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# Hong Kong Law Issue 179

## Hong Kong Stock Exchange Issues Guidance Letter And Listing Decisions In Relation To Mineral Companies

The Stock Exchange of Hong Kong (the **Exchange**) has recently published Guidance Letter GL47-13 (the **Letter**) in relation to the continuing disclosure obligations of listed Mineral Companies (as defined in the Listing Rules) and other listed issuers that publicly disclose details of resources and/or reserves (**R18.15 Companies**). The Exchange also published seven Listing Decisions (the **Decisions**) in January 2013 in relation to issues under Chapter 18 of the Listing Rules. These concerned for the most part proposed acquisitions by Main Board listed companies of mineral assets in transactions which constituted reverse takeovers for the purposes of the Listing Rules. The Decisions therefore considered various issues which arose in relation to whether the target companies were able to meet the requirements for a new listing applicant under Chapter 18.

This note is a summary of the Letter and the Decisions. The [Letter](http://www.hkex.com.hk/eng/rulesreg/listrules/listguid/Documents/gl47-13.pdf) ([see archive](gl47-13.pdf)] and the [Decisions](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/2013listdec.htm) can be accessed on the Exchange’s website.

### 1. Guidance Letter GL47-13: Disclosure Obligations Under Chapter 18

Rule 18.14 of the Main Board Listing Rules (the **Rules**) requires listed Mineral Companies to disclose in their interim and annual reports details of their exploration, development and mining production activities as well as a summary or the expenditure incurred on these activities during the period under review. Rule 18.16 requires that a Mineral Company includes an update of its resources and/or reserves in its annual report in accordance with the reporting standard under which they were previously disclosed.

Rule 18.15 applies to listed issuers (other than Mineral Companies) that publicly disclose details of resources and/or reserves. It requires them to give an update of those resources and/or reserves once a year in their annual reports in accordance with the reporting standard under which such resources and/or reserves were previously disclosed or one of the reporting standards specified in Chapter 18.

#### Disclosure in interim and annual reports

##### Exploration, development and mining production activities

The Exchange expects Mineral Companies and R18.15 Companies to disclose the following details in relation to exploration, development and mining production activities in their interim and annual reports:

* details of exploration activities including the number, average size and total length of holes drilled during the review period;
* details of development activities including progress on the mining structure or infrastructure; and
* details of mining activities including the quantity of mineral ore being mined during the review period by project or at least a separate discussion on major projects.

The disclosure should also include details of new contracts and commitments entered into, including those for infrastructure projects, subcontracting arrangements and equipment purchases. Information should be presented on a project basis if there are several mineral assets/projects.

##### Expenditure incurred

The summary of expenditure should not be limited to operating expenses, i.e. costs that were directly charged to income statement during the period they were incurred. Capital expenditure incurred should also be disclosed. Common expenses include mining costs, processing costs, transportation, royalties or fees payable to government and financing costs. A Mineral Company should also consider providing a further breakdown of expenses incurred to provide more meaningful information to shareholders and enhance transparency as to its activities. For example, it should consider disclosing separately labour costs incurred for mining activities and those incurred for processing activities.

#### Annual Reports

##### Annual updates on resources and reserves

Rules 18.15 to 18.18 generally require Mineral Companies and R18.15 Companies to provide updates of their resources and reserves in a table and present it in their annual reports in a readily understandable manner. Annual reports should also disclose any assumptions that were adopted. Where there has been any material change in the assumptions as compared with previous disclosures, the reasons for such changes should be disclosed.

The Letter also suggests that Mineral Companies should include a discussion of the reasons for changes in the resources and reserves. Examples of reasons given include changes in geological confidence level, additional drilling information becoming available, amount of mineral mined during the period, etc.

