MinterEllison LLP
Legal update – June 2021

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OUR PARTNERS CONTACT

Capital, Market & Corporate

Fred Kinmonth	2841 6822
Anne Ko	2841 6826
Barbara Mok	2841 6803
George Tong	2841 6836
Katherine U	2841 6873

Disputes, Competition & Insurance

William Barber	2841 6934
Nathan Dentice	2841 6881
Jonathan Green	2841 6808
Alex Kaung	2841 6866
Desmond Liaw	2841 6819
David Morrison	2841 6932
Eddy So	2841 6879
Desmond Yu	2841 6878
Jun Kwong	2841 6930

Infrastructure, Construction & Property

Malcolm Chin	2841 6870
Steven Yip	2841 6843

Intellectual Property

Steven Birt	2841 6933

Welcome to our latest bulletin featuring various legal and market updates

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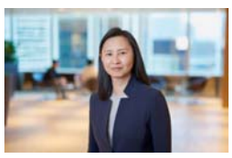
We hope that you find this edition informative and we welcome your comments and suggestions for future topics.

If you have any questions regarding matters in this publication, please refer to the contact details of the contributing authors.

Authors

Anne Ko
Partner
T 2841 6826

Jun Kwong
Partner
T 2841 6930



Katherine U
Partner
T 2841 6873

Nancy Lau
Consultant
T 2841 6807

Pryderi Diebschlag
Senior Associate
T 2841 6931

Andrew Chan
Senior Associate
T 2841 6924

Iris Cheng
Associate
T 2841 6814

Rachel Liu
Associate
T 2841 6912

Bridget Chan
Associate
T 2841 6841

Kennis Cheung
Trainee Solicitor
T 2841 6805

MinterEllison LLP
铭德有限法律责任合伙律师事务所

Hong Kong Stock Exchange's consultation conclusions on Review of Listing Rules Relating to Disciplinary Powers and Sanctions

Anne Ko T: +852 2841 6826 | E: anne.ko@minterellison.com
Nancy Lau T: +852 2841 6807 | E: nancy.lau@minterellison.com

Background

On 20 May 2021, The Stock Exchange of Hong Kong Limited (**SEHK**) published the Conclusions on Review of Listing Rules Relating to Disciplinary Powers and Sanctions with respect to its consultation paper published on 7 August 2020 (**Consultation Paper**).

After considering the feedback from a broad range of respondents, including listed issuers, professional bodies, industry associations, professional advisers and individuals, SEHK decided to adopt all the proposals outlined in the Consultation Paper, except one with modification, to ensure that the disciplinary regime of SEHK remains fit for purpose, to continue to promote market quality and to align with stakeholder expectations and international best practice. Accordingly, the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (**Listing Rules**) and the Rules Governing the Listing of Securities on GEM of The Stock Exchange of Hong Kong Limited (**GEM Listing Rules**) will be amended. The amended Listing Rules and the GEM Listing Rules will become effective on 3 July 2021.

Current disciplinary sanctions

Under the current Chapter 2A of Listing Rules, the main sanctions that can be imposed by SEHK for breaches of the Listing Rules include:

(a) reputational sanctions in the form of:

(i) private reprimand;

(ii) public statement involving criticism;

(iii) public censure;

(iv) in the case of wilful or persistent failure by a director of a listed issuer to discharge his responsibilities under the Listing Rules, a public statement that in the SEHK's opinion the retention of office by the director is prejudicial to the interests of investors (**PII Statement**);

(b) rectification or remedial sanctions;

(c) in the case of wilful or persistent failure by a director of a listed issuer to discharge his responsibilities under the Listing Rules, denial of facilities of the market to the listed issuer; and

(d) suspension or cancellation of listing.

There are also ancillary or operational sanctions such as:

(a) reporting the offender's conduct to another regulatory authority;

(b) imposing a ban on professional advisers or their employees from representing a specified party in relation to matters coming before the Listing Division or the Listing Committee of SEHK; and

(c) taking such other action as appropriate.

Amendments to be made to the Listing Rules

Set out below are the key amendments to be made to the Listing Rules in relation to SEHK's disciplinary powers. Unless otherwise specified, the corresponding amendments are also made to the GEM Listing Rules.

A. Enhancement to the existing disciplinary sanctions

1. Lowering the existing threshold for PII statements

The threshold for issuing a PII Statement will be lowered by removing the requirement of '*wilful*' or '*persistent*' failure, and enabling the PII Statement to be made to an individual whether or not he/ she continues in office at the time of the PII Statement.

2. Extension of the scope of PII Statement

The PII Statement will not only cover directors of listed issuer, it is extended to include directors and senior management (see E.1 below for the new definition of

senior management) of the relevant listed issuer and any of its subsidiaries.

3. Enhancing follow-on actions at the same time when making a PII Statement

   Where an individual continues to be a director or senior management member of the named listed issuer after a PII Statement has been made against him, SEHK may direct follow-on actions including (i) denial of facilities of the market to the listed issuer for a specified period, and/or (ii) suspension or cancellation of listing.

4. Inclusion of a reference to a PII Statement in announcements and corporate communications

   After a PII Statement with follow-on action(s) has been made against an individual, the named listed issuer must include a reference to the PII Statement in its announcements and corporate communications unless and until the individual subject to a PII Statement with follow-on action(s) is no longer its director or senior management member.

B. Introduction of new disciplinary sanctions

1. Introduction of the Director Unsuitability Statement

   In the case of serious or repeated failure by a director to discharge his responsibilities under the Listing Rules, SEHK may state publicly that in the SEHK's opinion, the director is unsuitable to occupy a position as director or within senior management of a named listed issuer or any of its subsidiaries (**Director Unsuitability Statement**).

2. Follow-on actions/ publication requirements also apply to Director Unsuitability Statements

   The follow-on actions, publication requirements and enhanced disclosure as applicable to PII statements also apply to directors against whom a Director Unsuitability Statement has been made.

C. **Denial of facilities of the market**

1. Lowering the existing threshold for ordering the denial of facilities of the market

   An order for the denial of facilities of the market can be made against a listed issuer without the requirement for '*wilful*' or '*persistent*' failure by the said listed issuer to discharge its responsibilities under the Listing Rules, such denial may be for a specified period and/or until fulfilment of specified conditions.

D. **Additional circumstances where disciplinary sanctions can be imposed**

1. Introduction of secondary liability on Relevant Parties

   Sanctions may be imposed on all Relevant Parties (as defined below) through secondary liability if they have caused by action or omission or knowingly participated in a contravention of the Listing Rules.

E. Expansion of the range of individuals that may be subject to disciplinary sanctions

1. Expansion of definition of Relevant Parties

   The scope of parties to which sanction may be imposed (**Relevant Parties**) will be expanded to include, among others, the following:

- employees of a professional adviser of a listed group or any of its subsidiaries;
- guarantors of structured products;
- guarantors of debt securities;
- parties who provide an undertaking to, or enter into an agreement with the SEHK; and
- 'senior management' (which was not previously defined) of a listed issuer or any of its subsidiaries, which include any person: (i) occupying the position of chief executive, supervisor, company secretary, chief operating officer or chief financial

officer, by whatever name called; (ii) performing managerial functions under the directors' immediate authority; or (iii) referred to as senior management in the listed issuer's corporate communication or any other publications on the SEHK's website or on the listed issuer's website.

