

HKEx LISTING DECISION

Cite as HKEx-LD40-1 (October 2004) (Withdrawn in January 2023)

[This Listing Decision is withdrawn following the repeal of the outdated transitional arrangements under the old Rule 17.10.]

Summary	
Category	Listing Decisions Series 40-1 (LD40-1)
Name of Party	Company A - a Main Board listing applicant
Subject	Grant of waivers <ul style="list-style-type: none">• Whether the number of shares issued under a share option scheme may exceed the limit prescribed under Chapter 17 of the Listing Rules• Whether the exercise price of option grants may be made at a discount to market price on the date of grant
Listing Rules	Rules 17.03(3); 17.03(9)
Decision	Waiver was granted in respect of Rule 17.03(9) only

Summary of Facts

Company A proposed a dual primary listing of its shares on the Exchange and the New York Stock Exchange. Company A proposed to establish, among other things, an employee stock purchase plan after listing (“Proposed Plan”). The Proposed Plan was analogous to a share option scheme under Chapter 17 of the Listing Rules and was therefore subject to its requirements. The Proposed Plan satisfied the requirements of Chapter 17 of the Listing Rules save for two factors:-

- (a) the exercise price for purchase of shares under the Proposed Plan would be at a discount to the market price of the underlying shares at the date of grant, which would be contrary to Rule 17.03(9) (see item (5) below).
- (b) the number of shares issued under the Proposed Plan exceeded the 10% limit prescribed under Note (1) to Rule 17.03(3) (see item (9) below).

The Proposed Plan had the following features:-

- (1) All eligible employees of the Group were entitled to join. There was a standardised procedure for employees wishing to participate in the Proposed Plan, and no discretion could have been exercised by Company A to reward certain employees over others under

the Proposed Plan.

- (2) The Proposed Plan was intended to operate as a savings-related share purchase plan which enabled employees, through exercise of options granted to them, to purchase shares in Company A at a discount through payroll deductions.
- (3) The Proposed Plan satisfied the requirements of published U.S. tax regulations which required it to be made available generally to all employees. Employees of Company A who were U.S. taxpayers would receive favourable tax treatment in the United States on subsequent disposal of the shares purchased under the Proposed Plan, although this would have no effect on non-U.S. taxpayers.
- (4) As required by the U.S. tax regulations, the share options that might be granted to each participant each year under the Proposed Plan were subject to a maximum limit.
- (5) A discount rate of more than 10% to the market price of the underlying shares was contemplated under the Proposed Plan.
- (6) Purchase rights granted under the Proposed Plan were exercisable automatically on the last day of the offer period. There was no possibility that the purchase rights would expire unexercised. The only question was what the exercise price would be.
- (7) A participant in the Proposed Plan was entitled to withdraw all but not less than all contributions before the automatic exercise date (i.e. the last day of the offer period).
- (8) The Proposed Plan fundamentally followed the existing stock option plans of Company A (“Old Plan”) which had been established prior to 1 September 2001, that is, the date on which certain amendments to Chapter 17 of the Listing Rules regarding stock options took effect. However, the Old Plan which allowed grants of options at the same discount rate was a discretionary plan because options were not granted to all employees of Company A on an equivalent basis.
- (9) The Proposed Plan would have a life of 10 years and the initial share option limit would be 10% of the issued shares of Company A at the date of listing. Such initial 10% limit complied with Note (1) to Rule 17.03(3). However, the Proposed Plan adopted a provision allowing for automatic increases in the number of shares available on an annual basis by an aggregate amount equal to 1% of the issued share capital of Company A. Effectively, the Proposed Plan would allow Company A to issue shares representing up to 20% of its issued share capital.

Questions Presented

Was it appropriate to grant Company A a waiver of:-

- Rule 17.03(9) which states that the exercise price of option grants must not be at a

discount to market price on the date of grant?

- Rule 17.03(3) which specifies the aggregate limit for the number of shares that may be issued upon exercise of all options to be granted under all the share option schemes?

