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# HKEx Publishes Listing Decision On The Listing Eligibility Of An Entity Under Joint Control

## HKEx Listing Decision 106-1 (October 2010)

### Summary of Issue

In this decision the Exchange had to assess if a new applicant operating under a jointly controlled entity structure [[1]](#footnote-25) was suitable for listing.

### Facts

The Company ("**Company A**") was involved in the automobile business on the Mainland and operated via a jointly controlled entity ("**JCE X**"). The Listing Rules do not currently cater for JCEs and Company A could not consolidate JCE X's results to meet the financial tests of Rules 8.05(1), (2) and (3), as these only take into account the results of the issuer and its group, with results of associated companies and JCEs being excluded. Company A therefore applied for listing under Rule 8.05B(3), which deals with exceptional situations where the issuer or its group have a trading record of a minimum of two financial years, the Exchange considers the listing to be in the interests of investors and the issuer, and investors have the information required to form an informed opinion regarding the issuer and the securities to be listed.

### HKEx Analysis and Decision

In 2005, the Exchange devised a scheme for appraising the eligibility of a new applicant operating under a JCE framework. This scheme consists of two elements: (i) the existence of a set of exceptional circumstances for assessing the applicant’s eligibility under Rule 8.05B(3); and (ii) conditions imposed on the applicant after listing. The Exchange state that the rationale underpinning this scheme is to ensure consistency between the regulation of JCEs (including JCEs newly established after listing) and the regulation of subsidiaries under the Listing Rules. This framework has apparently been applied to a Mainland automobile manufacturer operating via JCEs.

#### Eligibility Criteria

The Exchange state that the following criteria will apply when evaluating whether the "exceptional circumstances test" is satisfied:

* the applicant must be able to meet the large market capitalisation test of HK$4 billion in Rule 8.05(3) if the proportionate results of its JCEs are included;
* the JCE structure must be common in the applicant’s industry, or be the result of the regulatory environment;
* the joint venture partners must participate in the management of the JCEs together with the applicant;
* the applicant and the joint venture partners must be able to make contributions to the JCE's operation and growth, such as management expertise, production techniques, patents or production facilities;
* the joint venture agreement must contain safeguards to avoid the applicant’s share of the JCE's profits flowing to other entities without the applicant's consent;
* the joint venture agreement must set out clear terms of distribution of the JCE's assets upon termination of the agreement;
* the listing document must contain disclosure of the historical dividend payment patterns and its future dividend policies;
* the listing document must include the terms of the joint ventures and disclose the risk factors of the JCE's structure and business; and
* the applicant must comply with the continuing obligations imposed as a condition of listing.

#### Post-listing Conditions

The Exchange stated in the decision that if JCEs seek to be treated as subsidiaries, they must comply with the continuing obligations governing subsidiaries. This includes those detailed in Chapters 13, 14, 14A, 15, and 17 of the Listing Rules and Practice Note 15, subject to the following modifications:

* Chapter 13: The JCE's activities will be treated as those of the applicant, obliging it to disclose price sensitive information (see Rule 13.09(1)). However Rules 13.12 to 13.19 will not apply to JCEs.
* Chapter 14: The percentage ratio tests for classifying different transactions will be adjusted to take into account only the proportionate interest of the applicant in the JCE. For example, in an acquisition by a 50/50 JCE, the applicant will only pick up 50% (being its proportionate share in the JCE) of the acquisition cost of the target in calculating the numerator of the consideration ratio.
* Chapter 14A: The percentage ratio tests for de minimis connected transactions with JCEs will also be adjusted to take account of the proportionate interests of the applicant in the JCEs. Connected persons of the applicant will include the directors and joint venture partners of the JCEs and their respective associates. Transactions between the applicant (including the JCEs) and (i) the joint venture partners and their associates; (ii) the directors of JCEs and their associates; or (iii) the connected persons of the applicant (e.g. the substantial shareholder and its associates), will be regarded as connected transactions. The Exchange may also deem transactions involving the variation of the terms of the joint venture to be connected transactions, with this evaluation involving an appraisal of materiality and minority shareholders' protection.

After detailing the conditions described above, the Exchange confirmed that Company A satisfied all eligibility criteria and post-listing stipulations under the JCE framework and that it considered the listing to be advantageous for the issuer and investors, with the latter having access to the information required to make an informed investment decision. However, the Exchange also made clear that having regard to the exceptional listing conditions in this case, all future JCE applications would be considered on their own specific merits.

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1. The IASB defines JCEs as follows: "A jointly controlled entity is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity." [↑](#footnote-ref-25)