



Hong Kong

March 2015

HONG KONG STOCK EXCHANGE TO ISSUE CONCLUSIONS ON WEIGHTED VOTING RIGHTS

Introduction

The Hong Kong Stock Exchange Limited (**Exchange**) will issue its conclusions on its August 2014 Concept Paper on Weighted Voting Rights (**Concept Paper**) in due course, according to Mr. Ashley Alder, CEO of Hong Kong's Securities and Futures Commission (**SFC**), speaking at an SFC media event on 19 March 2015.

The Concept Paper, to which responses had to be submitted by 30 November 2014, sought views on whether the Hong Kong Listing Rules should be changed to allow the listing of companies with dual class share structures and other weighted voting rights (**WVR**) structures, which give certain persons voting power or other related rights disproportionate to their capital contribution to the company. These companies are currently prohibited from listing in Hong Kong by the Listing Rules' one-share one-vote requirement. The Listing Rules thus currently prevent companies like Alibaba, and other major Chinese technology companies, which typically adopt WVR structures, from listing in Hong Kong. The right of Alibaba's founding shareholders to nominate a majority of the board would have contravened the Exchange's one-share one-vote principle. Alibaba chose instead to list on the New York Stock Exchange where WVR structures are not an obstacle to listing and raised US\$25 billion in the largest IPO ever in September 2014.

Having asked the question whether companies with WVR structures should be allowed to list in Hong Kong, the Concept Paper went on to raise a series of questions as to what if any

restrictions should be imposed if these companies are allowed to list. Should WVR structures only be allowed for certain types of companies – e.g. just technology or innovative companies? Would they only be allowed for new listing applicants or could existing listed companies convert? What types of WVR structures should be allowed – dual class share structures only or all, including where special control rights are granted by a company's articles? Should the WVR structure be forced to terminate on a set future date, on a change in control of the company, or on transfer of the founder's shareholding?

The Concept Paper said that if responses supported the listing of companies with a WVR structure, the Exchange would publish its conclusions on the Concept Paper, and then proceed to a second stage formal consultation process on the detailed Listing Rule changes.

Latest SFC Comments

In the first development in relation to the Concept Paper since its publication last summer, Mr. Ashley Alder's remarks to the SFC media lunch¹ stressed that the SFC is open to new ideas and gives careful consideration to proposals that might enhance Hong Kong's position as a leading international finance centre. Noting that it is for the Exchange to take the next step on WVR structures, since changes to its Listing Rules are required, he said that the Exchange will issue its conclusions in due course.

¹ SFC. "Opening remarks at SFC's media luncheon". Ashley Alder, CEO. 19 March 2015 at http://www.sfc.hk/web/EN/files/ER/PDF/Speeches/Ashley_20150319.pdf.

Mr. Alder then went on to consider some of the critical issues which will need to be considered:

Restriction on types of companies allowed to list with WVR

A key question raised in the Concept Paper was whether WVR structures should be restricted to certain types of companies, such as information technology companies or a wider concept of “innovative companies”, although the difficulty of defining these terms was noted, and the fact that such a restriction would make Hong Kong the only exchange to restrict the types of companies that can list with a WVR structure. Mr. Alder commented that it is more difficult to justify allowing standard companies in the industrial, financial or service sectors to adopt a WVR structure when the likelihood is that they would be willing to list without WVR, if not given the option to adopt them. This echoed comments attributed to SFC Chairman Mr. Carlson Tong Ka Shing in press reports of the SFC media event,² who was quoted as saying “we should consider whether to allow all companies to use such shareholding structure, or only creative high-tech companies whose corporate values rely on their founders”.³ Mr. Alder however identified in his talk the practical difficulty of creating a workable definition of this type of company.

Investor Protections to be put in place

The other major area highlighted was investor protection and the possible imposition of requirements for measures which are voluntarily adopted by US-listed companies with WVR structures. Examples include a “sunset clause” under which the superior rights under the WVR structure are permitted only for a specified period; a minimum shareholding requirement for the founder; or provision for the superior rights to terminate on any transfer of the founder’s interest.

Related Issues: China’s Draft Foreign Investment Law

Another consideration in relation to WVR structures is one raised by China’s draft Foreign Investment Law published on 19 January 2015 by China’s Ministry of Commerce. One of the key changes proposed is formal recognition of the legal validity of so-called VIE structures, which have long been used to get around China’s foreign investment restrictions which apply to many of its most important industries, including

telecommunications and information technology. For that reason, China’s overseas-listed technology companies like Alibaba, Baidu and Weibao all use VIE structures under which the offshore listing vehicle controls the sensitive licences necessary to conduct the business in China through a series of contracts with the VIE and its Chinese shareholders. When implemented, the new law will prohibit the use of the VIE structure to circumvent the restrictions on foreign investment. However where the VIE is controlled by a Chinese shareholder, and for this purpose the new law will recognise the concept of *de facto* control (including where a Chinese party has control through a dual share class structure or rights to nominate a majority of the board), the VIE will not breach any provisions prohibiting or restricting foreign investment in a specified industry. A change to Hong Kong’s Listing Rules to allow the listing of a company with a WVR structure would then pave the way for the continued listing of Chinese companies in industries in which foreign investment is either restricted or prohibited where the Chinese founders have control under the WVR structure.

For further information on the draft Foreign Investment Law, please see Charltons newsletter “The 10 Most Important Things to Know about China’s New Foreign Investment Law”.⁴

² The Standard. “Share Voting Change Hinted”. Ling Wang. March 20 2015 at http://www.thestandard.com.hk/news_detail.asp?pp_cat=1&art_id=155390&sid=44109079&con_type=1

³ Ibid.

⁴ Charltons. “The 10 Most Important Things to Know about China’s New Foreign Investment Law”. February 2015 at <http://www.charltonslaw.com/the-10-most-important-things-to-know-about-china-new-foreign-investment-law/>.

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