

Linklaters
年利達律師事務所

Linklaters



Corporate Communications Department
Hong Kong Exchanges and Clearing Limited
12th Floor, One International Finance Centre
1 Harbour View Street, Central
Hong Kong

By Fax (2524 0149) and By Hand

7 April 2008

Our Ref 我所文號

Dear Sirs

Combined Consultation Paper on Proposed Changes to the Listing Rules

We refer to the Combined Consultation Paper on Proposed Changes to the Listing Rules issued by Hong Kong Exchanges and Clearing Limited in January 2008 and enclose herewith our response for your kind consideration. Please note that we have limited our response to those sections of the consultation paper which we have serious concerns or objection to.

Please do not hesitate to contact Jeremy Webb of this office ([redacted]) if you would like to discuss our response relating to Issue 11 (General mandates) or Celia Lam of our Beijing office (Tel no.: [redacted]) if you have any questions on our other comments.

Yours faithfully



Linklaters
Encl.

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A09257519/0,3/07 Apr 2008

Linklaters' Response to Issue 11.34(b) and (c) of the Hong Kong Stock Exchange ("HKSE") Consultation Paper (the "Consultation Paper")

We are writing to raise our strong objection to the proposals set out in 11.34(b) and (c) of Issue 11: General Mandate of the Consultation Paper (the "**Proposals**"), namely:

- (b) all issues of securities to satisfy an exercise of convertible securities would need to be made pursuant to a specific mandate from the shareholders; and
- (c) for the purpose of seeking the specific mandate, the listed issuer would be required to issue a circular to its shareholders containing all relevant information.

Convertible Bond Market in Hong Kong

This type of financing is very attractive to issuers and investors, because of its low headline interest rates, downside debt protection and equity upside through the option. Since 2004, there have been over 40 issues of convertible bonds issued by companies listed on the HKSE raising funds of over US\$10,500,000. Some of Hong Kong's largest corporate groups have accessed the market in this way including Henderson Land, Hopewell Holdings Limited, Kerry Properties, Hong Kong Land and China Gas Holdings Ltd.

Our concern is that the Proposals will potentially have an adverse effect on the Hong Kong convertible bond market, which is neither in the interests of issuers or minority shareholders.

Timing Implications of the Proposals

As stated in the Consultation Paper, notwithstanding the importance of pre-emptive rights, it has been generally accepted in the Hong Kong market (and internationally) that there should be some flexibility for listed issuers to issue equity without having to do so on a pre-emptive basis.

Practically all convertible bonds are launched on an accelerated bookbuild basis in order to ensure that the appropriate market window is caught, decreasing pricing risk for the issuer and underwriters. A transaction may be launched at a couple of days notice, and the book is usually built after market close, but prior to the opening of the market the next day. The timetable for issuing convertible bonds is therefore extremely tight.

The requirements for a shareholders' resolution authorising the issue of convertible bonds along with the requirement for a circular containing all relevant information, would severely constrain the convertible bond market in Hong Kong. These requirements would delay the issue of a convertible bond for approximately 5 to 6 weeks, denying the issuer access to the market for this period and hence pricing risk. The shareholder resolution and circular requirements would also give the market prior knowledge of the issue (perhaps resulting in market speculation including shorting the stock) and result in greater expense for the issuer.

As a result, without a quick and flexible means of accessing capital, shareholders may be prejudiced. Further, Hong Kong listed companies would be placed at a significant disadvantage to those listed in Singapore, the UK and other jurisdictions where such restrictions do not apply.

Equality of Treatment for Equity Linked Securities

The two key concerns raised in the Consultation Paper are whether:

- the 20% general mandate should continue to apply to all types of equity as well as equity-linked issues and
- there should be restrictions on the current prohibition of issues at more than 20% or more to the 'benchmarked' price.

We do not see why convertible securities should be distinguished in each case from equity.