### 2. Suitability For Listing: Establishing A Portfolio Of Natural Resources - Listing Decision LD39-2013

Listing Decision LD39-2013 published in January 2013 concerned whether the target company of a proposed acquisition by a Main Board listed issuer was able to satisfy the requirement of Listing Rule 18.03(2) that it should have at least a portfolio of Indicated Resources or Contingent Resources that is meaningful and of sufficient substance to justify the listing. The resources must be identifiable under one of the accepted reporting standards and substantiated in a Competent Person’s Report. The Exchange regards early stage exploration companies as speculative by nature and therefore not suitable for listing.

The listed company was to pay the vendor 10% of the consideration on completion of the acquisition based on the vendor’s production of a valuation report showing that the target company had Indicated Resources valued at least 10% of the total consideration. After completion of the acquisition, the vendor was to carry out additional works for a specified period and it was agreed that the vendor would receive convertible bonds held by an escrow agent representing any additional Indicated Resources subsequently discovered.

The size of the acquisition was very significant to the listed issuer. In assessing whether the acquisition amounted to a reverse takeover for the purposes of Listing Rule 14.06, which would require the listed issuer to be treated as a new listing applicant, the Exchange considered whether the mineral company target met the requirements of a new listing applicant. There was an issue as to whether the target could meet Rule 18.03(2), i.e. the requirement to have at least a portfolio of Indicated Resources which is meaningful and of sufficient substance to justify the listing.

At the time of the acquisition, the parties could only prove the existence of 10% of Indicated Resources and a substantial part of the target company’s portfolio of minerals was not substantiated in the competent person’s report. The vendor was given a long period after completion of the acquisition to ascertain whether there were any additional Indicated Resources. This led the Exchange to conclude that the target company was an early stage exploration company at the time of the acquisition. The Exchange did not therefore consider that the target company had a portfolio of natural resources that was “meaningful and of sufficient substance” as required by Rule 18.03(2).

### 3. Waiver Of Requirement For Competent Person’s Report And Valuation Report On Acquisition Of Mineral Assets By Listed Issuer – Listing Decision LD40-2013

Main Board Rules 18.09(2) and (3) and 18.10 require that a listed issuer (not being a Mineral Company) should produce a Competent Person’s Report and a Valuation Report where it proposes to acquire assets which are solely or mainly Mineral or Petroleum assets as part of a major transaction, a very substantial acquisition or a reverse takeover under Rules 14.06(3), 14.06(5) or 14.06(6), respectively.

In Decision LD40-2013 (published in January 2013), a Main Board listed issuer proposed to acquire a target company whose main asset was an interest in a mining project (**Mine X**) for which it held the mining licence. It also held exploration licences for two other mines.

The Listing Rules required the listed issuer to include in the circular for the acquisition Competent Person’s and Valuation Reports for all mines held by the target. The listed issuer sought a waiver from this requirement on the basis of the following:

* The target had not carried on any exploration or mining activities at the two other mines and there was thus little geological information or resources data available for them. A competent person would therefore need to conduct a substantial amount of work and spend a long time to prepare Competent Person’s Reports;
* Due diligence performed by the listed issuer indicated that that the resources in the two other mines were likely to be Inferred Resources. It was expected that their economic values would be immaterial and no valuation of the resources would be allowed under the Listing Rules.
* The listed issuer’s reason for acquiring the target was its wish to acquire a controlling interest in Mine X which had substantial reserves and resources. It had no intention of exploring or exploiting the other two mines after the acquisition and based on a preliminary valuation, the value of Mine X represented more than 90% of the consideration for the acquisition.

The listed issuer therefore considered the other two mines to be insignificant to the portfolio of mineral resources the subject of the acquisition and that to produce Competent Person’s and Valuation Reports for these two mines would be unduly burdensome.

The Exchange agreed that the two other mines amounted to a minor part of the target company’s portfolio of mineral resources under the acquisition and that the waiver of the requirement for Competent Person’s and Valuation Reports for those mines would not result in an omission of material information from the circular. It agreed that it would be unduly burdensome for the listed issuer to have to produce those reports on the two other mines.

