

HKE_x GUIDANCE LETTER

HKE_x-GL20-10 (July 2010)

Withdrawn, superseded by Germany Country Guide in December 2013

Subject	Matters to be considered by German incorporated listing applicants
Listing Rules and Regulations	<ul style="list-style-type: none">• Chapter 19 of the Main Board Listing Rules (“Listing Rules”)• <u>Joint Policy Statement Regarding the Listing of Overseas Companies of 7 March 2007</u>
Related Publications	<u>HKE_x-LD71-1</u>
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Important note: *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Division on a confidential basis for an interpretation of the Listing Rules, or this letter.*

1. Purpose

1.1 This letter provides guidance on five areas which a joint stock company incorporated in Germany (Aktiengesellschaft or “AG”) seeking a listing on the Exchange should pay special attention to. They are:

A. Matters requiring shareholders’ approval

- Delegation of approval powers to shareholders in general meeting;

B. Requirements relating to directors

- Independent non-executive directors;
- Length of directors’ office;

C. Shareholders’ rights

- Restriction of voting on certain transactions;
- Right to buy out minority shareholders;
- Exit right of minority shareholders in the case of a successful takeover offer;

D. Matters requiring court’s approval

- Court’s confirmation of the share capital reduction;
- Petition to court to cancel a class rights variation; and

E. Share issuance

- Preference shares, non-voting or restricted voting shares and redeemable shares.

2. Background

- 2.1 In Listing Decision HKEx-LD71-1 of September 2009, we indicated that, subject to certain amendments to the issuer's constitutional documents, Germany is an acceptable place of incorporation of an issuer.
- 2.2 To facilitate the vetting of German applicants HKEx-LD71-1 states that a German applicant should provide:
- legal opinions by reputable professionals on whether the applicant's articles are duly registered by the relevant German authorities;
 - confirmation from each sponsor that it has considered all material shareholder protection areas during its due diligence review under Practice Note 21 and it is independently satisfied that the shareholder protection standards in Germany are at least equivalent to those in Hong Kong; and
 - legal opinions by reputable professionals and confirmation from each sponsor that the listing applicant's constitutional documents do not contain provisions which will prevent it from complying with the Listing Rules, the Securities and Futures Ordinance – Disclosure of Interests, and the Hong Kong Codes on Takeovers and Mergers and Share Repurchases ("**Takeovers Codes**"), to the extent they apply.

3. Guidance

- 3.1 This letter contains observations based on experience with different German applicants who provided submissions on German law prepared by their German legal advisors.
- 3.2 We do not interpret foreign laws and we acknowledge that laws may be interpreted differently in certain situations. Instead, we rely on directors' and sponsors' confirmations about the scope and impact of foreign laws upon production of legal and other professional opinions to support their views. We do not normally verify those confirmations and opinions absent obvious mistakes and incongruities. Instead, we require applicants to disclose the basis of any legal interpretations and conclusions to enable investors to understand the legal implications of foreign incorporation.
- 3.3 Where a listing applicant proposes to change its corporate practices (e.g., by amending its constitutional documents or administrative procedures) to achieve equivalence with the Hong Kong shareholder protection standards, **there may be more than one acceptable method to do so. We do not prescribe the method used.** However, if the same method is repeatedly used by the applicants over time, its consistent application will provide greater comfort.

A. Matters requiring shareholders' approval

Delegation of approval powers to shareholders in general meeting

Hong Kong

3.4 The Companies Ordinance requires shareholders' approval of:

- directors' appointment and removal;
- payment of compensation to directors or past directors;
- loans (including quasi loans or credit transactions) to directors;
- auditors' remuneration;
- annual accounts, etc.

3.5 The Listing Rules require shareholders' approval of:

- certain transactions (see Chapter 14 - Notifiable Transactions and Chapter 14A - Connected Transactions) including the spin-off (Rule 14.07, Practice Note 15);
- share repurchases (Rule 10.06(1)(a)(iii));
- adoption of share option schemes and related matters (Rules 17.02, 17.03(4) and 17.04(1)).

Germany

3.6 Under German Stock Corporation Act ("AktG") an AG has a three-tier governance structure comprising:

- the management board,
- the supervisory board, and
- shareholders in general meeting ("GM").

3.7 The *management board* is responsible for managing an AG's business operations.

3.8 The *supervisory board's* role is to supervise and monitor the management board. It also appoints and dismisses management board members. It must not simply act upon the instructions of shareholders or the GM. It has exclusive and unrestricted powers to resolve certain corporate matters (**Appendix I**). Accordingly, delegating the approval powers on these matters to an AG's GM is unlawful.