The argument put forward in the Consultation Paper is that the prohibition on issuing shares at a discount of 20 per cent. or more to the 'benchmarked price' limits is only effective in cases where the share issue takes place near to the time the benchmark valuation is performed. If there is a gap between the valuation and the issue of the shares, the effectiveness of the price limitation is reduced. The Consultation Paper cites options with a long exercise period as examples of such securities.

As noted in the Consultation Paper, "where the option is properly priced, there should not be any cause for concern". We agree with this view and would emphasise that the vast majority of the convertible bonds issued in Hong Kong and listed on the Hong Kong stock exchange are issued at a premium to the share price on the date of pricing the security. The premium over the share price for a Hong Kong convertible is commonly in the 20 to 30% range above the closing price of the equity. The net result is that the issuer has been paid a premium to its share price for such security (to the benefit of the minority shareholders).

The whole commercial rationale of a convertible security is that if the market price rises above the conversion price holders will convert at that price and achieve a profit. From the issuer's perspective the debt is extinguished on exercise and it will have achieved a low cost financing (typically convertible bonds are issued at a low or zero coupon). Although on exercise the issuer will be issuing shares at a discount to the then market price, it has also had the benefit of the premium achieved on issue. The holders of course also take the risk of the security never going up by the extent of the premium and the option being worthless.

Issues of convertible bonds or other equity-linked instruments at a discount to the 'benchmarked price', do arguably result in a diminution in value for existing shareholders. However, so would an issue of shares at a discount. In terms of the initial issue, why then should the Listing Rules distinguish convertible securities from pure equity issued at a discount? The time value of the option may exaggerate the discount if the share price rises, but the investor is still taking risk with the instrument, and the market is informed and aware of the potential future dilutive effect. Clearly these instruments cannot be sold to connected parties, so it is independent third parties that benefit from such diminution in value.

Conclusion

In principal we do not think that a distinction should be made between equity and equity linked securities. However, the key question is how do you regulate the extreme examples where the security is not priced commercially. We believe that management of a company should be left to decide what the most appropriate funding option is for the company in light of the current market situation and indeed what the best pricing is that they can achieve in the market. The Directors of a Hong Kong incorporated company have a fiduciary duty to act in the best interests of the company. If they fail in this duty shareholders have recourse to the courts.

In conclusion, it seems that the primary purpose of the Proposals is to prevent a very small number of issuers issuing equity-linked securities at a discount. However, the effect of removing the general mandate and requiring a shareholders resolution and circular for convertible securities, will in our view prejudice the entire convertible bond market in Hong Kong. This will put HKSE

listed companies at a significant disadvantage to their peers listed in other jurisdictions and restrict their access to an important method of financing.

Linklaters' Response to other issues raised in the Consultation Paper

We also set out below our comments on some of the other issues raised in the Consultation Paper:-

1 Issue 5 – Qualified accountants

Question 3.1: We agree that the requirements in the Main Board Rules for a qualified accountant should be removed for the reasons set out in the Consultation Paper.

2 Issue 5A – Minimum level of public float

Question 5.1: We agree that the existing Rule 8.08(1)(d) should be amended to enhance regulatory clarity and to remove the need to apply for waivers from the Exchange under the existing Rule 8.08(1)(d).

Question 5.2: Please see our response to Question 5.3 below.

Question 5.3: The existing Rule 8.08(1)(d) provides that the “Exchange may, at its discretion, accept a lower percentage of between 15% and 25% in the case of issuers with an expected market capitalisation at the time of listing of over HK\$10,000,000,000,... on condition that the issuer will make appropriate disclosure of the lower prescribed percentage of public float in the initial listing document...”. As drafted, Rule 8.08(1)(d) contemplates that a waiver may only be granted at the time of listing and, as far as we are aware, there is no other provision in the Listing Rules which allows the Exchange to grant a waiver from the public float requirements to an issuer subsequent to the listing date (other than a temporary waiver which may be granted after a general offer under Rule 8.08(1)(c)). Whether the proposed amendment to Rule 8.08(1)(d) as set out in the Consultation Paper is to be adopted or not, we would suggest the Exchange to consider amending the existing Rule 8.08(1)(d) to provide for the flexibility to grant public float waiver at any time after the listing date.

