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Dear Sirs

Re: Corporate WVR CP

We are writing in response to the Consultation Paper on Corporate WVR Beneficiaries ("***Consultation Paper***") issued by the Hong Kong Stock Exchange ("***Exchange***"). Terms used in this letter have the meaning attributed thereto in the Consultation Paper.

A. General

Question 1

We welcome the Exchange's initiative to expand WVR beneficial holding to corporate entities, provided suitable safeguards are in place against the misuse of the WVR regime.

In our view, there are a number of areas where further consideration and/or clarification may be called for. We set out in this paper our observations and suggestions for the Exchange's consideration.

B. The ecosystem concept

Questions 8 - 14

The proposed corporate WVR regime is largely predicated on the "ecosystem" concept. In para. 44 of the Consultation Paper, the Exchange has opted for not defining the term "ecosystem" but setting out some of the main characteristics, many of which will likely involve subjective qualitative judgment. We are generally sympathetic to this approach, given the obvious difficulties in drawing precise parameters around the concept. However, we see a number of potentially difficult areas which may require further clarification by the Exchange to the market.

1) Ecosystem and reliance

We note that the ecosystem concept as discussed in the Consultation Paper anticipates or even tends to encourage a high level of reliance by the listing applicant / listed issuer on the ecosystem and the corporate WVR holder who controls the ecosystem. Notably:

- As a listing eligibility issue, for WVR to be held by a corporate entity, the community of companies of which the listing applicant is a member must have grown and co-evolved around a platform or core products / services owned or operated by the corporate WVR holder; the core components of the ecosystem must in substance be controlled by the corporate WVR holder; and the applicant must owe its success to participation in the ecosystem and will continue to benefit materially from such participation – this in practice indicates a significant degree of reliance on the ecosystem and the corporate WVR holder in particular.

- The element of "irreplaceability" is emphasised in para. 8 of the Consultation Paper, where the Exchange describes the synergistic benefits of the ecosystem and the strategy and vision of the leader in developing the ecosystem as being difficult for a listing applicant to replicate on its own or with other business partners.

- As a post-listing ongoing requirement, it is proposed that the corporate WVR holder must continue to provide a contribution to the issuer. (Notably, HKEx has not spelt out in paragraphs. 50(a) and 168(a) of the Consultation Paper what might be the expected nature and extent of such contribution, although it is expected that the contribution should be significant.) This is reinforced by the proposed requirement for the issuer's board committee to monitor and make disclosure on such contribution on a regular basis.

- The close relationship between the listing applicant and the WVR holder is further enhanced by the corporate representative requirement.

Whilst these elements are all understandable to ensure the existence of a suitable degree of synergy and an alignment of interests between the issuer and the WVR holder, they do raise some unfamiliar, and potentially problematic, issues of over-reliance.

Over the years and for all types of listings across various industry sectors, excessive reliance on the controlling shareholder can be taken to be a potential problem in terms of listing eligibility.

Whilst reliance is not expressly addressed in Chapter 8 by way of listing qualifications, GL68-13, which focuses on listing suitability, deals with reliance as an (at least potential) listing suitability issue ***unless*** mitigating factors exist. More specifically, under para. 3 15 of that guidance letter:

"… a new applicant's material reliance on a Relevant Counterparty is a matter of disclosure if, absent red flags to indicate otherwise, (i) the relationship with the Relevant Counterparty is unlikely to materially adversely change or terminate; or (ii)

new applicant is / will be able to effectively mitigate its exposure to any material adverse changes to or termination of its relationship with the Relevant Counterparty."

Likewise, we note that under GL97-18, the Exchange will not consider a new applicant in the high-tech sector that is heavily reliant on its parent to be unsuitable for listing only if "there are no red flags indicating its relationships with the parent company or another connected person are likely to be terminated or otherwise materially adversely change".

In other words, reliance is prima facie undesirable as a business sustainability issue, but it will be ***tolerated*** in some circumstances – e.g. if the reliance in mutual, or the relationship is not expected to change.

Our concern is that the proposed ecosystem concept contains a paradox, in that it seems positively to ***encourage*** reliance on the parent's ecosystem. This appears to derogate from the Exchange's traditional approach to the question of reliance / over-reliance of the issuer on its controlling shareholder, as we have summed up above.