Way forward and potential impact

The changes made to the Listing Rules are aimed at providing SEHK with a spectrum of graduated disciplinary sanctions so that an effective regulatory response can be delivered to address different types of misconduct with an aim of improving market quality. Particular emphases are being placed on instances of misconduct by individuals in relation to breaches of the Listing Rules.

As we summarise below, all in all, under the enhanced disciplinary regime, SEHK is empowered to impose a wider scope of disciplinary sanctions to listed issuers and a broader group of persons, and in some cases, under lower thresholds:

- The issue of a PII Statement (see A.1 above) and the order for the denial of facilities of the market (see C.1 above) are considered serious sanctions, which are intended for cases involving misconduct and breaches of the Listing Rules with a high level of severity. The removal of '*wilful*' or '*persistent*' threshold for these sanctions will overcome evidential changes and provide SEHK with a greater flexibility towards ensuring that appropriate sanction can be matched with the misconduct.

- SEHK's power to impose follow-on actions (see A.3 above) where an individual has been sanctioned with a PII Statement, and he/she continues to be a director or senior management member of the named listed issuer, will prompt the board of directors and/or the shareholders of the listed issuer to take timely action to avoid follow-on action(s) being imposed by re-evaluating if such individual should continue in office.

- Similarly, while SEHK does not have the power to compel any listed issuer to remove a director, the issue of a Director Unsuitability Statement (see B.1 above) is considered by SEHK to be at the top end of the spectrum and is reserved for the most egregious or severe case of misconduct, which will normally be accompanied by follow-on actions (see B.2 above). This will allow SEHK to state its view publicly regarding the unsuitability of a named director and will prompt the board of directors and/or the shareholders of the listed issuer to assess and determine if such individual should continue in office.

- The introduction of secondary liability (see D.1 above) will allow SEHK to impose sanction on such Relevant Parties who are not primarily responsible for compliance with the relevant requirements if they have *'caused by action or omission or knowingly participated in contravention of the Listing Rules'*. In assessing whether a person has triggered the threshold, the facts and circumstances of the matter, including the roles and responsibilities of the relevant person in question in respect of the subject matter of the breach and also the listed issuer's compliance, will be taken into consideration.

- Coupled with the introduction of secondary liability, the expansion of the scope of Relevant Parties who may be subject to disciplinary actions (see E.1 above) will allow SEHK to impose the same standards, duties and responsibilities that apply to directors of listed issuers on non-directors such as members of senior management (including company secretaries) who generally act in accordance with the directors' instructions and play a supporting role.

This article only summarises the key changes made to the disciplinary regime under the Listing Rules. For details of all changes made, please refer to the revised Listing Rules and the GEM Listing Rules.

Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of Hong Kong

Jun Kwong T: +852 2841 6930 | E: jun.kwong@minterellison.com

On 14 May 2021, the Mainland Supreme People's Court and the Hong Kong Government signed the "*Record of Meeting of the Supreme People's Court and the Government of the Hong Kong Special Administrative Region on Mutual Recognition of and Assistance to Bankruptcy (Insolvency) Proceedings between the Courts of the Mainland and of the Hong Kong Special Administrative Region*" (關於內地與香港特別行政區法院相互認可和協助破產程序的會談紀要) (the "**Record of Meeting**").

This marks the beginning of a new framework of judicial assistance between courts in the Mainland and Hong Kong in respect of insolvency matters. Pursuant to the Record of Meeting:-

(i) Application for recognition in the Mainland:

A liquidator or a provisional liquidator in insolvency proceedings in Hong Kong may apply to the courts in certain cities in the Mainland (the "pilot areas") for recognition of compulsory winding up, creditors' voluntary winding up and corporate debt restructuring proceedings as sanctioned by the Hong Kong courts, recognition of a liquidator's or a provisional liquidator's office, and grant of assistance for discharge of the liquidator's or provisional liquidator's duties.

(ii) Application for recognition in Hong Kong:

An administrator in Mainland bankruptcy proceedings may apply to the Hong Kong High Court for recognition of bankruptcy liquidation, reorganisation and compromise proceedings under the Enterprise Bankruptcy Law (中華人民共和國企業破產法), recognition of an administrator's office, and grant of assistance for discharge of the administrator's duties.

Initially, the Mainland Supreme People's Court has designated the following cities to be the "pilot areas" for this new framework: Shanghai, Xiamen and Shenzhen. Applications for recognition can be made to the Intermediate People's Court in the pilot areas.

The Mainland Supreme People's Court and Hong Kong Department of Justice have issued their respective guidance opinion / practical guide as to how things ought to be done. Copies can be found at the following links:-

(i) The Opinion issued by the Mainland Supreme People's Court (the "**Opinion**"): LINK

(ii) The Practical Guide issued by the Hong Kong Department of Justice: LINK

Pursuant to the Opinion, the new framework will apply to liquidators / provisional liquidators appointed in Hong Kong, and to insolvency proceedings commenced in accordance with the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) and the Companies Ordinance (Cap. 622), which includes compulsory winding up, creditors' voluntary winding up and scheme of arrangement promoted by a liquidator or provisional liquidator and sanctioned by the Hong Kong Court in accordance with section 673 of the Companies Ordinance.

To enable a liquidator / provisional liquidator appointed in Hong Kong to make an application for recognition and assistance, the "centre of main interests" (主要利益中心) of the debtor shall have been in Hong Kong continuously for at least 6 months at the time when the application for recognition and assistance is made. The term "centre of main interests" generally means the debtor's place of incorporation, although the Mainland court will also look at other factors including the debtor's place of principal office, the principal place of business and the place of principal assets.

If the debtor's principal assets in the Mainland are in a "pilot area", the Intermediate People's Court in the "pilot area" will have jurisdiction over such applications. If multiple applications are made in

more than one "pilot areas", the first court to accept the case shall have jurisdiction.

The Opinion also sets out various other important matters, e.g. the orders that one can seek under the framework, circumstances where the Mainland Court would refuse the application, and procedural matters that one shall follow in making an application under the new framework.

For a number of Hong Kong listed companies, which are largely incorporated in other jurisdictions (typically, Cayman Islands and Bermuda), they could have a centre of main interests in Hong Kong, and could have assets in the Mainland. The historical difficulty in seeking recognition and assistance in the Mainland in insolvency proceedings has attracted judicial attention, which may potentially be resolved under the new framework. It remains to be seen how the framework will operate in practice when the first wave of applications are made under this framework.

Nevertheless, we remain reasonably optimistic that the framework is a step forward, and could well assist Hong Kong / Mainland cross-border insolvency and restructuring matters. The framework will advance the Hong Kong Courts' recognition of Mainland administrators as seen in two earlier decisions in Re CEFC Shanghai International Group Limited [2020] HKCFI 167 and Re Shenzhen Everich Supply Chain Co Ltd [2020] HKCFI 965, and it would give the foundation to the Mainland Courts to do the same

Arbitration Update

Pryderi Diebschlag T: +852 2841 6931 | E: pryderi.diebschlag@minterellison.com

In this update, we highlight four cases from the past few months, which may serve as useful reminders of some base principles.

Set aside application made 7 days late – application for time extension refused

A, B, C v D [2020] HKCFI 2887

On 21 May 2020, an award was made in an arbitration administered by the Hong Kong International Arbitration Centre (the "**HKIAC**").

On 28 August 2021, A and B issued an originating summons to set aside the award.

