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4 May 2010

The Hon Paul Chan
Chairman
Bills Committee on Companies (Amendment) Bill 2010 and
Business Registration (Amendment) Bill 2010
Legislative Council Building
8 Jackson Road, Central
Hong Kong

Dear Mr Chan,

Re: Proposal on "Multiple Statutory Derivative Actions"

Thank you for the invitation to comment on Clauses 14 - 20 of the Companies (Amendment) Bill 2010.

As matters currently stand, and as a result of the Court of Final Appeal's decision in Waddington Ltd v. Chan Chun Hoo Thomas[1], shareholders who wish to bring a multiple derivative action must do so at common law. Those wishing to bring a single derivative action should use section 168BC of the Companies Ordinance as their basis of claim. This is an unsatisfactory state of the law.

We are in favour of the proposed legislative amendments. Corporate structures in group form are common in Hong Kong, and large public companies often conduct their affairs through wholly controlled subsidiaries. A majority of the listed companies in Hong Kong are holding companies and a registered shareholder only holds shares in the listed holding company, and not in their subsidiaries. As such, if the wrongdoing occurs at the subsidiary level, which is commonly the case, a shareholder would have no grounds to launch a derivative action under the statutory regime because he is not a shareholder of the wrongdoing subsidiary.

Minority shareholders have a bona fide interest in the governance of subsidiary companies. Mismanagement of the related subsidiary would affect the minority's financial stake in the holding company. Wrongdoing in a subsidiary causes indirect loss to its parent company and its shareholders.

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[1] FACV 15/2007, 8 September 2008 [2008] HKCU 1381.

The same reasons for statutory enactment of a single derivative action also justify multiple derivative actions; if wrongdoers must not be allowed to defraud a parent company with impunity, they must not be allowed to defraud its subsidiary with impunity. Policy reasons dictate the need to expose wrongdoing in a corporate group where a blind eye has been turned by the management of the parent company.

A statutory regime for derivative actions which extends to subsidiary companies of a specified corporation would act as a deterrent to potential corporate wrongdoing by imposing the threat of liability; if the directors and management know that their actions can be taken to class by a larger class of interested stakeholders, they will, in theory, be deterred from acting without care, in ignorance of the law, or in breach of their duties. Directors would have an incentive to exercise their powers appropriately to discharge their functions in the interests of the company.

On the other hand, a sufficient safeguard has already been built in the system to protect a company from an overzealous minority by requiring leave of the court to bring proceedings, which minimises abuse of process and vexatious litigation.

Enabling minority shareholders to have rights against a subsidiary of the holding company attracts investment to Hong Kong and provides confidence to potential investors that appropriate safeguards are in place for their investments in the event of corporate abuse at the subsidiary level.

I hope members of the Bills Committee will find our comments useful.

Sincerely,

Alex Fong
CEO