We believe this area should be smoothed out and clarified, perhaps by appropriate amendments to the relevant guidance letters, so as to provide a clear message to the market as to how to address the reliance issue in corporate WVR applications.

2) Ecosystem and competition

A different but related issue is competition with the controlling shareholder group.

Competition is an area on which the Exchange has a number of established practices, set out recently in GL100-19. Under paragraph 2 of that guidance letter, it is clear that the issue of competition is closely associated with the question of reliance on / independence from the controlling shareholder.

In the past decade or so, many listing applicants have managed competition issues by a combination of business / geographical delineation, contractual undertakings (e.g. non-competition agreements, right of first refusal, right to business opportunities, etc.) and corporate governance measures.

We note that, in the market, powerful "ecosystem leaders" do not typically incubate only one investee in the innovative industries, but more likely multiple investees in the same space. There can be a wider or narrower scope for competition within the ecosystem, as long as it fits within each leader's own vision for the development of the ecosystem.

In this context, we have concerns that the traditional safeguards may not be sufficient to deal with the issues that arise. To give one very simple example, in an "ecosystem" scenario it may often be unrealistic for the ecosystem leader to undertake not to invest in more than, say, 5% or 10% in a business that competes with the listing applicant. In practice, the ecosystem leader does very often invest in substantially more than 10% in competing businesses.

Again, the Exchange may need to consider more fundamentally its regulatory stance on the issue of competition, so that either a space may be specially carved out for the class of innovative listing applicants in question, or that the treatment of competition for all listing applicants (not just innovative ones) may be re-considered and restated. In any event, we believe that market will benefit greatly from further guidance from the Exchange on this subject.

3) Ecosystem continuation

In reality, especially in innovative industries, technological developments as well as changes in market conditions are constant and rapid. It may not be practicable for the rules to require a specific ecosystem structure, or specific patterns or modes of business contribution, to be "locked in" to the position at listing for up to 10 years thereafter (or whatever else the Exchange determines after consultation to be the appropriate time-defined sunset period). The concept of a "continuing" ecosystem with specific levels of mutual contribution may not fit well with market reality.

Another important issue is the prescribed penalty or sunset for corporate WVR, in that once the ecosystem ceases to benefit the issuer, the WVR holder will lose the WVR. Admittedly, this would be a powerful incentive for the WVR holder to continue to continue to run that ecosystem as close to the original form as possible. However, under the proposed rules, if the issuer cannot benefit from the ecosystem anymore, whatever penalty may be meted out to the WVR holder, the minority shareholders are still stuck with shares in a company that cannot (and under the proposed rules is purposely designed not to) survive outside the ecosystem. This ties in with the reliance / over-reliance point we have raised above, which seems to us a regulatory conundrum that may need further clarification.

4) Ecosystems as a yardstick for eligibility

Overall, the ecosystem principle would, in practice, be relevant largely (if not only) to established "platform" companies of the kind that the market seen so far. In other words, it tends to be "backward-looking", in terms of trying to capture a particular style of business structure that have so far been successful – some may even argue that the proposed scheme caters only for specific identifiable companies that are successful today.

As opposed to this, the Exchange may widen the regime by making some forward-looking provisions for other types and styles of business which may evolve in the future.

For example, the Exchange may introduce some sensitivity, in exceptional cases, as to non-ecosystem type companies with a significant strategic / corporate investor whose holding of WVR is both legitimate (e.g. to maintain control of the company post-listing to steer its business direction and growth) and demonstrably in shareholders' best interest.

C. Minimum economic interest and management

Question 3(a)

We do not have any objections to the 30% minimum economic interest requirement, but we would propose requiring ***either*** the Eligible Entity to hold 30% economic interest, ***or*** to be the single largest shareholder, but not both.

Moreover, we note that for individual WVR holders, Rule 8A.12 anticipates (on a case-by-case basis) a lower minimum shareholding percentage where an interest of less than 10% already represents a high dollar amount. The Exchange may consider introducing a similar flexibility for corporate WVR holders.

