Comments on Companies (Amendment) Bill 2010

Part 4 – Amendments Relating to Statutory Derivative Actions

1. By the proposed amendments, it is intended to broaden the class of persons who may apply to the Court for leave to bring or intervene a statutory derivative action on behalf of the specified corporation from "a member of a specified corporation" to "a member of a specified corporation or of a related company of a specified corporation".

2. A "related company of a specified corporation" is defined in s.168BA(3) as including (a) a subsidiary of the corporation, (b) a holding company of the corporation or (c) a subsidiary of a holding company of the corporation.

3. As I understand it, a person within category (b) has the right to bring a multiple derivative action under the common law, on the basis that it is the logical extension of the exception to the rule in Foss v Harbottle, which is essentially a "Judge made rule" to ensure that proceedings can be commenced on behalf and for the benefit of the company where there is a "fraud on minority" and the company is under the control of the "wrongdoer". This was the point decided by the CFA in Waddington Ltd v Chan Chun Hoo (2008) 11 HKCFAR 370, FACV 15 of 2007. See also the decision of the Court of Appeal reported in [2006] HKLRD 896 and the Judgment of Barma J in HCA 3291 of 2003, 29 April 2005.

4. The proposed amendment to allow a person within **category (b)** to bring a derivative action on behalf of the specified corporation is consistent with the rationale behind allowing a member of a holding company to bring a multiple derivative action in respect of a wrong done to the subsidiary. It is however not sufficient to address the fact that nowadays it is not uncommon to find that for various commercial reasons, a group of companies is often structured in the way that a number of intermediate holding companies (often wholly owned by the ultimate holding company) are interposed between the ultimate holding company (where different shareholders hold their shares) and the operating subsidiaries (where the real operation and revenue are generated). In fact many listed companies in Hong Kong are structured in this way.

5. The proposed amendment, at it now stands, only entitles a member of the holding company to bring a derivative action on behalf of its "direct" subsidiary. It does not allow a member of a holding company to bring a derivative action on behalf of the "indirect" subsidiaries (i.e. where there are intermediate holding companies interposed between the ultimate holding company and the operating subsidiaries discussed above) which is permissible under the common law.

6. As for the person in **category (a)**, it is difficult to see what is the rationale behind allowing a member of a subsidiary to bring a derivative action on behalf of the holding company. This is not what Waddington decided. While one can see that a shareholder of a holding company has a legitimate interest, albeit indirect interest, in the subsidiary, the converse is not true. It is questionable what legitimate interest a shareholder of a subsidiary has or may have over its holding company.

7. The Administration in its Response dated March 2010 Annex D §7 gives an example where "a holding company whose directors are also the only shareholders of the holding company". Under this scenario, the only persons who have interest in the holding company are its directors and shareholders. No other "outside" or minority shareholders are involved. If the directors of the holding company "misappropriate" the assets of the holding company, no "outside" or minority shareholders would be affected. The only persons who may conceivably be affected are the creditors of the holding company if the holding company is insolvent at the time the "misappropriation" took place. It is none of the concern of the subsidiary as the subsidiary does not have any legitimate interest in the holding company. The situation where a subsidiary has provided security for the holding company's liabilities can be dealt with at the level of the subsidiary. If a member feels aggrieved by the decision of the Board (at the subsidiary level) approving the subsidiary to grant a security in favour of the holding company (whether on the ground that there is no sufficient protection in place to protect the interests of the subsidiary or other ground), he can bring a derivative action (qua member) on behalf of the subsidiary to redress the wrong.

8. It is also difficult to see what is the rationale behind allowing a person within **category (c),** who is a member of an affiliated company of the

specified corporation (the affiliation derived from the fact that both companies have the specified corporation as its common majority shareholder), to bring a derivative action on behalf of the specified corporation.

9. The only relationship between this affiliated company and the specified corporation is that both companies have a common majority shareholder. Under this scenario, it is questionable what legitimate interest a shareholder of an affiliated company can or may have in the specified corporation. Again, this is not what Waddington decided.

10. The Administration described in §§10 to 16 of Annex D the position in other common law jurisdictions. On its face, it is not clear whether what is provided in those jurisdictions is a true multiple derivative action such as the one discussed in Waddington or the what is now proposed by the Bill which, for the reasons set out in §§6-9 above, are not truly "multiple derivative action".

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