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Panel on Financial Affairs

Meeting on 8 April 2010

Background brief on the Companies Ordinance rewrite exercise

Purpose

This paper provides background information on the rewrite exercise of the Companies Ordinance (Cap. 32) (CO) and summarizes the main concerns and views expressed by members when the subject was discussed by the Panel on Financial Affairs (the Panel). The paper also outlines other initiatives being pursued outside the rewrite exercise but involving amendments to the CO.

Background

2. The CO is one of the largest and most complex pieces of legislation in Hong Kong with over 600 sections and subsections and 20 schedules. The last major review of the CO took place in 1984. Since then, there have been amendments from time to time to keep the CO attuned to business needs. The Standing Committee on Company Law Reform (SCCLR)¹ was formed in January 1984 to advise the Financial Secretary on necessary amendments to the CO as and when experience shows such amendments are required.

3. In February 2000, SCCLR published "The Report of the Standing Committee on Company Law Reform on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance". Initiatives to implement the recommendations in the Report have been taken in the context of a series of amendment bills, most notably the Companies (Amendment) Bill 2003

¹ Members of SCCLR include representatives of Securities and Futures Commission, the Hong Kong Exchanges and Clearing Limited and relevant government departments, as well as personalities from the relevant sectors or professions such as accountancy, legal and company secretarial.

and the Companies (Amendment) Bill 2004². At the Panel meeting on 5 July 2004, the Administration advised that a complete rewrite and restructuring of CO was necessary to modernize Hong Kong's company law in light of the experiences of comparable common law jurisdictions and to enhance Hong Kong's competitiveness and attractiveness as a major international business and financial centre.

Organizational framework for the rewrite exercise

4. According to the Administration, in addition to a Joint Working Group between the Government and the Hong Kong Institute of Certified Public Accountants (JWG) which was tasked with reviewing the accounting and auditing provisions in the CO, four dedicated Advisory Groups³ commenced work in phases since October 2006 to review and advise on specific areas of the CO. Recommendations made by the JWG and the Advisory Groups were then considered by the SCCLR, which is the principal body advising the Administration on matters relating to the CO rewrite. A Steering Committee formed within the Administration, chaired by the Permanent Secretary for Financial Services and the Treasury (Financial Services), is responsible for supervising and steering the entire rewrite exercise, examining all major proposals discussed at the SCCLR, the JWG and the Advisory Groups.

5. The Administration has also commissioned an external legal consultant to study and formulate proposals on certain complex areas of the CO, including share capital and debentures, distribution of profits and assets and registration of charges.

The CO rewrite exercise

6. Given the extensive nature of the rewrite exercise, the Administration has adopted a phased approach by tackling the core company provisions which affect the daily operation of live companies in Hong Kong in Phase One. The winding-up and insolvency-related provisions, which are mainly administered by the Official Receiver's Office, will be reviewed in Phase Two of the rewrite exercise⁴.

² The Companies (Amendment) Bill 2003 was introduced to LegCo on 13 June 2003 and was passed on 9 July 2004. The Companies (Amendment) Bill 2004 was introduced to LegCo on 8 October 2004 and was passed on 29 June 2005.

³ The Advisory Groups comprise members nominated by the relevant professional bodies (including Hong Kong Institute of Certified Public Accountants, Law Society of Hong Kong, Hong Kong Institute of Chartered Secretaries, Hong Kong Bar Association, Hong Kong Institute of Directors and Hong Kong Association of Banks) and business organisations (including the Hong Kong General Chamber of Commerce and the Chinese General Chamber of Commerce), company law academics, Standing Committee on Company Law Reform members and representatives from relevant Government departments/agencies.

⁴ As mentioned in the discussion paper prepared by the Administration for the meeting of the FA Panel on 26 February 2009 (CB(1) 678/08-09 (05)), the Official Receiver's Office had started the initial scoping of Phase II of the rewrite in late 2008, with a view to mapping out a more detailed work plan in due course.

