

Bills Committee on Companies Bill

Supplementary Information in relation to headcount test

Purpose

This paper sets out the supplementary information in relation to the headcount test requested by Members at the meeting on 30 May 2012.

Procedures for Sanctioning a Scheme of Compromise or Arrangement

2. Members sought information on the procedures involved for a scheme of compromise or arrangement (“scheme”) to be sanctioned by the court. In this regard, we anticipate that our proposal to adopt the 10% objection rule to replace the headcount test¹ would not alter the current procedures for sanctioning a scheme. The procedures would involve the following –

Under Companies Ordinance

- (a) an application, usually by the company ex-parte, is made to the court for an order that a meeting be summoned;
- (b) members holding at least 75% in value of the holdings of those present and voting in person or by proxy vote in favour of the scheme;
- (c) the number of votes cast against the resolution to approve a scheme of arrangement is not more than 10% of the votes attached to all disinterested shares (new test under our proposal);
- (d) the scheme, having passed the tests under (b) and (c), may be sanctioned by court.

¹ See LegCo Paper No. CB(1)2019/11-12(02).

Under the Takeovers Code issued by the Securities and Futures Commission

3. Apart from the tests under (b) and (c) above, any person who seeks to use a scheme to acquire or privatise a listed company must also comply with the Code on Takeovers and Mergers (“Takeovers Code”) issued by the Securities and Futures Commission (“SFC”). Under the Takeovers Code, there are requirements to protect the interests of minority shareholders, including:

- (a) under Rule 2 of the Takeovers Code, an independent board committee comprising all non-executive directors who have no conflict of interest in the scheme has to be established to give advice to disinterested shareholders about its recommendation of voting. The independent board committee would seek advice from an independent financial adviser who will set out its recommendation and the details of its analysis of the merits of the scheme in its letter to the independent board committee reproduced in the scheme document; and
- (b) Rule 2.10(b) of the Takeovers Code stipulates that the number of votes cast against the resolution shall not be more than 10% of the voting rights attached to all disinterested shares, i.e. shares not held by the controlling shareholders or their concert parties. This requirement, which renders an additional safeguard for minority shareholders, is not provided in other jurisdictions adopting similar rules on takeovers and mergers such as the UK, Australia and Singapore.

4. A table summarising the procedures is at **Annex** to facilitate Members’ perusal.

5. It is a requirement in the Takeovers Code that an offer document must be submitted to the Takeovers Executive of SFC for review and comment before it is sent to shareholders. The Takeovers Code requires that the offer document should include as conditions of the acquisition or privatization the compliance with the statutory requirements (e.g. requirements in the Companies Ordinance) and the requirements under the

Takeovers Code. With these conditions included in the offer document, failure to comply with the various requirements will mean that a proposed scheme cannot take effect. In practice, the court's sanction of a scheme will only be sought after all the statutory requirements and the requirements under the Takeovers Code have been met.

Costs of Legal Action in Challenging a Scheme

6. Members were concerned that minority shareholders might be reluctant to challenge a scheme in court because of the potential legal costs.

7. The court has a wide discretion to award costs. Section 52A of the High Court Ordinance (Cap 4) provides that subject to the rules of court, the costs of proceedings in the Court of Appeal in its civil jurisdiction and in the Court of First Instance shall be in the discretion of the Court, and the Court shall have full power to determine by whom and to what extent the costs are to be paid. Normally the Court will order costs to follow the event, except when it appears to the Court that in the circumstances of the case some other order should be made as to the whole or any part of the costs (see Order 62 rule 3 of the Rules of the High Court (Cap 4A)).

8. In *Re Peninsular and Oriental Steam Navigation Co* [2006] EWHC 3279, the court accepted that, for schemes of arrangement, special rules were developed by the courts displacing the ordinary approach of the successful party getting its costs from the unsuccessful party. The objective of the special rules was to ensure that cases can be dealt with justly, having regard to the need to avoid discouraging shareholders and creditors affected by schemes from appearing at the hearing and pointing out matters to which the attention of the court may properly be drawn. For example, in the *PCCW* case (HCMP 2382/2008), Hon Kwan J referred to a dicta in the case of *Re Peninsular and Oriental Steam Navigation Company* and pointed out that “the courts do not, as a rule, make costs order against objecting shareholders... when their objections are not frivolous and have been of assistance to the court”. We believe it is clear under common law that the court does not, as a rule, make a costs order against shareholders objecting to a scheme when their objections are not frivolous and have been of assistance to the court.