3.9 *Shareholders* are generally not involved in an AG's day-to-day operations. A GM is held at least once a year. In addition to some statutory matters that must be decided in a GM (**Appendix II**), a GM is competent to decide on:

- material matters of fundamental importance which the management board must refer to GM for decision. The parameters for determining materiality of a matter as developed by the case law and legal literature are:

- whether the AG's structure is affected;
- whether the GM's core competency to decide the AG's constitution is affected;
- whether the matter has effects similar to amending the articles; and
- whether approximately 80% of the AG's assets are affected¹;
- matters of particular importance, even though such matters do not affect 80% or more of the AG's assets, which the management board may voluntarily refer to GM for decision ("**Voluntary Referral**").

3.10 It is unlawful to shift all or a substantial part of the management decisions to the GM. Any provision in an AG's articles shifting competencies between the boards and any resolution passed by the GM without the requisite competency will be null and void.

Our view

- 3.11 The requirement that the supervisory board must approve certain corporate matters, which under Hong Kong requirements must be approved by the shareholders (**para. 3.4** above), does not necessarily mean a deficiency in shareholder protection standards because AktG contains other shareholder protection measures. For instance, the supervisory board members are appointed by the shareholders in a GM and they may be removed without a need to provide reasons, must be independent and act in the shareholders' best interests, must disclose any conflict of interests and may be required to abstain from voting on matters giving rise to conflicts of interests.
- 3.12 However, if the supervisory board were to take over the role of independent shareholders in approving notifiable and connected transactions, extensive Listing Rules waivers would have been required.
- 3.13 Voluntary Referral could substantially reduce the need for Listing Rules waivers. We therefore believe that an AG's management board should consider adopting Voluntary Referral procedures for matters requiring shareholders' approval under the Listing Rules, unless the matters are under the exclusive competence of the supervisory board or otherwise not permitted by law. The matters for Voluntary Referral should include:

Listing Rules	Matters
14A.13	approval of connected transactions with any of the applicable percentage ratios reaching 5% or above
14A.14	approval of continuing connected transactions with any of the applicable percentage ratios reaching 5% or above calculated on an annual basis
Chapter 14	approval of notifiable transactions with any of the applicable percentage ratios reaching 25% or above

¹ We understand that the threshold percentage is flexible and some German legal literature and case law recognise a 75% threshold based on other criteria such as turnover, fixed/total/net assets.

- 3.14 The supervisory board should scrutinise the Voluntary Referrals, comment on the management board's referral decisions and provide written recommendations on matters referred to GM.

B. Requirements relating to directors

Independent non-executive directors

Hong Kong

- 3.15 Under Rule 3.10 an issuer's board of directors must include at least three independent non-executive directors ("**INED**"), and at least one INED must have appropriate professional qualifications or accounting or related financial management expertise.

Germany

- 3.16 AktG does not have a concept of non-executive directorship. As such, no INEDs may be appointed to an AG's management board.

Our view

- 3.17 We accept, as an alternative, the appointment to the supervisory board of three independent supervisors which satisfy the independence requirements of Rule 3.13 ("**Independent Supervisors**") to take up the principal duties and obligations of INEDs under the Listing Rules (**Appendix III**), and will consider granting a waiver from strict compliance with Rule 3.10.

Length of directors' office

Hong Kong

- 3.18 Paragraph 4(2) of Appendix 3 to the Listing Rules requires that any person appointed by the directors to fill a casual vacancy on or as an addition to the board shall hold office only until the next following annual general meeting of the issuer, and shall then be eligible for re-election.

Germany

- 3.19 We understand that under AktG certain matters that require a shareholders' approval under Hong Kong laws are delegated to an AG's supervisory board. These matters include:

- directors' (i.e., management board members') appointment; and
- payment of compensation to directors or past directors.

- 3.20 The supervisory board should have the absolute discretion to determine the length of directors' office which may be up to 5 years under German law. Therefore, any new appointment of a director by the supervisory board should not be referenced to, or tied with, the timing for holding the GM.

Our view

- 3.21 We accept the appointment of the management board members by the supervisory board. Further, we accept that a director's appointment to fill a casual vacancy may continue after the annual GM provided that the terms of the director's office are properly disclosed.
- 3.22 We will consider granting a waiver from strict compliance with paragraph 4(2) of Appendix 3 to the Listing Rules.

