



**CONSULTATION  
ON  
CAPITAL RAISINGS BY LISTED ISSUERS**

**The Law Society's Submissions**

The Stock Exchange of Hong Kong Limited ("the Exchange") issued a Consultation Paper on "Capital Raisings by Listed Issuers" on 22 September 2017. The Law Society makes the following submissions on the consultation questions posed.

***Q1. Do you agree with the proposal to disallow highly dilutive pre-emptive offers unless there are exceptional circumstances? If not, why not?***

**Law Society's response:**

We agree. It is time to close some long standing loopholes and abuses. However, the solution for some of the problems identified, such as issuing shares without a proper commercial rationale, should be dealt with by way of enforcement of directors' duties. The same applies to the extent to which regulatory reliance may be based on minority shareholders' approval (this relates to the comment in the Consultation Paper that the Exchange has considered but decided not to elevate minority approval threshold to above 50% as in the vast majority of cases, highly dilutive offers were approved by over 75% of members attending). Whether or not shareholders who voted are in fact genuine minority shareholders is again a matter that should be dealt with by law enforcement. We would hence like to caveat on a general basis that the attempt to regulate extreme situations should not be formulated into black and white rules drafted or administered in such a way that may impede proper transactions.

***Q2. Do you agree with the proposed 25% threshold on value dilution? If not, what is the appropriate percentage threshold and the reasons for this threshold?***

**Law Society's response:**

Agree with the principle and while good reasons have been advanced to support a 25% threshold, we are open-minded on the percentage level, provided it is not lower than 25%.

We note as well that this percentage threshold will only be a bright line test and the Exchange will retain discretion to disallow offers on a principle based test where the terms of the offer are egregious.

***Q3. Do you agree that the proposed requirements should also apply to share issuance under a specific mandate? If not, why not?***

**Law Society's response:**

Agree.

***Q4. Do you agree with the proposal to aggregate rights issues, open offers and specific mandate placings within a rolling 12-month period? If not, why not?***

**Law Society's response:**

Agree.

***Q5. Do you agree with the proposed method of calculating cumulative value dilution? If not, what is the appropriate method?***

**Law Society's response:**

Agree.

***Q6. Do you agree with the proposal to extend the minority shareholder approval requirement to all open offers (unless the new securities are issued under the general mandate)? If not, why not?***

**Law Society's response:**

Agree. Open offers made under the general mandate should henceforth count towards the 20% threshold, and we note that this has been picked up by the proposed drafting changes to the Listing Rules.

***Q7. Do you agree with the proposal to remove the underwriting requirement for pre-emptive offers? If not, why not?***

**Law Society's response:**

Agree. As right issues will no longer be required to be fully underwritten, those dealing in nil-paid rights should be aware of the additional risks, but we note this is the position with GEM in any event.

***Q8. Do you agree with [the] proposal to require underwriters to be licensed persons independent from the issuers and their connected persons?***

**Law Society's response:**

Assuming the mischief is to avoid the situation of a third party acquiring or consolidating control by acquiring shares cheaply through dilutive offers that they underwrite, we doubt whether this problem will be adequately addressed by simply requiring the underwriter to be a licensed person. In short, we question how effective the proposal will be.

***Q9. In view of paragraphs 72 and 73 of the Consultation Paper:***

***(a) Do you agree that controlling shareholders should be allowed to act as underwriters? If so, why?***

**Law Society's response:**

Agree, for the reasons set out in the Consultation Paper.

***(b) Do you think that substantial (but not controlling) shareholders should be allowed to act as underwriters? If so, why?***

**Law Society's response:**

Disagree, as it goes against the underlying theme of avoiding third parties gaining control through dilutive offers by acting as underwriters. However, if the Exchange implements the proposal that minority shareholders' approval will be required for such underwriting, we consider that substantial shareholders should be allowed to act as underwriters (see our responses to Q11 below).

***Q10. Do you agree that compensatory arrangements should be mandatory when pre-emptive offers are underwritten by connected persons?***

**Law Society's response:**

We agree on the basis that the proposal in Q11 will not be implemented. If the Exchange decides to implement the proposal that connected person underwriting must be approved by independent shareholders, we consider that this further requirement will be too burdensome.

***Q11. Do you agree with the proposal to remove the connected transaction exemption for underwriting (including sub-underwriting) of pre-emptive offers by connected persons? If not, why not?***

**Law Society's response:**

Disagree. Highly dilutive offers will be subject to separate regulation and as proposed, they will be strictly prohibited save in exceptional circumstances. There could be legitimate reasons for connected persons underwriting and requiring independent shareholders' approval will prolong the timetable, increase costs and add a layer of uncertainty.

***Q12. Do you agree with the proposal to make it mandatory for issuers to adopt either the excess application arrangement or the compensatory arrangement in rights issues and open offers? If not, why not?***

**Law Society's response:**

Agree.

***Q13. Do you agree with the proposal to limit the excess applications by a controlling shareholder and his/her/its associates to a maximum number equivalent to the offer shares minus their pro rata entitlements? If not, why not?***

**Law Society's response:**

Agree.

***Q14. Do you agree with [the] proposal to disallow the use of general mandate for placing of warrants and options for cash consideration? If not, why not?***

**Law Society's response:**

The crux of the issue seems to relate to determining a fair valuation with respect to which there may be different views and valuation models but the Exchange has the ultimate discretion to grant or withhold listing approval. In that case, we do not understand why this issue should go to support introducing an absolute ban on the issuance of warrants and options for cash.

***Q15. Do you agree with the proposal to disallow any price discount of the initial conversion price of convertible securities to be placed under general mandate? If not, why not?***

**Law Society's response:**

Disagree as there must be flexibility. However, we would agree to limit this flexibility to avoid abuse and accept the proposal in paragraph 103 of the Consultation Paper that the discount should not exceed 20%.

***Q16. Do you agree with the proposal to require disclosure of the use of proceeds from all equity fundraisings in interim and annual reports? If not, why not?***

**Law Society's response:**

While we agree with the principle behind, the Rules must recognise that it is perfectly legitimate for fundraisings to be conducted in order to take advantage of favourable market conditions, and in some cases, the funds raised may genuinely be for general corporate purposes including building up a war chest for possible acquisitions and expansions although nothing has yet been targeted. We are of the view that the Rules must not be framed and (of equal importance) administered in such a manner as to require issuers across the board and in all situations to, in effect, artificially divide the funds up and attribute a specific purpose to each amount.

***Q17. Do you agree with the proposal to impose a minimum price requirement on subdivision or bonus issue of shares? If not, why not?***

**Law Society's response:**

Agree.

***Q18. Do you agree with the proposed minimum adjusted price of HK\$1? If not,***

*what is the threshold you consider appropriate: (a) HK\$0.5; or (b) other?*

**Law Society's response:**

We agree with the principle behind the change and are open minded on what should be the appropriate amount.

*Q19. Do you support a demonstration period of six months? If not, please specify the period you consider appropriate.*

**Law Society's response:**

Agree.

**The Law Society of Hong Kong  
22 November 2017**