Question 3(b)

As we have stated above, we believe it would be more practical to require the corporate WVR holder to be either a 30% shareholder or the single largest shareholder (but not both). Additionally, the minimum 30% interest requirement should be subject to customary exceptions such as to share capital alterations and events such as capital reorganisations, placing and top-up, rights issues and open offers, etc. In this respect, the market will be helped by having more clarity on the maximum permissible duration for the interest to stay below 30% (cf. 14 days allowed for placing and top-up under Rule 14A.92(4)(a)(ii)), as well as more guidance on "same terms or better" (probably in practice referring to the subscription price only, as it would be difficult to take into account non-monetary terms such as scope of indemnity, termination events and the like).

Question 6

The Exchange also proposes that corporate WVR holder must have held at least 10% in economic interest, and have been materially involved in the management of the listing applicant for at least two financial years before the listing application.

We have some concerns as to the practical application of this two-year 10% requirement, if it is in fact a "continuity" requirement that does not tolerate temporary disruptions. Where a company has not decided or is unable to decide where to list (e.g. due to not having been properly advised), it may be difficult to comply with this requirement. We note that, at the time when a company starts to contemplate listing in Hong Kong, the two-year requirement will in effect apply retrospectively, which may cause problems for companies that have experienced accidental dilution during the lookback period. We invite the Exchange to consider if, and under what circumstances, it may be prepared to waive or modify this requirement.

Question 6

We have concerns about the requirement that Eligible Entities should have been "materially involved in the management or the business of, the listing applicant" for not less than two financial years, commercial reality being that pre-IPO investors are not normally expected to be substantively involved in the daily management of investee companies where they only hold 10%-30% and their representatives typically perform non-executive roles on the board.

However, we note that the Exchange has qualified (in paragraph 147 of the Consultation Paper) this material involvement with the words in brackets "(for example through the inclusion of the business of the applicant in its ecosystem)". If mere inclusion in the ecosystem would satisfy this requirement, then the above should not be a problem. We would therefore invite the Exchange to clarify whether this is the approach that the Exchange will take. Generally, we believe that having a corporate representative of the WVR holder on the board of the issuer (Question 20 of

the Consultation Paper, discussed below) should in itself be an indication of material involvement in the management. We would invite the Exchange to elaborate on the material involvement requirement to give more guidance to the market.

D. Ratio of WVR

Question 7

We appreciate that the proposed maximum of 1:5 weighting may be intended largely an additional safeguard to reduce the impact of a corporate WVR holding, but observe that:

- Under the proposed scheme, a corporate WVR holder must hold a minimal 30% economic interest which carries at the proposed weighting ratio 68% of the voting rights. A 38% economic interest can carry a 75.3% super majority in voting.

  If the WVR holder were a natural person, he would, with a 30% economic interest, have 81% of the voting rights, or with a 38% economic interest, 86% of the voting rights.

  As can be seen from the above hypothetical numbers as to what percentage holding is required to give a super-majority in voting, the proposed maximum 1:5 ratio for corporate WVR holding does not appear to give significantly more rights to ordinary shareholders, as compared to the current 1:10 for individual WVR holding.

- On the other hand, the disparity between maximum 1:5 weighting (for corporate WVR) and 1:10 (for individual WVR) can be very influential when the company has both corporate and individual WVR holders, and where the board is not controlled by the former but the latter. This disparity of weighting ratios potentially allows founders who are individual WVR holders to overpower the corporate WVR holder. It may even be possible for the founders to threaten the corporate WVR holder with discontinuation of the "ecosystem" structure agreements, in order to get better terms from the latter. This may not be justifiable and appears to run against the ecosystem concept (where, as we have stated above, the issuer is supposed to be able to rely on the ecosystem and not be at periodic risk of losing its benefits).

  In light of the ecosystem concept that underlies the new regime, we believe it should not be the Exchange's intention to promote anything that would incentivise an individual WVR holder to leverage off his higher-weighted WVR to demand unduly harsh terms from, or even force out, the lower-weighted corporate WVR, which by definition would be detrimental to the company and shareholder.

  This problem could be partially addressed if the individual WVR holder's voting power would be required to be adjusted to stay the same in relation to the corporate WVR holder, if the latter loses the benefit of its WVR upon a non-time-based sunset event. This would significantly reduce the individual WVR holder's incentive to

jeopardise the relationship between the listed company and the corporate WVR holder.