7. The Administration conducted three public consultations in 2007 and 2008 to gauge views on the more complex subjects, including -

- (a) accounting and auditing provisions;
- (b) company names, directors' duties, corporate directorship and registration of charges; and
- (c) share capital, capital maintenance regime and court-free merger procedure.

8. The Administration has issued the consultation conclusions for public information and consideration by the SCCLR. The Panel was briefed on the consultation conclusions at its meeting on 26 February 2009.

9. Taking into account the views received, the Administration has prepared draft clauses of the CB for further consultation in two phases. On 17 December 2009, the Administration published a consultation document entitled "Draft Companies Bill First Phase Consultation" to consult the public on 10 parts of the draft CB, which are roughly equivalent to half of the CB. The consultation lasted for three months and ended on 16 March 2010. The second phase of the public consultation will cover the more technical parts relating to share capital and accounting and will be launched within the first half of 2010. The Administration aims to introduce the CB into the Legislative Council (LegCo) by the end of 2010.

Legislative amendments involving the CO but dealt with outside the rewrite exercise

Companies (Amendment) Bill 2010

10. The Administration has separately worked on legislative amendments to the CO ahead of the introduction of the CB to provide for electronic incorporation of companies and filing of company documents, so as to tie in with the development of the Phase II of Companies Registry's Integrated Companies Registry Information System. In this connection, the Administration has also proposed to improve the company name registration system with a view to expediting the company incorporation process and empowering the Registrar of Companies to tackle "shadow companies"⁵. The Administration introduced these amendments into LegCo on 3 February 2010. A Bill Committee on Companies (Amendment) Bill

⁵ "Shadow companies" refer to those companies incorporated in Hong Kong with names which are very similar to existing and established trademarks or trade names of other companies and which pose themselves as representatives of the owners of such trademarks or trade names to produce counterfeit products in Mainland China bearing such trademarks or trade names.

2010 and Business Registration (Amendment) Bill 2010 has been set up to scrutinize the two Bills.

Review of legislative proposals on corporate rescue procedure

11. The corporate rescue and insolvent trading proposals were originally scheduled to be reviewed as part of the Phase Two CO rewrite. With the onset of the global financial crisis and the likely increase in companies facing financial difficulties, the Administration announced in January 2009 that it would adopt the recommendation of the Task Force on Economic Challenges to re-consider the introduction of a corporate rescue procedure, ahead of the schedule of the Phase Two CO rewrite. On 29 October 2009, the Administration launched a three-month public consultation on the subject. Subject to the outcome of the consultation, the Administration plans to issue consultation conclusions in mid-2010.

Possible reforms to the Prospectus Regime in the CO and the Offers of Investment Regime in the SFO

12. With the onset of the recent global financial crisis, SFC submitted a report to the Financial Secretary in December 2008 recommending various measures to restore investor confidence in the financial market, including the need to reconsider whether Hong Kong should retain two public offering regimes in CO and the Securities and Futures Ordinance (Cap. 571) (SFO). On 30 October 2009, SFC published a consultation paper on “Possible Reforms to the Prospectus Regime in CO and the Offers of Investment Regime in SFO” for a two-month consultation to solicit public views on the proposals to align the two regimes by transferring⁶ the regulation of public offers of structured products in the form of debentures from the CO prospectus regime to the regulatory regime under the SFO. SFC plans to publish the consultation conclusions in the second quarter of 2010.

13. As regards the remaining reform proposals, including transferring the whole prospectus regime from the CO to the SFO; changing the regulatory focus of the prospectus regime from the documents containing the offer to the act of offering; and other measures to modernize the regime, SFC aims to issue a consultation paper in the first half of 2011.

Deliberations of the Panel

Discussions in 2004 to 2009

14. The Administration discussed with the FA Panel its proposal to rewrite CO at the meetings on 5 July 2004, 4 July 2005, 7 November 2005, 16 October 2006,

⁶ As a result of this transfer, the safe harbours in the Seventeenth Schedule to the CO will no longer be applicable to the offers of structured products.

