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5 September 2003

Clerk to Bills Committee
Legislative Council Secretariat
3rd floor Citibank Tower
3 Garden Road
Central, Hong Kong

(Attn: Mr. Matthew LOO)

Dear Mr. Loo,

**Bills Committee on
Companies (Amendment) Bill 2003**

Thank you for your letter of 24 July 2003 inviting the Council to give its views on the Companies (Amendment) Bill 2003.

The Council would like to pledge its general support regarding the proposed amendments in the Companies Bill to enhance corporate governance standards in Hong Kong, particularly those in Schedule 4 to the Bill that enhance shareholder remedies.

The Council has previously provided a submission on some issues in the Bill, in a consultation document regarding proposals made in Phase 1 of the Corporate Governance Review by the Law Reform Commission. The Council's submission to the Law Reform Commission can be found at <http://www.consumer.org.hk/legal/english/011101/011101e.htm>.

In brief, the Council expressed its support for the following:

Unfair prejudice

The Council agrees that the statutory unfair prejudice remedy should be amended so that the court has clear powers to award damages and interest on damages. Section 4 of Schedule 4 to the Bill refers.

The Council supports the proposal because this makes clear whether the unfair prejudice remedy should be available to shareholders for breach of directors' duties generally. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

Derivative action

The Council supports the introduction a statutory right of derivative action, as proposed in Section 5 of Schedule 4 to the Bill.

The Council agrees with the observation that has been made that under the common law, a person who suffers loss may find it difficult to seek redress through civil action against a person responsible for causing the loss. It agrees that there are difficulties involved, for instance, the person generally needs to fit a cause of action into litigation on contract law or tort such as negligence, and may not be aware of his legal position.

In view of this, the Council pledges its support for making derivative action statutory. This provides an effective mechanism by which shareholders can protect themselves. Further, making statutory clarification would remove uncertainties and provide a more effective means of enforcing directors' duties and other wrongdoing committed in relation to the company.

Should you have any queries about our views, please feel free to contact the undersigned at 2856 8585.

Yours sincerely,

Mrs. CHAN WONG Shui
Chief Executive

Competition Policy Study

Consumer Council
Corporate Governance Review
By the Standing Committee on Company Law Reform

INTRODUCTION

1. The Consumer Council is pleased to submit its views and comments on the proposals made in the Corporate Governance Review by the Standing Committee on Company Law Reform (SCCLR).

THE COUNCIL'S RESPONSE

2. As a whole, the Council welcomes these proposals as a means of applying more stringent control to protect the interests of shareholders and to enhance the corporate governance standards in Hong Kong.

3. In view of the Council's main concern in these matters being consumer protection, the Council focuses its comments on those proposals which have direct relevance to the interest of shareholders (consumers).

4. In responding to the proposals, the OECD Principles for Corporate Governance provide an importance basis for evaluation of the proposed framework for corporate governance in Hong Kong. These principles are annexed.

(A) Proposals on directors' duties and responsibilities

Voting by directors in relation to directors' self-dealing

5. With regard to the principle of equitable treatment of shareholders, the Council supports prohibiting any abusive self-dealing by directors (and also controlling shareholders). This prevents interested directors from extracting excess benefits through self-dealing or disregard of minority shareholders' economic right

Shareholder approval for connected transactions of significance involving directors

6. The SCCLR proposes the adoption of a statutory provision so that for transactions or arrangements above a certain threshold or requisite value involving directors or persons connected with directors, the approval of disinterested shareholders voting on a poll should be obtained.

7. The Council supports making the provision statutory as this ensures that shareholder interests are protected by law and sets out more clearly the circumstances under which shareholders' approval should be obtained for such arrangements.

8. In determining the requisite value from a consumer protection perspective, the Council supports adopting a low threshold. This would ensure that shareholders are better informed about connected transactions as more frequent shareholders' approval would be required.

Transactions between directors or connected parties with an associated company

9. The SCCLR proposes that requirements for disinterested shareholders' approval for connected party transactions should be extended to transactions between a company and an "associated company" and not limited to transactions between the company and "subsidiaries".

10. The Council supports this proposal as it is intended to deal with arrangements where a director or controlling shareholder might be acting in concert with other parties for the purpose of transferring assets into an associated company at inflated prices, or vice versa.

Nomination and election of directors

11. The Council supports the SCCLR's proposals that any shareholders should be provided with a reasonable opportunity to lodge their nominations with the company and to elect their choice of directors. There is a fundamental right for investors to have the opportunity to participate effectively and vote in general shareholder meetings and to be sufficiently informed of voting procedures that govern general shareholder meetings. Company procedures should not make it unduly difficult or expensive to cast votes. In fact, the use of clear procedures for the nomination of directors should be encouraged as a matter of best practice.

Role of the independent director

12. The Council agrees that imposing a general statutory duty for the independent directors to perform a special monitoring role to represent the interests of minority shareholders at this stage may be onerous especially if independent directors do not have ready access to information. But the matter should be subject to review.

(B) Proposals on shareholders' rights

Self-dealing by controlling shareholders

13. For commercial certainty, the SCCLR proposes that connected transactions involving controlling shareholders should be subject to voting (on a poll) by disinterested shareholders only. The Council supports the proposal as this ensures procedural fairness.

Derivation action

14. The SCCLR proposes that the common law derivative action should be replaced by a statutory derivative action. In addition, the Securities and Futures Commission (SFC) should be allowed to bring derivative actions, on behalf of a listed public company.

15. The Council agrees with the observation that under the common law, a person who suffers loss may find it difficult to seek redress through civil action against a person responsible for causing the loss. It agrees that there are difficulties involved, for instance, the person generally needs to fit a cause of action into litigation on contract law or tort such as negligence, and may not be aware of his legal position.

