

HKEx REJECTION LETTER
Cite as HKEx-RL16-06 (April 2006)

[Withdrawn in March 2019; GEM Rule 11.12 repealed in 2008]

Summary	
Listing Rule	GEM Listing Rule 11.06
Reason for rejection and the subsequent disposal of the case on review	<p>The Listing Division rejected the listing application of the Company for the reason that the Company had failed to demonstrate that the Company and its business were suitable for listing under GEM Listing Rule 11.06.</p> <p>The Listing Division's rejection decision was reversed by the GEM Listing Committee, subject to certain specified conditions.</p>
Contents	<p><u>LETTER 1:</u> Extracts of the decision letter of the Head of Listing, the Stock Exchange of Hong Kong Ltd</p> <p><u>LETTER 2:</u> Extracts of the decision letter of the Acting Secretary to the GEM Listing Committee on hearing the application of the Company to review the decision of the Listing Division</p>

LETTER 1

[Date]

[Name and Address of Sponsor]

Dear Sirs,

Re: Application for new listing of a GEM listing applicant
(the "Company" together with its subsidiaries, the "Group")

We refer to your Form 5A dated [**day*month*year*] applying, on behalf of the Company, for the listing of the shares of the Company on the Growth Enterprise Market (the "**Application**") and our earlier letter of [**day*month*year*] (the "**Hearing Letter**"). Terms used in this letter have the same respective meanings as defined in the hearing proof of the prospectus dated [**day*month*year*] (the "**Prospectus**") and the Hearing Letter, unless the context requires otherwise.

At the GEM Listing Committee meeting of [**day*month*year*], the Committee directed the Listing Division to reconsider its analysis of the Application, in light of a number of concerns raised as follows:

- (1) The exclusion of *[certain specified form of production in the specified servicing industry, “Excluded Activities”]* from the Company’s business;
- (2) The exclusion of *[Mr. X’s Excluded Activities]* from the management contract signed between *[Mr. X]* and the Company;
- (3) The heavy reliance of the Company on the success and contribution of one person, namely, *[Mr. X]*; and
- (4) The importance of past breaches of various statutory requirements by the Group.

These concerns constitute a framework established by the Committee for the Listing Division to review the Company’s compliance with GEM Listing Rule 11.12 and the suitability of the Company for listing under GEM Listing Rule 11.06. Further to this guidance provided by the Committee and in light of the particular facts and circumstances of this case, the Listing Division has reached the following conclusions:

I. GEM Listing Rule 11.12

Relevant Facts

The Group is principally operating as a service provider for *[certain specified type of servicing]* industry in the *[* Region]*. Its business activities comprise: (i) *[management of individuals who have entered into personal management contracts with the Company, pursuant to which the Company procures performance opportunities for them, “Contracted Individual Management”]*; (ii) *[specified type of production in the related servicing industry (“Operation 1”)]*; and (iii) *[other specified type of production in the related servicing industry (Operation 2”)]*. The Sponsor has represented that the Group’s turnover which were generated from assignments with *[Mr. X]*’s participation were approximately *[80%]* and *[70%]* for *[first year and second year of the Track Record Period]* respectively *[“Year 1”and “Year 2”]*.

The founder and controlling shareholder of the Group, *[Mr. X]*, has other personal businesses, including the *[Excluded Activities]*. For commercial reasons the *[Excluded Activities]* are excluded from the Group’s business. The Group has represented that the *[Excluded Activities]* can be delineated from those of *[Operation 1]* and *[Operation 2]*, based on *[method of distribution]*, expertise and techniques required, and different costs of production.

The Group provides guidance to *[contracted individuals]* under its management on their career development in the *[specified type of servicing]* industry and procures performance opportunities for them. The Group currently has *[over 10 contracted individuals]* under its management, including *[Mr. X]*. The contract regarding *[Contracted Individual Management]* between *[Mr. X]* and the Group has specifically excluded *[Mr. X’s Excluded Activities]* on a *[specified]* basis. The Group has represented that the reason for such exclusion is that *[Mr. X]* intends to further develop his *[non-local]* career within the *[Excluded Activities]*.

Issue

Whether the exclusion from the Group of the *[Excluded Activities]* conducted by *[Mr. X]*, and the associated revenues from *[Contracted Individual Management]*, is permissible under the requirements of the GEM Listing Rules.

The Rule

GEM Listing Rule 11.12(1) states that:-

“.....a new applicant must demonstrate that..... it has, either by itself or through one or more of its subsidiaries, actively pursued one focused line of business.....”

Note 1 to the Rule states that:-

“The requirement for a new applicant to demonstrate its active business pursuits is one specific to GEM.”