7 May 2007 and 26 February 2009. The major views and suggestions given by members include the following -

- (a) the CO rewrite exercise should leverage on the experiences of other common law jurisdictions in company law reforms or reviews, while the unique circumstances of Hong Kong should be fully considered;
- (b) the rewrite exercise should cover issues of wide public concern, such as review of the provisions governing privatization of listed companies, and enhancement of corporate governance of companies through codifying directors' general duties;
- (c) the rewrite exercise should aim at keeping the CO up-to-date to meet present-day circumstances and to improve Hong Kong's business environment; and
- (d) since CO rewrite exercise involves complex legal and technical issues, the Administration should expedite the exercise to allow sufficient time for LegCo to complete scrutiny of the CB before the end of the LegCo term in July 2012.

Discussion on the reform proposals in 2010

15. Following the launch on 17 December 2009 of the first phase public consultation covering 10 Parts or roughly half of the draft CB, the Administration briefed the Panel on the reform proposals contained in the draft CB on 4 January 2010. The major objectives of the reform proposals are: enhancing corporate governance; ensuring better regulation; business facilitation; and modernizing the law. A list of the proposed legislative changes is given in **Appendix I**.

16. The Administration also highlighted the following issues on which the Administration would like to seek more views before deciding on the way forward

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- (a) whether the headcount test⁷ for approving a members' scheme of arrangement or compromise for listed companies, non-listed companies and creditors' schemes should be abolished, retained, or retained but allowed the court to have discretion to dispense with the test;

⁷ The "headcount test" refers to the requirement under section 166 of the CO which provides that, for a compromise or arrangement between a company and its members or creditors to be approved, a majority in number of those who cast votes in person or by proxy at the meeting must have voted in favour of the compromise or arrangement.

- (b) whether the disclosure of residential addresses of directors and identification numbers of directors and company secretaries on the public register should continue;
- (c) whether a private company associated with a listed or public company, such as a private company that is a member of a group of companies which include a listed company, should be subject to more stringent regulations similar to public companies for the purposes of the provisions on fair dealings by directors; and
- (d) whether the common law derivative action should be abolished once the CO has been extended to cover multiple derivative actions⁸.

17. During the discussion on 4 January 2010, Panel members expressed various concerns including the guiding principles for the rewrite exercise, the scope and time frame of the exercise and how far the reform proposals could enhance corporate governance of companies.

Objectives of and guiding principles for the rewrite exercise

18. A member expressed concern that the objectives of enhancing corporate governance and business facilitation might be in conflict with one another. The member also highlighted the need to strengthen protection of investors' interest, and pointed out that many investors had asked for enhancement of the disclosure requirements for listed companies and the legal backing for investors to seek remedies for damages arising from the misconduct of company directors. Investors were also concerned that the senior executives/managing directors of some listed companies were receiving excessive remuneration.

19. The Administration advised that the rewrite exercise aimed at updating and modernizing the legal framework for companies in Hong Kong, so as to facilitate the conduct of business on the one hand and enhance corporate governance on the other. In analysing the views of the public on the proposals, it would take into account the need for facilitating the conduct of business and protecting investors.

20. On the assessment of views collected during the consultation exercise, a Panel member considered that the following principles should be adopted –

- (a) the CO should be in tandem with the corresponding legislation in other international business and financial centres;
- (b) the CO should be able to cater for the needs of the future development of Hong Kong as a business and financial centre; and

⁸ Multiple derivative action allows a member of an associated company of the specified corporation (i.e. the specified corporation's subsidiary or holding company, or a subsidiary of that specified corporation's holding company) to take a statutory derivative action on behalf of the specified corporation.

- (c) where changes to the CO would be conducive to attaining the objectives, the Administration should actively pursue such changes notwithstanding that technical difficulties in implementation were envisaged.

Scope and timeframe of the rewrite exercise

21. A member expressed concern about the progress of the work to amend the legislation on the regulation of structured products, and questioned the co-ordination between the Administration and the relevant regulatory authorities in handling the various reform proposals involving the CO.

