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31 May 2001

Hon Henry K C Wu
Member of the Legislative Council
Room 420, West Wing
Central Government Offices
Hong Kong

Securities (Disclosure of Interests) Ordinance ("SDIO")

Thank you for your letter of 19 February 2001 which raised a number of issues relating to the application of section 18 of the SDIO and the relevant provision under Part XV of the Securities and Futures Bill (SF Bill). As the same issues and a number of related issues were also discussed at the meeting of the Bills Committee on the Securities and Futures Bill and Banking (Amendment) Bill 2000 on 21 May 2001, we believe it would be useful to set out further information to supplement our responses made at the meeting.

Rationale for empowering listed companies to conduct investigation

Section 18 of the SDIO enables a listed company to commence an investigation to discover the true identity of persons having an interest in its shares. Under section 21 of the SDIO shareholders who together control 10% or more of the shares of a listed company can also require a listed company to commence an investigation under section 18. These powers are similar to the law in other jurisdictions and have been in force in Hong Kong for over 10 years.

The powers are necessary because blocks of shares are often held in the names of nominees, or companies, so that the identity of the persons having an interest in the shares of a listed company is concealed. Another reason for vesting the powers is to combat the secret acquisition of shares in a listed company through "warehousing," where a number of parties act in

concert each acquiring an interest in shares in the company through nominees. Each of the separate interests acquired is below the threshold level for disclosure of holdings. The aim of the parties may, for example, be to influence company policy or to build up a substantial holding in a company prior to making a takeover bid. Generally speaking, warehousing would be reduced by dropping the threshold for disclosure, by reducing the period for notification and by empowering a company to investigate the economic interests of its shares. The courts in Hong Kong, the UK and Australia have all recognized the importance of these powers, as illustrated in the following cases.

The courts in the UK have stated the purpose of the disclosure provisions (referring to the Companies Act 1981) in the following terms –

> " . . . the clear purpose of Part IV of the 1981 Act is to give a public company, and ultimately the public at large, a prima facie unqualified right to know who are the real owners of its voting shares." *(see Norse J re F.H.Lloyd Holdings Plc. [1985] BCLC 293)*

Specifically on the powers given to a company to investigate ownership the courts in the UK have explained that the powers are needed –

> " to counter the limitless ingenuity of persons who prefer to conceal their interests behind trusts and corporate entities" *(see re TR Technology Investment Trust plc [1988] BCLC 256)*

In Hong Kong Mr Justice Rogers in *A-G v. Killenny Ltd. [1994] 3 HKC 314 at page 318* used the expression "The Financial Secretary and ultimately the public at large have a right to know the real owner of the shares" adopting to the words of Nourse J and applying them to the SDIO.

The court in Australia said this of the comparable Australian provisions –

> " The purpose of the legislation . . . is to promote an informed market for the shares in public companies, and to prevent substantial transactions on an uninformed market. A practical means adopted for effecting this purpose is to compel disclosure of ultimate control of purchased shares by compelling disclosure of all links in the chain between the purchaser on the record and the person who controls the shares purchased, and requiring registration of the facts disclosed."*(Re North Broken Hill Holdings Ltd.(1986) 4 ACLC 131)*

In the *North Broken Hill* case the ultimate beneficial owner had amassed a holding of over 78,000,000 shares of North Broken Hill representing over 17% of the issued capital, using a large chain of nominee companies "to obfuscate inquiry into the true ownership of the shares while it brought up large parcels of shares on an uninformed market."

These cases indicate that the powers to conduct an investigation under section 18 of the SDIO (or clause 320 of the SF Bill) are resorted to when a listed company is concerned that someone is seeking to build up a controlling interest and whether there has been a breach of the Takeovers Code. Apart from the listed company on its own volition, holders of 10% of the shares in a listed company can also call for an investigation (section 21 of the SDIO or clause 322 of the SF Bill). For example, they may do this to establish whether a person is a substantial shareholder because a transaction between a listed company and substantial shareholder is a notifiable transaction under the Listing Rules and for compliance with the Takeovers Code.

Reasonable time

As regards what constitutes a "reasonable time" for responding to a request for information by the listed company concerned, we consider that the period must be determined in the light of all of the circumstances. Generally speaking, we envisage a longer period should be given for the provision of information which requires more time to research into the archives. The time given will depend upon the amount of information sought, whether the information sought relates to past interests as well as current interests, the identity of the recipient, the location of the recipient, the urgency to the company and any other matters bearing on the ability of the recipient to respond *(see Palmer – Company Law page 7053 - Re Lohnro plc (no.2) [1989] BCLC 309).*

In drafting the SF Bill, we have considered whether to specify any particular period within which the information requested by the listed corporation should be provided. However, there is a risk that this period may be taken as appropriate in all circumstances. On balance we think that the interests of the parties are best served by retaining the protection and flexibility that the current provision affords them. What period is reasonable must be considered in the light of all of the circumstances.

Clause 320 of the SF Bill imposes a 3-year limit on the information that can be sought after in an investigation (same as under section 18 of the SDIO). Section 212 of the UK Companies Act (identical to section 18

of the SDIO) also contains a 3 year-limitation on the period that can be covered by an investigation. The equivalent provisions in the Australian legislation however contain no limitation on time.

A reasonable period of time must be allowed as it may take some years for concert parties to build up a sizeable stake in a target listed company and it will be necessary for the listed company to investigate transactions over a period of years. In addition, it may take some time for an investigation to be completed. In the *North Broken Hill* case the chain was specifically set up in such a manner as to delay an investigation.

We should add that there are also two safeguards against abuse of these provisions by a listed company. First, the company's only remedy for failure to comply with a notice issued is for it to apply to the court for restrictions to be imposed on the shares in which the person to whom the notice is addressed is interested. The court would not exercise its discretion to impose restrictions unless it was satisfied that this was appropriate and that a reasonable period had been given to comply with such a notice. Second, it is a defence to any criminal proceedings for a person to whom a notice is addressed to show that the requirement to give the information was frivolous or vexatious.

Reimbursement of cost

There is no provision in the SDIO, or in the equivalent provisions in the UK, for reimbursement of expenditure incurred by either the listed company (conducting an investigation of its own initiative, or at the request of minority shareholders) or the persons to whom notices are addressed. If a company had to reimburse expenses incurred by persons to whom notices were sent, then the question arises as to who should bear the costs of the investigation, whether it should be the shareholders generally or the persons whose actions (i.e. failure to disclose) prompted the investigation. As we mentioned at the Bills Committee meeting on 21 May, we certainly need to strike a reasonable balance between (a) empowering the listed company to discover the true identity of persons having an interest in its shares without subjecting it to hefty costs and complex procedures; and (b) protecting persons requested to provide such information against abuse by the listed company. We are prepared to consider the need for building extra safeguards into the process of making requests, having regard to the experience in Australia and the UK, on which the SDIO is based. We shall share our findings with the Bills Committee in the clause-by-clause examination.

We have taken the liberty to copy this letter to the Clerk to the Bills Committee as the issues have also been discussed at the Bills Committee meetings. We should be grateful if the Clerk to the Bills Committee could help circulate this letter to other Bills Committee Members for their information.

Yours sincerely,

(Miss Vivian Lau)
for Secretary for Financial Services

c.c. C/SFC
CE/HKEx
Mrs Florence Lam, Clerk to Bills Committee on Securities and Futures Bill and Banking (Amendment) Bill 2000