

Hong Kong Publishes Groundbreaking New Rules for Dual-Class Shares, Emerging and Innovative Sectors

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After publishing the “[New Board Concept Paper](#)” in December 2017, the Stock Exchange of Hong Kong Limited (the Exchange) issued a consultation paper on February 23, 2018, titled “[A Listing Regime for Companies From Emerging and Innovative Sectors](#)” (Consultation Paper), which sought public feedback on the proposed new rules to expand Hong Kong’s listing regime to facilitate listings of companies from emerging and innovative sectors. The new rules subsequently published on April 24, 2018, represent the most significant changes to the Hong Kong listing regime in over 20 years.

The new rules and corresponding amendments to the Main Board Listing Rules (collectively, the Rules):

- permit listings of high-growth and innovative companies with dual-class shares or “weighted voting rights” (WVR) structures;
- permit listings of preprofit/prerevenue biotech issuers; and
- facilitate Greater China and international companies seeking a secondary listing in Hong Kong.

The new Rules will come into effect on April 30, 2018.

Skadden Comments on the Significance of the New Rules

These new Rules represent the single most significant change in the Hong Kong market since the first “H share” listings of People’s Republic of China companies in the early 1990s, and they pave the way for a vast pipeline of Chinese tech companies and global biotech companies to list in Hong Kong, as well as a “homecoming” listing for Chinese tech companies already listed in the United States. The expectation is that the Exchange will now become a listing venue of choice for Greater China high-tech and innovative companies, giving a significant boost to the Hong Kong capital market; the Exchange’s owner/operator, Hong Kong Exchanges and Clearing; the financial and professional services sector; and potentially the broader Hong Kong economy at large.

Issuers With WVR Structures

The new Rules will permit companies with a dual-class share structure, referred to by the Exchange as a WVR share structure, to list in Hong Kong. Only “innovative” issuers will be permitted to list using a WVR structure, and they will need to satisfy a number of requirements and implement detailed investor protection safeguards.

A company would only be considered suitable for listing in Hong Kong with a WVR structure if it is able to demonstrate the characteristics set out below, subject to the Exchange’s absolute discretion to reject an application for listing with a WVR structure.

Nature of the Company. The applicant must be an innovative company, which would normally be expected to possess more than one of the following characteristics:

- Its success is demonstrated to be attributable to the application to the company’s core business of new technologies, innovations and/or a new business model (e.g., a new way of connecting consumers and providers);
- Research and development (R&D) is a significant contributor of its expected value and constitutes a major activity and expense;

Hong Kong Publishes Groundbreaking New Rules for Dual-Class Shares, Emerging and Innovative Sectors

- Its success is demonstrated to be attributable to its unique features or intellectual property; and/or
- It has an outsized market capitalization/intangible asset value relative to its tangible asset value.

Success of the Company. The applicant must demonstrate a track record of high business growth objectively measured by operational metrics, such as business operations, users, customers, unit sales, revenue, profits and/or market value (as appropriate), and its high-growth trajectory is expected to continue.

Contribution of WVR Beneficiaries. Each WVR beneficiary must have been materially responsible for the growth of the business, by way of the WVR beneficiary's skills, knowledge and/or strategic direction in circumstances where the value of the company is largely attributable or attached to intangible human capital.

Role of WVR Beneficiaries. Each WVR beneficiary must be an individual who has an active executive role within the business and has contributed materially to the ongoing growth of the business, and each of them must be a director of the issuer at the time of listing.

External Validation. The applicant must have previously received meaningful third-party investment from at least one sophisticated investor (which must remain at the time of the initial public offering, or IPO). Such investors will be required to retain an aggregate 50 percent of their investment for a period of at least six months post-IPO. If the applicant is a spin-off from a parent company, it is not subject to the requirement of having received meaningful third-party investment.

Expected Market Capitalization

An applicant with a WVR structure must have:

- (a) a minimum expected market capitalization at listing of HK\$40 billion; or
- (b) a minimum expected market capitalization at listing of HK\$10 billion, and at least HK\$1 billion of revenue in its most recent audited financial year.

New Listing Applicants Only

Only new applicants will be able to list with a WVR structure. After listing, issuers with WVR structures will be prohibited from increasing the proportion of WVR in issue or from issuing any further WVR shares (except on a pro rata basis in certain corporate actions, such as rights issues or open offers).

Minimum Economic Interest at Listing

The beneficiaries of a company's WVR structure are required to collectively beneficially own a minimum of at least 10 percent of the underlying economic interest in the applicant's total issued share capital at the time of its initial listing.

A lower minimum shareholding percentage may be accepted by the Exchange on a case-by-case basis if the lower percentage shareholding still represents a very large amount in absolute dollar terms (*e.g.*, if the company has a market capitalization of over HK\$80 billion at the time of its initial listing).

