Charltons - Hong Kong Law Newsletter - 06 June 2013

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# Hong Kong Stock Exchange Publishes Listing Decisions On Rights Issues and Spin-Offs

Three listing decisions have been made available on Hong Kong Exchanges and Clearing Limited’s (the **Exchange**’s) website. Listing decision [LD70-2013](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld70-2013.pdf) [[archived copy](ld70-2013.pdf)] concerns a company’s obligation to allocate excess shares in a rights issue on a fair basis. Listing decision [LD71-2013](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld71-2013.pdf) [[archived copy](ld71-2013.pdf)] deals with the requirement to obtain independent shareholders’ approval for a rights share. Lastly, listing decision [LD72-2013](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld72-2013.pdf) [[archived copy](ld72-2013.pdf)] relates to a company’s obligation to provide assured entitlement for a spin-off when it is restricted from doing so under the laws of the People’s Republic of China (**PRC**). This note provides summaries of these listing decisions.

## HKEx-LD70-2013

In this listing decision, the company (**Company A**) announced a rights issue that entitled shareholders to one rights share for two existing shares. In the listing document for the rights issue, it was stated that the board of directors would allocate excess rights shares at its discretion and on a fair and equitable basis on the following principles:

* preference would be given to applications to top-up holdings to board lots as long as the directors believe that the applications were not made to abuse this mechanism; and
* any remaining excess shares would be allocated according to a sliding scale with reference to the number of excess rights shares applied for by the applicants.

Although the rights issue was over-subscribed, Company A’s board of directors noticed unusual patterns of excess applications and had reason to believe that certain applications had been made with the intention of abusing the mechanism to top-up holdings to board lots. It appeared that some shareholders had split their shareholdings into odd lots to allow them to submit multiple top-up applications. Accordingly, the directors decided to allocate the excess rights shares to the far smaller number of top-up applications that they believed were not made with the intention to abuse the top-up mechanism. The remaining excess rights shares would then be allocated to other applicants based on a sliding scale with reference to the number of excess rights shares the subject of applications. Company A enquired whether these arrangements would comply with Main Board Listing Rule 7.21(1), which requires allocations of excess securities to be conducted on a fair basis. The breach in this case could lie in Company A’s exclusion of the excess rights shares applications that its board of directors considered to be an abuse of the allocation mechanism disclosed in its listing document.

The Exchange decided that Company A had complied with Listing Rule 7.21(1), which it interpreted to require Company A to identify any possible abuse of the allocation mechanism for the excess rights shares and to take steps to avoid the abuse and ensure fair treatment of shareholders. The Exchange found that Company A had disclosed its intention to allocate excess rights shares to applicants that it believed did not intend to abuse the allocation mechanism in its announcement and listing document and acknowledged the unusually high number of applications for the excess rights shares in this case. Therefore, the Exchange concluded that Company A had taken reasonable steps to allocate the excess rights shares to shareholders on a fair basis and in a manner that was consistent with the principles disclosed in its listing document.

## HKEx-LD71-2013

A mainboard listed company (**Company B**) announced a rights issue of one rights share for every two existing shares which would increase its issued share capital by 50%. No other rights issue had been made during the preceding twelve months. The issue was whether the rights issue would increase Company B’s market capitalisation by more than 50% and therefore require independent shareholder approval under Main Board Listing Rule 7.19(6). That rule requires that any rights issue that, either on its own or when aggregated with other rights issues or open offers within the previous twelve months, increases the issuer’s market capitalisation by more than 50%, must be approved by its independent shareholders in general meeting. The issue price determined for the rights shares was at a small discount to the average closing price of the existing shares over the five days prior to the announcement, but at a premium of about 10% to the closing price on the day of the announcement. Company B submitted that the rights issue would not exceed the 50% threshold based on its market capitalisation calculated using the average closing share price in the five trading days before its announcement.

The Exchange explained that Listing Rule 7.19(6) should be applied with reference to the listed issuer’s market capitalisation at the time of the rights issue, which should be based on the closing price of the issuer’s shares on the date on which the terms of the rights issue are finalised. In this case, Company B’s market capitalisation should be calculated based on the closing price of its shares on the day that the rights issue was announced. Here, the rights issue would exceed the 50% threshold based on Company B’s market capitalisation calculated based on the closing price of its shares on the date of the rights issue’s announcement. Accordingly, the rights issue required independent shareholders’ approval under Listing Rule 7.19(6).

## HKEx-LD72-2013

Company C proposed a spin-off of Company D to list on a stock exchange in the PRC, which would be a discloseable deemed disposal for Company C. Under PRC law, foreign natural persons cannot invest in the A-share market unless they are qualified foreign institutional investors. Since many of Company C’s investors were not qualified investors, they were unable to invest in the A-shares of Company D that were to be issued and thus Company C could not provide them with the assured entitlement to Company D’s shares under the spin-off as is required by paragraph 3(f) of Practice Note 15 to the Main Board Listing Rules. Company C sought a waiver from the assured entitlement requirement for this spin-off: as it would be burdensome for Company C to propose a resolution in general meeting to waive the assured entitlement since the legal restriction on foreigners acquiring A-shares could not be overridden even if the shareholders failed to approve the waiver.

The Exchange considered two major factors:

* the spin-off was not a material transaction for Company C and did not require shareholders’ approval under the Listing Rules; and
* Company C’s inability to provide an assured entitlement was due to legal restrictions in the PRC.

The Exchange granted Company C a waiver from the assured entitlement requirement on the condition that the announcement for the spin-off would disclose details of the waiver including the reasons for not providing Company C’s shareholders with an assured entitlement to Company D’s A-shares, including the legal restriction under PRC law.

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**Charltons - Hong Kong Law Newsletter - Issue 195 - 06 June 2013**