16. In view of this, the Council pledges its support for making derivative action statutory. This provides an effective mechanism by which shareholders can protect themselves. Further, making statutory clarification would remove uncertainties and provide a more effective means of enforcing directors' duties and other wrongdoing committed in relation to the company.

17. In addition to the above, the SCCLR proposes that it should be made clear that the securities regulator is able to bring derivative actions against wrongdoers in relation to a company for breaches of duty on behalf of the company. This would allow the SFC to conduct civil proceedings on behalf of any public company or individual in relation to fraud, negligence, default in relation to any laws or rules etc.

18. However, this is a discretionary power, and given that investors have rights of their own, there may be some circumstances where the SFC either chooses not to exercise that power, or may feel it appropriate to leave the matter to individual investors. This raises a question as to whether those investors would have the resources to fund a court

action. Consideration could therefore be given to provide investors with access to funds and other assistance for a court action, for example, expanding the scope of the Legal Aid system.

Unfair prejudice

19. The SCCLR proposes that the statutory unfair prejudice remedy should be amended so that the court has clear powers to award damages and interest on damages.

20. The Council supports the proposal because this makes clear whether the unfair prejudice remedy should be available to shareholders for breach of directors' duties generally. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

Personal rights

21. The SCCLR has recommended previously that the law should be clarified so an individual shareholder can enforce all rights in the memorandum and articles of association as personal rights. The Council supports any initiatives to remove uncertainties.

Orders for inspection

22. The Council supports the proposal that shareholders should have a statutory method of securing access to company records so as to have access to relevant information.

Other powers of the court

23. The SCCLR proposes that the court should have a general power to grant an injunction in relation to any proposed contravention of the CO or breach of fiduciary duties; and a clear power to grant orders as to costs for shareholders taking action. The Council supports this proposal.

(C) Proposals relating to Corporate Reporting

Filing of financial statements

24. The Council supports the proposal that private companies with limited liability should be required to file their financial statements with the CR for public inspection. This is conducive to good corporate governance which enables better access to financial information on companies, whether public or private, and thereby better assessment of the risks.

Management discussion and analysis (MD&A)

25. The SCCLR proposes that the listing rules should be amended to require MD&A to include more qualitative and forward-looking disclosure.

26. The Council supports the proposal as investors are particularly interested in information that may shed light on the future performance of the company. This improves the ability of investors to appropriately monitor the company and the basis to value securities.

Inconsistencies between the audited financial statements and other financial information contained in the directors' report and other sections of the annual report

27. The Council supports disclosure of material matters (such as reporting on any inconsistencies between the audited financial statements and financial information contained in the directors' reports and other sections of the annual reports) to all shareholders in order to ensure their equitable treatment. It is important that reliable information is disclosed to enable investors to have better insight into company performance.

Standards setting process

28. The SCCLR proposes that the accounting and auditing standards setting function should continue to be vested in the HKSA subject to greater involvement of the public in the standard setting process. The Council supports the proposal of bringing in public members into the standard setting process.

29. This should enhance the transparency of the process and enables public a greater role in the decision process. The Council also welcomes being recommended as one of the organizations for nomination with regard to representatives in the standard setting process.

Body to investigate financial statements

30. While supporting the need for investigating complaints of non-compliance with applicable standards and re-issuing of financial statements, the Council has a concern whether a separate and autonomous body with legislative backing would be the appropriate mode of establishment. The Council notes that Australian and the US securities regulators both have the function of investigating financial statements, rather than an autonomous body. There does not seem to be any major reason why the SFC cannot take on this role.

31. With regard to the jurisdiction of the body, the Council accepts that at start, the body's work should be confined to public companies but to be extended to large private companies in the future.

Quality of audit practice and monitoring of audit practice

32. In response to what improvements to the Practice Review should be carried out, the Council supports measures to improve the Practice Review mechanism. As to the specific questions on auditors of public listed companies, the Council adopts a position where, in view of the heightened importance of publicly listed companies to the future livelihood of Hong Kong citizens, due to the creation of the MPF and the exposure that funds would have to publicly listed companies, that a high level of standard setting and auditing should apply, as compared to publicly listed companies. The Council considers if necessary for the SCCLR to clarify whether this higher standard would imply a 'double standard'.

Revision of audited financial statements and related matters

33. The Council supports the proposal that directors should be required to file a warning document with the CR to prevent further reliance on misstated financial statements. This would prevent investors from further relying on misstated financial statements. This again protects shareholders' right to obtain timely and reliable information on the company.

Consumer Council

October 2001

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The OECD Principles for Corporate Governance cover:

- **The rights of shareholders** to receive relevant information about the company in a timely manner, to have the opportunity to participate in decisions concerning fundamental corporate changes, and to share in the profits of the corporation, among others. Markets for corporate control should be efficient and transparent, and shareholders should consider the costs and benefits of exercising their voting rights.
 - **Equitable treatment of shareholders**, especially minority and foreign shareholders, with full disclosure of material information and prohibition of abusive self-dealing and insider trading; all shareholders of the same class should be treated equally. Members of the board and managers should be required to disclose any material interests in transactions.
 - **The role of stakeholders in corporate governance** should be recognized as established by law, and the corporate governance framework should encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and financially sound enterprises.
 - **Timely and accurate disclosure and transparency** on all matters material to company performance, ownership, and governance and relating to other issues such as employees and stakeholders, financial information should be independently audited and prepared to high standards of quality.
 - **The responsibilities of the board**, the corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and shareholders.
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