Applicable Listing Rules

Rule 17.01(1) states that the provisions in Chapter 17 apply, with appropriate modifications, to all schemes involving the grant by a listed issuer or any of its subsidiaries of options over new shares or other new securities of the listed issuer or any of its subsidiaries to, or for the benefit of, specified participants of such schemes. Any arrangement involving the grant of options to participants over new shares or other new securities of a listed issuer or any of its subsidiaries which, in the opinion of the Exchange, is analogous to a share option scheme as described in such rule must comply with the requirements of Chapter 17.

The Exchange amended the requirements under Chapter 17 of the Listing Rules in September 2001 following a market consultation. A number of restrictions in the old rules (such as the number of options that could be granted under share option schemes, the maximum entitlement of each individual participant and the eligibility of participants) were relaxed to allow greater flexibility in the operation of share option schemes. At the same time, stricter requirements were introduced in other areas, including the exercise price of share options. Since the rule change came into effect, listed issuers have been prohibited from granting share options at a discount to the market price of the relevant shares even under the terms of existing share option schemes, unless any such grant of options falls under the Note to Rule 17.10.

The Note to Rule 17.10 provides that the Exchange may allow a listed issuer to grant options under the terms of its existing share option schemes on or after 1st September 2001 if the listed issuer is able to demonstrate to the satisfaction of the Exchange that such options are granted to a participant pursuant to a contractual commitment given by the listed issuer to such participant before 1st September 2001.

Rule 17.03(9) states that the exercise price must be at least the higher of: (i) the closing price of the securities as stated in the Exchange's daily quotations sheet on the date of grant, which must be a business day; and (ii) the average closing price of the securities as stated in the Exchange's daily quotations sheets for the five business days immediately preceding the date of grant.

Rule 17.03(3) lays down the upper limit of the total number of securities which may be issued upon exercise of all options granted under a Chapter 17 scheme. Note (1) Rule 17.03(3) provides that:-

“Notes: (1) The total number of securities which may be issued upon exercise of all options to be granted under the scheme and any other schemes must not in aggregate exceed 10% of the relevant class of securities of the listed issuer (or the subsidiary) in issue as at the date of approval of the scheme....”

Rule 17.02(1)(b) states that, where a share option scheme of a new applicant does not comply with the provisions of Chapter 17, no further options may be granted under the scheme after listing.

Analysis

On the facts and circumstances of the case, the Exchange concluded that there had not been any contractual commitment on the part of Company A, under the Old Plan, with regard to its employees to grant options at a discount to market price on or after September 2001, which, pursuant to the Note to Rule 17.10, would have enabled the Exchange to consider allowing Company A to continue granting options under the Old Plan with the share discount feature after September 2001.

Rule 17.03(9)

As regards the application for a grant of a Rule 17.03(9) waiver, the Exchange noted that the Proposed Plan was a form of compensation plan designed to provide tax benefits to its U.S. employees who made up a large part of its work force. The Proposed Plan was, in effect, an instalment purchase plan structured in the form of an option that was designed to be always in the money. The Exchange considered favourably that all employees of Company A were eligible to participate in the Proposed Plan; that Company A was seeking a dual primary listing in the New York Stock Exchange and the Proposed Plan satisfied the requirements of the tax regulations of the United States; and that the maximum number of shares that might be granted would be limited under the Proposed Plan and the relevant U.S. tax regulations. The Exchange therefore considered it appropriate to grant a waiver of Rule 17.03(9) to Company A.

Rule 17.03(3)

As regards the application for a grant of a Rule 17.03(3) waiver, the Exchange noted that, in order to amend the limit on the number of shares that could be issued under the Proposed Plan, both the New York Stock Exchange rules and the relevant provisions of U.S. state law (incorporated by reference into the Company's charter), required the total of all votes cast on the matter to represent the majority of Company A's shares. Therefore, it was understandable why the Proposed Plan, like other similar plans adopted by some other U.S. public companies, built in an annual automatic increment mechanism to raise the limit of shares that might be granted under the Proposed Plan. However, the Exchange noted that the annual automatic increase mechanism of the Proposed Plan (annual increase of 1%) was in direct conflict with Rule 17.03(3) and the reason given on behalf of Company A was not considered sufficiently compelling. Therefore, the Exchange did not consider it appropriate to grant a waiver in this respect.

Decision

A waiver of Rule 17.03(9) was granted to Company A on a case specific basis. No waiver was granted of Rule 17.03(3).