THE HONG KONG INSTITUTE OF COMPANY SECRETARIES
香港公司秘書公會

Secretary for Financial Services and the Treasury
Financial Services Branch
Financial Services and the Treasury Bureau
18th Floor, Admiralty Tower 1
18 Harcourt Road
Hong Kong

Attention: Ms Shirley Lam

Your Ref.: C2/1/57/3(04) Pt.7

5 April 2004

By Fax 2528 3345 & By Post

Dear Sir,

Consultation Paper on Statutory Derivative Action in the Companies (Amendment) Bill 2003

Thank you for your letter of 22 April enclosing the consultation paper and inviting the Institute to make a submission.

I have pleasure in enclosing the Institute's position paper.

Yours sincerely,

Linda Wong
Director, Professional Development

Encl.

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香港公司秘書公會
(以有限責任形式成立)
特許秘書及行政人員公會

ICSA

Response to the Financial Services and the Treasury Bureau on the Consultation Paper on Statutory Derivative Action in the Companies (Amendment) Bill 2003

The Hong Kong Institute of Company Secretaries ("HKICS") supports, in principle, the protection of shareholders interests by the introduction of measures to improve their rights to take action against a company where their interests are being compromised and submits below its comments on the introduction of statutory derivative action ("SDA") in the Company (Amendment) Bill 2003 ("the Bill").

The Bill as currently drafted permits a member of a Hong Kong or non-Hong Kong company to commence an action in the name of that company after first having served the required written notice on that company specifying his intention to commence the action and his reasons for doing so, but **WITHOUT** being required to obtain leave of the court. This mechanism places only a modest procedural burden on a member and is in our view a welcome and much-needed improvement to the current common law requirement that the member first demonstrate to the satisfaction of the court that his proposed action satisfies the *Foss v Harbottle* exceptions.

It will of course remain open to the other parties named in a SDA (and this would include the plaintiff company as well as the named defendants) to apply under existing High Court Rules to have an action struck on the grounds that it discloses no reasonable cause of action, is frivolous or an abuse of the court's process. Furthermore, the proposed section 168BD includes additional grounds upon which the plaintiff company or any named defendant could seek to have the SDA struck out.

However, regardless of how straightforward in terms of cost and procedure it might be (on the one hand) for a member to commence an action on behalf of a company, or how easily a named party may argue (on the other hand) that the action is an abuse of the court's process, it is important that the proposed SDA is not turned into a means by which upset shareholders begin to usurp the proper role of the board. There are very many cases where the board is
faced with a relatively straightforward claim or action, but where the board's decision not to pursue it is taken honestly and for sound commercial reasons. There are of course be cases where the board's decision is motivated by other factors which raise questions about the board's bona fide, leaving shareholders understandably aggrieved.

In HKICS' view, the question is reduced to a decision between the following:

1. Should a member be tasked with showing in an application for leave that it appears to be prima facie in the interests of the company that the action be brought?

2. Should the plaintiff company or a named defendant be tasked with showing in a strike-out application that the bringing of the proceedings is not in the best interests of the company?

HKICS takes the view is that a member should **NOT** be required to obtain leave before being entitled to commence an action. In order for a member to discharge this burden, he will have to demonstrate that the matter is not simply of a management nature which should be left to the board. He will have to show that the board's decision was not in fact arrived at bona fide, because that decision will not otherwise be questioned by the court. This will require him to demonstrate knowledge of the board's deliberations and previous correspondence to which he may very well not have access, making his task of seeking leave quite impossible in practice, particularly if he is required under the proposed section 168BB(3) (a) to meet a "**best interests** of the company" test, a far HIGHER burden than a "**prima facie** in the interests of the company" test, as in the case of section 216(3) (c) of the Singapore Act..

On the other hand, if the company wishes to argue that the action is not in the best interests of the company, all it will need to show is that the board's decision was reached bona fide. Where this is in fact the case, that will be the end of the matter, regardless of whether the decision was commercially sound.

HKICS urges the Bills Committee not to introduce its proposed amendment, otherwise the proposed reform will, in HKICS' view, prove a pointless exercise.

May 2004