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Llinks Corporate Finance Bulletin
June 2010

SZSE Further Regulates the Use of Over-raised Funds by ChiNext Listed Companies

By James Weng and Harriet Li

The Shenzhen Stock Exchange (the "**SZSE**") promulgated the *Working Memorandum No.1 for ChiNext Information Disclosure—Use of Over-raised Funds* and its amendment (the "**Memorandum No.1"**) in December 2009 and April 2010 respectively, in order to regulate the use and management of over-raised funds by ChiNext listed companies. The Memorandum No.1 is supplementary to the relevant provisions specified in the *Guidelines on the Regulated Operation of ChiNext Listed Companies* (the "**Guidelines"**).

Scope of Application

Pursuant to the Memorandum No.1, if the over-raised funds of a listed company reach or exceed RMB 50 million yuan or 20% of the funds the company planned to raise, the Memorandum No.1 shall apply. According to the current market practices by ChiNext listed companies, most of ChiNext listed companies shall be governed by the Memorandum No.1.

Use of Over-raised Funds

The Guidelines, promulgated by the SZSE in October 2009, requires that the over-raised funds shall be properly used by listed companies to develop their main business, instead of being used for high-risk investments, such as securities investments, entrusted wealth managements, derivatives investments, and venture investments, or financial assistance to other people. The Memorandum No.1 further sets out that if a ChiNext listed company plans to use the over-raised funds to repay bank loans or replenish working capital, the following requirements shall be satisfied:

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- The listed company was not engaged in high-risk investments, such as securities investments, entrusted wealth managements, derivatives investments and venture investments during the past 12 months;

- If the over-raised funds are to be used to permanently replenish working capital or repay bank loans, the cumulative amount of the funds used in every 12 months shall not exceed 20% of the total amount of the over-raised funds. Such plan shall be approved by over two thirds of the directors and all independent directors;

- Using over-raised funds to temporarily replenish working capital will be considered as using the idle raised funds for the same purpose. Therefore, the relevant requirements with respect to the use of the idle raised funds specified in the Guidelines and other regulations shall be satisfied; and

- The sponsor shall verify and give positive confirmation on whether the plan to use over-raised funds has complied with the requirements.

The aforesaid provisions clearly show the prudent attitude of the regulatory authorities towards the use of over-raised funds by ChiNext listed companies. Compared with the relevant regulations for companies listed on the Small and Medium Enterprises Board, the regulatory authorities impose more stringent restrictions on the use of over-raised funds by ChiNext listed companies, which will effectively reduce the risks that might occur in the use of over-raised funds.

Procedure

According to the Memorandum No.1, the use of over-raised funds can be divided into two stages: (1) the planning stage; (2) the practice stage.

- Planning for the Use of Over-raised Funds

  The Guidelines and the un-amended Memorandum No.1 require that each listed company shall properly draw up a plan for the use of over-raised funds in light of the company's future development and actual operation requirements. Such plan shall be approved by the board and disclosed within 6 months after the funds are raised. The aforesaid provisions intend to prevent the over-raised funds from lying idle, so as to improve the efficiency for the use of over-raised funds. However, given that it takes time for listed companies to assess and decide on an investment project, the 6 months' window period is generally considered to be too short to make a comprehensive investment decision.

  In order to prevent listed companies from making random decisions of using the funds to meet the aforesaid timing requirement, the SZSE amended the Memorandum No.1 in April 2010. The amended Memorandum No.1 sets forth that if a listed company can not submit the plan within the required period, it shall disclose to the public its subsequent arrangements with respect to the use of over-raised funds before the expiry of 6 months. Such amendments give listed companies more time to think over how to properly use the over-raised funds to maximize their profits. Under the influence of the amended Memorandum No.1, currently some listed companies which can not submit the plan on time have announced their subsequent arrangements for the use of over-raised funds.

- Put the Over-raised Funds Into Use

  Before a listed company puts the over-raised funds into actual use, the company shall go through the corresponding procedure for approval by the board or the general shareholders' meeting. The company shall also perform its duty of information disclosure in accordance with the requirements in the *Rules of Shenzhen Stock Exchange for ChiNext Stock Listing*. The Memorandum No.1 especially emphasizes that if the amount of the over-raised funds which are used by a listed company in a lump sum reaches or exceeds RMB 50 million yuan and 20% of the total amount of the over-raised funds, the prior approval by the general shareholders' meeting shall be obtained.

In addition to the above, the Memorandum No.1 has also given specific provisions regarding information disclosure by listed companies during the different stages of using over-raised funds, which generally reflects the regulatory authorities' intention to tighten the supervision on ChiNext listed companies.

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