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Date: 14 March 2012

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

By Fax 2840 0797 and By Post

Dear Sirs

Invitation for submissions on the retention of the headcount test for members' schemes

We are in favour of abolishing the headcount test for **members' schemes of listed companies**.

Our reasons include those set out in paragraph 2 below, but we wish to point out in particular the differences we note between the Hong Kong and the UK situations in paragraph 1 below.

1. Hong Kong should not follow the UK headcount test regime

For those proposing to retain the headcount test under the Companies Ordinance, much had been said about the UK's decision in 2006 not to adopt the recommendation of the UK Company Law Review Steering Group to abolish the headcount test and, therefore, Hong Kong should not venture to do so.

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On reviewing the House of Lords Hansard which recorded the discussions at the time in 2006, Lord Goldsmith, who opposed the proposal in the UK to abolish the headcount test, noted that he had no evidence of share splitting and that none was presented to him. Lord Sharman, who supported abolition of the headcount test, pointed out that the test was superfluous and in practice can result in a scheme being blocked, even when the holders of an overwhelming majority of the shares are in favour of it going ahead. Unfortunately, Lord Sharman was not able to present any evidence of share splitting in the UK at the time. Lord Goldsmith concluded that "theoretical possibility is not a good enough reason to do away with the protection which this provides".

However, share splitting is not a theoretical possibility in Hong Kong. The Hong Kong market profile is quite different from that of the UK. In SFC's submission to the Consultation, it referred to its interventions in relation to suspected manipulation in the proposed privatisation of PCCW and the privatisation of Chinese Estates Holdings Limited. It is not known how many incidents of share splitting there had been in Hong Kong. It is clear however that very substantial resources of the SFC, law enforcement agencies and the courts had been spent in dealing with the two cases intervened by the SFC.

There are at least two other features which distinguish the Hong Kong regime from the UK regime:-

- (a) jurisdictions like the UK and Australia have implemented a scripless market, to different degrees, and have a higher percentage of publicly traded shares being held by institutional investors than in Hong Kong, which make the headcount test less of a concern in the UK and Australia; and
- (b) Hong Kong has the additional safeguard for minority shareholders provided under Rule 2.10(b) of the Takeovers Code – this safeguard is not provided in other jurisdictions adopting similar takeovers and mergers rules such as the UK, Australia and Singapore.

For the above reasons, we believe that the markets and regimes in Hong Kong and the UK are very different, and that Hong Kong should not follow the UK headcount test regime.

2. We also support the following reasons for abolishing the headcount test

- (a) the headcount test deviates from the fundamental "one share one vote"

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principle in other Companies Ordinance provisions dealing with shareholder meetings;

- (b) rather than acting as an additional protection to the minority (in the case of a takeover or privatization in Hong Kong the minority comprises *the independent minority shareholders* who are independent from the offeror), the headcount test places disproportionate veto power in the hands of a small number of shareholders and prejudices the interests of the independent minority shareholders as a whole;
- (c) the headcount test requirement attracts attempts to manipulate the outcome of the vote by share splitting, which can be for or against a scheme. Coupled with the typical low attendance of shareholder meetings in Hong Kong, results of headcount tests can be manipulated easily and cheaply; and
- (d) the headcount test is not indicative of the decisions of the beneficial owners of the shares since a very large proportion of shares in listed companies are held by nominees and custodians.

An overwhelming majority of the responses to the FSTB consultation (86%) favors abolition of the headcount test, including responses from professional bodies such as The Law Society, the Bar Association and the Hong Kong Institute of Certified Public Accountants. The proposal is part of the complete rewrite and restructuring of the Companies Ordinance which was last substantially reviewed and amended in 1984, nearly three decades ago. It would be a great pity if the legislature does not seize the opportunity now to make the change.

We urge the Bills Committee on Companies Bill to consider abolishing the headcount test.

A copy of this submission in Chinese will be provided to you for your reference.

Yours faithfully



Woo Kwan Lee & Lo