HKEx LISTING DECISION
Cite as HKEx-LD59-1 (August 2007) (Withdrawn in October 2012; Superseded by GL43-12)

Summary	
Name of Party	Company A - a Main Board listing applicant Investor X - a pre-IPO Investor holding more than five per cent. of Company A's shares
Subject	Whether certain rights granted to Investor X would be permitted to continue after listing, given that the rights were not generally available to other shareholders of Company A and the nominated directors' compliance with such rights might, in certain circumstances, conflict with the duty of directors to act in the best of the interests of shareholders as a whole at all times
Listing Rule	Listing Rule 2.03
Decision	The Exchange determined that: (i) The relevant director nomination right provided by the investment agreements between Company A and Investor X should be terminated upon Company A's listing on the Exchange. (ii) The exclusivity provision and the no-more-favorable-terms provision of the investment agreements between Company A and Investor X would be accepted provided that the investment agreements were modified to include an explicit clause recognising the fiduciary duties of directors and that such provisions were described in the prospectus.

SUMMARY OF FACTS

1. This matter arose for decision by the Listing Committee in considering a new listing application. As part of an investment in Company A prior to the time of the IPO, Company A agreed to grant various rights to Investor X, pursuant to relevant investment agreements between Company A and Investor X. These rights, among other things, included:

    (i) Directors nomination right

    Investor X would have the right to nominate one person for election to Company A's board of directors. Company A was required to (1) procure that Company A's board and the relevant board committee recommended such nominated person to the board; and (2) take all corporate action required under the PRC law to cause such nominated person to be duly elected to serve as a member of the board.

(ii) Exclusivity right

Company A was not permitted to issue / offer to issue any shares, options, warrants and rights to any direct competitor of Investor X other than in a public offering.

(iii) No-more-favourable-terms

Subject to applicable law and explicit policy directives of government entities for the issue of shares to an entity controlled by a PRC government entity, Company A was not permitted to issue any shares to any other person on terms more favourable than the terms on which the shares were issued to Investor X.

THE ISSUE RAISED FOR CONSIDERATION

2. Whether certain rights granted to Investor X would be permitted to continue after listing, given that the rights were not generally available to other shareholders of Company A and the directors' compliance with such rights might, in certain circumstances, conflict with the duty of directors to act in the best of the interests of shareholders as a whole at all times?

APPLICABLE LISTING RULE OR PRINCIPLE

3. Listing Rule 2.03 sets out the general principles of the Listing Rules as follows:

> The Exchange Listing Rules reflect currently acceptable standards in the market place and are designed to ensure that investors have and can maintain confidence in the market and in particular that:-
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> (1) applicants are suitable for listing;
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> (2) the issue and marketing of securities is conducted in a fair and orderly manner and that potential investors are given sufficient information to enable them to make a properly informed assessment of an issuer and, in the case of a guaranteed issue, the guarantor and of the securities for which listing is sought;
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> (3) investors and the public are kept fully informed by listed issuers and, in the case of a guaranteed issue, the guarantors of all factors which might affect their interests - and in particular that immediate disclosure is made of any information which might reasonably be expected to have a material effect on market activity in, and the prices of, listed securities;

(4) all holders of listed securities are treated fairly and equally;

(5) directors of a listed issuer act in the interests of its shareholders as a whole - particularly where the public represents only a minority of the shareholders; and

(6) all new issues of equity securities by a listed issuer are first offered to the existing shareholders by way of rights unless they have agreed otherwise.

In these last four respects, the rules seek to secure for holders of securities, other than controlling interests, certain assurances and equality of treatment which their legal position might not otherwise provide.

ANALYSIS

4. During the vetting process, the Exchange raised a comment concerning whether certain rights granted to Investor X should be allowed to continue after listing in light of the principle of fairness and equality set out in Listing Rules 2.03(4).

5. The Exchange specifically raised the following comments with respect to each of these rights: -

   a. *Directors nomination right*

   Company A was requested to add disclosure in the prospectus to confirm whether the nomination right would be subject to the fiduciary duties of each of the directors serving on Company A's nomination committee. As such nomination rights were generally available to all shareholders holding more than 5% of Company A's shares pursuant to Company A's articles of association, the Exchange requested that disclosure be added to the prospectus to clarify whether and to what extent the nomination right of Investor X was different from those available to other shareholders. To the extent the right held by Investor X did not comply with the principles of Rule 2.03(4), Company A was asked by the Exchange to consider terminating such right upon listing.

   b. *Exclusivity right*

   The Exchange commented that the exclusivity right could potentially hinder the board of directors of Company A from considering bona fide alternative proposals that would be in the best interest of Company A and its shareholders as a whole to pursue, even after accounting for any contractual damages that might arise from terminating their investment agreements with Investor X. Company A was requested to advise and disclose in the prospectus:

(i) whether the respective agreements provided that the exercise of the exclusivity right would be subject to the directors' fiduciary duties; and

(ii) whether the contractual requirements would override the directors' fiduciary duties requirements under applicable PRC Company Law and Company A's articles of association.

c. No more favourable terms

The Exchange requested Company A to disclose whether the no-more-favourable-terms would override the directors' fiduciary duties requirements under applicable PRC Company Law and Company A's articles of association.

d. "Fiduciary out" clause

Company A was also requested to consider including language in the relevant investment agreements explicitly recognising directors' fiduciary duties and designed to ensure that directors would not be faced with an impossible conflict between honouring a company's contractual commitments and honouring their fiduciary duties to shareholders. An example of such provision is set forth below:

"The board may participate in negotiations with or furnish information to a third party if the board decides upon the advice of its outside counsel that failure to do so would result in a breach of the board's fiduciary duties."

Comments taken by Company A

6. In response to the Exchange's comments, Company A and Investor X agreed in principle that: -

(i) the director nomination right would terminate at the time of Company A's listing and Investor X would propose any nomination pursuant to the existing articles of association;

(ii) the exclusivity right and the no-more-favourable-terms would not operate to override the fiduciary duties of the directors of Company A; and

(iii) a clause explicitly recognising the fiduciary duties of directors would be added to the investment agreements with Investor X.

DECISION

7. Based on the above analysis and having regard to the material facts, the Exchange determined that:

(i) The relevant director nomination right provided by the investment agreements between Company A and Investor X should be terminated upon Company A's listing on the Exchange.

(ii) The exclusivity provision and the no-more-favorable-terms provision of the investment agreements between Company A and Investor X would be accepted provided that the investment agreements were modified to include an explicit clause recognising the fiduciary duties of directors and that such provisions were described in the prospectus.