Some two months later, the applicants appear to have realised that they missed the three month deadline to apply to set aside an award under Article 34(3) of the Model Law, and issued a summons for a retrospective extension of time.

The grounds asserted for set aside were essentially twofold:

(1) applicants B & C were not parties to the arbitration agreement, but were merely guarantors of A's obligations; and
(2) under the law of the PRC, the arbitration agreement was invalid.

Madam Justice Mimmie Chan dealt with each of these swiftly, firstly stating that commercial parties are presumed to intend that all of their disputes should be determined by one tribunal (applying *Fiona Trust & Holding Corporation v Privalov* [2007] 4 All ER 951), and as no other dispute resolution mechanism had been identified as between the parties, it made "*no commercial sense*" to hold that the parties had intended the arbitration clause to apply only to parties A and D, with the dispute resolution mechanism between parties B, C and D remaining undecided.

Secondly, Chan J noted that while the governing law of the underlying contract was PRC law, and there was no express stipulation as to the law applicable to the arbitration agreement, the seat of the arbitration was Hong Kong and, under the validation principle, the fact that PRC law could potentially invalidate the arbitration agreement is a strong indicator that Hong Kong law should apply (see *Sulamerica Cia Nacional de Seguros SA v Enesa Engelharia SA* [2013] 1 WL 102.)[1]

Perhaps controversially, D also sought to argue that the court has no power to extend time as Article 34(3) of the Model Law states that an applicant "*may not*" apply after the deadline.

This point was not fully argued, but it should be noted that in *Sun Tian Gang v Hong Kong & China Gas (Jilin) Ltd* [2016] 5 HKLRD 221, Madam Justice Mimmie Chan has already confirmed that the court can extend time, albeit that as a general rule it should not do so without good reasons.

In this case, the applicants had no explanation for the delay and the merits of the set aside application were weak. As a result, irrespective of the fact that the deadline was only missed by 7 days, the summons to set aside was dismissed with costs on an indemnity basis.

Court set aside an award made against a non-party to the arbitration agreement

AB v CD [2021] HKCFI 327

The parties entered into a contract wherein AB was defined as "AB Bureau or any other Affiliated entity". A dispute arose, and the claimant's notice of arbitration named "*AB Bureau*" as the respondent.

Three months later, the claimant amended its notice of arbitration to revise the respondent's name to "*AB Bureau also known as AB Bureau Co, Ltd.*"

Some four months later, the claimant again revised the respondent's name, this time to "*AB Engineering*", as AB's website suggested there had been a restructuring and AB Bureau was now known as AB Engineering.

The arbitrator did not require the claimant to re-serve its submissions on the respondent.

Shortly following issuance of the award on 18 March 2020, and having played no part in the arbitration itself, AB Engineering sought to set it aside under Article 34(2) of the Ordinance, on the basis that:

(1) AB Engineering was not a party to the arbitration agreement;
(2) it had not been given notice of the arbitration or appointment of an arbitrator; and
(3) the award exceeded the scope of the submission to arbitration.

The court essentially agreed. At all material times AB Engineering was a separate company from

AB Bureau and, although the contract did refer to "affiliates", whether that was sufficient to extend to AB Engineering was a matter of construction of the contract. In this case, the body of the contract did not suggest that the parties had actually intended for the rights and obligations of the specifically named parties to extend to a broad raft of unnamed affiliates.

Perhaps unsurprisingly, service of the notice of arbitration was also identified as an "important step" in the proceedings. AB Engineering denied receiving the notices and the court noted that there were typographical errors in the addresses to which documents were sent. Further, even if such notices had been received, they were addressed to "AB Bureau" or "AB Bureau Co, Ltd" not "AB Engineering."

Finally, the court reiterated the well-established position that if you deny being a party to an arbitration agreement, it is entirely valid to play no part in the arbitration and then seek to set aside the award or challenge enforcement.

The award was set aside.

A tribunal is not *functus officio* while it has the power to amend or issue additional awards

SC v OE1 and Anor [2020] HKCFI 2065

A dispute broke out between two "OE" parties and SC relating to an OEM Supply Agreement. The award concluded that SC was (a) in breach of the agreement, (b) liable for the costs of the arbitration, and (c) that "*all other claims and relief sought by the Parties are rejected*".

OE had applied for a licence and an injunction, which the Tribunal had failed to address in the award. OE therefore applied for correction of the award under Article 33(1)(a) of the Model Law, or the issuance of a further award under Article 33(3), on the basis that the omission to grant these was inconsistent with the Tribunal's finding on liability.

SC opposed the application, arguing that the award did in fact deal with those claims as it expressly rejected "all other claims". The Tribunal was therefore functus, and unable to change its award.

The Tribunal disagreed with SC and issued an addendum to the award, confirming that it had found against SC on liability, the relief sought flowed from the breach, and the omission to provide a declaration for the relief sought was the result of a clerical error. The relief was therefore granted.

SC sought to set aside parts of the addendum under Article 34 of the Model Law on the grounds that the procedure adopted was not in accordance with the parties' agreement or the Model Law, and was contrary to public policy.

In her judgment, Madam Justice Mimmie Chan confirmed that the court should be careful not to characterise a mistaken application of a rule as a decision which was made outside of the tribunal's jurisdiction. Here, while Article 33(1) is functionally equivalent to the slip rule, intended only for the "*almost mechanical*" correction of typographical mistakes rather than for correcting errors of judgment, Article 33(3) of the Model Law does allow the issuance of addendums or additional awards. Accordingly it could not be said that the tribunal's issuance of an addendum was it "acting beyond its jurisdiction", even if it was mistakenly sought under Article 33(1).

As to whether the Tribunal was functus officio, Chan J found that the Award had set out the list of issues and analysed the arguments, but had failed to deal with OE's claims for the licence or injunctions, hence when read as whole, it could not have been the Tribunal's "*true objective intention*" to reject claims which had not actually been dealt with by the Tribunal. The Tribunal was therefore not functus and retained the power to deal with the issues as an addendum.

SC's setting aside application therefore failed, and OE sought to enforce.

In opposition to enforcement, SC attempted to deploy additional arguments in its challenge to enforcement which it had not deployed in its set aside application.

This prompted Chan J to clarify that while the choice of remedies doctrine is "indisputable", it is just that – a choice. A party faced with an award has two options, to apply proactively to the courts of the country in which the award is made to have it set aside, OR, to take no such steps but wait passively until enforcement is sought and oppose it at that stage.

Here, SC tried to have its cake and eat it – applying to set aside and applying to challenge to enforcement. This allowed it to effectively supplement its set aside application with new

[1] See also our legal update here with regard to the more recent decision in *Enka Insaat Ve Sanayi AS v OOO Insurance Company Chubb* [2020] UKSC 38.

arguments months after the deadline to set aside had expired, under the veil of a challenge to enforcement.

Madam Justice Mimmie Chan did not find this acceptable, holding that while Order 73 rule 5(4)(a) of the Rules of the High Court provides that an originating summons to set aside an award must state *the* grounds of application, this requires *all* of the grounds to be stated. SC's decision to deploy additional grounds to challenge enforcement were in "*bad faith to obscure, procrastinate and delay the enforcement of the award.*" As a result, Chan J found that SC had waived its ability to rely on the additional grounds, and ordered costs on an indemnity basis.

