LATHAM&WATKINS
瑞生國際律師事務所

18th Floor, One Exchange Square
8 Connaught Place, Central
Hong Kong
Tel: +852.2912.2500 Fax: +852.2912.2600
www.lw.com
香港中環康樂廣場八號交易廣場第一座十八樓

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March 23, 2018

BY EMAIL

Corporate and Investor Communications Department
Hong Kong Exchanges and Clearing Limited
12/F, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Dear Sirs

Subject: Consultation Paper on a Listing Regime for Companies from Emerging and Innovative Sectors

1. INTRODUCTION

1.1 This is a submission by Latham & Watkins in response to the consultation paper issued by the Stock Exchange of Hong Kong Limited (the "**Exchange**") regarding a listing regime for companies from emerging and innovative sectors (the "**Consultation**").

1.2 Unless otherwise defined, capitalized terms used in this submission are used as defined in the Consultation.

1.3 If you would like to discuss any aspect of this submission, please feel free to contact our Cathy Yeung (direct line: [redacted] email: [redacted]) or Terris Tang (direct line: [redacted] email: [redacted]).

2. BIOTECH COMPANIES

2.1 Sophisticated Investor

The definition of "Sophisticated Investor" is drafted very broadly and only made reference to the factors that the Exchange will take into account, namely net assets or assets under management, relevant investment experience, and the investor's knowledge and expertise in the relevant field. There is no guidance as to how the Exchange will assess such factors in order to determine whether or not an investor is a Sophisticated Investor. We invite the Exchange to provide further guidance on this point, for instance, the years of investment experience that the Exchange will be expected from a Sophisticated Investor, the minimum

Resident Partners: Amy E. Beckingham, Joseph A. Bevash, Simon J. Cooke, Gary K. T. Hamp, Sungjin Kang, Howard K. H. Lam, Posit Laohaphan, Catherine M. McBride, Simon D. Powell, Qiuning Sun, Terris C. C. Tang, Ing Loong Yang, Cheung Ying Yeung
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amount of the net assets or assets under management that the Exchange will be expected from a Sophisticated Investor.

One of the features that a Biotech Company will be expected to demonstrate is that it has received meaningful third party investment from at least one Sophisticated Investor. There is a number of uncertainties around this requirement, what may be perceived as "meaningful" to the applicant may not be "meaningful" from the perspective of the Exchange. The Exchange may consider further elaborating the definition of "meaningful" third party investment by making reference to monetary value, percentage of shareholding or investment size that represents a minimum valuation of that particular Biotech Company. Further, it is also not clear what would constitute "third party investment", one line of interpretation is that any investment from someone who is not a connected person with the applicant will be considered as "third party investment", however, there is no clear guidance on this point. We recommend the Exchange to specify the exact requirement of what would constitute "meaningful" investment and also its interpretation of a "third party" investment for the purposes of this feature of a Biotech Company.

2.2 Definition of Biotech Company

The definition of "Biotech Company" in the draft Rule 18A.01 is drafted very broadly to refer to a company that is primarily engaged in the research and development, application and commercialisation of Biotech Products, which in turn means products, processes, or technologies where the application of science and technology have been applied to produce commercial products with a medical or other biological application. In particular, the degree of "application of science and technology" that will be considered sufficient for a product to constitute a "Biotech Product" is not clearly set out. As a result, the proposed definitions do not provide much guidance for a potential applicant to determine whether or not it falls under the definition of "Biotech Company" or not. In order to avoid the possibility of Biotech Companies becoming shell companies in the future if the business deteriorates, we believe that a stringent approach shall be adopted and we recommend the Exchange to supplement the definitions of "Biotech Company" and "Biotech Products" with further guidance and provides with examples or case studies of what the Exchange would consider as "Biotech Company" and "Biotech Products" and those that are not.

2.3 Material Change of Business

Under the draft Rule 18A.09, a Biotech Company will not be allowed to effect any transaction that will result in a fundamental change to its principal business without the Exchange's prior consent. As noted in paragraph 88 of the Consultation, such prior consent will normally be given if the Biotech Company can satisfy the Exchange that it is engaging in a legitimate business expansion or diversification that forms part of its business strategies. We understand that the Exchange will seek specialist advice to assist in its determination, however, there is no further elaboration as to what circumstances the Exchange would consider a transaction resulting in a change to its business would constitute a legitimate business expansion or diversification. To provide for regulatory certainty and not to deter Biotech Companies from engaging in legitimate business expansion or diversification plan, we recommend the Exchange to provide further guidance on the factors that it will take into account in considering whether or not the proposed transaction constitutes a legitimate business expansion or diversification and the documentation that will be required to support the case for a legitimate business expansion or diversification.

2.4 **De-listing Process**

We have reservation that the proposed de-listing process for Biotech Companies will serve the best interests of minority shareholders of Biotech Companies. We understand the Exchange's concern that such Biotech Companies that are in early stage of development may eventually fail and may end up becoming shell companies, but there may be circumstances where there is still a substantial level of interest from shareholders but that Biotech Company may require a longer grace period in order to resolve the relevant issues. A balance needs to be struck between potential abuse of the flexibility offered to Biotech Companies and also protecting the interest of shareholders.