22. The Administration affirmed that it had been in close liaison with SFC regarding legislative amendments to the CO and the SFO, and advised that SFC was conducting a separate consultation exercise relating to the regulation of public offerings of structured financial products in Hong Kong. Subsequent to the meeting on 4 January 2010, the Administration provided supplementary information (**Appendix II**) about the progress and timetables regarding the outstanding initiatives of legislative amendments relating to the CO. The Administration has indicated that it plans to introduce a Bill into LegCo within 2010 to give effect to the proposal to transfer the regulation of public offers of structured products in the form of debentures from the CO prospectus regime to the Offers of Investment regime of the SFO.

23. Panel members were concerned whether there would be sufficient time for LegCo to complete the scrutiny of the future CB within the current LegCo term, given the complexity of the legislative changes involved. As the rewrite proposals had been developed since 2006, they might become outdated at the time the CB was introduced into LegCo.

24. The Administration advised that the broad framework for the CB had been formulated based on the outcome of the three topical consultation exercises conducted in 2007 and 2008. The draft provisions of the CB were put forward for public consultation in two phases, with a view to attaining a general consensus on the major proposed provisions and facilitating LegCo to complete scrutinizing the Bill before the end of the current legislative term in July 2010.

Corporate governance

25. A member expressed concern about the governance of charitable organizations, and pointed out that many charitable organizations were incorporated as guarantee companies and some operated as a trust fund. The Administration explained that under the current proposals, guarantee companies would be required to comply with more stringent disclosure requirements regarding their financial situation and submit their financial reports to the Companies

Registry for scrutiny. The Law Reform Commission was also conducting a review of the legislation relevant to the regulation of charitable organizations.

26. On the concern as to how the CB would codify the standard of directors' duty of care, skill and diligence and the sanctions to be imposed, the Administration advised that only general principles were stated in the proposed provisions. Such principles were based on the reasonable expectations of the public and shareholders on the performance of directors of listed and private companies. Similar to the existing arrangement under the common law, any company director who had breached the provisions, if enacted, would be liable to civil litigation actions.

27. On a member's suggestion of safeguarding the interest of small shareholders by allowing them to appoint non-executive directors of companies, the Administration advised that the CO rewrite exercise was not the appropriate forum for dealing with issues purely related to listed companies. The Administration undertook to relay the proposal to SFC for consideration in the review of the SFO.

Business facilitation

28. Regarding the legislative proposals to enable private and guarantee companies to take advantage of the simplified accounting and reporting requirements to save their compliance and business costs, a member expressed concern on whether the public would be adequately consulted and the public interest well protected. The Administration responded that it would liaise closely with the relevant professional bodies to work out the requirements and draw up appropriate provisions in the draft CB for public consultation.

Headcount test

29. Some members expressed concern about the impact on protection of the interest of small investors if the headcount test was abolished. They urged the Administration to work with SFC in reviewing the headcount test arrangements and measures for prevention of vote splitting, making reference to relevant arrangements in other major financial centres. The Administration advised that the SCCLR and the Administration had yet to finalize their stance on the issue. At the Panel's request, the Administration provided supplementary information (**Appendix III**) on the legislative amendments enacted in Australia in 2007 regarding the headcount test arrangements and the latest development.

Disclosure of information on public register

30. Panel members expressed diverse views on whether the disclosure of residential addresses of directors and identification numbers of directors and company secretaries on the public register should continue. Some members opined that the Administration should follow the practices in the United Kingdom to discontinue the disclosure arrangement so that personal data privacy could be

protected. However, a member opined that the disclosure arrangement should continue in order to protect public interest.