Common law enforcement of arbitral awards

Xiamen Xinjingdi Group Co. Ltd v Eton Properties Limited and Others [2020] HKCFA 32

This case started in 2005 and reached the CFA in August 2020. At a very high level, the dispute was straightforward – Eton Properties Limited ("**Eton**") agreed to transfer its shares in a wholly owned subsidiary to Xiamen Xinjingdi Group Co. Ltd ("**XXG**") for the development of a parcel of land in Xiamen. However, Eton had a change of heart and sought to terminate the agreement.

After a lengthy CIETAC arbitration, the tribunal issued an award requiring Eton to perform the original agreement and pay damages of RMB 1.3m for delay.

However, by the time of the award, Eton had undergone a corporate restructuring such that the target shares were transferred to a third party. Eton was therefore no longer in a position to comply with the specific performance order.

A further problem was that Eton's assets were in Hong Kong, so XXG's first attempt to enforce the award in Xiamen was dismissed.

XXG therefore sought to enforce in Hong Kong. However, section 2GG of the old Arbitration Ordinance (Cap. 341)[2] provided for the almost mechanical conversion of an award into a judgment of the Hong Kong court. This remedied the jurisdictional problem, but the fundamental specific performance issue remained.

XXG's solution was to enforce the award by a common law action, rather than under the statute, claiming (a) specific performance as per the award or in the alternative, (b) damages for non-performance. This action failed at the CFI, but it was largely successful in the CA and CFA.

On appeal to the CFA, the Court confirmed that the statutory mechanism for enforcement of awards under the Arbitration Ordinance does not prohibit parties from enforcing by common law action. While the statutory route may be more efficient, if parties are content to sue on the award and prove their case, the common law route remains open.

In order to do so, the applicant must show:

(1) a valid submission of the dispute to arbitration;
(2) that the arbitration was conducted in pursuance of that submission; and
(3) the award is made pursuant to the provisions of that submission and valid according to the *lex fori* of the place where the arbitration was carried out and where the award was made.[3]

Secondly, the CFA confirmed that when parties enter into an arbitration agreement, there is an implied promise to honour an arbitral award. At common law the cause of action is a breach of that implied promise, which is independent and distinct from the underlying dispute. Accordingly, when granting relief, the court is not limited by the relief awarded in the arbitration.

Finally, Eton argued that an award of damages would be fundamentally inconsistent with the award, which required the performance of the underlying agreement. The correct approach is therefore for the court to return the matter to the tribunal, so that it may rescind its award for specific performance, put an end to the contract and award damages (see *Johnson v Agnew* [1980] AC 367 at 394).

However, the court reiterated that common law enforcement is a wholly separate cause of action, hence the rule in *Johnson v Agnew* did not apply. Eton's appeal was dismissed.

Going Forward

While some of the issues identified above may appear to be basic, we hope that they show how easily such issues can arise and accordingly how important it is to obtain advice at an early stage of proceedings.

[2] Equivalent to s.84 of the Arbitration Ordinance (Cap. 609).
[3] See para. 90, quoting MacKinnon J in *Norske Atlas Insurance Co Ltd v London General Insurance Co Ltd* (1927) 28 LLR 104. These requirements were phrased in different terms by the Court of Appeal, which required (i) a valid submission of the dispute to arbitration, (ii) an award made in favour of the applicant, and (iii) a failure by the defendant to honour the award: see [2016] 2 HKLRD 1106 at 165-167.

Remote hearings in Hong Kong Arbitration and Court Proceedings

Iris Cheng T: +852 2841 6814 | E: iris.cheng@minterellison.com
Rachel Liu T: +852 2841 6912 | E: rachel.liu@minterellison.com

Overview

In light of the travel restrictions and compulsory social distancing measures implemented around the world, courts, arbitration centres and legal practitioners have had to familiarise themselves with the technology and practices associated with virtual hearings. Since the outbreak of the COVID pandemic, the Hong Kong Judiciary and the Hong Kong International Arbitration Centre ("**HKIAC**") have both been actively exploring a wider use of remote hearings by telephone and video-conferencing.

HKIAC Arbitration

Arbitration is inherently an innovative and flexible process and has historically been at the forefront of procedural and technological innovation. Pursuant to section 46(3)(c) of the Arbitration Ordinance (Cap. 609), the arbitral tribunal has the discretion to use "*procedures that are appropriate to the particular case*" and to *"avoid unnecessary delay or expense*" and is therefore empowered to resort to remote hearings when necessary.

Before the pandemic, the HKIAC rules already conferred wide discretion to the tribunals to decide on the procedures and to consider the effective use of technology[4]. For many years this has resulted in tribunals often directing that for example case management hearings be heard by telephone conference and that the evidence of certain overseas witnesses be heard by way of video-conferencing. In most cases such directions have not be controversial. Since the outbreak of the pandemic, the HKIAC has promoted the conduct of virtual hearings as a means of avoiding delays in the arbitral process. In April and May 2020, approximately 85% of the hearings required virtual hearing services either in full or in part[5].

Technological advances now enable virtual hearings to proceed efficiently even where parties are in various locations throughout the world. However, there are certain issues which are peculiar to virtual hearings.

In our experience, it is not uncommon for witnesses to try to "cheat" in virtual hearings. For example, a witness may read from a script that is hidden from the camera, or communicate with his/her own lawyers or third parties using a phone or a computer while the hearing is ongoing or during a break.

To address this problem, the HKIAC recommends that the tribunal reminds the witnesses of their obligation of truthfulness by administering an oath at the start of the witness's testimony [6]. This in our experience is often beneficial.

The HKIAC also recommends the appointment of an independent third party as "hearing invigilator" to be present in the same room as the witness to ensure the integrity of the witness testimony.

In practice, where witnesses are located in various locations across multiple time zones and with different COVID-related restrictions, it may be difficult or disproportionately expensive to find trustworthy independent invigilators to observe the testimony in person. As an alternative, and to save costs, instead of having invigilators, the parties might agree to use a separate camera which allows the tribunal and the parties to monitor the witnesses during the entire process.

In addition to "cheating" witnesses, virtual hearings impose challenges including:

- inability of the tribunal to fully assess the demeanour and body language of the witnesses;

[4] Article 13 of the 2018 HKIAC Administered Arbitration Rules

[5] See the HKIAC's press release dated 6 May 2020 at: https://www.hkiac.org/news/virtual-hearings-hkiac-services-and-success-stories

[6] See the HKIAC's Guidelines for Virtual Hearings at : https://www.hkiac.org/sites/default/files/ck_filebrowser/HKIAC%20Guidelines%20for%20Virtual%20Hearings_3.pdf

- technology and network hiccups such as problems with electronic bundles, hyperlinking and screen sharing;
- unsatisfactory video or audio quality due to inferior equipment or unstable network used by witnesses;
- network security and hacking risks;
- where the interpreter is not in the same room as the witness, interpretation may be less accurate and effective; and
- time zone inconveniencies.

While the HKIAC's recommendations may be able to address most of the challenges, the success of a virtual hearing largely depends on the careful planning and testing by the parties and their lawyers, taking into account the characteristics of the relevant arbitration.

Court

Nearly all physical court proceedings in the Hong Kong Court were adjourned between January and May 2020. Starting from 3 April 2020, video-conferencing facilities ("**VCF**") were used for remote hearings for suitable and urgent civil cases at the Hong Kong High Court. Since 2 January 2021, the Hong Kong Judiciary has introduced "browser-based" VCF as a low-cost option for VCF hearings. In February 2021, the Judiciary Administration commenced a consultation on the greater use of remote hearings for court proceedings.

