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Hong Kong General Chamber of Commerce
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13 March 2012

Ms Christina Shiu
Clerk to Bills Committee on Companies Bill
Legislative Council Secretariat
Tamar
Hong Kong

***By email and fax: 28400797***

Dear Ms Shiu,

**SUBMISSION ON THE "HEADCOUNT TEST"**
**FOR MEMBERS' SCHEMES OF ARRANGEMENT**

The Hong Kong General Chamber of Commerce welcomes this opportunity to present its views to the Bills Committee.

We consider that the "headcount test" for members' schemes of arrangement should be abolished, for the following reasons:

1. The headcount test deviates from the "one share one vote" principle and gives disproportionate control to a potentially very small number of shareholders who may have invested very little in the company. A small group can override the majority holding(s) of the minority shareholders. This is unfair.

2. Apart from being intrinsically unfair to minority shareholders, the reality in Hong Kong for a long time has been that most shares of public companies are held by custodians/nominees rather than by the individual beneficial owners (which presumably used to be the case when the provisions first originated). So the original intention (presumably) of balancing the interests of, potentially, a few "large" minority shareholders with potentially a greater number of "small" minority shareholders is distorted by the way shares are now actually held.

   (It is most unlikely incidentally that a scheme would be used in respect of a private company - if it was, and any shareholder was unhappy, the Court would be alert to abuse: an example of circumstances where its general discretion on approval of the scheme would come into play, and be an effective safeguard).

3. Further, the ability to place shares with a number of nominees clearly makes the headcount test open to abuse.

4. As we consider the headcount test itself to be unfair, we see the solution as its abolition, rather than giving the Court a discretion to override it. This proposal (a discretion to override) is intended to prevent abuse of the headcount test, but would add even more uncertainty to the process.

5. As it is, the existence of the headcount test, and the uncertainty that it introduces (that a scheme might not succeed even though the majority holding(s) of the minority shareholders were in favour), currently acts as a deterrent to schemes of arrangement. Schemes of arrangement cost considerable time and money to put forward. As schemes typically provide an exit for minority shareholders at higher than current market prices, and very often in cases where trading in the shares is illiquid, having a deterrent to putting schemes forward is not in the interests of minority shareholders.

6. With respect to safeguards:

   (a) **members' schemes of arrangement are subject to the Court's sanction (s.664(3): "The Court *may* [emphasis added] .... sanction the arrangement ....). The Court therefore has a general discretion not to approve in cases where a scheme is considered unfair to minority shareholders: this is a major - and sufficient, from a legislative perspective - safeguard.**

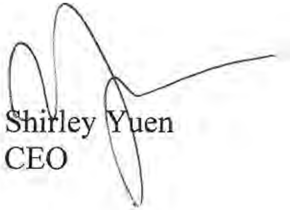
   (b) as a supplement to the Court's overriding discretion as a safeguard, there are the provisions of the Takeover Code. The Takeover Code applies to both listed and unlisted public companies (i.e. in practice, virtually all companies which are likely to be the subject of a scheme). Considerable care has been taken in the Takeover Code to protect the position of minority shareholders. For example, the Takeover Code requires that the 75% approval threshold must constitute "disinterested shares" i.e. shareholdings not connected with the offeror, requires the establishment of an independent board committee to advise minority shareholders - and that such shareholders be provided with competent independent financial advice. In contrast to the Companies Ordinance, the Takeover Code can and often is changed reasonably quickly in order to address current market issues and abuses.

7. In summary, the Court's overriding discretion on schemes, together with the additional safeguards of the Takeover Code, provide proper protection to minority shareholders. The headcount test is unfair and from an economics perspective (please see paragraph 5 above) is not in the best interests of minority shareholders.

8. The headcount test is an historical relic from a time when the holding of shares was generally effected differently and the protections of the Takeover Code didn't exist. The existence of such a test in certain other jurisdictions is not a valid reason for retaining it in Hong Kong, especially when other jurisdictions are moving towards abolishing it or have already done so. Retention of the headcount test is inconsistent with the Government's stated policy of supporting Hong Kong's position and reputation as an international financial centre. Removing it would help enhance that position and reputation, especially as some other

jurisdictions are also now reviewing or abolishing the test with similar considerations in mind.

Yours sincerely,



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