



## HKEx Consultation Paper

### Proposed Listing Rules for Mineral and Exploration Companies

#### Law Society's response to the Consultation Questions

##### *Consultation Questions on Additional Eligibility Requirements for New Applicant Mineral and Exploration Companies*

- 3.1 Do you agree with the Exchange's proposal that new applicant Mineral and Exploration Companies must demonstrate that they have adequate rights to participate actively in the exploration or exploration and extraction of resources, either by having controlling interests in a majority (by value) of the assets in which they have invested or through other rights, which give them significant influence in decisions over the extraction of those resources?

☐ Yes

☒ No

Please provide specific reasons for your views.

*The requirement to demonstrate control of assets is consistent with international practice and can be applied where the exploration and/or exploitation activities are conducted through a joint venture (as is common in China). However, we would like clarification on the exact test that is proposed in Q3.1.*

*Is it intended to be interpreted as at least a 30% voting right in at least 50% of the assets?*

*What assets will be taken into account for the purposes of the test? Some asset investments may not be exploration or mining assets.*

*We note that the first limb of the test is the same as that used in the UK's Listing Rules, but we have not encountered any specific FSA guidance on its application.*

*With regard to the second limb, we are concerned with any proposal for a sweep-up which is not well defined. In the absence of control over the assets used, we cannot easily envisage circumstances when a listing applicant would otherwise be able to claim any other "significant influence in decisions" to a satisfactory level.*

- 3.2 Do you agree with our proposal that new applicant Mineral and Exploration Companies that have not yet obtained rights to extract relevant reserves must disclose

details of how they plan to proceed to extraction and must state risks relevant to obtaining relevant rights?

☒ Yes

☐ No

Please provide specific reasons for your views.

*Rule 18.02(1) currently requires that where a listing applicant's current activities consist solely of exploration, it must show that it already has exploration and exploitation rights. Since PRC regulations (Article 16(6) of Rules for Implementation of the Mineral Resources Law of March 26, 1994) only grant exploration licensees "priority" in obtaining the mining right within the relevant exploration area (and since the factors which might lead to a refusal of granting rights to a company holding "priority" status are not specified nor consistently applied), it will rarely be the case that an applicant can fulfill the current Rule 18.02 requirement.*

*Nevertheless, the ability to extract is essential to the economic success of the listing applicant and it is important that investors have the opportunity to assess the commercial risk of not obtaining exploitation rights. The proposal to require disclosure of the applicant's plans for (and risk factors associated with) extraction therefore seems a sensible compromise in an environment where a significant portion of applicants will be engaged in exploration in the PRC.*

- 3.3 Do you agree that new applicant Mineral and Exploration Companies must demonstrate that they have sufficient working capital for 125% of their budgeted working capital needs for the next twelve months? Do you consider that the requirement for a working capital statement should be extended beyond a period of twelve months?

☐ Yes

☒ No

Please provide specific reasons for your views.

*We do not believe it is appropriate to mandate that a company has more cashflow than the directors and their professional advisers think they need for the next 12 months. The company's accountants, in giving their opinion, will have built in a "buffer" which is appropriate for the company and the industry concerned. Whilst the rules in other jurisdictions do require mandatory additional headroom, we believe this is unnecessarily burdensome.*

- 3.4 Do you agree that estimates of cash operating costs must include those of: (a) workforce employment; (b) consumables; (c) power, water and other services; (d) on and off-site administration; (e) environmental protection and monitoring; (f) transport of workforce; (g) product marketing and transport; (h) non-income taxes, royalties and other governmental charges; and (i) contingency allowances?

☒ Yes

☐ No

Please provide specific reasons for your views.

*The list appears to cover all relevant costs.*

- 3.5 Do you agree that producing new applicant Mineral and Exploration Companies must disclose their operating cash cost per appropriate unit for the mineral(s) and/or oil and gas produced?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We believe that on this issue, the Exchange should adopt an approach consistent with other markets.*

- 3.6 Do you agree that a new applicant Mineral and Exploration Company must demonstrate that its board and senior management, taken together, have adequate experience relevant to the mining and/or exploration activity that the applicant is pursuing, unless it can meet the financial track record requirements under Listing Rule 8.05? Do you agree that individuals relied on must have a minimum of five years relevant experience?