However, virtual hearings are still only available to limited court cases and an applicant seeking to give evidence by VCF must clear a high threshold.

The courts have noted that the solemnity of court proceedings and their atmosphere are important features in the taking of evidence and sound reasons are required to justify a departure from the general rule that evidence should be given in the solemn setting of the court. The principles in this regard were laid down by the Hon. Anthony Chan J in *Tsang Woon Ming v. Lai Ka Lim* [2020] HKCFI 891.

In this case, the applications to give evidence by VCF were made by three witnesses who resided in, respectively, Taiwan, Macau and Shenzhen. In the case of the first two witnesses, the basis of their applications was that their attendance at the trial would require 28 days of quarantine. Having found that there was sufficient time for the witnesses to come to Hong Kong to give evidence and that the real reason for the applications was their unwillingness to have their business commitments interfered during the period of quarantine, the court refused their applications on the ground that there is no good reason to justify such applications.

In January 2021, the Hon. Anthony Chan J dismissed another application to give evidence by VCF in *Standard Chartered Bank (Hong Kong) Ltd v. Lau Lai Wendy and Another* [2021] HKCU 170 (5 January 2021). The application was made by the 2nd Defendant (who resided in Beijing) on the sole ground of health concerns due to COVID. Having regard to the established principles set out in *Tsang Woon Ming*, the judge was not satisfied that health concern is a real deterrence to the 2nd Defendant's attendance at the trial.

Further, given that the application was made at an extremely late stage, it was found to be a tactical manoeuvre designed to force the court's hand due to the risk of adjourning the trial (as there would not be sufficient time for the 2nd Defendant to meet the quarantine requirement if the application is declined).

Towards the end of the judgment, the Hon. Anthony Chan J noted that in *Tsang Woon Ming*, an application was made to the Department of Justice for dispensation of the strict quarantine requirements to enable the witness to give evidence. In any event, the judge regarded the 2nd Defendant to be the author of her own misfortune if it was too late for her to attend trial. He therefore dismissed the application with costs.

Recently, in March 2021, the Hon. Poon CJHC dismissed a trainee solicitor's application to attend his application to be admitted as a solicitor in Hong Kong by way of VCF in *So v The Law Society of Hong Kong* [2021] HKCFI 617.

In this case, the applicant was working in London at the time of the VCF application (November 2020) and his application to be admitted as a solicitor was due to be heard in March 2021. He made the VCF application on the basis of costs and inconvenience caused by COVID-associated quarantine requirements.

In considering the VCF application, the Hon. Poon CJHC noted that admission of a solicitor is a solemn process where personal attendance at the hearing is normally required and that cogent reasons must exist for any exemptions. While it was not doubted that travelling to Hong Kong would cause additional expenses and inconvenience to the applicant, on the basis that that the applicant could have made travel arrangements, the applicant's situation did not justify exemption from his personal attendance at the March hearing.

So v The Law Society of Hong Kong is not strictly about giving evidence by VCF but it, together with *Tsang Woon Ming* and *Standard Chartered Bank (Hong Kong) Ltd,* suggests that the courts consider the solemnity of court proceedings very important. Mere inconvenience that may be suffered by an overseas witness in having to undergo compulsory quarantine is unlikely to be regarded by the courts as a sufficient reason justifying the use of VCF in giving evidence.

Comments

While it may be hugely beneficial to have virtual hearings in the (post-)COVID era, virtual hearings can impose challenges, and the effectiveness of such hearings will depend on the willingness and ability of the tribunals, courts, practitioners and parties to embrace technologies and to put in place necessary measures to ensure fair, efficient, and economical resolution of disputes.

In any event, notwithstanding the Judiciary's attempt to enable the use of remote hearings, it appears that arbitration remains a flexible process compared to court proceedings in this regard.

Meanwhile, certain subsidiary legislation under the Court Proceedings (Electronic Technology) Ordinance (Cap. 638), which will essentially permit electronic filing of documents, will likely come into operation in District Court and Magistrates' Courts later this year[7]. It remains to be seen if further technology and procedures would be rolled-out to promote a wider use of remote Court hearings by, among other things, preserving the solemnity of court proceedings in a virtual context.

[7] The ordinance was designed to allow court users to transact court business by electronic means by enabling handling court documents electronically. It was enacted on 17 July 2020 and is not yet in force. See the Judiciary's Press Release dated 4 June 2021 at: https://www.info.gov.hk/gia/general/202106/04/P2021060400316.htm .

Use of a competitor's registered trade mark in the context of comparative advertising

Andrew Chan T: +852 2841 6924 | E: Andrew.chan@minterellison.com
Kennis Cheung T: +852 2841 6805 | E: kennis.cheung@minterellison.com

A company may wish to use a competitor's registered trade mark in advertising for the purpose of comparing its own products and/or services with those of the competitor. Would such use of a competitor's registered trade mark constitute a trade mark infringement in Hong Kong? In the landmark case of *PCCW-HKT Datacom Services Ltd & Ors v Hong Kong Broadband Network Ltd* [2018] 4 HKLRD 575, the Court of First Instance provided important guidance on the interpretation of section 21 of the *Trade Marks Ordinance* (Cap. 559 of the laws of Hong Kong) ("**TMO**") which effectively provides a potential defence permitting use of a competitor's registered trade mark in honest comparative advertising.

Background

The Plaintiffs are part of a group of companies carrying on business in the fields of telecommunications and media and they have registered a number of trade marks, eg. PCCW, 電訊盈科, eye, etc. ("**Marks**"), in respect of telecommunications and Internet services. The Defendant is a competitor of the Plaintiffs. From February to April 2015, the Defendant published advertisements ("**Advertisements**") that contained straplines making use of the Marks and describing the monthly fees for the Plaintiffs' services, such as "PCCW Home Telephone Service customers say goodbye to bloated monthly fees!", "PCCW Home Telephone and eye Communications Service customers say goodbye to bloated monthly fees", "電訊盈科家居電話及 eye 用戶唔駛再忍受咁大食嘅家居電話用費", etc..

The Plaintiffs brought a trade mark infringement claim against the Defendant for its use of the Marks in the Advertisements. There was no dispute that the Defendant had used the Marks in the Advertisements. The Defendant defended the claim by raising the statutory defence as provided under section 21 of TMO, the relevant subsections of which provide as follows:-

(1) Nothing in section 18 (infringement of registered trade mark) shall be construed as preventing the use by any person of a registered trade mark for the purpose of identifying goods or services as those of the owner of the registered trade mark or a licensee, but any such use which is otherwise than in accordance with honest practices in industrial or commercial matters shall be treated as infringing the registered trade mark.

(2) In determining for the purposes of subsection (1) whether the use is in accordance with honest practices in industrial or commercial matters, the court may consider such factors as it considers relevant including, in particular, whether -

(a) the use takes unfair advantage of the trade mark;

(b) the use is detrimental to the distinctive character or repute of the trade mark; or

(c) the use is such as to deceive the public.

Whether the use was in accordance with honest practices

The Court recognised that whilst this was a claim of trade mark infringement, it was in essence a case of comparative advertising and the Court was required to determine whether the Defendant's use of the Marks in the Advertisements could be said to be "*in accordance with honest practices in industrial or commercial matters*" such that section 21 of TMO offers a defence to the Defendant.