Latest development

31. The Administration will update the Panel on the progress of CO rewrite exercise at the meeting on 8 April 2010.

Relevant papers

32. The relevant papers are available at the following links:

Legislative Council Brief on Companies (Amendment) Bill 2010 and Business Registration (Amendment) Bill 2010 (February 2010)
http://www.legco.gov.hk/yr09-10/english/bills/brief/b19_20_brf.pdf

Administration's paper on implementation of the Headcount Test for approving a Scheme of Arrangement or Compromise in Australia (follow up paper) (January 2010)
<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa0104cb1-1004-2-e.pdf>

Administration's paper on the progress and timetable of the reviews and consultations relating to the Companies Ordinance (Cap. 32) (follow up paper) (January 2010)
<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa0104cb1-1004-1-e.pdf>

Administration's paper on "A proposed operational model for implementing a scripless securities market in Hong Kong"
<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa0201cb1-978-5-e.pdf>

Minutes of Panel meeting on 4 January 2010 (Paragraphs 6 to 29)
<http://www.legco.gov.hk/yr09-10/english/panels/fa/minutes/fa20100104.pdf>

Administration's paper on Companies Ordinance rewrite – First phase consultation on the Draft Companies Bill (December 2009)
<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa0104cb1-765-3-e.pdf>

Consultation paper on first phase consultation on draft Companies Bill
(December 2009)

<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa0104cb1-722-1-e.pdf>

Paper on review of corporate rescue procedure legislative proposals
prepared by the Legislative Council Secretariat (Background brief)
(December 2009)

<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/fa1207cb1-527-e.pdf>

Information note on public consultation on the review of corporate rescue
procedure legislative proposals (October 2009)

<http://www.legco.gov.hk/yr09-10/english/panels/fa/papers/facb1-191-1-e.pdf>

Consultation paper on Possible Reforms to the Prospectus Regime in the
Companies Ordinance and the Offers of Investments Regime in the
Securities and Futures Ordinance

<https://www.sfc.hk/sfcConsultation/EN/sfcConsultMainServlet?name=coproandsfoofferinvestregime>

Council Business Division 1
Legislative Council Secretariat
31 March 2010

Main legislative changes in the draft Companies Bill

1. Enhancing Corporate Governance

- (a) codify the standard of directors' duty of care, skill and diligence;
- (b) restrict the appointment of corporate directors by requiring every company to have at least one director who is an individual for the purpose of improving the accountability and transparency of company operations and the enforceability of directors' obligations;
- (c) improve disclosure of company information by requiring public companies and larger private companies to furnish a more analytical and forward-looking business review as part of the directors' report;
- (d) strengthen auditors' rights to obtain information for performing their duties;
- (e) enhance shareholders' engagement in the decision-making process and facilitate their participation through the use of information technology, e.g. introduction of rules to allow electronic communications between a company and its members and permit companies to hold general meetings at two or more places using audio-visual technology; and
- (f) foster shareholder protection by strengthening rules on directors' self-dealing and connected transactions, providing for multiple derivative actions and extending the scope of the unfair prejudice remedy.

2. Ensuring Better Regulations

- (a) introduce electronic incorporation and expedited company name approval process to enable companies to be incorporated within one day⁹;
- (b) empower the Registrar of Companies ("Registrar") to tackle "shadow companies"¹⁰, including acting on court orders to direct such companies to change their names and substituting a company's name by its

⁹ The proposal will be included in the Companies (Amendment) Bill 2010 which is planned to be introduced into the LegCo in early 2010.

¹⁰ These refer to those companies incorporated in Hong Kong with names which are very similar to existing and established trademarks or trade names of other companies and pose themselves as representatives of the owners of such trademarks and/or trade names or produce counterfeit products bearing such trademarks or trade names.

registration number if it fails to comply with the direction to change its name¹¹ ;

- (c) enhance the Registrar's powers to help ensure that the information on the public register is accurate and up-to-date and to obtain necessary information for enforcement;
- (d) streamline those regulations which are outdated and no longer serve any purpose (e.g. removing the share qualification requirement for directors);
- (e) streamline and update the regime of registration of charges; and
- (f) improve the enforcement regime by updating the provisions on company investigations, offences and penalties.

3. Business Facilitation

- (a) allow small private and guarantee companies to take advantage of simplified accounting and reporting requirements so as to save their compliance and business costs;
- (b) allow companies to dispense with AGMs by unanimous members' consent;
- (c) introduce cheaper and less time-consuming court-free procedures for the reduction of share capital and intra-group amalgamation; and
- (d) streamline the buy-back rules for all companies subject to a solvency test.