☒ Yes

☐ No

Please provide specific reasons for your views.

*In the absence of management continuity for a three year track record period, we support some requirement as to the qualifications or experience of the senior management for the reasons given in paragraph 3.26 of the Consultation Paper. Naturally, the proposals need to balance experience in mining and exploration against other skills necessary to operate a listed group. An attempt to provide this balance is provided by the words "taken together", but clarification will be needed at the outset on how this rule will be applied in practice. Specifically, what proportion of the board and/or senior management must fulfil the experience requirement?*

*We do not see any particular justification for extending the period of relevant experience from the three years currently required under Rule 18.03, to five years.*

*Consultation Questions on Disclosure (General) Obligations*

- 4.1 Do you agree with our proposal that technical reports and valuations required by the Listing Rules must be prepared by independent Competent Persons?

☒ Yes

☐ No

Please provide specific reasons for your views.

*We support the view that Hong Kong is a market where it would be preferable for there to be a requirement for independence.*

- 4.2 Do you agree with our proposal that a Competent Person must be a member of a Recognised Professional Organisation?

☒ Yes

☐ No

Please provide specific reasons for your views.

*Given the reliance that is likely to be placed on CPRs by investors, it is appropriate that the Listing Rules set out a minimum level of qualifications for Competent Persons. A requirement for the person to be a member of a Recognised Professional Organisation will restrict the number of individuals capable of working as Competent Persons. However, as stated in paragraph 4.2 of the Consultation Paper, this disadvantage is outweighed by the benefits of professional regulation and in particular, the disciplinary powers of the professional body. The requirement to use a registered professional as a Competent Person is entirely consistent with the Listing Rule requirements for other expert opinions.*

- 4.3 Do you agree that the Exchange should only accept Competent Persons' Reports (CPRs) prepared by Competent Persons who are registered in jurisdictions where the statutory securities regulator has adequate arrangements with the Securities and Futures Commission for mutual assistance and exchange of information for enforcing and securing compliance with relevant laws of each jurisdiction?

☒ Yes

☐ No

Please provide specific reasons for your views.

*This would certainly be the ideal situation.*

- 4.4 Do you agree that the CPR must have an effective date less than six months prior to the date of the publication of the prospectus or circular required under the Listing Rules?

☒ Yes

☐ No

Please provide specific reasons for your views.

*In other jurisdictions this has proved to be a workable time period.*

- 4.5 Do you agree that CPRs must include an up to date no material change statement?

☒ Yes

☐ No

Please provide specific reasons for your views.

*This is a sound principle, although presumably in practice such a statement would be qualified as to awareness.*

- 4.6 Do you agree that all Mineral and Exploration Companies must disclose in the CPR, where one is required, risk factors and provide a risk analysis in the format outlined in Appendix I to the Consultation Paper?

☒ Yes

☐ No

Please provide specific reasons for your views.

*We have no specific comment on the precise format of the risk analysis as this is not our area of expertise. However, in principle we support the idea of specifying the format (see our comments on Question 4.8 below).*

- 4.7 Do you agree with the Exchange's proposal that disclosure on risks must be provided as part of a Competent Person's Report?

☒ Yes

☐ No

Please provide specific reasons for your views.

*The investigation of risk and summarising the findings in the CPR is of paramount importance to investors. The risk assessment from the CPR will be the primary source of the general and specific Risk Factors in the prospectus.*

- 4.8 Do you agree that data on reserves and resources must be presented in tables in a manner readily understandable to a non-technical person?

☒ Yes

☐ No

Please provide specific reasons for your views.