Note 6 to the Rule states that:-

“For a new applicant to be considered suitable for listing, it should be actively engaged in one focused line of business rather than two or more disparate businesses. The reason for this is that the Exchange expects an applicant’s management to be devoting its attention towards advancing one core business rather than a variety of concerns which compete or may compete for their attention.”

Our Analysis

In considering whether a new applicant conducts one focused line of business, the Exchange applies the principle set out in Note 6 to GEM Listing Rule 11.12. When interpreting the GEM Listing Rules in this respect, the Exchange will normally consider a new applicant that is engaged in multiple business activities to be engaged in one focused line of business if there is a rational basis for the activities of the company to be conducted in one enterprise, and all the material business activities of the company have been conducted for the 24 months constituting the active business pursuit period.

Having further reviewed the facts of this case in light of the guidance provided by the Listing Committee, we are of the view that it is not reasonable to make a distinction between (i) *[Operation 1]* and *[Operation 2]* and (ii) *[Excluded Activities]* in a case where such production activities relate to the activities of one particular person. *[Certain specified forms of merchandise]* have become an important revenue source for both *[the business of the Company]* and the *[Excluded Activities]*. Given *[Mr. X’s]* heavy involvement in the *[Excluded Activities]*, his stated intention to develop this aspect of his career further, and the Group’s reliance on *[Mr. X’s]* personal success and contribution, conflicts of interest would remain an issue and would likely be difficult to control given the structure adopted by the Group. Given this background and the potential for conflicts of interest to arise in this case, in our view the Listing Rules should be interpreted to require the applicant and sponsor to present clear and convincing support for the proposition that the Group’s structure is necessary in order to pursue its proposed line of business, and that adequate steps have been taken to limit the potential for conflicts of interest.

- Group Structure

Applying this standard, it is our conclusion that there is no convincing reason for the exclusion of *[Mr. X's Excluded Activities]* from his contract regarding *[Contracted Individual Management]* with the Group. Such exclusion is not found with the other contracts regarding *[Contracted Individual Management]* executed by the Group. Therefore, in our view the contract structure proposed for *[Mr. X's]* contract is not a necessary element of the Group's proposed line of business.

- Potential Conflicts of Interest

Furthermore, it is our conclusion that the Group's current structure creates inherent conflicts of interest between *[Mr. X]* and the Group, and in our view no effective means to ensure a meaningful contribution by *[Mr. X]* to the Group in the future has been established. Since *[Mr. X]* will also control the management of the Group, any non-compete undertaking to be provided by *[Mr. X]* will be difficult for the Group to enforce effectively. Such conflicts of interest arising from separate business activities that compete or may compete for the attention of management are a specific concern identified in Note 6 to Rule 11.12.

Our Conclusion

Under the framework for review established by the Committee and in light of the facts and circumstances of the case, we are of the opinion that the Group has not satisfied the requirements of GEM Listing Rule 11.12.

II. **GEM Listing Rule 11.06**

Relevant Facts

All facts relevant for our consideration of Rule 11.12 as discussed immediately above are also relevant for our consideration of Rule 11.06. Reference is made to such facts for purposes of our analysis, but they are not repeated here. Additional facts relevant for our analysis of Rule 11.06 are as follows:

Based on materials submitted, two former group companies had failed to comply with various Hong Kong statutory requirements. At the time of conducting the Group's business, each of the two group companies had failed to, within the prescribed time limits, (i) apply for business registration after commencement of business in Hong Kong; (ii) register itself as an overseas company with the Hong Kong Companies Registry after its establishment of a place of business in Hong Kong, (iii) notify the Commission of Inland Revenue of Hong Kong regarding employment of its employees who were chargeable to salaries tax, (iv) enroll its employees on a mandatory provident fund scheme and to make contributions for such employees to the scheme; and (v) take out employment compensation insurance policy in respect of its liability as an employer. One of the two group companies had also failed to notify the Commissioner of Inland Revenue of Hong Kong of its chargeable profits in respect of the *[two years prior to the Track Record Period]* within the time limits prescribed under the Inland Revenue Ordinance. In response to comments by the Exchange, the Sponsor has submitted that the business transfers from the two former group

companies to the Group had been effected in accordance with the Transfer of Business (Protection of Creditors) Ordinance and, on the basis of a counsel's opinion, the Group will not be exposed to any penalty that may be imposed on the two former group companies as a result of the latter's non-compliances. However, such instances of non-compliance could result in the former group companies being subject to monetary fines under the relevant Ordinances and each of the then officers (who include *[Mr. X]*) being subject to monetary fines and an imprisonment sentence of up to 84 months.

Issue

Whether, in light of the framework for review established by the Listing Committee in light of the facts and circumstances of this case, the Company and its business are suitable for listing.

The Rule

Rule 11.06 requires that the Company and its business must, in the opinion of the Exchange, be suitable for listing.