C. Shareholders' rights

Restriction of voting on certain transactions

Hong Kong

- 3.23 The underlying principle of the Listing Rules is that all shareholders have the same right to vote at the general meeting, except for shareholders that are interested in the relevant transactions under Chapters 14 and 14A (e.g. major transaction, very substantial acquisition/disposal, reverse takeover and connected transactions which require independent shareholders' approval).
- 3.24 The Listing Rules also require controlling shareholders to abstain from voting on certain matters in a general meeting (e.g. on rights issue, open offer, refreshment of the general mandate before the annual general meeting, transactions resulting in a material change of the business within 12 months from the listing, and voluntary withdrawal of the primary listing on the Exchange without an alternative listing on another exchange).
- 3.25 Paragraph 14 of Appendix 3 to the Listing Rules requires that where a shareholder is required to abstain from voting on a particular resolution or restricted to voting only for or only against any particular resolution, any votes cast by or on behalf of such shareholder in contravention of such requirement or restriction shall not be counted.

Germany

- 3.26 We understand that under German law a shareholder entitled to vote in a GM cannot be restricted from voting solely because it is interested in the transaction the subject of the vote.

Our view

- 3.27 We will consider granting a waiver from the strict compliance with paragraph 14 of Appendix 3 if the AG adopts a mechanism to ensure that the votes of shareholders, who would otherwise need to abstain from voting under the Listing Rules, will not be counted. For instance, we accept:
- counting the cast votes twice as follows:
 - the first count will involve all votes cast, including votes of the shareholders who are required to abstain from voting, if any;
 - the second count will include all votes cast, excluding votes of the shareholders who are required to abstain from voting; and

- both counts must result in a simple majority before the resolution is approved.

Right to buy out minority shareholders

Hong Kong

- 3.28 Part 1 of the Ninth Schedule to the Companies Ordinance sets out the right of the transferee company to buy out the remaining minority shareholders' interest ("**Squeeze-out Right**") in a take-over upon acquiring not less than 90% of the target's shares by value.

Germany

- 3.29 We understand that under AktG only the holder of least 95% interest in the acquiree AG can exercise the Squeeze-out Right.

Our view

- 3.30 Because of the higher shareholding threshold, the Squeeze-out Right under AktG provides protection to the minority shareholders comparable to that under the Companies Ordinance.
- 3.31 We therefore accept that no amendments to the constitutional document of an AG are necessary in this regard.

Exit right of the minority shareholders in a case of a successful takeover offer

Hong Kong

- 3.32 Part 2 of the Ninth Schedule to the Companies Ordinance sets out the right of a dissenting minority shareholder to request the acquirer to buy out the remaining shares of that shareholder within one month after the close of the general offer when the transferee company acquired 90% of the target's shares by value.

Germany

- 3.33 We understand that AktG does not provide for an exit right. A provision in the AG's constitutional documents providing minority shareholders with an exit right would only be binding upon the shareholders who specifically agreed to the provision but not upon any future shareholders.

Our view

- 3.34 We consider that, in practice, minority shareholders rarely exercise an exit right. If the transferee acquired 95% interest in a company, it would likely exercise its Squeeze-out Right to privatise the company or place down its shares to restore the minimum public float in order to maintain the company's listing status.
- 3.35 We also note that no exit right is available under the laws of Cayman Islands, a recognised jurisdiction, and issuers incorporated in the Cayman Islands do not normally include exit right provisions in their constitutional documents.

3.36 We therefore accept that a German issuer does not have to adopt an exit right in its constitutional documents.

D. Matters requiring court's approval

Court's confirmation of the share capital reduction

Hong Kong

3.37 Under the Companies Ordinance any share capital reduction must be confirmed by the court.

Germany

3.38 AktG does not require any court's confirmation for share capital reduction. However, for a capital reduction to be valid an AG must register the capital reduction and the consequential amendments to the articles with the commercial register at the local court.

3.39 Nevertheless, AG's shareholders are afforded sufficient protection in the event of a capital reduction as:

- any capital reduction requires a special resolution;
- any resolution to reduce the share capital must adhere to the principle of equal treatment so that the capital reduction must affect all shareholders proportionally and equally;
- shareholders may bring a validity action or a contesting action to court (**para. 3.43** below) to invalidate the capital reduction.

3.40 Court confirmation is not required for share capital reduction under the laws of other recognised and accepted jurisdictions, such as the PRC, Bermuda and Luxembourg.

Our view

3.41 German laws provide sufficient shareholder protection regarding capital reduction matters.

Petition to court to cancel a class rights variation

Hong Kong

3.42 Under the Companies Ordinance the court may cancel a variation of class rights upon a petition by members holding not less than 10% of the nominal value of the issued shares of that class, if the court is satisfied that the variation would unfairly prejudice the shareholders.