*There is a choice to be made between specifying the exact format in which information must be presented and merely giving guidance on the manner of presentation. The proposal in paragraph 4.23 of the Consultation Paper (which gives a free hand as to the manner of presentation) is at odds with the detailed proposal for the format of the risk analysis (in paragraph 4.17).*

*We are of the view that the Exchange should follow a consistent approach.*

*On the whole, we support the more specific approach. Where it is necessary for a company to diverge from the specified format, it can do so following a dialogue with the Exchange. Proposals such as that outlined in Question 4.8 are open to interpretation and result in a lack of certainty.*

*In any event, if a provision similar to that outlined in Question 4.8 is adopted, this should specify that the format is "appropriate for comparative analysis".*

#### **Consultation Questions on Disclosure (Technical Reporting) Standards**

- 5.1 Do you agree with the Exchange's proposal to accept the three main JORC-type codes for the presentation of information on resources and reserves, namely the JORC Code, NI 43-101 and the SAMREC Code?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

- 5.2 Do you agree with the Exchange's proposal to request reconciliation to one of the above codes where information is presented in accordance with Russian or Chinese standards, until such time as they achieve widespread recognition or efforts at convergence between these standards and JORC-type codes are sufficiently advanced?

☐ Yes

☐ No

Please provide specific reasons for your views.

*The proposal sounds sensible.*

- 5.3 Do you agree with the Exchange's proposal to require that estimates of mineral reserves be supported at a minimum by a pre-feasibility study as defined in the SAMREC Code and NI 43-101?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

- 5.4 Do you agree with the Exchange's proposal that information on mineral resources and mineral reserves must not be combined?

☒ Yes

☐ No

Please provide specific reasons for your views.

*The suggested approach prevents over-statement of assets and therefore should be supported.*

- 5.5 Do you agree with the Exchange's proposal that mineral resources must only be included in economic analyses if they are appropriately discounted for the probabilities of their conversion to reserves and the basis on which they are considered to be economically extractable is stated?

☒ Yes

☐ No

Please provide specific reasons for your views.

*The suggested approach prevents over-statement of assets and therefore should be supported.*

- 5.6 Do you agree with our proposal that Mineral and Exploration Companies must explain the methodology used to determine commodity prices used in pre-feasibility and feasibility-level studies and valuations of reserves and resources, and state the basis on which such prices represent reasonable views of future prices?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

- 5.7 Do you agree with our proposal that Mineral and Exploration Companies must present sensitivity analyses on price in their valuations of reserves and profit forecasts?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

- 5.8 Do you consider that the requirement to state the methods used to determine prices and state the basis on which they are reasonable should extend to forecast prices of oil and gas?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

- 5.9 Do you agree with our proposal to adopt the PRMS as the accepted reporting code for CPRs related to oil and gas resources?

☐ Yes

☐ No

Please provide specific reasons for your views.



*We have no comment on this proposal.*

- 5.10 Do you agree with the proposal that Proved and Proved plus Probable Reserves be presented as Net Present Values ("NPVs") on a post-tax 'unrisked' basis at varying discount rates, including a reflection of the weighted average cost of capital or minimum acceptable rate of return applicable to the entity at the time of evaluation?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

- 5.11 Do you agree with the proposal that Proved Reserves and Proved plus Probable Reserves must be analysed separately and the principal assumptions must be stated in all cases?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

- 5.12 Do you agree with the proposal that companies must present estimates of NPVs of reserves using a forecast price as a base case but must also provide a sensitivity analysis including a constant price, to be represented by the unweighted arithmetic average of the closing price on the first day of each month in that 12 month period? Please note the possible variation in this proposed rule applicable for companies that may be subject to the SEC's Oil and Gas Disclosure Standards in paragraph 5.59 of the Consultation Paper.

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

- 5.13 Do you agree with the Exchange's proposal that disclosures about estimated volumes

of oil and gas resources should be allowed, provided relevant risk factors are clearly stated?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

5.14 Do you agree with our proposal that Mineral and Exploration Companies should not be permitted to attach economic values to Contingent or Prospective Resources?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

5.15 Do you agree with the Exchange's proposed definition of 'Competent Person' for oil and gas reporting?

☒ Yes

☐ No

Please provide specific reasons for your views.

