Hong Kong Institute of
Certified Public Accountants
香港會計師公會

20 March 2012

By email < bc_03_10@legco.gov.hk > and by post

Our Ref.: C/PAIBLP, M82431

Clerk to Bills Committee on Companies Bill
Legislative Council Secretariat
Room 1010, Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Sir,

Retention of the Headcount Test for Members' Schemes (Clause 664)

In the context of the Draft Companies Bill first phase consultation in 2009/10 the Hong Kong Institute of CPAs supported abolition of the headcount test for members' schemes of arrangements, on the basis that the requirements of Rule 2 in the Code on Takeovers and Mergers ("Takeovers Code") issued by the Securities and Futures Commission ("SFC") provides a reasonable safeguard for the interests of minority shareholders of listed companies; in particular Rule 2.10, which is not commonly found in other jurisdictions, offers useful protection by stipulating that votes cast against the resolution should not be more than 10% of the voting rights attached to all disinterested shares. This is in addition, to the requirement under the same rule that at least 75% of the votes attaching to disinterested shares, cast in person or by proxy at a duly convened meeting, are needed to approve a scheme of arrangement.

We note the results of the previous consultation and the government's position and arguments for retaining the headcount test in respect of members' schemes for listed companies. The government proposes to give the court "a new discretion to dispense with the test in special circumstances, such as where there is evidence that the result of the vote has been unfairly influenced by share splitting". However, we consider that this could create significant uncertainty, especially given that the court's discretion under clause 664 does not seem to be limited in the way indicated above, i.e., to special circumstances. The result of this uncertainty could be to discourage companies from incurring the costs involved a scheme of arrangement, even though the company genuinely believes such a scheme to be in the interests of all shareholders.

We note the government's position that the Takeovers Code is intended to supplement, but not substitute, the statutory protection in Companies Ordinance ("CO"). While the CO requires at least 75% of the voting rights of those voting at the meeting in person or by proxy to agree to the arrangement, this is not limited to disinterested shares. The Takeovers Code thus offers better protection for minority shareholders in listed or public companies where there is a controlling shareholder and it is to the code that minority shareholders should look.

Some of those proposing abolition of the test have also pointed out that a large proportion of shares in listed companies are held by nominees and custodians in the Central Clearing and Settlement System who may hold shares on behalf of

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thousands of shareholders, rather than being registered in the names of individual beneficial owners. This tends to dilute the original purpose of headcount test and result in the outcome being more arbitrary and uncertain. Fundamentally, its operation is different from how it would have been when it was first introduced.

Even if a scripless market is introduced in Hong Kong, it is by no means certain that most shareholders will hold their shares in their own name rather than through nominees.

We suggested previously that, if any additional safeguard is considered necessary for minority shareholders of listed companies, it should be dealt with separately by the Securities and Futures Commission through the Takeovers Code. One area we consider should be looked at is the sanctions for breaches of the code to ensure the sanctions are commensurate with seriousness of non-compliance with the relevant provisions of the Takeovers Code. Another option would be to consider giving statutory backing to the relevant provisions of the code.

In the final analysis, even if the headcount test is removed from the statute, schemes of arrangement will still require the sanction of the court. If the court considers that a particular scheme prejudices the interests of minority shareholders, it can decline to sanction the scheme. This is particularly relevant for private companies, which cannot benefit from the requirements of Rule 2.10 of the Takeovers Code.

In our 2010 submission, on the subject of the headcount test, we mentioned also, and would reiterate here, that, as an additional safeguard, consideration could be given to adding a general provision into the Companies Bill to give aggrieved parties a right to apply to the court where they believe a scheme is prejudicial to the interests of the members generally, or some part of the members.

For the reasons indicated, and subject to the above qualifications, the Hong Kong Institute of CPAs confirms its previous view that the headcount test in relation to members' schemes of arrangement should be removed.

Yours faithfully,

Peter Tisman
Director, Specialist Practices

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