### 4. Possible Deferral Of Competent Person's Reports And Valuation Reports In Hostile Takeovers - Listing Decision LD45-2013

Listing Decision LD45-2013 (January 2013) concerned a Main Board listed company which proposed to acquire an Australian iron ore development company listed on the Australian Stock Exchange. The company’s offer was conditional on its acquisition of an interest of at least 50.1% in the target. The transaction constituted a major transaction under Chapter 14 and a Relevant Notifiable Transaction under Chapter 18 for the acquiring listed company.

The listed company would publish an initial circular seeking shareholders’ approval for the offer under Listing Rule 14.67A, and then proposed to publish a supplemental circular to include outstanding information within 45 days of the earlier of it being able to: (i) gain access to the target company’s books and records; and (ii) exercise control over the target.

Under Rules 18.09(2) and (3) and 18.10, the listed company was also required to include a Competent Person’s Report and Valuation Report in the initial circular. Rule 18.05(4) further required the listed company’s initial circular to include the information required by Rules 18.05(2) to 18.05(6) in respect of the assets being acquired. However, the offer was not invited by the target’s board and the listed company submitted that since it did not therefore have access to the target company’s non-public information, it had practical difficulties in making the necessary disclosures in the initial circular.

The listed company therefore sought a waiver from Rules 18.09(2), (3) and (4) so that it could defer disclosure of the information to the supplemental circular for the offer. It offered to summarise and reproduce the public statements and reports on the target company’s mineral assets and other published material information in the circular to enable investors to make an informed decision on how to vote on the offer.

#### The Decision

The decision noted that Rule 14.67A addresses practical difficulties faced by issuers in disclosing non-public financial and other information on target companies in hostile takeover situations. The Exchange considered that the same principle may also apply to the disclosure requirements under Chapter 18 based on the circumstances of each case.

The Exchange granted the waiver because:

* The offer met the conditions set out in Rule 14.67A that:
  1. The lack of availability of non-public information was due to the lack of co-operation by the target’s board;
  2. The target was listed on regulated stock exchange recognised by the Exchange; and
  3. The target would become a subsidiary of the listed company; and
* The target was listed on an overseas stock exchange (the Australian Stock Exchange) and had provided regular updates on its mineral assets. These disclosures were subject to supervision by regulatory authorities. The initial circular would contain material public information of the target company to allow shareholders to make an informed voting decision.

### 5. Acceptable Reporting Standards - Listing Decision LD41-2013

At issue in Listing Decision LD41-2013 (January 2013) was whether an estimate of resources and reserves under Chinese reporting standards was acceptable for the purpose of establishing that a target company had a portfolio of natural resources that was meaningful and of sufficient substance to justify a listing.

The Decision concerned a Main Board listed company’s proposed acquisition of a company that held the mining rights of certain iron mines in the PRC. The mines had not commenced production.

The size of the acquisition was very significant to the listed company. In assessing whether the transaction constituted a reverse takeover, which would require the listed company to be treated as a new listing applicant, the Exchange considered whether the target company met the requirements of a new listing applicant. There was an issue as to whether the target could meet Rule 18.03(2), i.e. the requirement to have at least a portfolio of Indicated Resources which is meaningful and of sufficient substance to justify the listing.

Rule 18.29 requires disclosures of mineral resources and reserves to be made under one of three accepted reporting standards:

* the Joint Ore Reserves Committee Code (**JORC Code**);
* National Instrument 43-101 (**NI 43-101**); or
* the South African Code for the Reporting of Exploration Results, Mineral Resources and Mineral Reserves (**SAMREC Code**)

Chinese and Russian standards are not currently accepted by the Exchange which requires information presented in accordance with such standards to be reconciled to one of the above three accepted reporting standards. According to the Consultation Conclusions on New Listing Rules for Mineral Companies (May 2010), Chinese and Russian standards were not considered acceptable because they are based on in-situ estimates rather than commercial extractability taking account of mining dilution and losses, which forms the basis of the accepted standards. Therefore, what might be considered a reserve under Chinese standards might be categorised as a resource under JORC-type Codes and what might be a resource under Chinese standards may not be classified as such under JORC-type Codes.

