

## HKEx LISTING DECISION

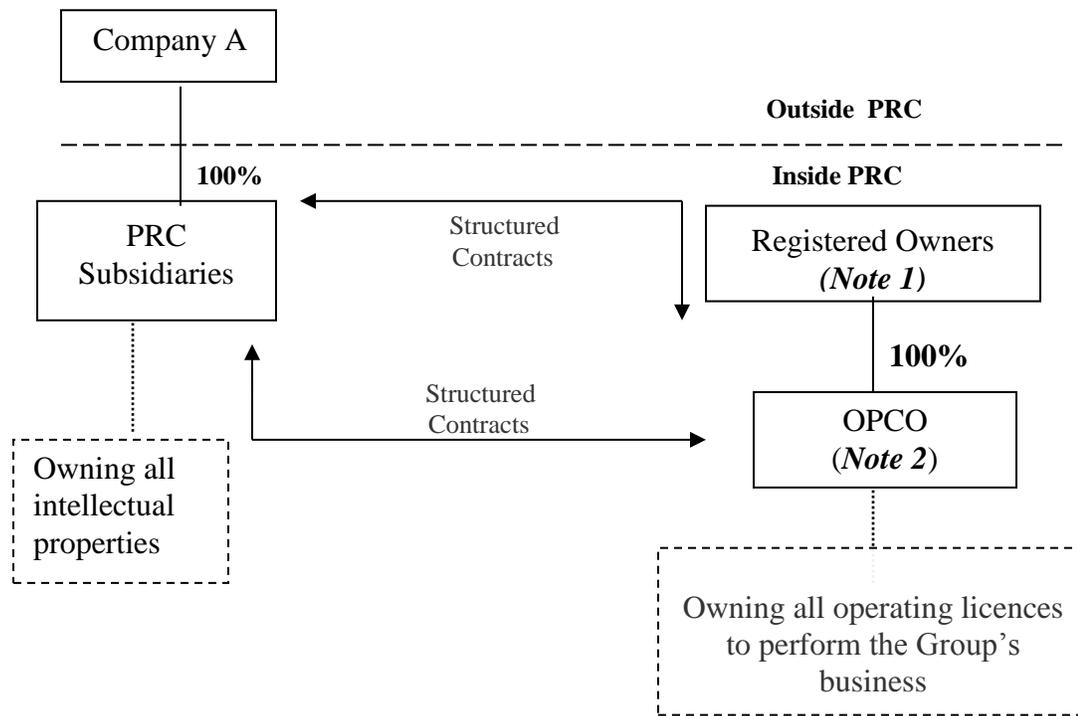
Cite as HKEx-LD43-3 (**Published in** First Quarter of 2005) (~~Updated in November 2011, August 2012, November 2012, December 2012, November 2013, and April 2014 and August 2015~~)

Summary	
<b>Name of Parties</b>	<p><b>Company A</b> - a Main Board listing applicant</p> <p><b>Group</b> - Company A together with its subsidiaries</p> <p><b>PRC Subsidiaries</b> - subsidiaries of Company A with substantially all operations in the PRC</p> <p><b>OPCOs</b> - companies owned by the Registered Owners and controlled by Company A through the Contractual Arrangements</p> <p><b>Registered Owners</b> - shareholders of the OPCOs</p>
<b>Subject</b>	Whether, in view of the fact that, in the conduct of its business in the PRC, Company A was a party to a number of contract-based structures (“ <b>Contractual Arrangements</b> ” or “ <b>Structured Contracts</b> ”) between or among Company A, the PRC Subsidiaries, the OPCOs and the Registered Owners, Company A was unsuitable for listing due to legal questions associated with the Contractual Arrangements?
<b>Listing Rules</b>	Rules 1.01; and 8.04
<b>Decision</b>	The Exchange determined that the Contractual Arrangements would not render Company A unsuitable for listing.

### SUMMARY OF FACTS

1. Company A was incorporated outside Hong Kong. The Group operated a business in the PRC, and PRC regulations applicable to its industry sector limited foreign investment.
2. Therefore, the Group did not possess the licences required to operate its business in the PRC. However, the Group adopted Contractual Arrangements designed to give the various rights listed in paragraph 4. The Contractual Arrangements were binding on Company A, the PRC Subsidiaries, the OPCOs and the Registered Owners.