WVR Shares Cannot Be Transferred

Beneficiaries of WVRs will be restricted to those individuals who are directors of the issuer at listing and remain directors afterward. The WVRs attached to a WVR beneficiary's shares will lapse permanently if a WVR beneficiary dies, ceases to be a director, or is deemed by the Exchange either to be incapacitated or to no longer meet the requirements of a director set out in the Rules. The WVRs attached to a WVR beneficiary's shares will also lapse permanently if a WVR beneficiary transfers his or her beneficial or economic interest in those shares, or the voting rights attached to them, to another person.

Limits on WVR Voting Power

The voting power attached to WVR shares is capped at not more than 10 times the voting power of ordinary shares.

Protecting Non-WVR Shareholders' Right to Vote

A listed issuer's WVR structure must enable non-WVR shareholders to cast at least 10 percent of the votes that are eligible to be cast on resolutions at the listed issuer's general meetings. The non-WVR shareholders holding at least 10 percent of the voting rights on a one-share, one-vote basis must be able to convene a general meeting and add resolutions to the meeting agenda.

The following key matters are required to be decided on a one-share, one-vote basis, and WVR beneficiaries will not be able to exercise WVRs on these matters:

- changes to the issuer's constitutional documents, however framed (although the Exchange has clarified that it will allow issuers to include a provision in their constitutional documents to prevent any changes without the consent of the holders of WVR shares);
- variation of rights attached to any class of shares;

Hong Kong Publishes Groundbreaking New Rules for Dual-Class Shares, Emerging and Innovative Sectors

- the appointment or removal of an independent nonexecutive director (INED);
- the appointment or removal of auditors; and
- the voluntary winding-up of the issuer.

Enhanced Corporate Governance

In the interests of enhancing investor protection for WVR companies, the Exchange will require WVR companies to adopt the following enhanced corporate governance measures:

- establish a Corporate Governance Committee comprised of a majority of INEDs and chaired by an INED;
- establish a nomination committee comprised of a majority of INEDs and chaired by an INED;
- require the retirement of INEDs by rotation at least once every three years;
- require directors, senior management and the company secretary to have undertaken training on the WVR rules and risks associated with the WVR structure; and
- engage a compliance adviser on a permanent basis and consult with this adviser on WVR-related matters.

The Exchange also will require WVR safeguards to be incorporated into the issuer's constitutional documents, to allow shareholders to take civil actions to enforce provisions in the constitutional documents (including WVR safeguards) against the issuer.

Enhanced Disclosure

The Exchange will require issuers with WVR structures to be prominently identified through a unique stock marker, "W," at the end of their stock name. An issuer with a WVR structure has to include the warning "a company controlled through weighted voting rights" and inform prospective investors of potential risks prominently on the front page of all its listing documents, periodic financial reports, circulars, notifications and announcements required by the Rules. The listing documents and financial reports must prominently describe the WVR structure, the issuer's rationale for having it and associated risks.

Skadden Comments on the WVR Structure

The criteria surrounding what will constitute an "innovative company" permitted to adopt a WVR structure require the Exchange to exercise a high degree of subjective judgment. Simply put, the Exchange will be in a position to decide which companies it will allow to list with a WVR structure. The new Rules do not currently permit WVR shares to be held in corporate entities or other vehicles; this is expected to be addressed through a subsequent additional consultation process. It is likely that there will be some ongoing tensions between the desire of the Exchange for WVR shares to impose restrictions on the WVR structure and the desire for founders to have a real, substantive WVR structure similar to that adopted by many U.S.-listed companies.

Biotech Companies

The new Rules also permit the listing of preprofit/prevenue biotech issuers that produce pharmaceuticals (small molecule drugs), biologics and medical devices (including diagnostics).

Suitability to List

A new biotech company applicant is expected to have:

- been in operation in its current line of business for at least two financial years prior to listing, and under substantially the same management;
- developed at least one core product beyond the concept stage (generally, completed Phase I clinical trials and approved for Phase II clinical trials by the U.S. Food and Drug Administration, China Food and Drug Administration or European Medicines Agency);
- been primarily engaged in R&D:
 - for the purposes of developing its core product(s), and
 - for a minimum of 12 months prior to listing;
- as its primary reason for listing the raising of finance for R&D to bring its core product(s) to commercialization;
- durable patent(s), registered patent(s), patent application(s) and/or intellectual property in relation to its core product(s);

Hong Kong Publishes Groundbreaking New Rules for Dual-Class Shares, Emerging and Innovative Sectors

- a pipeline of potential products, if it is engaged in the R&D of pharmaceutical (small molecule drugs) products or biologic products;
- previously received meaningful third-party investment from at least one sophisticated investor at least six months before the date of the proposed listing (which must remain at the time of the IPO);
- available working capital to cover at least 125 percent of the group's costs (which must substantially consist of general, administrative, operating and R&D costs) for at least the next 12 months; and
- a minimum expected market capitalization of HK\$1.5 billion, of which at least HK\$375 million must be held by the public at the time of listing.