If the Exchange is minded not to adopt this approach or make other provisions to alleviate the problem, we would propose that the same maximum ratio should apply for both individual and corporate WVR holders, to alleviate any unfair bargaining leverage that an individual WVR holder may have against a corporate WVR holder, arising purely from the discrepancy between the weighting ratio caps.

E. Traditional economy corporate WVR holder

Question 11

The Exchange proposes that a corporate WVR holder can be a traditional economy company, provided that it develops an ecosystem that can satisfy the eligibility criteria.

In principle, we have no objections to this proposal. It is entirely conceivable that old economy companies may have developed ecosystems that harbour a number of innovative business.

We note that the Exchange (see para. 168(a) and Question 17 of the Consultation Paper) appears to anticipate WVR holders that are either innovative companies themselves, or have substantial relevant operational and investment experience. From the Consultation Paper, the Exchange's position is not abundantly clear on the question whether the corporate WVR holder must have materially contributed not just generally, but specifically to the "innovative" aspects of the applicant's business.

How this plays out in practice will depend very much on the way the rules are drafted and applied. On one hand, the rules may be worded so that there must have been substantial direct involvement in the ***innovative aspects*** of the listing applicant's business. Conversely, the rules may broadly allow any corporation to hold WVR provided only that the ecosystem tests are met, so that even indirect and non-technological business contribution (e.g. financial contribution, corporate governance oversight, etc.) will suffice. We would respectfully invite the Exchange to provide more clarity in the final rules.

F. Continuing monitor of corporate WVR holder's contribution

Question 14

The Exchange proposes for the issuer's corporate governance committee to review and disclose, on a 6-month and annual basis, the WVR holder's contribution to the issuer.

We have no objections generally with these requirements. However, we believe the rules should allow for reasonable changes in circumstances (e.g. in business model, technological developments, group strategies) which may lead to changes in the ecosystem structure.

As we have mentioned above, the proposal to base the corporate WVR regime on the ecosystem concept, both at the time of listing and on an ongoing basis, has the potential downside of tying the issuer to a specific ecosystem too much and for too

long, giving rise to problems of over-reliance and intra-group competition. It is therefore important to strike a balance, with rules that are flexible enough to allow for the relationship between the issuer and the corporate WVR holder to develop healthily and organically post-listing.

We can see potential difficulties for Board members who are charged with the proposed monitoring. Will / should corporate WVR holders be held strictly to the original mode and pattern of contribution to the issuer? What will happen (e.g. will the WVR shares lapse automatically or will there be scope for waivers based on appropriate disclosure) if that pattern or mode has changed over time but the overall contribution and ecosystem leadership by the WVR holder remains substantial and material enough to justify its holding of WVR shares? On what basis should the Board make that "materiality" judgement and on what basis could they be challenged?

In the situation we have mentioned above, where a company has a founder / controlling shareholder who holds individual WVR shares (and who controls the board) as well as an "ecosystem" shareholder that holds corporate WVR shares, and the former is in dispute with or is trying to leverage off its voting power to drive out the corporate WVR shareholder, the intended corporate governance benefits of the Board's continuing monitor requirement may become illusory or even out of context.

It seems to us that Board members will need considerably more guidance than is set out in the Consultation Paper as to how the Exchange will expect them to make the ongoing assessment.

Question 26

We note that in relation to the continuing monitor requirement, disclosure should be a key aspect, to ensure that shareholders will be able to make an informed decision on a proposal to renew the corporate WVR. In this connection, the Exchange may consider setting minimum content requirements for the relevant shareholders' circular.

G. Market cap and listing status

Question 15

We agree with the HK$200b market cap and listing status requirements for the corporate WVR holder.

H. Maximum 30% contribution to the WVR holder's business

Question 19

The Exchange proposes that the listing applicant must not represent more than 30% of the corporate WVR holder in terms of market capitalisation at the time of listing. We have no objections to the rationale behind this – i.e. preventing listed issuers from substantially introducing a WVR post-listing, by spinning off a material part of its business under Chapter 8A.