9. Turning to the question whether the court ought to make a costs order in favour of the objecting shareholders against the company, it is to be decided on a case by case basis in accordance with what the justice of the case demands.

10. Indeed, in the *PCCW* case (HCMP 2382/2008) Hon Kwan J “...decide to exercise my discretion to order the costs of the shareholders be borne by the Company... I do this for three reasons:

- (1) these are shareholders whose shares are being compulsorily acquired. They are not merely interested parties who objected out of commercial interests;
- (2) the principal objections raised are well-founded in the sense that they required careful consideration and raised points of importance; and
- (3) the court has been assisted by the submissions made by the objectors.”

11. Based on the above, there have been established precedent cases that are clear and more favourable to shareholders objecting to a scheme of arrangement.

Voting by Nominees under the Headcount Test

12. Noting that a vast majority of investors have chosen to hold their shares within the Central Clearing and Settlement System (“CCASS”) through their brokers, banks and custodians in Hong Kong, Members sought information on how nominees would vote in a proposed scheme under the current headcount test. In this regard, shares held within CCASS are registered in the name of HKSCC Nominees Limited. Past experience is that many beneficial owners chose not to express their views. As HKSCC Nominees Limited is only one registered shareholder of the listed company, technically it will only be considered as having one vote. In practice, however, as has been the case for a majority of shareholders’ meetings held in the past, because the vote submitted by HKSCC

Nominees Limited contains a certain number of shares in favour of a scheme and a number of shares opposing a scheme, HKSCC Nominees Limited will usually be considered as having voted one vote in favour of the scheme and one vote against the scheme for the purpose of the headcount test. This is not reflective of the interests of individual beneficial owners of shares.

The Regime in Canada

13. At the Federal level, under the Canada Business Corporations Act, there is no headcount test for the approval of an arrangement. We have also checked the company legislation in British Columbia, Ontario, Alberta and Quebec and there is no headcount test for arrangement with shareholders in these jurisdictions.

Advice Sought

14. Members are invited to note the contents of the paper and provide their views.

**Financial Services and the Treasury Bureau
Companies Registry
30 May 2012**

**Scheme involving a Takeover Offer or General Offer –
Thresholds under the Companies Bill and the Takeovers Code**

| Companies Bill / Takeovers Code | Test | Threshold |
|--|--|--|
| CB Clause 664A(2)(a)(i) and 664A(2)(b)(i) | Share value | 75% in value of the members or the relevant class, of those present and voting in person or by proxy at the meeting of members. |
| CB Clause 664A(2)(a)(ii) and 664A(2)(b)(ii) (with proposed revision) | No substantial objection of disinterested minorities | Number of votes cast against the scheme not more than 10 % of the votes attaching to all disinterested shares. |
| Takeovers Code Rule 2.10 | Share value | 75% of the votes attaching to the disinterested shares that are cast either in person or by proxy. |
| Takeovers Code Rule 2.10 | No substantial objection of disinterested minorities | Number of votes cast against the scheme not more than 10 % of the votes attaching to all disinterested shares. |
| CB Clause 664(1) and (3) and case law | Court sanction | In exercising its power of sanction the court must be satisfied with the following matters: (a) compliance with the statutory provision; (b) the meetings were properly constituted (with class meetings held where required); |

| Companies Bill / Takeovers Code | Test | Threshold |
|--|-------------|--|
| | | <ul style="list-style-type: none"> <li data-bbox="754 353 1439 488">(c) the meetings were duly convened in accordance with the directions given by the court; <li data-bbox="754 528 1439 801">(d) the members were given sufficient explanation of the scheme and its effect and sufficient information to enable them to make a reasonable judgment as to how to vote at the meeting; <li data-bbox="754 842 1439 927">(e) the requisite approvals were given at the meetings; <li data-bbox="754 967 1439 1196">(f) the class of members is fairly represented and the statutory majority are acting bona fide and not coercing the minority in order to promote interests adverse to those of the class; <li data-bbox="754 1236 1439 1420">(g) the scheme may reasonably be approved by an intelligent and honest man of that class acting in respect of his interest; and <li data-bbox="754 1460 1439 1594">(h) if the scheme involves a reduction of capital, the reduction must be for a discernible purpose. |