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3 December 2002

Mrs Mary Tang
Bills Committee on
Companies (Amendment) Bill 2002
Legislative Council
Hong Kong

Dear Mrs Tang,

Companies (Amendment) Bill 2002 – Clause 26(c)

Since my letter to you of 16 October 2002, it has come to my attention that in a recent unreported decision of the Companies Court in re Singapore Hong Kong Properties Investment Limited, HCMP 3094/2002 (date of handing down Judgment: 26/11/2002 and copy enclosed), the Companies Judge was clearly under the impression that the present wording of the Bill admits reduction in the par value of the shares notwithstanding that the paid up capital of $756,978,444.08 in that case (based on $30,279,137,763 shares of $0.025 each having been issued and were fully paid as stated in paragraph 4 of the Judgment) has virtually been wiped out based on the amount of the loss of $726,699,306.312 as embodied in the undertaking set out in paragraph 20 of the Judgment. The observations of the Companies Judge on Clause 26(2) of the Bill as appear in paragraphs 26 and 27 of her Judgment clearly justifies paragraph (1) of my criticism as set out on page 5 of my letter to you of 16 October 2002.

Yours faithfully,

Winston Poon, QC

Encl.
cc. The Honourable Mr Justice Rogers, V.P.,
Chairman of the Standing Committee on Company Law Reform

IN THE HIGH COURT OF THE

HONG KONG SPECIAL ADMINISTRATIVE REGION

COURT OF FIRST INSTANCE

MISCELLANEOUS PROCEEDINGS NO. 3094 OF 2002

IN THE MATTER of SINGAPORE HONG KONG PROPERTIES INVESTMENT LIMITED (星港地產投資有限公司)

and

IN THE MATTER of the Companies Ordinance (Chapter 32 of the Laws of Hong Kong)

Before: Hon Kwan J in Court

Date of Hearing: 20 November 2002

Date of Judgment: 20 November 2002

Date of Handing Down Reasons for Judgment: 26 November 2002

REASONS FOR JUDGMENT

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1. This is a petition to confirm a reduction of the capital of Singapore Hong Kong Properties Investment Limited ("the Company"), pursuant to section 59 of the Companies Ordinance, Cap. 32. On 8 October 2002, I have given directions for advertising the notice of this hearing and dispensing with the settlement of a list of creditors. No creditor has appeared at the hearing. At the conclusion of the hearing, I have made an order confirming the reduction and these are the reasons for my judgment.

The background

2. The Company was incorporated in Hong Kong on 11 August 1972 and its name was changed to its present name on 11 October 1972. Its shares have been listed on the Stock Exchange of Hong Kong since 1972. The Company is mainly an investment holding company with operating subsidiaries (collectively "the Group"). The Group is principally engaged in property investment in

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10. For the past two years, the shares of the Company had been trading on the Stock Exchange at prices below their par value of HK$0.025 each. In June 2002, the average trading price of the shares of the Company was HK$0.0039 each. As the par value of its shares exceeds the price at which the shares are traded on the Stock Exchange, the Company may not issue new shares to raise funds as this would be issuing shares at a discount to the par value of the shares, unless, inter alia, the issue is authorised by an ordinary resolution of the members of the Company and is sanctioned by the court under section 50 of Cap. 32.

11. The Company is of the view that it would not be suitable to proceed under section 50 to seek sanction to issue new shares at a discount. There are a number of reasons.

12. Firstly, the Company intends to raise funds mainly by way of rights issues or placements of new shares, which would involve multiple issues of shares at different times. This would involve multiple applications to the court if the application is made under section 50 and there would be a duplication of costs.

13. Secondly and more importantly, in the placement of shares in a listed company, the investor will expect and require that the new shares be allotted to him within a short period of time, say one or two days from the placing agreement, so that depending on the market conditions he may swiftly dispose of the new shares to reap the profit or to minimise loss. If the placement is subject to and conditional upon a successful section 50 application, which has no definite time-table, the placee would need to commit himself to an investment that may or may not proceed and shoulder the risks associated with unforeseen changes to economic conditions and market fluctuations in the interim before the application is heard. By the same token, these concerns would apply to offerees and underwriters of a rights issue. Thus, it is unlikely that any potential investor would be interested in investing in the Company through a placement of new shares if such placement were to be subject to successful section 50 applications by the Company on each occasion.

14. Thirdly, although the directors have identified at least one potential investor, no terms of any issue have yet been agreed. It is not possible at this stage to use the procedure under section 50. Further, even if an application under this section is granted, the investor or investors identified may not proceed at the end of the day and if some other investor is to be found later and a fresh application under 50 is to be made, this would lead to delay.

15. Fourthly, given the financial position of the Company and the current economic situation, and that there is no sign of recovery in the short term, the board of directors considers it is in the best interests of the Company and its shareholders that the Company should actively place itself in a position in which it would be able to obtain an injection of funds as and when required by way of the proposed capital reduction, instead of passively waiting for a section 50 situation to arise and then apply for sanction to issue new shares at a discount. It is only through a permanent par value reduction of the shares that the Company will be given the flexibility to raise funds as and when the need arises.

16. For the above reasons, the Company proposes at this stage to apply for the court's approval of a capital reduction to lower the par value of the shares, so as to obtain capital injection to tide the Company over, pending a fuller investigation of its losses by the new management. It is envisaged that the question of eliminating or reducing the accumulated losses is to be dealt with at a later stage, when the Company is able to prepare and provide a proper accounting analysis of the Group's books and accounts. At present, the directors are not in a position to give a detailed analysis as to whether the accumulated losses or which part of the losses amounted to permanent losses. Most of the senior executives had also resigned when the former chairman resigned in October 2001.