Our Analysis

The Group's sources of revenue are very limited and rely most significantly on (i) *[Mr. X]* as a *[contracted individual]* under the Group's management and (ii) *[Mr. X's]* personal reputation and relationships in the industry. *[Mr. X]* will also be the chairman of the board of directors, a member of the Group's senior management team, and the dominant controlling shareholder of the Group. For these reasons, we consider that there is a substantial identity between the Group and the success and contribution of one person, *[Mr. X]*, during the active business pursuit period ("ABP period"). But for the existence and contribution of *[Mr. X]*, the Group would not have had any business of substance during the ABP period.

The persistent breaches of various statutory requirements by the former group companies have illustrated a clear disregard of laws and regulations by the Group's management. Whether or not the Group is insulated from legal liability for such past events, such actions remain relevant for purposes of the Listing Rules and may be relied upon by the Exchange in reaching its conclusions regarding suitability. The past actions of directors and management of the Group in conducting business activities substantially similar to those of the Group inform the Exchange's review of whether it would be reasonable to expect that the Directors would comply with applicable laws, regulations and the Listing Rules in the future. In addition, any custodial sentence imposed on *[Mr. X]* by the courts would be likely to have an extreme adverse impact on the Group, given its undue reliance on *[Mr. X]* as discussed immediately above.

Given the substantial identity between the Group and the success and contribution of one person, *[Mr. X]*, during the ABP period, in our view past actions by *[Mr. X]* individually and the potential personal responsibility of *[Mr. X]* for such actions must necessarily inform the analysis of the Company's suitability for listing under Rule 11.06. Further, the nature of the statutory breaches on the record as having been conducted by former group companies are serious and, taken in aggregate, would

constitute convincing grounds for finding a new applicant unsuitable for listing if they had been conducted by such company directly. In light of the repeated breaches of various statutory requirements by former group companies controlled by [Mr. X], as well as the potential personal liability of [Mr. X] for such actions, in our view the Company should not be considered suitable for listing under Rule 11.06. The steps taken by the Company to insulate itself from legal liability are relevant to this analysis, but the Listing Division does not consider them to be adequate in light of the substantial identity between the Company and [Mr. X] in this case.

Our Conclusion

Under the framework for review established by the Committee and in light of the facts and circumstances of the case, we are of the opinion that the Group is not suitable for listing, pursuant to GEM Listing Rule 11.06.

Given our conclusions set forth above, we have decided to reject the Application. Pursuant to Chapter 4 of the GEM Listing Rules, the Company has the right to have this decision reviewed by the GEM Listing Committee.

[Portion of Letter Purposely Omitted]

Yours faithfully,
For and on behalf of
The Stock Exchange of Hong Kong Limited

[Signed]

Head of Listing

.....
LETTER 2

[Date]

[Name and Address of Sponsor]

Dear Sirs,

Re: Review Hearing of the GEM Listing Committee
(the "Review Hearing") regarding the Company
Date of the Review Hearing: [* day* month* year]

On [* day* month*year], the GEM Listing Committee of The Stock Exchange of Hong Kong Limited conducted a review hearing (the "Review Hearing") to consider an application from the Company for a review of the decision of the Listing Division to reject the listing application of the Company as set out in [LETTER 1] dated [* day* month* year], (the "Decision").

The Review Hearing was conducted before the GEM Listing Committee comprising [names of members purposely omitted] (the "Committee").

Note: Terms and expressions used and defined in the written submission of the Listing Division shall have the same meanings when used herein unless otherwise defined.

Decision

The Committee considered the submissions (both written and oral) made by the Company and the Listing Division. The Committee decided, upon fulfillment of the following condition, to overturn the Decision and that the Company could proceed with its listing application with the Exchange in accordance with the Rules Governing the Listing of Securities on the Growth Enterprises Market of The Stock Exchange of Hong Kong Limited:

[Mr. X] provides an undertaking to the Company that he would only serve six months prior written notice *[to the Group]* to terminate his contract regarding *[Contracted Individual Management]* (as per definition in the hearing proof prospectus) when:

- a. the proportion of the Group's turnover attributable to assignments related to *[Mr. X]* fell below 50%; or
- b. *[Mr. X]* and his associates together held less than 30% of the issued share capital of the Company.

The Committee wishes to stress that the above decision is specific to this particular instance and shall not serve to create a precedent for any other companies.

For the avoidance of doubt, should the Company decide to proceed with its application for new listing, such application will be treated strictly on its merits at the material time, and no representation is given, whether express or implied, as to the acceptability of such application if pursued. The new listing application of the Company in its entirety will be subject to the final approval by the GEM Listing Committee.

Yours faithfully,
For and on behalf of
The Stock Exchange of Hong Kong Limited

[Signed]

Acting Secretary to the GEM Listing Committee