The Plaintiffs claimed that the Defendant's use of the Marks in the Advertisements was without due cause, and took unfair advantage of and/or was detrimental to the repute of the Marks. The Plaintiffs argued, amongst other claims, that the Defendant's use of the Marks in the Advertisements was to convey the message that consumers get a better deal from the Defendant and the use of such words as "bloated fees" and

"大食" (literally, big eater) conveyed the erroneous, unfair and/or misleading impression to the public that the Plaintiffs' fees are bloated, unduly excessive and/or unreasonable. The Plaintiffs further argued that such use of the Marks by the Defendant discredited and denigrated the Marks and was detrimental to the repute of the Marks.

On the other hand, the Defendant argued, amongst other claims, that the message conveyed by the Advertisements was that the Defendant's services were less expensive than the similar services provided by the Plaintiffs, and reasonable readers of the Advertisements would find the Advertisements honest and not misleading in any material respect. The Defendant backed up these arguments with evidence showing the actual prices charged by the Plaintiffs and the Defendant respectively during the time when the Advertisements were published. The Defendant also argued that its use of such words as "bloated fees" and "大食" in the Advertisements was mere advertising language or puff, and did not have any discrediting or denigrating effect, when read in their context.

The Findings

The Court confirmed that the primary objective of section 21 of TMO is to permit comparative advertising. In deciding whether the trade mark use complained of was "*in accordance with honest practices in industrial or commercial matters*" such that section 21 of TMO is satisfied, the Court has to determine the matter objectively, taking into consideration all relevant factors and circumstances and conducting a "global assessment" of the use of the Marks in the Advertisements.

It is the Court's view that the reasonable reader of the Advertisements in Hong Kong was more than used to hyperbole and exaggeration. Bearing this in mind, the words "bloated" and "大食" complained of by the Plaintiffs mean no more than "expensive", expressed in sensational and coloured language, as is usual in advertising. The "take home message" conveyed by the Advertisements was simply that a customer would get a cheaper price by using the Defendant's services, instead of using the Plaintiffs' same services which were more expensive. Further, the Court is of the view that the words "bloated" and "大食" would not be considered by a reasonable reader to carry any derogatory or sinister meaning that the Plaintiffs had cheated their customers. The words would be understood as simply poking fun at the Plaintiffs' prices.

The Court proceeded on analysing the three factors under section 21(2) of TMO which are relevant to determining whether the Defendant's use of the Marks in the Advertisements was in accordance with honest practices in industrial or commercial matters.

(a) Deceiving the public (section 21(2)(c) of TMO) - Based on the evidence produced by the Defendant showing the actual prices charged by the Plaintiffs and the Defendant respectively during the time when the Advertisements were published, the Court is satisfied that the statement in the Advertisements, that the Plaintiffs' prices were more expensive, was substantially and sufficiently true and was not misleading to a substantial proportion of the reasonable audience, nor was it deceiving.

(b) Taking unfair advantage of the Marks (section 21(2)(a) of TMO) – The Court pointed out that the purpose of the Advertisements was to dissociate the Defendant from the Plaintiffs, rather than suggesting a connection with the Plaintiffs. Additionally, the Court also pointed out that the message conveyed in the Advertisements was substantially true and not misleading. The Court therefore found that the Defendant's use of the Marks did not take unfair advantage of the Marks.

(c) Detrimental to the repute of the Marks (section 21(2)(b) of TMO) – The Court also found that use of the Marks in the Advertisements was not detrimental to the repute of the Marks. The Court commented again that a reasonable reader would not consider the Advertisements to be suggesting that the Plaintiffs cheated the customers or that the Plaintiffs were dishonest. The Court further remarked that a statement of truth would not be detrimental to the reputation of the Marks, even if the Plaintiffs found it uncomfortable to be confronted with a substantial truth.

The Plaintiffs' claim of trade mark infringement against the Defendant was therefore dismissed on the basis that the use of the Marks was in

accordance with honest practices in industrial or commercial matters and the defence under section 21 of TMO was established.

Key Takeaway

The above case confirms that use of a competitor's registered mark in the context of comparative advertising may not constitute a trade mark infringement so long as the trade mark use is "*in accordance with honest practices in industrial or commercial matters*" such that section 21 of TMO is satisfied.

Subject to the above, hyperbole, exaggeration and sensational and colored language may be acceptable but care should be taken when choosing the words to be used in the advertisement. In particular, you should seek to ensure that the contents in the advertisement are true and not misleading or deceiving. You should also have all necessary documentary evidence to back up any statements that you make in relation to the competitor

Corporate Culture, Director Independence and Diversity – the latest consultation on corporate governance by the Hong Kong Stock Exchange

Katherine U T: +852 2841 6873 | E: katherine.U@minterellison.com

Introduction

On 16 April 2021, The Stock Exchange of Hong Kong Limited (the "**Stock Exchange**") published a consultation paper, "Review of Corporate Governance Code and Related Listing Rules" (the "**Consultation Paper**"), proposing amendments to the CG Code (as defined below), ESG Guide (as defined below), and related rules (each a "**Rule**") of the Rules Governing the Listing of Securities on the Stock Exchange (the "**Listing Rules**"). The proposals listed in the Consultation Paper (collectively the "**Proposals**", and each a "**Proposal**") mainly relate to areas including culture, director independence and diversity.

In this article, we summarise the key Proposals made by the Stock Exchange.

Background

The Corporate Governance Code and Corporate Governance Report, as set out in Appendix 14 of the Listing Rules (the "**CG Code**"), is a framework designed to help boards of issuers to deliver good corporate governance. The CG Code includes three levels of disclosures, (1) code provisions (each a "**CP**"), (2) recommended best practices (each an "**RBP**"), and (3) mandatory disclosure requirements (each an "**MDR**").

Issuers are expected to comply with, but may also choose to deviate from, each CP. Issuers must state in their interim reports and annual reports whether they have complied with each CP, and where it has deviated from a CP, give considered reasons for such deviation. This is known as the "comply or explain" approach. The approach is also applicable in the context of the Environmental Social and Governance Reporting Guide, as set out in Appendix 27 of the Listing Rules (the "**ESG Guide**").

In contrast, RBPs are for guidance only. Issuers are only encouraged, but are not required, to state whether they have complied with the RBPs and give considered reasons for any deviation.

Finally, disclosure against each MDR is mandatory, and any failure to do so will be regarded as a breach of the Listing Rules. MDRs are also applicable in the context of the ESG Guide.

The Stock Exchange reviews its corporate governance framework from time to time, and the Proposals represent the Stock Exchange's latest efforts in improving the quality of governance.

Key Proposals

We set out below a summary of the current requirements and key Proposals made by the Stock Exchange:

Corporate "Culture": Alignment of the issuer's culture with its purpose, value and strategy

Current requirement(s):	Proposal
Paragraph 5.3 of the Guidance for Boards and Directors published by the Stock Exchange in July 2018 dealt only with the risk culture of an issuer:- "The board should *lead in shaping and developing the issuer's risk culture, setting the tone at the top*".	Introduce a new CP, requiring an issuer's board to set the issuer's culture and ensure that it is aligned with the issuer's purpose, value and strategy.

The Stock Exchange has indicated in the Consultation Paper that disclosures on the issuer's culture should be precise and succinct (generally, no more than one page), and may include a description of the measures used for assessing and monitoring culture, and how the issuer's culture affects its KPIs. Further guidance will be issued by the Stock Exchange.