Germany

3.43 AktG does not provide for an equivalent petition right. Instead, any shareholder may bring a validity action or a contesting action to declare invalid the resolution on the class rights variation that violates German laws or an AG's articles. The grounds for a validity action or a contesting action include:

- resolution passed in a GM convened in contravention of the relevant laws;
- abuse of majority voting powers that prejudices the minority shareholders;
- resolution pursued special advantages for a shareholder or a third party to the detriment of the AG or other shareholders.

Our view

3.44 We accept that the variation of the class rights of a German applicant is on terms comparable to those required of a Hong Kong incorporated public company.

E. Share issuance

Preference shares, non-voting or restricted voting shares and redeemable shares

Hong Kong

3.45 Paragraphs 6, 8, and 10 of Appendix 3 to the Listing Rules contain requirements for the issuer's articles concerning preference shares, redeemable shares, non-voting and restricted voting shares.

Germany

3.46 We understand that AktG does not restrict the issue of preference shares, non-voting or restricted voting shares. However, an AG is not allowed to issue redeemable shares.

Our view

3.47 As an AG is not permitted to issue redeemable shares under German law, the corresponding Listing Rules are not applicable.

3.48 Where an AG has preference, non-voting or restricted voting shares, we expect its constitutional documents to be amended to comply with the relevant requirements of Appendix 3.

Matters to be resolved by the supervisory board under AktG

The supervisory board of an AG has, among others, the following powers and obligations:

1. it shall supervise the management board;
2. it may inspect and examine the books and records, as well as the assets of the AG, and may commission individual members or, with respect to specific assignments, special experts to carry out such inspection and examination;
3. it shall instruct the auditor to review the annual financial statements;
4. it shall call a GM whenever the interests of the AG so require;
5. it shall appoint the management board members and revoke their appointment, if necessary;
6. it shall approve granting loans to members of the management board and the supervisory board;
7. its approval is required for contracts between a supervisory board member and the AG other than for the member's services at the supervisory board;
8. it may issue by-laws of the management board;
9. it shall examine the annual financial statements, the annual report and the proposal for appropriation of distributable profits, and its approval is required for any advance payment of distributable profit;
10. it shall approve the financial statements unless this matter is assigned to the GM*;
11. it shall determine the aggregate remuneration of any management board member;
12. its approval is required for a management board member to engage in any trade or transaction in the AG's line of business; and
13. it shall represent the AG both in and out of court vis-à-vis the management board members.

* Matters requiring shareholders' approval under the Companies Ordinance

Matters to be resolved by the shareholders in a GM under AktG

Under German laws, the GM shall resolve, among others, on the following matters:

1. election of members of the supervisory board;
2. appropriation of distributable profits*;
3. ratification of the acts of the members of the management board and the supervisory board;
4. appointment of external auditors*;
5. amendments of the articles*;
6. measures to increase or reduce the share capital*;
7. appointment of auditors for the examination of matters in connection with the formation or the management of the company*; and
8. dissolution of the company*.

* Matters requiring shareholders' approval under the Companies Ordinance

**Specific duties and obligations of INEDs under Listing Rules
to be assumed by the Independent Supervisors**

The following principal duties and obligations of INEDs under the Listing Rules will be resumed by the Independent Supervisors:

1. Rule 3.21 - establishment of an audit committee comprising majority of INEDs;
2. Rule 8.10(3) - appointment of sufficient number of INEDs to ensure that the interests of the general body of shareholders will be adequately represented, if required by the Exchange in case where the controlling shareholder has an interest in a business, apart from the company's business, which competes or is likely to compete with the company's business;
3. Rules 13.39(6) and (7) - establishment of an independent board committee, which shall consist only of INEDs, to advise shareholders as to whether the terms of the relevant transaction or arrangement are fair and reasonable and whether such a transaction or arrangement is in the interest of the issuer and its shareholders as a whole;
4. Rule 13.68 - establishment of a remuneration committee having a majority of INEDs, which is required to form a view in respect of directors' service contracts falling under Rule 13.68;
5. Rule 14A.37 - annual review and confirmation of the continuing connected transactions by INEDs;
6. Rule 14A.56 - INEDs' views on connected transactions if no independent shareholders' approval is required for the transaction;
7. Rule 14A.57 - INEDs' opinion on the profit guarantees given by a connected person;
8. Rule 17.04(1) - INEDs' approval of the grant of options to a director, chief executive or substantial shareholder of a listed issuer or their associate;
9. B.1.1 of Appendix 14 - establishment of a remuneration committee having a majority of INEDs; and
10. A.4.4 of Appendix 14 - establishment of a nomination committee having a majority of INEDs.