3. A brief diagram illustrating the Contractual Arrangements is set out below:-



**Note 1:** *The Registered Owners were PRC nationals and controlling shareholders of Company A*

**Note 2:** *The OPCO was incorporated in the PRC*

4. The Sponsor submitted that the Contractual Arrangements were designed specifically to confer upon the Group:-

- a. the right to enjoy all the economic benefit of the OPCOs, to exercise management control over the operations of the OPCOs, and to prevent leakages of assets and values to shareholders of the OPCOs;
- b. the right to all intellectual properties through assignments from the OPCOs;
- c. the right to consolidate the financial results of the OPCOs as if they were wholly-owned subsidiaries of the Group under prevailing accounting principles;
- d. the right to acquire, if and when permitted by PRC law, the equity interests in and/or assets of the OPCOs for a nominal price or a pre-paid amount; and
- e. a first priority security interest in the OPCO shares owned by the Registered Owners, as security for the proper performance of the Contractual

#### Arrangements.

5. The Sponsor confirmed that Company A had satisfied all conditions for listing under the Listing Rules (save for waivers sought) and no alteration of the confirmation was necessary by reason of the existence of the Contractual Arrangements. The Sponsor intended to disclose full details of the Contractual Arrangements in the listing document.
6. The PRC legal adviser of Company A issued an opinion that the Contractual Arrangements complied with PRC laws, rules and regulations, including those applicable to the business of Company A, the PRC Subsidiaries and the OPCOs, and complied with the articles of association of the PRC Subsidiaries.
7. The reporting accountants of Company A confirmed that it had the right to consolidate the financial results of the OPCOs as if they were wholly-owned subsidiaries of the Group under prevailing accounting principles.

#### **THE ISSUE RAISED FOR CONSIDERATION**

8. Whether, in view of the fact that, in the conduct of its business in the PRC, Company A was a party to the Contractual Arrangements between or among Company A, the PRC Subsidiaries, the OPCOs and the Registered Owners, Company A was unsuitable for listing due to legal questions associated with the Contractual Arrangements?

#### **APPLICABLE LISTING RULES OR PRINCIPLE**

9. Rule 1.01 states that ‘subsidiary’ includes ‘any entity which is accounted for and consolidated in the audited consolidated accounts of another entity as a subsidiary pursuant to applicable Hong Kong Financial Reporting Standards or International Financial Reporting Standards.
10. Rule 8.04 provides that in the opinion of the Exchange both the issuer and its business must be suitable for listing.

## THE ANALYSIS

11. When considering Company A's suitability for listing under Rule 8.04, the Exchange reviewed whether the Group's business operations, including the use of the Contractual Arrangements, complied with all applicable laws and regulations.
12. In the review, the Exchange continued its established practice of utilizing a disclosure-based approach. Under this approach, the sponsor and the directors of Company A had to demonstrate, by a clear preponderance of the materials submitted for review, that it had complied in fact and in good faith with all relevant PRC laws and regulations. If Company A could meet this burden it would not be considered unsuitable for listing on the Exchange by reason of the Contractual Arrangements.
13. In this case, the Exchange adopted the following standard of review:-
  - a. the Listing Rules and Listing Division policies would be strictly construed;
  - b. the Contractual Arrangements should be narrowly tailored to achieve the applicant's business purposes and minimize the potential for conflict with relevant PRC laws and regulations. Wherever possible, the listing applicant would be required to demonstrate genuine efforts to comply with applicable laws and regulations. Evidence to the contrary would tend to indicate a higher risk of the contractual arrangements being considered non-compliant with relevant laws and regulations;
  - c. a broad review of all relevant facts and circumstances concerning the listing applicant would be undertaken by the Exchange, including a review of its legal and compliance history (if any), its management systems and corporate governance practices, its records in protecting shareholder interests and its financial resources to ensure compliance with the applicable laws and regulations. If material uncertainties were identified in the areas of the applicant's business, a higher level of assurance with respect to the arrangements would be required; and
  - d. subject to availability and practicability, appropriate regulatory assurance should be obtained from the relevant regulatory authorities. In the absence of such regulatory assurance, the applicant's legal counsel would be required to make a statement to the effect that in its legal opinion all possible actions or steps taken to enable it to reach its legal conclusions had been taken. In consultation with the applicant and the sponsor, other relevant forms of assurance could be considered.
14. Based on the submissions of the Sponsor which were supported by professional opinions from the PRC legal advisers and the reporting accountants, Company A had demonstrated that it had satisfied the above requirements. Consequently, the Exchange determined that the Contractual Arrangements were legal and binding and

that Company A had the ability to ensure the sound and proper operation of the Contractual Arrangements. Given that there would be full disclosure of the Contractual Arrangements in the listing document, the Exchange determined that Company A or its business would not be rendered unsuitable for listing by reason of the use of the Contractual Arrangements.