However, we see a few conceptual problems with the proposal:

a) The proposed level of 30% does not appear to be based on any business materiality test with which the market is familiar, unlike, for example, the Chapter 14 size tests.

b) More fundamentally, the market capitalisation test can be somewhat artificial, since the numerator can be manipulated through valuation of the listing applicant.

c) Unusual or unfair results may also appear if the corporate WVR holder's share price crashes on the relevant market, giving an abnormally high percentage in the few days leading up to the issuer's listing. It may be unfair to disqualify the shareholder from holding WVR shares in such circumstances. To address this, the Exchange may consider providing flexibility, for example by way of allowing market capitalisation to be averaged out over a certain period of time, or partially waving the requirement in case of anomalous results arising from unusual market conditions.

I. Corporate representative

Question 20

The Consultation Paper proposes that at least one director of the listing applicant must be a Corporate Representative (namely, a director, manager or secretary) of the corporate WVR holder at the time of listing. This is also meant to be an ongoing post-listing requirement, with the corporate WVR mandatorily lapsing if the requirement is not met for a continuous 30-day period.

We propose that the definition of "corporate representative" should be expanded to include key persons involved in the management of business of the corporate WVR holder.

By definition, the "ecosystem" concept anticipates corporate WVR holders that are conglomerates with numerous business units and a great number of subsidiaries operating across industries. More flexibility should be allowed for the Corporate Representatives requirement to cater for business reality. We would invite the Exchange to consider allowing a director, manager or secretary, or any other key person involved in the management of a business line or subsidiary of the corporate WVR holder to qualify as a Corporate Representative. It will not be practical for "Corporate Representatives" to mean only directors, managers or other senior officers at the level of the corporate WVR holder, as it is often not feasible to require such an officer to serve on the board of the listed issuer. Nor will the narrow definition necessarily benefit the market, as such a senior manager may not be best suited to serve on the board of the listed issuer.

J. Sunset period

Questions 22-23

We believe it is unnecessary and undesirable to impose a time-defined sunset clause for the reasons stated below. If such a requirement is imposed, we propose that the sunset period should be extended to considerably beyond 10 years.

Under the proposed rules, it is an essential investor protection safeguard that the renewal of corporate WVR should be subject to independent shareholders' approval after the expiry of the 10-year sunset period. In other words, from the corporate WVR holder's point of view, there is by definition no certainty of renewal.

A pre-IPO investor will this take into account when deciding whether it is commercially worthwhile to acquire the required 30% stake, or (as is more likely the case) increase its stake in the investee company during two years preceding the IPO to reach 30%, so as to take advantage of the proposed corporate WVR regime. The high uncertainty regarding the WVR holding at the end of 10 years is likely to be a strong disincentive for the substantial 30% economic investment for an ecosystem leader. If the rules, in practice, subject the pre-IPO investors to an unacceptable level of uncertainty, the proposed regime may not serve its purpose of opening up the Hong Kong market to quality listing candidates.

Meantime, we note that there are already a number of event-based sunset provisions under the proposal, and believe they should provide sufficient safeguards.

If the Exchange is minded to adopt a time-defined sunset, we would suggest a 20-year rather than 10-year sunset period. Alternatively, if the Exchange is minded to keep to 10 years, we would respectfully invite it to reconsider the 30% minimum economic interest requirement so as to work out a regime that is commercially attractive to pre-IPO investors and their investee companies.

K. Corporate and individual WVR holders

Question 28

The Exchange consults the market as to additional measures for the WVR holders or the issuer to safeguard the interests of the latter (e.g. prevent a deadlock) if there are both corporate and individual beneficiaries. In our view, voting shares always carry voting rights in whatever proportion as may be stipulated in the articles and applicable company law, and shareholders' freedom to vote is more or less absolute subject only to specific regulatory requirements (such as circumstances where certain shareholders must abstain from voting). To the extent that some practical difficulties are possible – e.g. abrupt changes in the balance of voting power, voting deadlock, etc. – we do not see these as being substantially aggravated by the co-existence of individual and corporate WVR holdings. It is not immediately clear to us what special hardship this will cause for listed companies with multiple WVR holders (as opposed to other types of listed companies) that would clearly call for regulatory interference.

Question 29

The Exchange consults the market as to whether, where an issuer has both a corporate WVR holder and individual WVR holder(s), the time-defined sunset should apply only to the former.