4. Modernising the Law

- (a) abolish the par value regime and adopt a mandatory system of no-par for all companies with a share capital;
- (b) remove the requirement for authorised capital;
- (c) enable scripless holding and trading of shares and debentures to tie in with the scripless securities market reform (details of which were included in a separate public consultation exercise launched in late 2009);

¹¹ The proposal will be included in the Companies (Amendment) Bill 2010 which is planned to be introduced into the LegCo in early 2010.

- (d) allow electronic communications between a company and its members;
and
- (e) modernise the language and re-draft the statutory provisions in a more logical and user-friendly order.

**The progress and timetable of the reviews and consultations
relating to the Companies Ordinance (Cap. 32)**

<u>Consultation/Review</u>	<u>Progress</u>	<u>Legislative Timetable</u>
1. Consultation on the draft Companies Bill (CB)	<ul style="list-style-type: none">● As part of the Companies Ordinance (CO) rewrite exercise, a three-month first phase consultation on the draft CB was launched on 17 December 2009 and will end in mid-March 2010. The first phase consultation covers roughly half of the draft CB.	<ul style="list-style-type: none">● The Administration aims to introduce the CB into LegCo by the end of 2010.

<u>Consultation/Review</u>	<u>Progress</u>	<u>Legislative Timetable</u>
	<ul style="list-style-type: none"> ● The second phase consultation will be launched in March 2010. 	
<p>2. Consultation Paper on Possible Reforms to the Prospectus Regime in the CO and the Offers of Investments Regime in the Securities and Futures Ordinance (SFO)</p>	<ul style="list-style-type: none"> ● Regarding the proposal to transfer the regulation of public offers of structured products in the form of debentures from the CO prospectus regime to the Offers of Investments regime of the SFO, the SFC has conducted a two-month consultation, which ended on 31 December 2009. <p>The SFC has received 13 submissions from market</p>	<ul style="list-style-type: none"> ● The Administration intends to introduce the bill into the Legislative Council within this year, to amend relevant provisions of the CO and SFO to give effect to the proposal to transfer the regulation of public offers of structured products in the form of debentures from the CO prospectus regime to the Offers of Investments regime of the SFO.

<u>Consultation/Review</u>	<u>Progress</u>	<u>Legislative Timetable</u>
	<p>participants. In general, the market is supportive of the proposed transfer, with comments on certain specific aspects. The SFC will revise the proposal as appropriate having regard to the comments received and submit its recommendations to the Administration for consideration, with a view to publishing the consultation conclusions in Q2 2010.</p>	

<u>Consultation/Review</u>	<u>Progress</u>	<u>Legislative Timetable</u>
	<ul style="list-style-type: none">● As regards the remaining reform proposals (including transferring the whole prospectus regime from the CO to the SFO; changing the regulatory focus of the prospectus regime from the documents containing the offer to the act of offering; and other measures to modernize the regime), the SFC aims to issue a consultation paper in the first half of 2011.	

<u>Consultation/Review</u>	<u>Progress</u>	<u>Legislative Timetable</u>
<p>3. Joint Consultation Paper on the Development of a Scripless Securities Market in Hong Kong</p>	<ul style="list-style-type: none"> ● The 3-month consultation on the proposed operational model for implementing a scripless securities market in Hong Kong was launched jointly by the Securities and Futures Commission, Hong Kong Exchanges and Clearing Limited and the Federation of Share Registrars Limited on 30.12.2009 until 31.3.2010. 	<ul style="list-style-type: none"> ● As a first step, technical amendments will be introduced to the CO, as part of the Companies (Amendment) Bill 2010, to provide exceptions to limitations arising from provisions that compel the use of paper certificates and instruments of transfer. These technical legislative amendments aim to facilitate the market to focus discussions on the proposed operational model for implementing a scripless securities market in

<u>Consultation/Review</u>	<u>Progress</u>	<u>Legislative Timetable</u>
		<p>Hong Kong, which is the subject under consultation at present.</p> <p>These will also lay the foundation for implementing a scripless securities market in Hong Kong.</p> <ul style="list-style-type: none">● Further amendments – including to the SFO and the CO – will be needed to provide for the regulation of the scripless environment and those that play a key role in that environment. These amendments will need to take into account the

<u>Consultation/Review</u>	<u>Progress</u>	<u>Legislative Timetable</u>
		operational model that is eventually agreed upon.

