who will determine whether a person is a "shadow director" or "de facto" controlling shareholder? We believe it would be highly unsatisfactory to leave the Exchange with a wide discretion to make such

determination without guidance to issuers as to the factors that will be taken into account, particularly if such discretion can be exercised ***after the event***.

In addition, the Exchange currently already has power to deem certain persons as connected persons pursuant to Listing Rule 14A.11 (4)(a). Given that 14A.11(4)(a) is drafted widely and should, for example, include those persons proposed to be included in paragraph 95, we question whether there is the need to provide separately for a deeming provision where the definition of terms such as "shadow director" and "de facto" controlling shareholder is not clear.

Question 7

We agree with this proposal. If the proposals in paragraphs 90(a), (b) and 100 are adopted, then effectively transactions between an issuer group and persons who are connected at the subsidiary level would not need to be announced or approved except that only transactions between a significant subsidiary and persons connected with that subsidiary would need to be announced. We believe this would strike the right balance taking into account the risk of abuse at the subsidiary level, the importance of updating shareholders on material developments relating to the issuer group and issuers' general compliance burden.

Question 8

We agree with this proposal.

In addition, we submit that the current rules are unduly restrictive with regard to professional trustees. At present, if an entirely independent intermediary firm is appointed as trustee to a portfolio of investments that includes shares in a listed issuer, that firm will become an associate if a connected person is to the trustee's knowledge a discretionary object. This would make any transaction between that firm and any member of the listed group a connected transaction.

For example, if XYZ Trustees Limited, a firm regulated by the SFC (or an overseas regulator of equal standing), is trustee to a private fund set up by a listed issuer's substantial shareholder for the benefit of his child, this firm cannot take up any mandate from the listed group for custodian or trustee services without complying with the requirements of Chapter 14A, even if the dealings are totally arm's-length, unless the de minimis exemption applies.

It will be noted that the "consumer services" exemption in Rule 14A.31(7) may not apply here, as engaging a trustee to manage assets may not be in the listed group's ordinary and usual course of business, as required under that rule.

This we believe is an unsatisfactory state of affairs which can easily be corrected by revising the rules.

Question 9

We agree generally with this amendment.

Question 10

We agree with retaining the current requirement.

Questions 11 – 13

We agree with these proposed changes.

Question 14

We do not have any strong views in this respect. However, we believe the Stock Exchange need not be overly concerned with specificity in the framework agreement or in the disclosure to shareholders. Instead of relying on regulators to "gate-keep" the issue, public shareholders may, and should, vote down a proposed continuing connected transaction if insufficient details are given to them. We believe this may be a more appropriate message for the Exchange to send to the market.

Question 15

We believe the current rules are appropriate. In practice, some issuers have genuine commercial reasons for entering into continuing connected transactions with connected persons, while others may be affected by other motives.

For the former category, making the rules more stringent (e.g. by imposing more rigid requirements on the content, duration or other provisions in the framework agreement) may be counter-productive to the interests of the listed issuer and its shareholders. For the latter category, the existence of basic requirements for a framework agreement does make connected transactions and their potential abuses more costly and may act as a deterrent to egregious cases.

The current regime appears to strike a balance between these considerations and we do not see any major problems with it.

Questions 16 - 17

We agree generally to codify the waiver practice from the requirement to have a written framework agreement subject to the following:

(a) We do not agree with the three-year mandate period. If the issuer's difficulty in arranging a written agreement is a structural problem (e.g. the circumstance outlined in paragraph 150), there is no reason why the problem would be resolved in three years' time. Imposing a time period only serves to increase both the issuers' and the Exchange's administrative burden since it means the transaction must be re-examined and a waiver applied for every three years. We believe the costs outweigh the benefit of this practice.

(b) We are not sure how the requirement of paragraph 151(3) can be met and specifically, what disclosure of terms would be "comparable" but not equivalent to having a written agreement. In practice, where there are practical difficulties in signing a framework agreement, the problem often lies in the parties' inability in agreeing terms and conditions that are clear, definite and capable of being reduced into an agreement – for example, it is often not possible or desirable to set down in very specific terms the parameters of various types of administrative support, consultancy, training and research, or other services that are in the nature of "mutual cooperation". If the issuer ends up with an obligation to disclose in an announcement the same information as it would put into a framework agreement, there is no realistic reduction in the issuer's compliance burden. We urge the Exchange to clarify what its expectations are for the required disclosure.

Question 18

We agree with this proposal.

Question 19

We agree with this proposal.

Question 20

Where the non-exercise of an option by an issuer amounts to a straightforward relinquishing of the right (potentially at the instigation of connected persons) for which no immediately perceivable benefits are received by the issuer, we agree with the requirement to do a valuation of the option to demonstrate that there is no material detriment caused to the issuer.

However, in other cases, there may be costs to the issuer in exercising an option (e.g. where a strike price is payable by the issuer, or works must be done by the issuer on the project which is the subject matter of the option). In such a case, the non-exercise of the option may simply be a commercial decision not to pay the expense or pursue the relevant project. We are concerned that the proposed alternative classification may be too rigid when applied to these cases. For example, will the valuation of the option take into account the costs that the issuer must incur to exercise it? What if the "cost" is not quantifiable (e.g. giving up another business opportunity)?

We believe that the "fair and reasonable" confirmation outlined in the second bullet point of paragraph 166 would be sufficient in these cases, provided that the grounds for the opinion are properly disclosed to public shareholders.

Question 21

We agree broadly with the proposals in (a) and (b), subject to the same issue as outlined in Question 20 above.

Question 22

We agree with this proposal.

Questions 23 – 24

We have no particular view on these issues.

Question 25

We agree with this proposal.

Questions 26 – 27

We agree with these proposals.

Question 28

We do not have further proposals.