Anti-corruption and whistleblowing policies: Establishment of anti-corruption and whistleblowing policies

Current requirement(s):	Proposal
Under the ESG Guide, issuers are required make certain anti-corruption disclosures on a "comply or explain" basis.	Introduce a new CP, requiring the establishment of an anti-corruption policy. Upgrade the current RBP C.3.8 to a CP.

Under the current RBP C.3.8, the audit committee is recommended to establish a whistleblowing policy for employees and those who deal with the issuer (e.g. customers and suppliers).	

The Stock Exchange has indicated in the Consultation Paper that they will provide guidance on the elements to be taken into account when formulating anti-corruption policy and whistleblowing policy.

Director Independence: Ensuring independent views and input are available to the board

Current requirement(s):	**Proposal**
Under Rule 3.13, the Stock Exchange takes into account a non-exhaustive list of factors when assessing the independence of an independent non-executive director (each an "**INED**").	Introduce a new CP, requiring the disclosure of a policy to ensure independent views and input are available to the board, and an annual review of the implementation and effectiveness of such policy.
Under the current CP A.5.5, where the board proposes to elect an individual as an INED, it is required to set out in the relevant circular the reasons why it considers the INED to be independent.	

Board refreshment and succession planning: Re-election and independence of Long Serving INEDs (as defined below)

Current requirement(s):	**Proposal:**
Under the current CP A.4.3, if an INED serves more than 9 years (a "**Long Serving INED**"), his further appointment should be approved by shareholders. The papers to shareholders should include reasons why the board believes the Long Serving INED is still independent and should be re-elected.	Revise the current CP A.4.3, which will now require (a) the re-election of Long Serving INEDs to be subject to *independent* shareholders' approval, and (b) the papers to the shareholders to state the factors considered, process and discussion of the board or nomination committee in concluding that the Long Serving INED is still independent and should be re-elected. Introduce a new CP requiring an issuer which has all of its INEDs being Long Serving INEDs to appoint a new INED at its forthcoming AGM, and disclose the name and tenure of the Long Serving INEDs in the shareholders circular for the AGM. (collectively the "**Long Serving INEDs Proposals**")

The Stock Exchange has indicated in the Consultation Paper that they may consider phasing out all Long Serving INEDs gradually in the long run.

Remuneration of INEDs: Issuers should generally not grant equity-based remuneration

Current requirement(s):	**Proposal:**
Under principle B.1 of the CG Code, remuneration levels for directors should be "*sufficient to attract and retain directors to run the company successfully without paying more than necessary*".	Introduce a new RBP, recommending issuers generally not to grant equity-based remuneration (eg: share options or grants) with performance-related elements to INEDs.

Diversity: Disallowing single gender boards and increased disclosure on board diversity

Current requirement(s):	**Proposal:**

Under the current principle A.3 of the CG Code, the board should have a balance of skills, experience and diversity of perspectives. Under Rule 13.92, an issuer must have a board diversity policy, and disclose the same in its corporate governance report. Under the current MDR L(d)(ii), the disclosure should include measurable objectives the issuer has set for implementing the policy, and the progress on achieving the same. Under the current CP A.5.5, an issuer is required to disclose diversity considerations when appointing an INED.	Introduce a new note to Rule 13.92, providing that diversity is not considered to be achieved in single gender boards. Introduce a new MDR, requiring the setting and disclosure of numerical targets and timelines for achieving gender diversity at both the board level and across the workforce. Introduce a new CP, requiring the board to annually review the implementation and effectiveness of its board diversity policy.

Should the above Proposal regarding Rule 13.92 be implemented, the Stock Exchange has further proposed in the Consultation Paper a three-year transition period, for current single gender boards to appoint at least one director of the absent gender.

Nomination committees: Requirement to establish nomination committees

Current Requirement(s):	**Proposal:**
Under the current CP A.5.1, issuers are required to establish a nomination committee which is chaired by the chairman of the board or an INED and comprises a majority of INEDs.	Upgrade the current CP A.5.1 to a Rule.

Communication with shareholders: Disclosure of shareholder communication policy

Current Requirement(s):	**Proposal:**
Under the current CP E.1.4, the board should establish a shareholder communication policy and review it on a regular basis to ensure its effectiveness.	Upgrade the current CP E.1.4 to an MDR, which will now require issuers to disclose their shareholders communication policy, and annually review the same to ensure its effectiveness.

Attendance at meetings: Disclosure of directors' attendance at general meetings

Current Requirement(s)	**Proposal**
Under MDR I(c), directors' attendance at general meetings must be published annually in the corporate governance report.	Introduce a new Rule, requiring disclosure of directors' attendance at general meetings in the poll results announcements of the relevant meetings.

Non-executive directors: Deletion of the requirement that non-executive directors shall be appointed for a specific term and subject to re-election.

Current Requirement(s)	**Proposal**
Under CP A.4.1, non-executive directors should be appointed for a specific term, subject to re-election.	Delete CP A.4.1.

Timing for publication of ESG reports: Requirement for ESG reports to be published at the same time as annual reports

Current Requirement(s)	**Proposal**
Under Rule 13.91, issuers are required to publish their ESG report no later than five months after the end of the financial year.	Revise the current Rule 13.91, which will now require ESG reports to be published at the same time as annual reports.

Other administrative proposals:

In addition to the above, the Stock Exchange has also made certain Proposals of an administrative nature. Such proposals include (i) elaborating on the linkage between corporate governance matters and environmental, social and governance matters in the introduction section of the CG Code, (ii) changing the full name of the CG Code from the "*Corporate Governance Code and Corporate Governance Report*" to just the "*Corporate Governance Code*", and (iii) re-

arranging the structure of the CG Code to make it clearer and more concise.

Implementation dates

Should they be adopted, the Stock Exchange has proposed to implement the Proposals (except for the Long Serving INEDs Proposals) for the financial year commencing on or after 1 January 2022.

As for the Long Serving INED Proposals, given their impact and the practical concern of finding a new INED suitable for the issuer, the Stock Exchange has proposed a longer transition period and for the Long Serving INED Proposals to be implemented for the financial year commencing on or after 1 January 2023.

Should you require assistance on any of the above*, please do not hesitate to contact any member of the Corporate and Capital Markets team of our firm. We have many years of experience advising clients on their obligations under and compliance with the Listing Rules*

SEHK's Consultation Conclusions/SFC and SEHK's Joint Statement

Anne Ko T: +852 2841 6826 | E: Anne.Ko@minterellison.com
Bridget Chan T: +852 2841 6841 | E: bridget.chan@minterellison.com

(A) Hong Kong Stock Exchange's consultation conclusions on Main Board Profit Requirement and (B) Joint Statement on IPO-related Misconduct by Securities and Futures Commission and Hong Kong Stock Exchange

On 20 May 2021, The Stock Exchange of Hong Kong Limited (**SEHK**) published the conclusions on the Main Board Profit Requirement with respect to its consultation paper published on 27 November 2020. On the same day, the Securities and Futures Commission (**SFC**) and SEHK issued a joint statement (**Joint Statement**) in relation to certain regulatory issues noted in recent listings and their approach in tackling such issues.