## THE DECISION

15. The Exchange continued to adopt a disclosure-based approach in considering Company A's listing application. Based on the material facts and the PRC legal opinion as submitted, the Exchange determined that Company A had demonstrated the legality of the Contractual Arrangements and its ability to ensure the sound and proper operation of the Contractual Arrangements. Subject to appropriate disclosures in the listing document of the Contractual Arrangements and the risks associated therewith, the Exchange determined that Company A was suitable for listing.

**SUBSEQUENT DEVELOPMENT** *(Paragraphs 16 to 18 added in November 2011; paragraphs 19 to 20 added in August 2012 and amended in November 2012 and December 2012; paragraphs 16A and 18A added in November 2013; paragraphs 18, 19 and 20 amended in November 2013; ~~and~~ paragraph 16B added in April 2014; paragraphs 18c(i) and 20a updated in August 2015; and paragraphs 21 and 22 added in August 2015)*

16. In a review in 2011, the Listing Committee confirmed the practice of allowing Contractual Arrangements (also commonly known as Structured Contracts) on a case-by-case basis after full consideration of the reasons for adopting such arrangements and subject to the conditions in this listing decision.
- 16A. For the avoidance of doubts, where restricted businesses are involved, the use of Structured Contracts are permitted only to address the foreign ownership restriction, e.g. foreign investors can only operate the restricted businesses under joint ventures with the foreign portion of the total investment and hence shareholding below 50%. For requirements other than the foreign ownership restriction (the “**Other Requirements**”), applicants should demonstrate to the satisfaction of the Exchange that they have, upon advice from their legal advisers, reasonably assessed the requirements under all applicable rules and have taken all reasonable steps to comply with them before listing (added in November 2013).
- 16B. All applicants without exception (including applicants transferring its listing from the Growth Enterprise Market to the Main Board), must take reasonable steps to comply with the Other Requirements before listing, regardless of materiality of the business on which the Other Requirements are imposed, in terms of revenue or profit or otherwise, to the applicant. While the applicant may not be in full compliance with the Other Requirements prior to listing (or prior to transferring its listing from

Growth Enterprise Market to the Main Board), it must have committed financial and other resources to implement full compliance (added in April 2014).

17. If non-restricted businesses are involved, the Listing Division will normally refer the case to the Listing Committee.
18. In addition to the matters in paragraph 13, the Exchange requires any applicant using Structured Contracts and its sponsor to:
  - a. provide reasons for the use of Structured Contracts in its business operation;
  - b. unwind the Structured Contracts as soon as the law allows the business to be operated without them. The OPCO's registered shareholders must undertake that, subject to the relevant laws and regulations, they must return to the applicant any consideration they receive in the event that the applicant acquires the OPCO's shares when unwinding the Structured Contracts. The undertaking must be disclosed in the listing document (updated in November 2013);
  - c. ensure that the Structured Contracts:
    - (i) include a power of attorney by which the OPCO's shareholders grant to the applicant's directors and their successors (including a liquidator replacing the applicant's directors) the power to exercise all rights of the OPCO's shareholders, including the rights to vote in a shareholders' meeting, sign minutes, file documents with the relevant companies registry. OPCO's shareholders should ensure that the power of attorney does not give rise to any potential conflicts of interest. Where OPCO's shareholders are officers or directors of the applicant, the power of attorney should be granted in favour of other unrelated officers or directors of the applicant;
    - (ii) contain dispute resolution clauses that:
      - provide for arbitration and that arbitrators may award remedies over the shares or land assets of OPCO, injunctive relief (e.g. for the conduct of business or to compel the transfer of assets) or order the winding up of OPCO;
      - provide the courts of competent jurisdictions with the power to grant interim remedies in support of the arbitration pending formation of the arbitral tribunal or in appropriate cases. The courts of Hong Kong, the applicant's place of incorporation, the OPCO's place of incorporation, and the place where the applicant or the OPCO's principal assets are located should be specified as having jurisdiction for this purpose; and

- (iii) encompass dealing with the OPCO's assets, and not only the right to manage its business and the right to revenue. This is to ensure that the liquidator, acting on the Structured Contracts, can seize the OPCO's assets in a winding up situation for the benefit of the applicant's shareholders or creditors.
  
- 18A. Where the relevant laws and regulations specifically disallow foreign investors from using any agreements or contractual arrangements to gain control of or operate a foreign restricted business (e.g. on-line game business in the PRC which is subject to GAPP's Notice 13<sup>1</sup>), the legal adviser's opinion on the Structured Contracts must include a positive confirmation that the use of the Structured Contracts does not constitute a breach of those laws and regulations or that the Structured Contracts will not be deemed invalid or ineffective under those laws and regulations. The legal opinion must be supported by appropriate regulatory assurance, where possible, to demonstrate the legality of the Structured Contracts (added in November 2013).
  