**Information on the
Implementation of the Headcount Test for
Approving a Scheme of Arrangement or Compromise in Australia**

Background

In Australia, in order to tackle the problem of share splitting by parties opposing a scheme, section 411(4) of the Australia Corporations Act 2001 (ACA) was amended in December 2007 to give the court a discretion to approve a members' scheme if it was approved by a 75 percent majority in value even though approval by a majority in number of those members present and voting at the scheme meeting was not obtained. The reasons for the amendment, as stated in the Explanatory Statement to the Exposure Draft of the Corporations Amendment (Insolvency) Bill 2007, were that:

“A members’ scheme could be defeated by parties opposed to the scheme engaging in ‘share splitting’, which involves one or more members transferring small parcels of shares to a large number of other persons who are willing to attend the meeting and vote in accordance with the wishes of the transferor. By splitting shares to increase the number of members voting against the scheme, an individual or small group opposed to the scheme may cause the scheme to be defeated. This may occur even though a special majority is achieved in terms of voting rights attaching to share capital, and if the

share split had not occurred, the majority of members were in favour of the scheme.”

2. Prior to the amendment, the court’s discretion was limited to either approving or rejecting a scheme that had met both the headcount test and the share value test. The amendment retains the headcount test “unless the Court orders otherwise” and thereby gives the court a discretion to dispense with the headcount test or disregard the outcome of the test. The share value test and the court’s general discretion to reject or amend a scheme approved by shareholders remain intact.¹

3. The ACA does not qualify the discretion given to the court to dispense with the headcount test. However, the Explanatory Memorandum on the amendment indicated that the principal concern is the increase of influence of certain persons under the headcount test by share splitting. The Explanatory Memorandum stated that —

“It is intended that the court would only exercise the discretion to disregard the majority vote under [the headcount test] in circumstances where there is evidence that the result of the vote has been unfairly influenced by activities such as share splitting, however the court’s discretion has not been limited to allow for unforeseen extraordinary circumstances.”

¹ The amendment to section 411(4)(a)(ii)(A) of the ACA added the words “unless the Court orders otherwise” at the beginning of sub-paragraph (A) so that sub-paragraph (A) reads as follows :-
“(A) unless the Court orders otherwise – passed by a majority in number of the members, or members in that class, present and voting (either in person or by proxy)”.

Latest development

4. Our research does not reveal any Australian cases ruling directly on or having elaborate discussion of the court's discretion in dispensing with the headcount test pursuant to the amended section 411(4) of the ACA. However, in making an enquiry with the Australian Corporations and Markets Advisory Committee (CAMAC), we note one possible case for the exercise of the judicial discretion as mentioned in the case *pSivida Limited v New pSivida, Inc* ([2008] FCA 627 at [11] – [12]) where a single shareholder held 53 percent of the total issued share capital on behalf of a very large number of beneficial owners and that shareholder could have been outvoted under the headcount test. The court observed that in such situation, the plaintiff, being the applicant for the court's approval of the scheme, may wish to ask the court to exercise discretion under the amended section 411(4) of the ACA to dispense with the headcount test.

5. In June 2008, a discussion paper on "Members' Schemes of Arrangement" was issued by CAMAC to invite public views on the review of various matters relating to members' schemes of arrangement including whether the headcount test should be amended or repealed. According to the Discussion Paper, there is no known instance where a proponent has succeeded under share value test, but failed to obtain a majority under the headcount test. However, there is anecdotal evidence that in some cases a decision was taken not to embark upon a scheme because of the possibility of an adverse headcount vote. The consultation period for the Discussion Paper ended by the end of September 2008. We understand from CAMAC that the report of the consultation conclusion will be published at around end of January 2010.