5.16 Do you agree with the Exchange's proposal that CPRs must be prepared by independent Competent Persons and deal with the list of items in Appendix II to the Consultation Paper?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

- 5.17 Do you agree with the Exchange's proposal to accept the VALMIN, CIMVAL and SAMVAL valuation codes for the valuation of natural resources properties?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We have no comment on this proposal.*

- 5.18 Do you agree with the Exchange's proposed definition of 'Competent Person' for valuation purposes?

☒ Yes

☐ No

Please provide specific reasons for your views.

*We support a minimum quantifiable experience. Although not a guarantee of expertise, this provides comfort as to a certain quality of work. We question whether the requirement for a minimum of 5 years of experience in the assessment and/or valuation of mineral or petroleum assets or securities may be too restrictive, on top of the 10 years general mining or petroleum experience. Are there enough individuals who would be capable and willing to act?*

- 5.19 Do you agree with the Exchange's proposal that company management and the relevant independent expert must determine whether a valuation report is required?

☐ Yes

☒ No

Please provide specific reasons for your views.

*In a market like Hong Kong, where many listing applicants operate in rapidly developing markets and are still (as businesses) relatively young, we can see distinct advantages in being specific as to when a valuation report is required.*

**Consultation Questions on Continuing Obligations (for companies treated as Mineral and Exploration Companies and existing listed issuers engaging in mineral and/or exploration activity)**

- 6.1 Do you agree with our proposal that Mineral and Exploration Companies must produce CPRs on transactions for the acquisition or disposal of resources and/or reserves, which require shareholder approval (i.e. transactions which are classed as 'major' or above)?

☒ Yes

☐ No

Please provide specific reasons for your views.

*It is appropriate that shareholders should have an expert report on which to formulate their voting decision.*

- 6.2 Do you agree with our proposal that listed issuers which enter into acquisitions for resources and/or reserves classed as major or above must also comply with the requirement to produce CPRs? Do you consider that such companies should be granted a short grace period for relevant transactions that have already been entered into and announced on implementation of the new rules?

☒ Yes

☐ No

Please provide specific reasons for your views.

*This is appropriate where the listed issuer is already classified as a Mineral and Exploration Company. In practice, a company which was not already so classified, would be most likely to be re-classified as a Mineral and Exploration Company following a "major" acquisition (or larger) of mineral resources or reserves. Therefore a CPR would also be an appropriate requirement in those circumstances.*

*A grace period will clearly be required unless the rules are implemented some time before their effective date.*

- 6.3 Do you agree with our proposal that, we may dispense with the requirement for CPRs on relevant transactions if detailed information on reserves and resources, in accordance with our approved mineral and/or oil and gas codes, is already in the public domain?

☒ Yes

☐ No

Please provide specific reasons for your views.

*Investors should be entitled to rely on an independent expert's report in making their voting decision. However, the Exchange should be entitled to waive the requirement in certain circumstances e.g. if there is already a CPR of a public company made to Australian or Canadian standards in the public domain.*

- 6.4 Do you agree listed issuers that have previously published details of reserves and resources must update such statements once a year in their annual reports?

☒ Yes

☐ No

Please provide specific reasons for your views.

- 6.5 Do you agree with our proposal that Mineral and Exploration Companies must provide details of exploration, mining production and development activities and details of expenditure incurred on these three activities in their interim (half-yearly) and annual reports?

☒ Yes

☐ No

Please provide specific reasons for your views.

*This approach is appropriate for the Hong Kong market, where investor knowledge of the sector and its risks is currently relatively weak.*

- 6.6 Do you agree with the Exchange's proposal to prohibit blanket disclaimers in technical reports?

☐ Yes

☐ No

Please provide specific reasons for your views.

*We would be interested in understanding the policy in jurisdictions other than Canada. Care is required in this area since taking an aggressive stance in relation to the liability of the expert is likely to severely restrict the pool of suitable candidates.*

*The current practice in relation to property valuations contained in circulars appears for there to be no disclaimer of liability in the valuation report itself. There may be disclaimers or limitations on liability in the engagement letter between the company and the expert, but these are not reproduced in the report. We suggest that this practice should be followed in relation to technical reports.*

- 6.7 Do you agree with the Exchange's proposal to disallow material indemnities in favour of the Competent Person or entity that prepared the report?