- 19. An applicant using Structured Contracts for the entire or part of its business should disclose the following information concerning the Structured Contracts in its listing document:
  - a. Detailed discussion about the OPCO's registered shareholders and a confirmation that appropriate arrangements have been made to protect the applicant's interests in the event of death, bankruptcy or divorce of the OPCO's registered shareholders to avoid any practical difficulties in enforcing Structured Contracts.
  - b. The extent to which the applicant has arrangements in place to address the potential conflicts of interest between the applicant and the OPCO's registered shareholders, particularly in cases where these shareholders are officers and directors of the applicant.
  - c. Bases why the directors believe that each of the agreements conferring significant control and economic benefits from the OPCO to the applicant is enforceable under the relevant laws and regulations.
  - d. The economic risks the applicant bears as the primary beneficiary of the OPCO, in what way the applicant shares the losses of the OPCO, the circumstances that could require the applicant to provide financial support to the OPCO, or other events or circumstances that could expose the applicant to losses.

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<sup>1</sup> "Notice Regarding the Consistent Implementation of the "Stipulations on Three Provisions" of the State Council and the Relevant Interpretations of the State Commission Office for Public Sector Reform and the Further Strengthening of the Administration of Pre-examination and Approval of Internet Games and the Examination and Approval of Imported Internet Games" (Xin Chu Lian [2009] No. 13) published jointly by PRC General Administration of Press and Publication, National Copyright Administration, and National Office of Combating Pornography and Illegal Publications on 28 September 2009 (as amended from time to time).

- e. A discussion on whether the applicant has, to date, encountered any interference or encumbrance from any governing bodies in operating their business through the OPCO under the Structured Contracts.
  - f. The limitations in exercising the option to acquire ownership in the OPCO, include a separate risk factor explaining these limitations, and clarifying that ownership transfer may still subject to substantial costs.
  - g. The Structured Contracts as material contracts in the “Statutory and General Information” section and make them available on the applicant’s website.
  - h. Corporate structure table in the “Summary” section for the purpose of illustrating the Structured Contracts and facilitating investors’ review and understanding of the arrangements.
  - i. Details of any insurance purchased to cover the risks relating to Structured Contracts, or a prominent disclosure that those risks are not covered by any insurance (added in December 2012).
  - j. A separate disclosure of revenue from Structured Contract arrangements if the applicant generates revenue from other subsidiaries apart from the OPCO (added in November 2013).
  - k. If the OPCO’s operations are in the PRC, a positive confirmation from the PRC legal advisers that the Structured Contracts would not be deemed as “concealing illegal intentions with a lawful form” and void under the PRC contract law (added in November 2013).
20. The relevant disclosure on Structured Contracts in listing document should follow the following guiding principles:
- a. **Various sections** – To avoid repeated disclosure in various sections, such as those relating to connected transactions arising from the Structured Contracts, the basis of consolidation of the OPCO, and the terms of the Structured Contracts, disclosure on Structured Contracts (other than risk factors) should be consolidated into one standalone section. Appropriate cross references should be sufficient.
  - b. **Risk Factors** – ~~To~~ disclose all related risk factors in a cluster under an appropriate heading, such as “Risks relating to Corporate Structure”. In addition, the listing document should include at least the following Structured Contracts-related risk factors:
    - (i) The government may determine that the Structured Contracts do not comply with applicable regulations;
    - (ii) The Structured Contracts may not provide control as effective as direct ownership;
    - (iii) The domestic shareholders may have potential conflicts of interest with the applicant; and
    - (iv) Structured Contracts may be subject to scrutiny of the tax authorities and additional tax may be imposed.

## **DRAFT PRC FOREIGN INVESTMENT LAW**

21. This Listing Decision is in part based on the conclusion that the Structured Contracts comply with PRC laws, rules and regulations, and are legal and binding. This is evident in paragraphs 6, 13(d), 14 and 15 above.
22. Following publication of the consultation draft of the new PRC Foreign Investment Law by the Ministry of Commerce in January 2015, concerns over the legality and validity of Structured Contracts to hold interests in PRC businesses which are subject to foreign ownership restrictions may be heightened. Applicants which use Structured Contracts to hold interests in PRC businesses are encouraged to contact the Exchange at the earliest possible opportunity to seek informal and confidential guidance.