To address the Rule 18.03(2) issue, the acquiring company provided a portfolio of natural resources that gave estimates of resources and reserves under Chinese standards. It proposed to appoint a competent person to report on the resources and reserves under the JORC Code when preparing the circular for the acquisition at a later stage. However, the Exchange determined the transaction classification (i.e. as a reverse takeover requiring the target to be able to meet the criteria for a new listing) at the announcement stage, when the listed company could only provide the estimate on resources and reserves under the Chinese standard. The Exchange concluded that the target could not meet Rule 18.03(2) based on the resources and reserves unidentified under the Chinese reporting standard.

### 6. Waiver Of Competent Person Report Requirement On A Disposal – Listing Decision LD42-2013

In Decision LD42-2013, The proposed sale by a Main Board listed Mineral Company of its interest in a mine (**Mine Y**) constituted a very substantial disposal and thus required a Competent Person’s Report on the resources/reserves to be included in the circular shareholders under Listing Rule 18.09(2).

The disposing company had acquired Mine Y some years previously, before the existing Chapter 18 came into effect. At that time, the transaction circular included a technical report prepared under Chinese reporting standards. The technical report included a comparison between Chinese standards and the JORC Code, and quoted the resources and reserves of Mine Y using categorisation under the JORC Code, but did not report them as JORC Code compliant resources and reserves because certain information required for such conversion was not available to the expert who prepared the report. After the acquisition, the listed company updated Mine Y’s resources and reserves in accordance with Chinese reporting standards in its subsequent annual reports.

#### Waiver Application

The note to Rule 18.09(2) provides that the Exchange may dispense with the requirement for a Competent Person’s Report on disposals where shareholders have sufficient information on the assets being disposed of.

The disposing company sought a waiver from the requirement to include a Competent Person’s Report on Mine Y in the circular for the disposal. It considered that the technical report provided together with the inclusion in the circular of a “no material change statement” from the company and the expert would provide sufficient information to enable shareholders to assess the proposed disposal.

#### The Decision

The Exchange denied the waiver request as it considered that the company’s proposed disclosure would not provide accurate and complete information on the resources of Mine Y sufficient to enable shareholders to make an informed voting decision. The Exchange considered that the technical report, having been issued several years previously, was outdated. Moreover the Technical Report was prepared under Chinese reporting standards which are not recognised by the Exchange under Chapter 18 and the comparison with the JORC Code did not report the resources and reserves as JORC Code compliant resources and reserves.

### 7. The Requirement For A Clear Path To Commercial Production – Listing Decision LD43-2013

At issue in Decision LD43-2013, was whether the target of an acquisition by a Main Board issuer was able to meet the requirement for a clear path to commercial production, which is a condition of the Exchange’s grant of waivers from the financial standards requirements for Mineral Companies which needed to be met since the transaction constituted a reverse takeover.

The target company had interests in mining companies (**Mining Companies**) in the PRC which held mining licences for a number of PRC coal mines (**Coal Mines**). The Coal Mines had substantial resources but their operations had been suspended for a number of years to undertake reconstruction and improvement works required by the government authorities. At the time of the acquisition, the coal mines did not have the permits and licences to commence operations and were undergoing reconstruction and improvements. Since operations at the coal mines had been suspended for years, the target could not satisfy the track record requirements under Rule 8.05.

Listing Rule 18.07 requires that if a Mineral Company has not commenced production, it must disclose its plans to proceed to production with indicative dates and costs. Guidance Letter HKEx-GL22-10 also states that waivers under Rule 18.04 of the requirement to meet the financial standards for listing under Rule 8.05, will only normally be given to companies at the development stage where they are able to demonstrate a clear path to commercial production.

