THE LAW SOCIETY OF HONG KONG 香港律師會

CONCEPT PAPER
WEIGHTED VOTING RIGHTS

The Law Society's Submissions

The Law Society provides the following responses to a Concept Paper entitled "Weighted Voting Rights" released by the Hong Kong Stock Exchange in September 2014.

Question 1: Should the Exchange in no circumstances allow companies to use WVR structures?
Please give reasons for your views.

Please only answer the remaining questions if you believe there are circumstances in which companies should be allowed to use WVR structures.

Law Society's Response:

No, the Law Society takes the view that there are suitable circumstances when WVR structures should be allowed. A simplistic "one share one vote" structure, in the absence of a controlling shareholder with a long term strategy, can lend itself to short-termism which may not be suitable for new applicants which seek to raise funds to pursue long term strategies.

Question 2: Should the Exchange permit WVR structures:

(a) for all companies, including existing listed companies; or
(b) only for new applicants (see paragraphs 147 to 152); or
(c) only for:
    (i) companies from particular industries (e.g. information technology companies) (see paragraphs 155 to 162), please specify which industries and how we should define such companies;
    (ii) "innovative" companies (see paragraph 163 to 164), please specify how we should define such companies; or
    (iii) companies with other specific pre-determined characteristics (for example, size or history), please specify with reasons.
(d) only in "exceptional circumstances" as permitted by current Listing

Rule 8.11[126] (see paragraph 81) and, if so, please give examples.

Please give reasons for your views.

If you wish, you can choose more than one of the options (b), (c) and (d) above to indicate that you prefer a particular combination of options.

Law Society's Response:

The Law Society chooses Option 2(b).

The Law Society takes the view the initially only new applicants should be allowed to use WVR structures so that existing Hong Kong stock investors do not feel that the goalposts have been moved on them. In the case of new applicants, each and every public investor would be coming in with full knowledge and every subsequent buyer would do so too. For listed issuers, unless unanimous agreement (which is almost impossible to achieve) is obtained, some investors would feel aggrieved that their right is prejudiced by the majority who voted for a change to a WVR structure.

The Law Society does not think the circumvention risk outlined in paragraph 151 of the Concept Paper is a significant one. In the case of privatization, stringent requirements exist to protect the minority (including a requirement for super majority support from the independent shareholders and a right for the dissenters to go to court). Once privatized, there is also no bar for the company to seek a new listing with WVR structure in jurisdictions which allow such structures.

In the case of spin-off (otherwise by way of introduction), if preferential voting rights are reserved for the listed company, the rights of the listed company and its shareholders would not be prejudiced, and each and every one of those who buy into the spun off entity through the public offer tranche would do so with full knowledge. If preferential voting rights are given to the new investors, the shareholders of the existing listed company has the opportunity of disapproving the spin-off, in the same manner as it can disapprove the disposal of the subsidiary if the spin-off or disposal is significant enough in the context of the existing listed company.

The Law Society supports the introduction of anti-avoidance provisions in the Listing Rules as mentioned in paragraph 152. Although the Exchange may be required to exercise subjective judgment, this is nothing new as the Exchange has in any event to determine whether a new applicant is suitable for listing under existing rules.

Question 3: If a listed company has a dual-class share structure with unequal voting rights at general meetings, should the Exchange require any or all of the restrictions on such structures applied in the US (see the examples at paragraph 153), or others in addition or in substitution?

Please identify the restrictions and give reasons for your views.

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[126] GEM Rule 11.25

Law Society's Response:

The Law Society takes the view that suitable restrictions should be imposed by the Exchange. The overriding principle should be that the WVR structure should only last as long as the rationale for its existence is still relevant, although in practice it may be difficult to convert such structures, and delisting would be unpalatable to investors.

While the restrictions outlined in paragraph 153 are good examples of the type of restrictions the Exchange may wish to impose on a new applicant with WVR structure, they should not represent an exhaustive list.

Question 4: Should other WVR structures be permissible (see Chapter 5 for examples), and, if so, which ones and under what circumstances?

Please give reasons for your views. In particular, how would you answer Question 2 and Question 3 in relation to such structures?

Law Society's Response:

Other WVR structures should as a matter of principle be allowed for new applicants. Our answers to Question 2 and Question 3 remain the same for these structures.

Question 5: Do you believe changes to the corporate governance and regulatory framework in Hong Kong are necessary to allow companies to use WVR structures (see paragraphs 67 to 74 and Appendix V)? If so, please specify these changes with reasons.

Law Society's Response:

The Law Society believes that emphasis on investor protection (including continuing to keep connected transaction on a tight rein) is key. However, large scale changes should not be necessary as Hong Kong's regulatory framework is already written with reference to "voting rights". Provisions of the Takeovers Code apply to the acquisition of voting rights, and the application of the Listing Rules' provisions relevant to "controlling" and "substantial" shareholders are likewise determined by percentage holdings of voting rights, rather than numbers of shares. Hong Kong's already stringent regime governing connected transactions should already be adequate to guard against controllers extracting private benefits.

Also, the SAR Government should work with the legal profession with a view to better empowering investors to take private action against corporate wrongdoing. Measures such as introducing class action law suits and alternative means of litigation funding could be deliberated.

In respect of the introduction of a class action regime, that would need to be considered carefully as it has the potential to be a double-edged sword: easier access to redress, but more potential for an increase in speculative claims. Drawing on experience in other

jurisdictions, these concerns may be addressed by imposing a higher threshold before leave is given to proceed with a class action.

In any event, the introduction of these measures should not delay allowing companies with WVR structures to list in appropriate circumstances. In the United States, shareholders' securities class action suits are brought almost exclusively to recover damages for company fraud or misleading disclosure which triggers a drop in a company's share price. According to data produced by Stanford University, 97% of the 166 securities class action suits in 2013 involved allegations of misrepresentation in financial statements: 84% were claims under Rule 10b-5.[i] Thus even in the United States where class action suits are available, they are not generally used to rectify the type of governance issues most likely to arise from WVR structures, namely the abuse of power by company controllers. Moreover, as the Concept Paper highlights, the SFC has had considerable success in obtaining redress for listed company shareholders using its powers under sections 212 to 214 of the Securities and Futures Ordinance.

Question 6: Do you have any comments or suggestions regarding the additional matters discussed in paragraphs 33 to 47 of this paper:

(a) using GEM, a separate board, or a professional board to list companies with WVR structures (see paragraphs 33 to 41); and

(b) the prospect of overseas companies seeking to list for the first time on the Exchange with a WVR structure or seeking a further primary or secondary listing here (see paragraphs 44 to 47)?

Law Society's Response:

(a) It is to be noted that the main purpose of contemplating acceptance of WVR structures is to attract top quality companies to list in Hong Kong. Given the history of GEM, those companies may simply choose not to list here if the only option is to list on GEM rather than the Main Board. Thus, the Law Society suggests that WVR listings should be allowed on the Main Board, provided that sufficiently clear disclosure is made to prospective investors.

(b) Overseas companies should be treated the same way as those coming from the recognized jurisdictions.

Question 7: Do you have any other comments or suggestions regarding WVR structures?

Law Society's Response:

NIL

The Law Society of Hong Kong
25 November 2014

[i] Cornerstone Research and the Stanford Law School Securities Class Action Clearinghouse, "*Securities Class Acting Filings 2013 Year in Review*", at page 7.