Further, under the draft Rule 18A.08, the Exchange "may" under Rule 6.10 give the relevant issuer a grace period of not more than 12 months to re-comply with Rule 13.24. However, it is not entirely clear under what circumstances such grace period will not be granted by the Exchange. To provide certainty to Biotech Companies, we invite the Exchange to provide further clarity on this point.

3. **ISSUERS WITH WVR STRUCTURE**

3.1 **Companies Suitable to List with a WVR Structure**

We are of the view that the "nature of the company" element in determining whether or not an applicant is "innovative" or not is drafted too broadly and provides for too high a degree of subjective judgment to be exercised by the Exchange, it does not provide much guidance for a potential applicant to determine whether or not it fulfils the characteristics to be categorised as an innovative company or not.

Whilst we appreciate that the importance for the Exchange to retain its ultimate discretion in determining the listing eligibility of applicants with WVR structure, it is equally important to provide for regulatory certainty to potential listing applicants and market practitioners. The current drafting makes it very difficult for market practitioners to advise potential applicants as to whether or not they are eligible for listing on the Exchange with a WVR structure. The only way to ascertain whether or not an applicant qualifies for listing as an innovative company is by way of pre-IPO enquiry with the Exchange, which will be a time consuming and costly exercise for an applicant. We recommend the Exchange to supplement the application of "innovative company" with further guidance and provides with examples or case studies of what the Exchange would consider as "innovative company" and those that are not.

3.2 **WVR Beneficiaries**

The draft Rule 8A.20 provides that the WVRs attached to a WVR beneficiary's shares will lapse if he or she transfers the beneficial or economic interest in those shares or voting rights to another person. We understand from paragraph 122 of the Consultation that the underlying rationale for such proposed rule is to ensure that only persons that have ongoing responsibilities can benefit from WVR. However, the underlying rationale can still be met if the shares with WVRs are being transferred to another person who is a director on the board who also meet the requirements of "contribution of WVR beneficiaries" and "role of WVR beneficiaries" as stipulated in paragraph 106 of the Consultation. For example, a founder of the company may wish to step down and gradually hand over the family business to a member of the family who is also a director, and who has been taking on an active executive role within the business and has been materially responsible for the growth of the business for a substantial period of time, in such circumstances, all the requirements imposed by the draft Listing Rules on the WVR beneficiaries will be met (except for the requirement that the WVR beneficiary must be a director at the time of listing) even if the founder were to transfer the

shares with WVRs to that other family member. We recommend the Exchange to consider providing for an exception under the draft Rule 8A.20 such that the WVRs attached to a WVR beneficiary's share are transferable to another person in limited circumstances without compromising the underlying rationale of this rule. The inability of WVR beneficiaries to transfer the beneficial or economic interests in the WVR shares to another person under limited circumstances like the abovementioned example may significantly limit the competitiveness of the proposed regime versus the US regime.

The Consultation further proposed that one of the circumstances under which the WVRs will lapse is when the beneficiary of the WVRs ceases to be a member of the issuer's board of directors. While we agree with the underlying rationale of such proposed rule is to ensure that only those who have ongoing responsibilities for the issuer's performance can benefit from WVR, however, there are indeed circumstances where the beneficiary of the WVR ceases to be a member of the board while he or she remains to have an active executive role within the business and continue to contribute to a material extent of the ongoing growth of the business This is more commonly seen in the Hong Kong market that traditionally has listed family businesses where the founder(s) may step down from the board but remain to be actively involved with executive decisions and matters while he or she introduces second or third generation of the family members to the board to gradually "take the reins" of the board in the future. We invite the Exchange to consider providing for an exception where the WVR beneficiaries remain to have an active executive role within the business with ongoing responsibilities for the issuer's performance, having been serving on the board for a certain number of years and with explicit guidance on the factors that the Exchange will take into account when assessing whether or not such beneficiaries remain to have an "active executive role".

3.3 Sophisticated Investors

As discussed in paragraph 2.1 hereto, we recommend the Exchange to specify the exact requirement of what would constitute "meaningful" investment and also its interpretation of a "third party" investment for the purposes of this feature of an applicant with WVR structure.

3.4 Minimum and Maximum Economic Interest at Listing

The underlying rationale of the draft Rule 8A.14 is to ensure that the economic interest held by WVR beneficiaries is large enough to align their interests with those of the other ordinary shareholders. It is important for such alignment of interest of the WVR beneficiaries to continue even after listing, as the WVR holders have higher voting power on matters presented at general meetings (except for the matters as set out in draft Rule 8A.25), their underlying economic interests should meet a certain level on an ongoing basis to ensure that they will vote in a manner that serves the best interests of their positions as shareholders which is likely to align with those of the other ordinary shareholders. We recommend the Exchange to consider imposing such requirement as an ongoing requirement for issuers with WVR structure.

Yours faithfully,

Latham & Watkins

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