Responses to the submission from the Hong Kong Bar Association (HKBA)

Paragraph 1

It is not our policy that the proper plaintiff rule should be abolished by the introduction of the proposed statutory derivative action (SDA). Hence, we do not consider that there is a need to define "proceedings" as proposed in the HKBA's submission. That said, to put the matter beyond doubt, we propose to add a doubt avoidance provision to make it clear that –

(a) a member cannot bring proceedings on behalf of his specified corporation under the SDA if the cause of action is not vested in the specified corporation and relief is not accordingly sought for the specified corporation; and

(b) a member cannot intervene in proceedings on behalf of his specified corporation under the SDA if the specified corporation does not have the right to continue, discontinue or defend the proceedings.

Paragraph 3

You may wish to note that the observation "In practice, it would normally be difficult to show that there are controlling or ill-motivated shareholders who are preventing litigation from taking place" is extracted from paragraph 15.11 of the Consultation Paper on Phase I of the Corporate Governance Review issued by the Standing Committee on Company Law Reform (SCCLR) in July 2001.

Paragraph 4

If a wrong is done to a company, the damages recovered in the concerned derivative action (whether it is taken under statute or common law) should belong to the company. As regards the costs of the action, section 168BG provides the court with a wide power to make orders as to costs at any time.

Paragraphs 5 - 8

While the introduction of a leave requirement in the SDA could result in

additional hearings before the SDA could commence, this does not necessarily mean that such requirement would make the SDA a much less attractive option when compared with the common law derivative action (CDA) where no such requirement exists.

It has been recognized in the SCCLR's Consultation Paper that difficulties lie in discerning from the case law clear principles under which a wrongdoing may be ratified by the majority shareholders and circumstances under which they may not. Furthermore, the concept of wrongdoer in control may be difficult to apply. In practice, it would normally be difficult to show that there are controlling or ill-motivated shareholders who are preventing litigation from taking place. Hence, we do not see any good reason to reinstate these exceptions in the SDA. It will be a very difficult, if not impossible, task to codify the "fraud on the minority" and "wrongdoers are in control of the company" exceptions in statute.

Indeed, these difficulties are also recognized in other comparable jurisdictions such as Australia, New Zealand and Singapore. To address these difficulties, they have amended their company law to provide for their SDAs (Australia in 2001, Singapore and New Zealand in 1993) whereby the court would consider, among other things, the good faith of the member, interests of the company instead of whether the case falls within the exceptions to the rule in Foss v Harbottle. We have adopted a similar approach in our SDA and have proposed to include these thresholds in a striking-out mechanism, and now in the form of a leave requirement, as proposed by the Bills Committee. Under the SDA, a member is no longer required to prove that the case falls within the exceptions to the rule in Foss v Harbottle and would only need to satisfy the relevant thresholds and obtain leave to commence the action.

Besides, unlike the CDA, ratification by a general meeting will not be a bar to the commencement of SDA. There are also express provisions in the SDA to deal with the costs of the action. Given the above, we do not agree that the addition of a leave requirement per se would make the SDA a much less attractive option when compared with the CDA.

As regards the consultation on the thresholds, you may wish to note that

comments were sought from the public (including all concerned organizations and the SCCLR) by the Clerk to the Bills Committee on the Bill (including the thresholds in the striking out mechanism) in July 2003. As requested by the Bills Committee, we also sought comments from more than 100 organizations (including the SCCLR) on the thresholds in the form of a leave requirement in April 2004.

Paragraph 9

While it is our intention to make the SDA a readily available remedy to minority shareholders, we consider it equally important to ensure that a proper balance has to be struck between the interests of shareholders and companies. We do not see any good reason to take out the thresholds from the SDA, which would effectively mean that a member can bring an action on behalf and in the name of his company without the need of satisfying any requirement (as he is no longer required to prove that the case falls within the exceptions to the rule in Foss v Harbottle under the SDA).

Whether the thresholds are included in the striking-out mechanism or leave requirement (as in the case of the SDAs in other comparable jurisdictions) would be an issue of striking a proper balance of interests between shareholders and companies. In the light of the Bills Committee's comments and given that the leave requirement approach is also adopted in the SDAs in other comparable jurisdictions, we propose to adopt a similar approach as a start. We will review the operation of the SDA after its introduction. If necessary, we could consider making further changes in the light of the experience in the operation of the SDA.

To address the comments from HKBA and other deputations, we have agreed to lower the thresholds further (as follows) so that the SDA would become a more readily available remedy to minority shareholders –

(a) it appears to be prima facie in the interests of the specified corporation that the proceedings be brought, continued, discontinued or defended;
(b) the applicant is acting in good faith;

(c) if the applicant is applying for leave to bring proceedings on

behalf of the specified corporation, there is a serious question to be tried and the specified corporation does not bring the proceedings;

(d) if the applicant is applying for leave to intervene in proceedings on behalf of the specified corporation, the specified corporation does not diligently continue, discontinue or defend the proceedings.

Paragraph 10

As explained above, the observation "there is difficulty under the existing law for shareholders to show that the wrongdoers are in control" is extracted from the SCCLR's Consultation Paper. To address the comments from HKBA and other deputations, we have agreed to replace the threshold "it is probable that the company will not itself bring the proceedings and will not itself properly take responsibility for the proceedings" with a lower one i.e. the specified corporation does not bring the proceedings and the specified corporation does not diligently continue, discontinue or defend the proceedings".

Paragraph 11

See the above responses to paragraph 5 -8.

Paragraphs 12 and 13

It should be noted that the CDA and the SDA differ not only in terms of form, but also in substantive issues. For example, the effect of ratification by the board of directors in a CDA is different from that in a SDA, and there is no need to prove the exceptions to the rule in Foss v Harbottle in a SDA. Hence, the court may not necessarily have the power to order one of the actions to be stayed or struck out. To put this matter beyond doubt and to address the Bills Committee's concerns, we propose to include express provisions in the Bill to confer the court with powers to prevent a member from commencing the CDA and SDA concurrently.

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Financial Services and the Treasury Bureau
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