Ms Anita Sit
Clerk to Bills Committee on Companies (Amendment) Bill 2003
Legislative Council
Hong Kong

25 September 2003

Re: Companies (Amendment) Bill 2003 – Schedule 4 (Amendments to the Companies Ordinance relating to shareholders' remedies)

Dear Ms Sit,

As a response to your letter dated 24 July 2003, this submission is to set out our views on the following provisions of Schedule 4 of the Bill:

Proposed ss 168A(2A) and 168A(2C) [Schedule 4, s 4]

According to s 168A(2A), the court 'may, *whether or not* with a view to bringing to an end the matters complained of, order payment by such person of such damages…to any members (including the member who made the petition) of the specified corporation, whose interests have been unfairly prejudiced by the relevant act or conduct' [emphasis added]. On this we have the following comments:

(1) There are authorities to the effect that a wrong done to the company, such as the misappropriation of a company's property by its directors or majority shareholders, may give rise to an action under s 168A (*Re Tai Lap Investment Co Ltd* [1999] 1 HKLRD 384). In such cases the company, instead of its shareholders, has a cause of action against the wrongdoers and this chose in action represents part of the company's assets. Therefore, to award damages to a petitioning shareholder for the reason that the company has suffered a wrong is inconsistent with the common law principle that a shareholder cannot sue for a loss (eg, diminution in the value of his shares) which is merely reflective of the company's loss, unless the company has no claim or where the loss which the shareholder suffered is additional to, and different from, that suffered by the company (*Johnson v Gore Wood* [2001] 1 BCLC 313, followed in *Re Keen Lloyd Resources Limited*, unreported, Companies (Winding-up) No. 1134 of 2002 (Court of First Instance, 23 July 2003), paragraph 45).

On the other hand, allowing a petitioning shareholder to get compensation from the wrongdoers may be prejudicial to the interests of the company's creditors, especially when the company is insolvent

(*Johnson v Gore Wood* [2001] 1 BCLC 313, 338 (per Lord Bingham)). One solution to the above problems is that the court may simply decline to award damages, but this will limit the attractiveness of s 168A(2A) to minority shareholders.

We have the same comments on s 168A(2C) under which a past member may petition the court for the award of damages on the ground of unfair prejudice.

(2) The wording of s 168A(2A) does not seem to prohibit the company from taking a legal action based on a cause of action in reliance of which a shareholder has been awarded damages on the ground of unfair prejudice. It appears that the wrongdoers may be penalised twice by having to pay damages to the s 168A(2A) petitioner and later on to the company itself.

(3) We understand that s 168(2A) is proposed on the recommendation of the Standing Committee on Company Law Reform that 'the powers in section 168A should be amended to make it clear that the court has the power to award damages by way of a remedy to shareholders in circumstances of unfair prejudice' (*Corporate Governance Review by the Standing Committee on Company Law Reform: A Consultation Paper on Proposals made in Phase I of the Review* (July 2001) paragraph 16.27(a)), but what it is not clear to us is why the amendment is not made directly to the list of the court's powers under s 168(2).

Proposed ss 168BB and 168BD [Schedule 4, s 5]

A member of a company may bring a statutory derivative action on behalf of the company without leave under s 168BB(1)(a), and it would be the task of any party to the statutory derivative action (eg, the defendant) to prove to the court's satisfaction that the action should not proceed, based on the grounds stated under s 168BD(2). It can be imagined that the party to such a proceeding, eg, a supplier which has breached a contract with the company, may meet great difficulty in proving whether the member who brought the action has acted in good faith (s 168BD(2)(b)) or whether the statutory derivative action is in the interests of the company (s 168BD(2)(a)). In view of the proper plaintiff rule (*Foss v Harbottle* (1843) 2 Hare 461) and the principle of company autonomy, it is submitted that the proposed law should ask the member who intends to take a legal action on behalf of the company to show why he should be so allowed, rather than putting the burden on the defendant of a statutory derivative action to persuade the court why the action should be halted.

It is trite that a major reason for proposing the statutory derivative action is that it is notoriously costly and time-consuming for a member of a company to prove a "fraud on the minority" exception to the rule in *Foss v Harbottle*. One may wonder why the Bill explicitly reserves the common law derivation action. Even if this proposal does not in itself impede the operation of the proposed law, the abolition of this common law action is more in line with the policy of the reform. In Australia, Part 2F.1A of the *Corporations Act 2001 (Cth)* establishes the statutory right of derivative action and abolishes 'the right of a person at general law to bring, or intervene in, proceedings on behalf of a company' (s 236(3)).

Yours sincerely,

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