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5 February 2004

Clerk to Bills Committee on
Companies (Amendment) Bill 2003
Legislative Council Building
8 Jackson Road
Central
Hong Kong

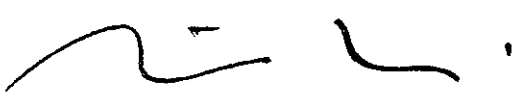
Attn: Ms Anita Sit

Dear Madam,

Schedule 4 to the Companies (Amendment) Bill 2003 – amendments to the Companies Ordinance in relation to shareholders' remedies

Further to the letter to you dated 12 January 2004 from Ms Linda Chan, Mr Godfrey Lam and me expressing our views on the above-mentioned Bill, I am enclosing herewith a copy of my letter to Ms Shirley Lam, Principal Assistant Secretary for Financial Services and the Treasury, of today in respect of another provision in the Bill which, I trust, is self-explanatory. I would be grateful if you could pass it onto the Chairman of the Committee for consideration.

Yours sincerely,



Winston Poon, SC

WP/dc

Encl.

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Ms Shirley Lam
Principal Assistant Secretary for
Financial Services and the Treasury
(Financial Services)
Financial Services and the Treasury Bureau
Government of the Hong Kong
Special Administrative Region
18/F, Tower 1, Admiralty Centre
18 Harcourt Road
Hong Kong

BY FAX & LETTER

Dear Ms Lam,

Sub-section (2) of proposed section 168BB in paragraph 5 of Schedule 4 to the Companies (Amendment) Bill 2003 – statutory derivative action brought in the name of the company

Thank you for coming to my chambers yesterday afternoon with your colleagues. Linda, Godfrey and I hope that our exchange of views on the contents of our letter of 12 January 2004 to the Clerk to the Bills Committee at Legco will serve to clarify at least some of our concerns about the Bill.

Thinking over the matter again last night, another major defect in one of the proposed provisions governing derivative action

occurred to my mind and I feel compelled to draw this to your attention and that of the Bills Committee. Hence a copy of this letter will be copied to the Clerk to the Committee.

Sub-section (2) of the proposed section 168BB in paragraph 5 of Schedule 4 to the Bill empowers a member of a specified corporation to bring proceedings "in the name of the specified corporation." This is wholly different from the common law position in which the minority shareholder himself will be the plaintiff and the relevant corporation will be joined as a nominal defendant for the purposes of discovery of documents and other interlocutory matters and it is not expected that it will take any or any active part in the proceedings, particularly at the trial of the action. One of the advantages of the common law position as compared to the proposed section 168BB(2) in this regard is that the company, which has to be represented by legal advisors independent of the plaintiff and the wrongdoer defendants, will have to comply with Order 24 of the Rules of High Court by producing all documents in its possession, custody or power which relate to the subject-matter of the claim. Moreover, as the minority shareholder is a party to the action, the Court will be able to award costs in favour of or against him.

If proceedings are brought in the name of the company as suggested in the provision, the existing procedures for discovery and inspection of documents will be unworkable since the minority shareholder has neither possession nor custody of nor power to gain access to any of the corporate documents because, as a matter of law, a shareholder *per se* is not entitled to any corporate property, including its documents. The wrongdoer

defendant, who may be a director or the majority shareholder or both, is not entitled to have access to the corporate documents for his own benefit, namely, defending himself in the action. One wonders how a trial can be conducted without any relevant documents.

In addition, bearing in mind the substantial costs involved in derivative actions, if a minority shareholder who brings the action on behalf of the company is not a party to the proceedings himself, the Court has no power to award or penalize him in costs. By allowing the minority shareholder to be an additional plaintiff will not solve this conundrum either as it is part of the common law that all plaintiffs must be represented by the same firm of solicitors and counsel. It would be wrong for the solicitors as agent for the minority shareholder, who are also the solicitors for the company, to conduct a roving expedition in the company to search for the relevant documents. Accordingly, if the proposed sub-section remains as it is, it appears to me that a new set of civil procedures will have to be invented for the sole purpose of this statutory cause of action.

Linda, Godfrey and I fully appreciate and are in entire agreement with your view that it is extremely difficult, if not impossible, to codify derivative action which, by itself, is one of the major topics of company law embodied in a substantial volume of case laws developed over a century and a half. Whilst the recommendation of the Standing Committee on Company Law Reform to codify this branch of the law is most laudable, unless the wording in the Ordinance is clear and can be understood by the general public no useful purpose will be served by putting this form of action on

the statute book as the remedy has already existed in common law. As an example of one of the difficulties involved, as we both agreed yesterday the word "fraud" in the exception to the Foss v Harbottle rule, which is an essential ingredient to the claim, is a term of art acquiring a meaning which is not apparent even to non-specialist lawyers, let alone the general public. If the wording of a statute does not mean what it says and the enactment itself is not user-friendly, one begins to question the merit of the legislation. It may well mislead the public and result in a proliferation of litigation. Coupled with the procedural obstacles introduced by the rest of the provisions such as the requirement for service of notice and the creation of additional grounds for striking out, the use of the statutory derivative action in its present form is highly questionable since mounting a derivative action under common law is a much simpler, cheaper and speedier remedy.

Yours sincerely,

Winston Poon, SC

WP/dc

cc. Ms Anita Sit, Clerk to Bills Committee on Companies (Amendment) Bill 2003
Mr Godfrey Lam, Barrister
Ms Linda Chan, Barrister