(A) Conclusion on Main Board Profit Requirement

After considering the feedback from a broad range of respondents that were representatives of all stakeholders in the Hong Kong capital market, SEHK decided not to proceed with the proposed double or even triple the annual profit requirements as set out in its consultation paper. Instead, SEHK has modified its proposal and will adopt the following approach:

(a) a 60% increase in the profit requirement resulting in an aggregate profit threshold of HK$80 million with a profit spread of 56%:44% (**Modified Profit Increase**), effective from 1 January 2022; and

(b) SEHK will be prepared to grant a relief from the modified profit spread on case-specific circumstances to provide flexibility.

Modified Profit Increase

Under the Modified Profit Increase, the minimum amount of profit attributable to shareholders for a Main Board listing applicant is (a) HK$35 million for the most recent financial year; and (b) HK$45 million in aggregate for the two preceding financial years of a three-year trading record period, resulting in an aggregate profit threshold of HK$80 million. The amended profit spread from 60%:40% to 56%:44% and hence a minimum profit of HK35 million for the most recent financial year of the trading record period will result in an implied historical P/E ratio of 14 times, which is in line with the average P/E ratio of the Hang Seng Index between 1994 and 2020, at the time of listing of a listing applicant, significantly lower than 25 times as seen in some IPOs recently and, particularly, since 2018.

The Modified Profit Increase will be effective from 1 January 2022. Any Main Board listing applications (including renewals of previously submitted applications or GEM Transfer applications) submitted on or after 1 January 2022 will be assessed under the Modified Profit Increase. A listing applicant will not be permitted to withdraw its listing application before it lapses and resubmit the listing application shortly thereafter before the effective date of the Modified Profit Increase such that the listing application will be assessed for a longer period of time in accordance with the current profit requirement.

Relief from the Profit Spread

SEHK will be prepared to grant relief from the profit spread on case-specific circumstances rather than through a set of fixed conditions, provided that the listing applicant meets an increased aggregate profit threshold of HK$80 million. In this respect, SEHK will ordinarily, among other things: (a) evaluate the listing applicant's business nature and the underlying reasons for its inability to meet the profit spread (e.g. growth stage companies and companies whose businesses have been severely affected by the COVID-19 pandemic and current economic downturn); and (b) impose conditions where appropriate, including disclosure of the listing applicant's profit forecast in its listing document.

Way Forward and Potential Impact

In considering an application for a waiver for the relief from the revised profit spread under the Modified Profit Increase, SEHK will critically assess the need to include a profit forecast in the listing document to enable investors to make an

informed decision on the position and prospects of an issuer and it may make enquiries on how the issuer's IPO price was determined with reference to the book-building process.

SEHK and the SFC will continue to monitor the situation after the implementation of the Modified Profit Increase and may revisit the Profit Requirement at a later time if circumstances warrant a review.

The Modified Profit Increase would indubitably affect companies at an early development stage and small or mid-sized companies seeking a Main Board listing on SEHK. Such companies would however still be able to access the capital market by pursuing a listing on GEM of SEHK, the listing requirements of which do not include any minimum profit during the track record period. Only sizeable companies which are able to demonstrate a more robust financial performance will be eligible for seeking a listing on Main Board, allowing the SEHK to reinforce its objectives to distinguish Main Board and GEM issuers.

Notwithstanding the satisfaction of the higher entry level of the Modified Profit Increase, SEHK and SFC will continue to critically review listing applicants with relatively high historical P/E ratios, particularly by comparison against those of their listed peers. To deter any possible over-valuation of a listing applicant through inflation of its profit forecast, SEHK and SFC will continue to critically evaluate the reasonableness of the applicant's valuations and, where applicable, require the disclosure of the profit forecast in an applicant's listing document.

Potential applicants seeking or contemplating seeking a Main Board listing should critically assess the potential impacts of the Modified Profit Increase on their eligibility for listing as well as their proposed listing timetable.

(B) Joint Statement on IPO-related Misconduct

Regulators' observations and concerns

SFC and SEHK are concerned with certain suspected arrangements in IPOs which artificially satisfy the initial listing requirements or facilitate market manipulation of the shares at a later date, which undermine the development of an open, orderly and fair capital market in Hong Kong.

The regulators have observed an increasing number of suspected "ramp-and-dump" schemes in recent IPOs whereby fraudsters used different means to "ramp" up the share price of a listed company and then induce unwary investors to purchase the shares that the fraudsters "dump" at an artificially high price. In certain IPOs, shares were apparently allocated in the placing tranche to controlled placees which were seemingly financed in part by funds from the unusually high underwriting commissions or other listing expenses paid under the IPOs. Shares were also allocated to controlled placees in the placing tranche to artificially satisfy the initial listing requirements under the Listing Rules (such as sufficient investor interest, minimum market capitalisation and adequate shareholders spread), creating a false market for the shares, or corner the shares for market manipulation after listing. In the absence of such arrangements, some listing applicants may not satisfy certain initial listing requirements and/or the IPO issue price and valuation may be substantially lower than what were stated in the listing prospectus. In some cases, the share price dropped substantially on the first trading day to a level which more closely reflected the true market value of the company.

In light of the concerns identified in the Joint Statement, where a listing application displays one or more of the following features, the SFC and SEHK will make enquiries to ascertain whether there is sufficient investor interest in the company and adequate spread of shareholders to enable an open, fair and orderly market for the securities after listing:

(i) The applicant's market capitalisation barely meets the minimum threshold under the Listing Rules.

(ii) Very high P/E ratio taking into account the applicant's fundamentals (including its profit forecast) and the valuations of its peers.

(iii) Unusually high underwriting or placing commissions or other listing expenses.

(iv) Shareholding is highly concentrated in a limited number of shareholders, particularly where the value of public float is small and the minimum threshold for shareholders spread is barely met.

The above is however a non-exhaustive list of features which the SFC and SEHK would consider in their review. The regulators may identify other features which entail their heightened scrutiny.

Regulatory Action

SEHK may exercise the discretion to reject a listing application if questions raised regarding the share placement and price discovery process are not satisfactorily addressed, or the basic conditions of listing under the Listing Rules are not met, including sufficient public interest, an open market in the shares and an adequate spread of shareholders. The SFC may also object to the listing application on the ground that the listing application does not comply with the Listing Rules, or on public interest grounds.

The SFC and SEHK not only have the discretion and power to object to a new listing, the regulators are empowered to investigate and take appropriate action against the parties involved under the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong SAR), the Securities and Futures (Stock Market Listing) Rules (Chapter 571V of the Laws of Hong Kong SAR) and the Listing Rules. In addition to SEHK's regulations of listed issuers based on the Listing Rules, the SFC has statutory powers, including its investigation powers, in relation to issuers, directors, major shareholders and intermediaries suspected of being involved in market misconduct. The SFC may also direct SEHK to suspend trading in any securities listed on SEHK. There will be an enhanced focus on the supervision of intermediaries involved in bookbuilding and placing activities in IPOs as part of SFC's regulatory framework with a view to identifying malpractices and misconduct.

Potential Impact

Listing applicants should be mindful that the SFC and SEHK may request a listing applicant to provide evidence to demonstrate that it satisfies the Listing Rules requirements, including there is a genuine investor demand and the reasonableness of its valuations having regard to those of its listed peers, during the IPO vetting process and to justify any unusual features in an IPO. Listing applicants should be prepared to explain to the regulators should their IPO exhibit any such problematic features, such as to demonstrate that the IPO price has been or will be determined through a robust and transparent price discovery exercise.