☐ Yes

☒ No

Please provide specific reasons for your views.

*The entity which prepared the report should be entitled to protect itself from liability to an extent consistent with market practice. Insofar as disclaimers are not permitted (or prove ineffective), any indemnity given by the company to the expert may be agreed through arms' length negotiations and is usually documented in the engagement letter. We query whether experts will be forthcoming if they are not permitted the protection of an indemnity.*

*We are of the view that investors are well protected by the damage to an expert's reputation which would result from a misleading report.*

#### ***Consultation Question on Social and Environmental Standards***

- 7.1 Do you agree with the Exchange's proposal to encourage Mineral and Exploration Companies to consider and provide disclosure on the social and environmental matters described in paragraph 7.1 of the Consultation Paper, where material to their business operations?

☐ Yes

☒ No

Please provide specific reasons for your views.

*We do not believe there is need for specific requirements on the matters listed. In most cases these will appear as risk factors in any event. Furthermore, many of the concepts outlined in paragraph 7.1 of the Consultation Paper are too abstract to enable meaningful compliance.*

*Consultation Questions on Eligibility of exploration companies*

- 8.1 Do you agree that Chapter 18 should be amended to allow Mineral and Exploration Companies that have mineral or oil and gas resources to apply for listing?

☒ Yes

☐ No

Please provide specific reasons for your views.

- 8.2 Do you agree that it is not appropriate to list early stage exploration companies in the interests of investor protection, i.e. those that have not yet determined the existence of resources?

☐ Yes

☒ No

Please provide specific reasons for your views.

*We question whether the Hong Kong market will be able to compete effectively with other international financial markets if it prevents early stage exploration companies from seeking a listing. Singapore is currently in consultations over allowing early stage exploration companies to list on Catalist. London already does so on AIM, and other international markets with strong resource sectors allow listing directly onto their main (or only) boards. Markets where a through-route exists are likely to develop more quickly in the medium-to-long term as early stage companies mature and the local investor base expands.*

*Unfortunately GEM does not provide a suitable alternative to a Hong Kong main board listing for early stage companies, so the issue is whether sufficient investor protection can be provided in the form of disclosure, to allow a Hong Kong main board listing of these entities. Although Hong Kong investors have limited experience in investing in mines and minerals, their appetite for risk is entrenched. This should be seen as a positive by exploration companies seeking to raise capital in the equity markets. We are therefore of the view that the Exchange should give some further consideration to whether disclosure might adequately address the issues.*

- 8.3 Do you agree that new applicant Mineral and Exploration Companies that have not yet commenced production must disclose their plans to proceed to production with indicative dates and costs?

☒ Yes

☐ No

Please provide specific reasons for your views.

*A requirement such as this appears to mitigate investor risk. However, in practice the assumptions and risk factors which very likely will accompany it, may limit its effectiveness.*

- 8.4 Do you consider that new applicant Mineral and Exploration Companies which have not yet commenced production should be subject to any additional eligibility requirements, such as a requirement to have a minimum market capitalisation?

☐ Yes

☒ No

Please provide specific reasons for your views.

*A new applicant will need to address market capitalisation as part of its Chapter 8 compliance. No special rules are necessary.*

- 8.5 Do you agree with the Exchange's proposed definition for 'Mineral and Exploration Companies'?

☒ Yes

☐ No

Please provide specific reasons for your views.

*We would prefer a title and definition that does not give such prominence to "exploration", if early stage exploration companies are to be carved out. In addition, the words "exploration for or extraction of natural resources" suggests that a company currently involved solely in exploration can be listed. The UK Listing Rules definition is clearer such that the principal activity must be "extraction ..... (which may or may not include exploration)".*

*We support a definition of "principal activity". The Exchange appears to be proposing a simple "25% or more" test. While this may be an appropriate rule of thumb, there should be greater flexibility for the Exchange to determine the issue on the basis of other factors.*

The Law Society of Hong Kong

Securities Law Committee

24 November 2009

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