

Corporate & Commercial

HKEx Has Taken a Step Forward for Weighted Voting Rights Structure in Hong Kong

In 2013, the proposed HKD100 billion IPO of the mainland internet giant Alibaba sparks debate on whether Hong Kong should allow non-standard shareholding structure such as dual class shares. In the same year, The Stock Exchange of Hong Kong Limited (the “**HKEx**”) published a concept paper seeking views from the public on whether weighted voting rights (“**WVR**”) structures should be permissible for companies currently listed or seeking to list in Hong Kong and there were strong and divided views on this subject as disclosed in the consultation conclusions released this month.

Background

WVR, by definition, refers to governance structures in which certain persons are given voting power, or other related rights disproportionate to their shareholdings. Currently, the concept of “one share, one vote” prevails unless there are exceptional circumstances. HKEx is now considering a proposal to develop and extend the “exceptional circumstances” concept to “limited circumstances” such that certain listed companies are allowed to have WVR structures in certain circumstances with enhanced investor protection safeguards. Nevertheless, it should be noted that the concept of “one share, one vote” still prevails in general.

Current Hong Kong Regime

For private companies in Hong Kong, under Companies Ordinance (Cap. 622), they are allowed to adopt WVR structure by setting out the same in their articles. For listed companies in Hong Kong, under the Listing Rules, they are required to have fair and equal treatment of their shareholders and they (together with the listing applicants) should ensure the voting power of their shares bears a “reasonable relationship” to the equity interest represented by those shares unless there are exceptional circumstances. However, such an exception has never been used.

Consultation Conclusions

HKEx raised several structured questions on the permissibility of WVR structures in the concept paper. As said, there are divided views on this subject and their responses and the HKEx’s conclusions are summarised as follows:

Permissibility of WVR structures

Generally, very few respondents to the Concept Paper take the view that WVR should be permitted unconditionally. Accountancy firms, sponsor firms and banks, law firms, professional bodies representing these industry groups and listed companies staff are supportive of permitting WVR structures in some circumstances. Listed companies have strong support as well but one-third of them opine that WVR structures should only be permitted in exceptional circumstances. Investment managers are split on this issue.

HKEx concluded that the “exceptional circumstances” provision should not be retained as it has effectively banned WVR structures for a long time and there would be too much uncertainty for companies planning a listing even with more guidance. Removing this restriction can improve the clarity and certainty of the Listing Rules. Furthermore, flexibility can be given to HKEx to list companies that fall below certain eligibility criteria of WVR structure as HKEx would retain its ability to waive eligibility criteria under the Main Board Listing Rules 2.04 depending on the company’s circumstances in the normal manner.

Scope of the permission

HKEx concluded that WVR structures should only be confined to new applicants. Existing companies may circumvent the restriction by re-incorporation or other re-structuring or through spin-offs, reverse takeovers or other corporate activities. This problem can be prevented by an anti-avoidance Rule. Furthermore, WVR should only be permitted for companies with pre-determined characteristics (e.g. size and history) and those which meet higher eligibility standards. This will alleviate some of the respondents’ concerns that permitting WVR structures will become commonplace in Hong Kong and thereby risk damaging reputation and competitiveness of the Hong Kong market. HKEx also has a preliminary view that WVR structures should not be restricted to only overseas companies.

Investor protection risk and corresponding safeguards

Both the supporting and opposing respondents agree that a heightened investor protection risk can be resulted by the use of WVR structures. Controllers may take advantage of their positions to extract personal benefits from a company at a disproportionate cost to shareholders in public. Although minority shareholders can rely on unfair prejudice petitions or derivative actions against company’s directors, it must be noted that class actions and contingency fees are not available to aggrieved shareholders in Hong Kong.

Supporters of WVR structures believe that sufficient enhanced safeguards can balance and mitigate these risks so the permission of WVR structures would be a competitive advantage for the Hong Kong market. The safeguards receiving most support from respondents include restriction on transfers, minimum equity threshold held by founders or others, sunset clause, shareholder vote, continued active involvement of the founder in the management of the

company and cap on votes per share. HKEx would make a number of the above restrictions and possibly others mandatory restrictions for companies with WVR structures.

Changes to corporate governance and regulatory framework

As Hong Kong's legal and regulatory framework is based on the assumption that the control over a company will be exercised at general meetings through voting power attached to shares, conferring WVR through multiple classes of shares is more easily accommodated and thus more preferable. Share-based WVR structures can confer very strong forms of control – the decision making process at both general meetings and board of directors meetings can be controlled. On the other hand, it is also possible for a company to implement another WVR structure that attaches much weaker, more restricted rights to shares, which would still fit with Hong Kong's legal and regulatory regime. In such circumstances, less additional regulatory restrictions would have to be imposed on the company.

Other than investor protection risks mentioned above, WVR structures also have implications on takeovers. For instance, minority shareholders with superior voting rights under WVR structure may be able to vote down takeover proposals at general meetings. Therefore, WVR structures may necessitate changes to other Rules and possibly The Codes on Takeovers and Mergers and Share Buy-backs of the SFC (the “**Takeovers Code**”).

Second Stage Consultation

HKEx is now in the process of finalising a draft proposal intended to be refined after discussions with stakeholders before putting forward a proposal for the second stage consultation. Formal consultation will be commenced in the third quarter of 2015 or early in the fourth quarter of 2015 depending on market feedback.

As to the scope, any second stage proposal will limit WVR structures to new companies only. Appropriate “anti-avoidance” measure will be developed to cope with the potential problem of circumvention. Further, precise parameters of ring-fencing to a “type of company” (with some specific pre-determined characteristics) will be established since there is no support for permitting all new companies to list with WVR structures and there is no intention to limit the availability to companies in any particular industries. It should be noted that there will unlikely be a completely “bright line” test in this regard.

As to the safeguards, HKEx will discuss with the Takeovers Panel through or jointly with Securities and Futures Commission (the “**SFC**”) in the second consultation because greater issues will be imposed on the Takeovers Code if WVR is conferred only through a company's constitutional documents. HKEx will also explore other safeguards, for example, a restriction on transfer and minimum equity threshold shareholding requirement.

It is noteworthy that the SFC published a statement in relation to the Consultation Conclusions. In gist, the Board of the SFC has unanimously concluded that it does not support the draft proposal for primary listings with WVR structures. It has concerns on the fair treatment of shareholders and potential impact of acquisitions of existing listed assets by WVR issuers. It has particular concerns about the proposals which require regulators to assess compliance with the “enhanced suitability” criteria for companies to be eligible for WVR because such criteria are inherently vague.

With the SFC’s disagreement to the draft proposal on WVR, it is anticipated that the extensive public debate on and widespread coverage of the WVR issue will continue to last for the next few months.

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Important: The law and procedure on this subject are very specialised and complicated. This article is just a very general outline for reference and cannot be relied upon as legal advice in any individual case. If any advice or assistance is needed, please contact our solicitors.

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