17. I turn to the four requirements that must be satisfied for the court to confirm a reduction of

capital (*Re Lippo China Resources Ltd* [1998] 1 HKLRD 20 at 23J to 24A).

Shareholders treated equitably

18. The proposed reduction affects all the shareholders in the same way by reducing the par value of their shares by identical amounts. This requirement is clearly satisfied.

Proposals for reduction properly explained

19. The proposals have been fully explained to the shareholders in the 1st Circular, which was despatched to them before the extraordinary general meeting on 22 July 2002. The reasons and effect of the capital reorganisation were set out, including why the directors have thought it appropriate to proceed by way of a reduction of share capital instead of issuing shares at a discount.

Safeguarding creditors

20. The proposed reduction does not involve either the diminution of any liability in respect of unpaid share capital or the payment to any shareholder of any paid up share capital. It is not intended at this stage to utilise the credit arising from the proposed reduction of capital to eliminate any part of the accumulate losses. What the Company proposes to do is to create a special capital reserve in its accounts for the credit arising from the proposed reduction and an undertaking has been given by the Company in these terms:

> "forthwith upon the reduction of the capital of the Company confirmed by this Order taking effect, the credit of HK$726,699,306.312 arising as a result of the reduction of the capital of the Company confirmed by this Order will be credited to a special capital reserve in the accounting records of the Company and that so long as there shall remain outstanding any debt of or claim against the Company which, if the date on which the proposed reduction of capital becomes effective were the date of the commencement of the winding up of the Company would be admissible to proof in such winding up and the persons entitled to the benefit of such debts or claims shall not have agreed otherwise, such reserve shall not be treated as realised profits and shall, for so long as the Company shall remain a listed company, be treated as an undistributable reserve of the Company for the purposes of section 79C of the Companies Ordinance (Cap. 32) or any statutory re-enactment or modification thereof PROVIDED that (1) the Company shall be at liberty to apply the said special capital reserve for the same purposes as a share premium account may be applied; and (2) the amount standing to the credit of the special capital reserve may be reduced by the amount of any increase, after the effective date, in the paid up share capital or the amount standing to the credit of the share premium account of the Company as the result of the payment up of shares by the receipt of new consideration or the capitalisation of distributable profits".

21. Further, the Company undertakes that:

> "for so long as the undertaking set out in the previous paragraph hereof remains effective, to (1) cause or procure its statutory auditors to report by way of a note or otherwise a summary of the undertaking in its audited financial statements or in the accounts of the Company published in any other form; and (2) publish or cause to be published in any prospectus issued by or on behalf of the Company a summary of the

undertaking."

22. I am satisfied that the above arrangement and undertaking would give adequate protection to the creditors.

Discernible purpose

23. The court must be satisfied that the proposed reduction is for a "discernible purpose". Discernible purpose in this context means "something which is demonstrated by evidence to the court and is something sufficiently solid and near in expectation to be a real prospect" (*Re Thorn EMI plc* (1988) 4 BCC 698 at 701). There are no limits to the matters which could be said to amount to a discernible purpose and the court has in practice taken a fairly broad view of what amounts to a discernible purpose.

24. As stated earlier, the purpose of the reduction is to reduce the par value of the shares to an amount below the price at which the shares are currently traded on the Stock Exchange, to enable the Company to raise further capital more conveniently. This has been recognised as a discernible purpose to justify giving confirmation to a reduction of capital in *Re Tian An China Investments Co. Ltd* [1998] 2 HKLRD 474 and *Re Cheuk Nang Technologies (Holdings) Ltd* [2001] 4 HKC 571. The only difference in the present case is that the directors see a present need to raise funds by way of rights issues or placements of new shares and seek a reduction of capital to facilitate the exercise, whereas in the previous decisions the companies did not have any present need to raise funds and merely sought to position themselves by obtaining a reduction of capital so that they might be able to act quickly if the need to raise funds by equity financing should arise. I agree with Mr Barma that the practicalities which the companies in the decided cases were concerned with, similar to the matters which the directors of the Company had taken into account in rejecting the alternative to issue shares at a discount, would apply with greater force in the present case, in that there is a real need for reducing capital for this particular purpose.

25. As to whether the proposed reduction would amount to an attempt to circumvent legislative protection under section 50, having considered the evidence before me, and the explanation given to the shareholders in the 1st Circular why this alternative was used instead of issuing shares at a discount, I am satisfied that the reduction was proposed on bona fide grounds for good reasons and that it was not done to circumvent section 50. Under the procedure for confirming a reduction of capital, this would require a special resolution of the shareholders and the sanction of the court, and this would ensure that the interests of creditors and shareholders would be adequately protected.

26. My attention was also drawn to section 26 of the Companies (Amendment) Bill 2002, which adopted the recommendation of the Standing Committee on Companies Law Reform Report, February 2000, Chapter 10, by which section 58 of Cap. 32 is to be amended by adding a provision that no court approval should be required for a capital reduction if the following conditions are satisfied:

(1) the company has only one class of shares;

(2) all issued shares are fully paid-up;

(3) the reduction is distributed equally to all shares; and

(4) the reduction is credited to the share premium account of the company.

27. In the present case, the above conditions are met save that the reduction is to be credited to a special capital reserve instead of to the share premium account. With the undertakings given by the Company, this would appear to make little practical difference. The proposed amendment to section 58 would seem to indicate that the scrutiny of the court should not be required in a situation where the only reduction involved is a re-designation of the par value to a lower amount and there is no distribution out of the company and shareholders are to be treated equitably.

Orders

28. For the above reasons, I have made an order confirming the reduction of capital on the undertakings given by the Company and approved the revised minute submitted to me.

(S Kwan)
Judge of the Court of First Instance
High Court

Mr Aarif Barma, SC and Mr Thomas Au, instructed by Messrs Anthony Chiang & Partners, for the Petitioner.