It seems to us that where an individual WVR holder is closely involved with, if not actually in control of, the corporate WVR holder, a different treatment between the two classes would not seem justifiable.

There are two other possible scenarios: (a) the corporate WVR holder and the individual WVR holder(s) are not connected with each other from the beginning; and (b) over time, the original link between the individual WVR holder and the corporate WVR holder weakens or ceases. In these two cases, provided that each of them continues to contribute to the listed company in the required manner, the difference in treatment (in terms of the sunset clause) may be easier to justify.

In general, it may be administratively more convenient for the both types of WVR holders to be treated equally in terms of the time-defined sunset provision. Alternatively, this may be left as a choice to the listed company based on relevant circumstances. Overall, we do not see any compelling reason for regulatory interference in this respect.

We have stated above our suggestions as to revising the proposal on the time-defined sunset requirement, to make the new regime realistic and attractive to pre-IPO investors and their investee companies.

Question 30

The Exchange proposes a regime whereby, if a corporate WVR holding falls away under the time-defined sunset clause, any individual WVR holder should be required to convert part of his WVR shares so as to maintain the same proportion of voting powers ("Scenario A"), but where the individual WVR holding falls away first, no conversion is required for the corporate WVR holder ("Scenario B"). Whilst we do not see any problem in principle with this proposal, we have two comments:

a) It would be helpful for the HKEx to provide a mathematical example to illustrate how the Scenario A conversion will work in practice.

b) Para. 60 of the Consultation Paper suggests that the rationale behind this proposal is to ensure that, when under Scenario A the vote is put to shareholders to renew the corporate WVR holding, independent ordinary shareholders should have a genuine vote that is not unduly distorted by the weighted votes of any individual WVR holder. In para. 62, however, the Exchange states that the same equalisation process is not required for Scenario B due to a degree of tolerance being currently afforded to multiple individual WVR holders. In principle, we do not see any reason why the same tolerance cannot be afforded in Scenario A, since it does not appear to be substantially more prejudicial to public shareholders than Scenario B.

L. Dual listings and grandfathering

The interaction between the proposed corporate WVR regime and the dual / secondary listing regime under the Listing Rule is not clearly set out in the Consultation Paper.

We note that there are currently a number of US-listed Chinese companies with corporate holders of WVR shares. For these companies, any material modification to the existing voting structure as a result of a dual (primary or secondary) listing in Hong Kong may cause significant and complex implications to the disclosure, accounting and trading of the listed issuer and its WVR-holding controller. Such implications could in practice discourage a number of these companies from pursuing a dual listing in Hong Kong.

In this connection, we would invite the Exchange to consider making exemptions or grandfathering or other suitable provisions, to make sure that quality listing candidates of this class will not be barred from the Hong Kong market.

M. Position in group

Question 2

We agree with the proposal that a corporate WVR holder must be an Eligible Entity or a wholly owned subsidiary of the Eligible Entity.

N. Other observations

Paragraph 49 of the Consultation Paper mentions, for illustrative purposes, about 297 companies listed on a relevant exchange with a market capitalisation of HK$200 billion or more. As the Exchange stresses, that is not to say that all these companies would automatically qualify for listing in Hong Kong with corporate WVR holders.

We believe, in fact, that the companies eligible under the proposed rules may be relatively few in number, due to the proposed eligibility and ring-fencing requirements. This is perhaps understandable for the time being, in light of the need to be extra cautious about making any further inroads into the "one vote per share" principle.

We are very much in support of exploring new areas where the Hong Kong market could be further opened up to high quality listing candidates with different corporate structures and strategic needs. We have highlighted in this paper some aspects of the proposed reforms that we believe may require fine-tuning or rethinking, to attain the optimal balance between good governance and commercial flexibility.

If the Exchange aims by this exercise to increase the competitive edge of our market, it should ensure as best it can that the proposed reforms do provide real practical incentives for high-quality listing candidates to choose Hong Kong over other markets. In the end, a system boasting iron-clad shareholders' protection standards is unlikely to develop our market significantly, if too many inhibitive factors have been built into the regulation.

O. Davis Polk Contacts

If you have any questions in relation to this submission, please contact [redacted].

Yours faithfully

[redacted]

Davis Polk & Wardwell