We note that the proposed amendments to Rule 8.08(1)(d) set out in Appendix 5 to the Consultation Paper also refer to public float “at the time of listing”. Please see our comments above and consider allowing a reduced minimum public float percentage if subsequent to its listing, a listed issuer’s market capitalisation meets the prescribed thresholds set out in Rule 8.08(1)(d).

3 Issue 5B – Constituents’ of “the public”

Question 5.4: We do not agree that the existing Rule 8.24 should be amended to cover any person who is entitled to exercise, or controls the exercise of, 5% or more of the voting power of any general meeting of the issuer.

While we understand the Exchange’s concerns on strategic or “cornerstone” investors, it is not uncommon for fund houses and institutional investors to hold a 5% or more interest in a company listed in Hong Kong. Such fund houses and institutional investors usually would not have board representation and would not be in a position to exert control or influence over the issuer. Accordingly, we believe it is unfair and inappropriate to exclude from the

“the public” any person who controls 5% or more of the voting power regardless of such person’s relationship with the issuer and/or its connected persons.

In the event the Exchange decides to amend Rule 8.24 as set out in the Consultation Paper, please consider introducing “grandfathering” provisions exempting existing shareholders holding a 5% or more (but less than 10%) interest from the application of the new rule.

4 Issue 7: Review of the Exchange's approach to pre-vetting public documents of listed issuers

Announcements

In general, we agree with the principle that the responsibility of preparing an announcement that is compliant with the Listing Rules and provides necessary information to investors rests with the listed issuer and therefore support the approach of gradually reducing the pre-vetting of announcements carried out by the Exchange. However, we would like to point out the following for the Exchange's consideration:

- (i) Any post-vetting of announcement is likely to be limited to checking against compliance with the Listing Rules as opposed to whether the announcement provides useful information to investors to appraise the subject matter of the announcement and its impact on the listed issuer. It is therefore quite likely that the new approach will lead to a drop in standard of disclosure.
- (ii) There are situations where currently guidance by the Exchange is needed before an announcement can be issued. An example will be the setting of an annual cap for continuing connected transactions. While we appreciate that announcements relating connected transactions will still be pre-vetted by the Exchange in Phase 1, we believe that the Listing Rules should clarify the circumstances where the Exchange should be consulted in advance prior to the publication of an announcement, before Phase 2 is introduced.
- (iii) The Listing Rules give wide powers to the Exchange in determining whether an exemption under Chapter 14A is available (Rule 14A.30), whether a party is a connected person (Rules 14A.06 and 14A.11) and whether a series of transactions or connected transactions should be aggregated (Rules 14.22-23 and 14A.25-27). Very often, the agreement would have been signed and would be legally binding on the listed issuer at the time the announcement is published. It is not clear from the proposed amendments to the Listing Rules how these powers will be exercised under the new approach and the types of enforcement actions that the Exchange will take in situations where the listed issuer has no prior knowledge of the views adopted by the Exchange when the Exchange exercises such wide powers post issue of the relevant announcements.

Circulars

- (i) We are supportive of the proposal to amend the Listing Rules so that circulars relating to amendments of memorandum and articles of association and explanatory statements for repurchase mandate no longer require pre-vetting. However, we disagree with the imposition of the requirement to submit a letter from the issuer's legal advisers that "there is nothing unusual about the proposed amendments for a company listed in Hong Kong". Legal advisers are well placed to comment on

whether with the amendments to the memorandum and articles of association comply with the Listing Rules and applicable laws. But the word "unusual" is too vague and the amendments may lead to consequences that are not legal by nature. We believe that such a confirmation should be provided by the listed issuer as opposed to the legal advisers. We note that this approach is adopted for the repurchase mandate circular.

- (ii) We are supportive of the proposal to amend the circular requirements relating to discloseable transactions as set out in the Consultation Paper. A circular for a discloseable transaction provides no helpful additional information to investors in relation to the transaction and the posting of physical copies of such circular to shareholders is not environmental friendly and is unduly costly to listed issuers.