Biotech companies applying for a listing will be required to provide enhanced prospectus and risk disclosures, as well as ongoing disclosures regarding their R&D activities in their interim and annual reports.

A biotech company is restricted from effecting any transaction that will result in a fundamental change to its principal business without the prior consent of the Exchange.

Restriction on Cornerstones

Shares subscribed by cornerstone investors in the IPO of a biotech company will not count toward the company's public float.

Existing shareholders of the applicant may subscribe for shares in the IPO, either under the existing regulatory framework or as a cornerstone investor. However, IPO shares subscribed by the existing shareholders will not count toward the public float.

Skadden Comments on Biotech Companies

As with the definition of "innovative companies," the Exchange will retain a significant degree of discretion in deciding which biotech companies will meet its standards to list in Hong Kong. The restrictions on cornerstone investors also are notable and may indicate the beginning of a broader move by the Exchange to limit and eventually phase out the phenomenon, which many market participants and observers agree have skewed the market. The big question mark around the biotech proposals is, "Having built it, will they come?" There already has been significant interest in the market, including from major China-based biotech players, to list under the new Rules, so the hope is that they will be a success. What remains to be seen is whether Hong Kong will attract the ecosystem of analysts, fund managers and other specialists necessary to ensure it becomes a true biotech hub.

Secondary Listing of Qualifying Issuers

The new proposals facilitate secondary listings in Hong Kong for large mainland and nonmainland emerging and innovative companies with primary listings on the NYSE, Nasdaq or London Stock Exchange.

Qualifications for Secondary Listing

To qualify for listing under the new route, an issuer with a WVR structure must:

- have a primary listing on the New York Stock Exchange, Nasdaq or London Stock Exchange (under the "Premium Listing" segment);
- be an innovative company (see the characteristics set out under the section "Issuers With WVR Structures" above);
- have a good record of compliance for at least two full financial years in its home market; and
- have an expected market capitalization at the time of secondary listing in Hong Kong of at least HK\$10 billion. A secondary listing applicant with a WVR structure, and/or which is a Greater China issuer, will also be required to have a market capitalization of at least HK\$40 billion, or a market capitalization of at least HK\$10 billion and revenue of at least HK\$1 billion in its most recent audited financial year.

Automatic Waivers

Qualifying issuers seeking a secondary listing under the new concessionary route would have the benefit of the extensive waivers from the Hong Kong Listing Rules, including waivers from the notoriously complex and burdensome connected transactions rules, as well as waivers from rules on notifiable transactions, new share issuances, corporate reporting and the Takeovers Code.

Special Dispensations for Non-Greater China Issuers and Already-Listed Greater China Issuers

A non-Greater China issuer or a Greater China issuer already listed on one of the permitted exchanges on or before December 15, 2017 (the date the "New Board Concept Paper" was published), must demonstrate, to the Exchange's satisfaction, how the domestic laws, rules and regulations to which it is subject and its constitutional documents, combined, provide the key shareholder protection standards set out in the [2013 Joint Policy Statement](#). However, they will be able to list with their existing WVR structures and will not have to comply with the WVR safeguards required of new WVR issuers in Hong Kong.

Hong Kong Publishes Groundbreaking New Rules for Dual-Class Shares, Emerging and Innovative Sectors

Other Greater China Issuers

Greater China issuers that have a primary listing after December 15, 2017, will not be granted the above concessions. At the point of secondary listing, these nongrandfathered Greater China issuers must vary their constitutional documents to meet the key shareholder protection standards (unless already provided for in their constitutional documents and/or the laws they are subject to), and their WVR structure, if they have one, must conform to all primary listing requirements, including all ongoing WVR safeguards.

The intention of this set of Rules is to facilitate the listing in Hong Kong of any Greater China tech companies already listed with a dual-class share structure “as is,” while preventing new listing applicants from seeking a primary listing elsewhere and then pursuing a secondary listing in Hong Kong in order to circumvent the Hong Kong rules on WVRs.

Migration of the Bulk of Trading to Hong Kong

Where the bulk of trading in the shares of an issuer migrates to Hong Kong on a permanent basis (which is defined as 55 percent or more of the total trading volume of those shares over the

issuer’s most recent fiscal year taking place on the Exchange’s markets), the Exchange will require the extensive waivers from the Rules to fall away and the secondary listing essentially to convert to a dual-primary listing (subject to a 12-month grace period).

Skadden Comments on Secondary Listings

While the new Rules also permit non-Greater China issuers to undertake a secondary listing in Hong Kong, that in itself is nothing new, as secondary listings have always been allowed for non-Greater China issuers; the real story here is the opening of a path for Greater China companies to pursue a secondary listing in Hong Kong, which traditionally has not been permitted. The “loss” of numerous China tech companies’ listings to the U.S. has long been a thorn in the side of Hong Kong Exchanges and Clearing. The hope is that these new Rules will permit all of those companies — regardless of the existing dual-class share structures they have in place — to undertake a “homecoming” secondary listing in Hong Kong.

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