

HKE_x LISTING DECISION
HKE_x-LD50-2013 (published in February 2013)

Summary	
Party	Company A – a Main Board listing applicant Company B – a state-owned oil company
Issue	Whether Company A had adequate rights under the production sharing contracts which gave it sufficient influence in decisions over the exploration for and/or extraction of crude oil
Listing Rules	Main Board Rule 18.03(1)(b)
Decision	Company A had established to the Exchange’s satisfaction that it had the right to participate actively in the exploration for and/or extraction of crude oil from the oilfields in light of: (i) Company A’s influence in the joint management committee; and (ii) Company B’s right to take over the oilfield operations would not affect Company A’s right under Rule 18.03(1)(b).

FACTS

1. A foreign company has to operate with authorised state-owned enterprises to conduct exploitation of onshore oil and gas resources in the PRC.
2. Company A entered into a production sharing contract (“PSC”) for each of the three oilfields where it acted as the sole operator and a foreign contractor with Company B. These oilfields had entered into the commercial production phase and the PSCs would only expire after more than 23 years.
3. Company B was a state-owned oil company and held the exploitation permits for the exploration, development and production of crude oil at the three oilfields.
4. Under the PSCs:
 - (i) Company A was solely responsible for, among others, applying appropriate technology and managerial experience for, and procuring equipment, supplies and subcontracting services relating to the oilfield operations;
 - (ii) Company B was responsible for, among others, submitting the overall development plan for the oilfields for relevant PRC governmental approval;
 - (iii) the crude oil was first allocated between Company A and Company B to recover the operating and development costs. After these costs were fully

recovered, the crude oil would be allocated between Company A and Company B for profit-sharing; and

- (iv) Company B had the right to take over the oilfield operations at the earlier of (a) the expiration of the PSCs; (b) when Company A had recovered all of its development costs and there was no additional approved overall development plan which required Company A to incur additional development costs; or (c) before the full recovery of Company A's development costs if agreed by the joint management committee (the "JMC").
5. Company A had recovered all of its development costs for one of the three oilfields but not for the other two.
 6. If Company B took over the oilfield operations, Company A would still be entitled to its allocation of crude oil for the purposes of cost recovery and profit-sharing during the remaining terms of the PSCs and would continue to participate in the JMC. However, Company A would not be able to invest in additional capital expenditure for further oil production and revenue generated.
 7. The JMC was comprised of eight members, four of whom were appointed by each of Company A and Company B. The JMC's chairman and vice chairman were designated by Company B and Company A respectively. The JMC should reach a unanimous decision on matters that it considered. During the track record period, the JMC was able to agree on all material matters concerning the oilfields.

APPLICABLE RULES AND PRINCIPLES

8. Rule 18.03(1)(b) states that a mineral company must establish to the Exchange's satisfaction that it has the right to participate actively in the exploration for and/or extraction of natural resources. One way is through adequate rights (arising under arrangements acceptable to the Exchange) which give the mineral company sufficient influence in decisions over the exploration for and/or extraction of the natural resources.
9. Frequently Asked Questions Series 12 states that "*[c]ompanies may rely on exploration and extraction rights held by third parties if they participate in mineral and/or exploration activity under joint ventures, product sharing agreements or other valid arrangements if they can demonstrate the agreements give them sufficient influence over the exploration for and extraction of Resources and Reserves.*"

ANALYSIS

10. The Exchange considered that the JMC allowed Company A to have adequate rights which gave it sufficient influence in decisions over the exploration for/or extraction of crude oil from the oilfields under Rule 18.03(1)(b) given that the JMC's decisions had to be made unanimously and Company A's representatives with half of the JMC's voting rights could vote down any resolution that Company B proposed which were not in Company A's interests.
11. In addition, the Exchange considered that Company B's right to take over the oilfield operations would not affect Company A's rights under Rule 18.03(1)(b) because it did

not pose any risk to Company A's continued oilfield operations or the risk was remote as:

- (i) the PSCs for the oilfields would not expire until more than 23 years later which was expected to be sufficiently long to extract most of the economic interests of the oilfields;
- (ii) Company A had not reached the limits set in the overall development plans for one of the oilfields for which it had recovered all of its development costs and continued to invest in that oilfield under the development programs approved by the JMC. In addition, Company B did not have the legal right to take over the remaining two oilfields' operation because Company A had not recovered all of its development costs; and
- (iii) all the PSCs that Company B entered into with other parties had the same standard takeover clause, and Company B had never exercised the right to take over the operations of any of these oilfields. In addition, Company B had confirmed that it would not exercise its rights to take over the three oilfield operations of Company A.

CONCLUSION

12. Based on the above, the Exchange was satisfied that Company A had adequate rights which gave it sufficient influence in decisions over the exploration for and/or extraction of crude oil from the oilfields under Rule 18.03(1)(b).