The acquiring company provided to the Exchange details of the reconstruction and improvement works at the Coal Mines and its plans for them to proceed to production, with indicative dates and costs as required by the Rule 18.07. It also submitted the following information in order to demonstrate that that the Coal Mines would be able to resume operations as planned:

* The target company had been delegated by government authorities to undertake the merger and reorganisation of mines in the province and it had acquired the Mining Companies in order to merge and organise the Coal Mines in accordance with government policies. Those policies also required that coal mines that could not meet required safety standards and minimum production capacity should be closed until the necessary reconstruction and improvement works had been completed.
* Most of the reconstruction and improvement works had been completed when the listed company acquired the target. The listed company also proposed to disclose all outstanding permits and licences required for commercial production and the status of the relevant applications. The PRC legal advisers confirmed that there was no impediment for the target company to obtain the outstanding permits and licences.
* A Competent Person opined that the schedule for the reconstruction and improvement works and the expected timetable for the commencement of commercial production were achievable. Therefore, the Exchange considered that the target of the acquisition had a clear path to commercial production, essentially waiving the financial standard requirements under Rule 8.05.

Following its consideration of the special circumstances of the case and the issuer’s submission to demonstrate that commercial production would commence within a reasonable period, the Exchange concluded that the target company had shown a clear path to commercial production. The risks to obtaining regulatory approval for commercial production of the Coal Mines were to be prominently disclosed.

### 8. Right To Participate Actively In Exploration Or Extraction – Listing Decision LD44-2013

At issue in Listing Decision HKEx LD44-2013 was whether the target of a Main Board listed company’s proposed acquisition had the right to participate actively in the exploration for and/or extraction of natural resources as required by Listing Rule 18.03(1).

The listed acquiring company proposed to acquire a target company which participated in a gold mining project (**Project**). At the time of the acquisition, the target did not have any interest in the Project, but it had entered into certain agreements with the owner of the Project to “earn” an interest in it. Under these agreements, the target company provided funding and technical expertise for the Project’s exploration activities. The owner of the Project was required under the agreements to transfer 52% of its interest in the Project to the target company when it achieved the performance targets set out in the agreements (including the completion of a scoping study, pre-feasibility study and a feasibility study). On completion of the exploration works, the target company and the owner would form a joint venture to develop the Project and share the profits of the mining activities.

The size of the acquisition was very significant to the listed company. In assessing whether the acquisition constituted a reverse takeover, one of the factors considered by the Exchange was whether the target company could meet the requirements for a new listing applicant. There was an issue as to whether the target could meet the Rule 18.03(1) requirement that a new applicant Mineral Company must be able to show that it has the right to participate actively in the exploration for, or extraction of, natural resources. This may be done either through: (a) control over a majority by value of the assets in which the applicant has invested together with adequate rights over the exploration for and/or extraction of resources; or (b) adequate rights (under arrangements acceptable to the Exchange) giving sufficient influence in decisions over the exploration for and/or extraction of the natural resources.

FAQ Series 12, No. 3 states that “Companies may rely on exploration and extraction rights held by third parties if they participate in mineral and/or exploration activity under joint ventures, product sharing agreements or other valid arrangements if they can demonstrate the agreements give them sufficient influence over the exploration for and extraction of Resources and Reserves. Ordinarily we would expect that applicants have an interest of at least 30% in assets relevant to extraction of Reserves. However, we will consider other arrangements where companies have interests smaller than 30% but actively operate mining projects. Rights granted under specific government mandates will be recognized …”

#### The Decision

The target company could not show the right to actively participate in exploration under Rule 18.03(1)(a) – through control over a majority by value of the assets. It could however establish this right by virtue of the agreements entered into with the Project owner which allowed it to explore for minerals in the Project areas using its own resources and to secure an interest in the Project by completing the exploration works. The listed company could therefore demonstrate that the agreements gave the target company the rights to exercise significant influence in the decisions over the exploration activities of the Project could do so by establishing that it controlled a majority of the assets and adequate exploration/extraction rights or that it has adequate rights “arising under arrangements acceptable to the Exchange” that give it sufficient influence over the exploration/extraction of the natural resources.

The Exchange concluded that the earn-in arrangement gave the target company the right to participate actively in the exploration for natural resources as required by Rule 18.03(1)(b).

