

HKEX LISTING DECISION
HKEX-LD111-2017 (published in October 2017)

Parties	Company A – a Main Board issuer Company B – a company engaged in the provision of payment services The Parent Company – Company A’s controlling shareholder holding a majority of Company A’s issued shares
Issue	Whether the Exchange would exercise its power to deem Company B as a connected person of Company A under Main Board Listing Rule 14A.19
Listing Rules	Main Board Listing Rules 14A.19 and 14A.20
Decision	The Exchange determined that Company B should be deemed as a connected person of Company A under Main Board Listing Rule 14A.19. Accordingly, the Transactions would constitute connected transactions of Company A.

FACTS

1. Company A proposed to engage Company B to provide certain payment processing services for Company A’s online sale of products (the **Transactions**).
2. Company A submitted that Company B was not an associate of the Parent Company under Chapter 14A.
3. Nevertheless, there were certain relationships between Company B and the Parent Company:
 - (a) Company B was initially established by the Parent Company to operate its payment service business. In light of the subsequent changes in the relevant business licensing regulations in the PRC, the Parent Company divested all its interest in and control over Company B to PRC nationals and restructured Company B as a PRC domestic company to facilitate its application for the PRC regulatory approvals. As part of the divestment, the Parent Company also entered into various agreements with Company B and other relevant parties to govern the Parent Company’s continuing financial and commercial relationship with Company B in the future.

- (b) At the time of the proposed Transactions, the Parent Company still maintained various arrangements with Company B to secure long-term economic participation in Company B, including that:
 - (i) the Parent Company would receive royalty streams and a service fee amounting to the sum of an expense reimbursement plus a profit sharing of 38% of the consolidated pre-tax income of Company B (the **Profit Sharing Arrangement**) for the license of certain intellectual properties and provision of software technology services; and
 - (ii) where Company B applies for, and receives, certain PRC regulatory approvals in the future and subject to certain conditions, it would issue new shares to the Parent Company for up to 33% of its equity capital.
- 4. The issue was whether the Exchange would exercise its power to deem Company B as a connected person of Company A such that the Transactions would become connected transactions of Company A.
- 5. Company A submitted that Company B should not be deemed as its connected person because:
 - (a) The deeming power under Rule 14A.19 should only be exercised by the Exchange with reference to Rule 14A.20 which, in this case, did not apply because the Profit Sharing Arrangement was executed before (and thus not “with respect to”) the Transactions.
 - (b) The Transactions would be conducted in the ordinary course of Company A’s business on an arm’s length basis under normal commercial terms. The Parent Company was not able to influence the terms of the Transactions.
 - (c) Neither the Parent Company nor Company A had an intention to circumvent the connected transaction Rules. As the Parent Company holds over 50% of the equity interest in Company A, but shares only 38% of the profit of Company B, there would be no incentive to manipulate the rates paid by Company A - the Parent Company would bear over 50% of any cost increase of Company A which would exceed the additional 38% profit it shares through the Profit Sharing Arrangement.

APPLICABLE LISTING RULES

6. Main Board Listing Rule 14A.19 provides that:

“The Exchange has the power to deem any person to be a connected person.”

7. Main Board Listing Rule 14A.20 provides that:

“A deemed connected person includes a person:

(1) who has entered, or proposes to enter, into:

(a) a transaction with the listed issuer’s group; and

(b) an agreement, arrangement, understanding or undertaking (whether formal or informal and whether express or implied) with a connected person described in rule 14A.07(1), (2) or (3) with respect to the transaction; and

(2) who, in the Exchange’s opinion, should be considered as a connected person.”

ANALYSIS

8. The purpose of the connected transaction Rules is to guard against the transfer of benefits by persons who are able to exercise significant influence over the issuer. Rule 14A.19 provides that the Exchange has the specific power to deem a person to be connected. When applying the deeming provision, the Exchange considers all relevant facts and circumstances surrounding the transaction and has particular regard to the substance and not the form of the arrangement.
9. In the present case, the Exchange noted that there was a close association between the Parent Company and Company B (see paragraph 3 above). The Exchange considered it appropriate to deem Company B as a connected person of Company A under Rule 14A.19 because:
- (a) The Parent Company, as a controlling shareholder of Company A, was in a position to exercise significant influence over Company A’s transactions with Company B.
- (b) The Profit Sharing Arrangement would enable the Parent Company to stand to benefit from Company A’s transactions with Company B and could effect a transfer of benefits from Company A to the Parent Company.

10. The Exchange disagreed with Company A's view because:
- (a) Under Rule 14A.19, the Exchange may deem any person to be a connected person. Rules 14A.20 and 14A.21 set out certain specific circumstances where the Exchange may apply the deeming provision, which are not meant to be exhaustive.
 - (b) The Profit Sharing Arrangement was part of the arrangements for the Parent Company to secure long-term economic participation in Company B. As the Parent Company was in a position to exercise significant influence over Company A and its transactions with Company B, there was a conflict of interests of Company A with those of the Parent Company. The Exchange's decision to apply the deeming provision was consistent with the policy intent of the connected transaction Rules, i.e. to guard against the transfer of benefits by persons with significant influence over a listed issuer.
 - (c) Intention of circumvention and incentive for rates manipulation were not the tests in the present case; neither were they the only circumstances where a deeming provision should be invoked. Company A's argument that the Transactions were negotiated on an arm's length basis was also not the relevant test in the present case. Because of the concerns mentioned in paragraph 9 above, to deem Company B as a connected person of Company A would appropriately increase the transparency and oversight of the Transactions within the regulatory ambit of the connected transaction Rules.

DECISION

11. The Exchange determined that Company B should be deemed as a connected person of Company A under Rule 14A.19. Accordingly, the Transactions would constitute connected transactions of Company A.