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6 May 2004

Ms. Shirley Lam
Financial Services Branch
Financial Services and the Treasury Bureau
18th Floor, Admiralty Centre Tower 1
18 Harcourt Road
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By Fax No.2528 3345 and
By Post

Dear Ms. Lam

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

1. Thank you for your letter dated 22 April 2004 enclosing a copy of the above Consultation Paper for our comment. We have carefully reviewed the proposals contained in the paper and in general we are supportive of them but would wish to highlight certain areas where further amendment may be required.

Requirement for leave to be obtained before a shareholder may bring a statutory derivative action (SDA)

2. We note that, at the suggestion of the Bills Committee, it is proposed to introduce a requirement for a shareholder of a company who intends to bring an SDA to obtain leave from the court before he can bring proceedings on behalf of the company. This represents a change in the Administration's initial stance on this point, and is proposed notwithstanding the recommendation of the Standing Committee on Company Law Reform that there should not be a "trial in a trial" for the purposes of determining the *locus* of an applicant to bring proceedings. The paper does not elaborate the reasons for the change in stance and, in fact, we are supportive of the Administration's original arguments for not imposing a leave requirement.

3. Hong Kong law and procedure, unlike the United Kingdom, does not contain a requirement for leave to be obtained before commencing a common law derivative action (CDA) (per Godfrey JA in Tan Eng Guan v. Southland Co. Ltd. [1996] 2 HKC 105G). Accordingly, if the right to take a CDA is permitted to co-exist with the proposed SDA, it will actually be procedurally more onerous for a shareholder to bring SDA proceedings than CDA proceedings if the subject matter of the litigation falls within the scope of both derivative actions. This appears to be anomalous and might have the effect of inhibiting use of the statutory remedy when the intent of the legislation is to facilitate the institution of SDA in order to remedy the shortcomings of the CDA.

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4.1 We refer to paragraph 6(b) of the paper which informs that it is proposed to introduce further new conditions to the grant of leave including conditions that (i) it is probable that the company will not itself bring the proceedings, or (ii) the company will not properly take responsibility for them. However, we note that the draft amended subsection 3 of section 168BB, reads as follows:

"(3) The court may, on the application of a member of a specified corporation, grant leave for the purpose of subsection (1) if it is satisfied that –

(a) it is in the best interest of the specified corporation that the applicant be granted leave;
(b) the applicant is acting in good faith;
(c) if the applicant is applying for leave to bring proceedings under subsection (1)(a), there is a serious question to be tried and it is probable that the specified corporation will not itself bring the proceedings;
(d) if the applicant is applying for leave to intervene in proceedings under subsection (1)(b), it is probable that the specified corporation will not itself properly take responsibility for those proceedings[.]"

It appears from the amended subsection that the condition (ii) (i.e. that the company will not properly take responsibility for the proceedings) applies only to an application by a shareholder under subsection (1)(b) of section 168BB, which deals with applications for leave to intervene in proceedings already instituted to which the company is a party, for the purpose of continuing, discontinuing or defending those proceedings on behalf of the company. This is different from the position expressed in paragraph 6(b) of the paper, which imposes condition (ii) on applications for leave to commence an SDA. Accordingly, we are puzzled as to whether it is the intention of the Administration to extend condition (ii) to applications by a shareholder under subsection (1)(a) of section 168BB in addition to applications under subsection (1)(b) of section 168BB.

4.2. We are of the view that the amended subsection as drafted sets out the better position, for when an action has not even been commenced it is difficult to conceive of what evidence a shareholder applicant could adduce to prove that the company would not "properly take responsibility for them."

4.3. However, notwithstanding the foregoing, we would echo the reservations about setting the threshold at too high a level and that the condition would present a very high hurdle for an applicant to overcome since, not being party to the ongoing litigation, the applicant would no way to find out the progress of the litigation or how it was being (mis)handled. Moreover, it is not clear what standard is required of a company before it can be said to be "properly taking responsibility:" is this test satisfied if solicitors are instructed? Or is there to be an enquiry into the instructions given by the company to its solicitors and whether those instructions are adequate? If so, this would involve issues of infringement of legal professional privilege. It would be helpful if some guidance could be given on how to satisfy this new condition.

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Co-existence of the CDA in parallel with the SDA

5. We agree with the Administration's position that the right to commence a CDA should be preserved. There is no reason to deprive shareholders of non-Hong Kong companies of rights that might otherwise be available to them and there are already adequate remedies under the current civil procedure rules to deal with a duplicity or multiplicity of proceedings.

Conduct and Scope of Proceedings

6. We agree that issues relating to discovery can be dealt with under the current framework for discovery. We have no comment on the Administration's decision not to restrict the types of wrongs in respect of which action may be brought under the SDA and consider that these are matters which can be dealt with by the trial judge.

We have kept our comments brief due to limited access to legal resources, but hope that they will be of assistance to you.

Yours sincerely

Susie Cheung
General Counsel and
Company Secretary

c.c. Mr. Peter Pang, Chief Executive Officer