## Hong Kong Stock Exchange Publishes Listing Decision Regarding A Main Board Listing Applicant That Was Engaged In The Mineral Industry

Listing Decision HKEx-LD49-2013 related to a Main Board listing applicant (**Company A**), which was established in Canada and engaged mainly in the development and production of oil sands. The Listing Decision concerned: (i) whether it is acceptable to disclose Net Present Values (**NPVs**) to Proved Reserves, Proved plus Probable Reserves, Proved plus Probable plus Possible Reserves and Contingent Resources both on a pre-tax and post-tax basis under Main Board Rule 18.33(2);[[1]](#footnote-45) and (ii) whether to grant a waiver of Main Board Rule 18.33(6)[[2]](#footnote-46) to allow Company A to disclose estimated values of Possible Reserves, Contingent Resources and Petroleum-Initially-In-Place (**PIIP**).

Company A, a Main Board listing applicant, proposed to disclose the following in its prospectus and on an ongoing basis:

* The NPVs attributable to its Proved Reserves, Proved plus Probable Reserves, Proved plus Probable plus Possible Reserves and Contingent Resources, both on a pre-tax and post-tax basis;
* Estimated volumes and values of Possible Reserves, Contingent Resources and PIIP in accordance with both National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities (**NI 51-101**) and Petroleum Resources Management System (**PMRS**, an acceptable petroleum reporting standard under Main Board Rule 18.32).

The rationale for the proposed basis of disclosure was that after listing, Company A would remain benchmarked to its peer group in Canada, which are allowed to disclose the NPVs attributable to their reserves and resources on both a pre-tax and post-tax basis, and estimated values on Possible Reserves, Contingent Resources and PIIP under NI 51-101. Company A considered that it would be difficult to compare its resource base against its competitors if it would not report in a way that was consistent with its peer group.

#### Applicable Listing Rules

Main Board Rule 18.33(2) requires that if the NPVs attributable to Proved Reserves and Proved plus Probable Reserves are disclosed, they are presented on a post-tax basis at varying discount rates or a fixed discount rate of 10%.

Main Board rule 18.33(6) requires that economic values are not attached to Possible Reserves, Contingent Resources or Prospective Resources.

#### The Analysis

The Exchange considered the following in determining the issues:

1. The proposed disclosure of NPVs on both pre-tax and post-tax basis was in accordance with the requirements of NI 51-101 and was thus in line with disclosure made by comparable companies listed in Canada. It also provided additional information to investors;
2. According to Company A’s competent person and the Exchange’s independent mineral consultant, the existence or recoverability of oil sand resources is less uncertain than oil and gas resources as the location and quantum of bitumen volumes is generally very high in Canada. The company’s Contingent Resources were largely dependent upon its commitment to develop the resources (such as filing of a regulatory application seeking approval to proceed with a development project) rather than uncertainty in recoverability. Upon filing of an application, the estimated volumes of Contingent Resources could be reclassified as Probable or Possible Resources; and
3. The proposed disclosure of Possible Reserves and Contingent Resources for oil sands was in accordance with the requirements of NI 51-101 (which is a widely adopted standard in Canada and is well known internationally in the mineral and oil industry), and is therefore in line with disclosure made by comparable companies listed in Canada.

#### The Decision

Having considered the above factors and based on the specific facts and circumstances, the Exchange considered that the relevant disclosure of NPVs on both pre-tax and post-tax basis in Company A’s prospectus and on an ongoing basis was acceptable under Main Board Rule 18.33(2) and agreed to grant Company A a waiver of the requirement under Main Board Rule 18.33(6).

Listing Decision [HKEx-LD49-2013](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld49-2013.pdf) ([see archive](ld49-2013.pdf)) is available on the Exchange's website.

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**Charltons - Hong Kong Law Newsletter - Issue 179 - 09 February 2013**

1. Rule 18.33(2) requires that if the NPVs attributable to Proved Reserves and Proved plus Probable Reserves are disclosed, they are presented on a post-tax basis at varying discount rates or a fixed discount rate of 10% [↑](#footnote-ref-45)
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