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14 March 2012

Our Ref: YTC/DK/CST

Clerk to Bills Committee on Companies Bill
Legislative Council Secretariat
Room 1010, Legislative Council Complex
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By email: bc_03_10@legco.gov.hk

and by hand

Dear Sir,

Invitation for submissions on the retention of the headcount test for members' schemes (clause 664)

We make this submission in response to the captioned Invitation (published on the website of the Legislative Council) in relation to the headcount test under clause 664(2)(c)(ii) of the Companies Bill. Our submission is made only in respect of members' schemes of public and listed companies. We are not commenting in respect of members' schemes of private companies or of creditors' schemes.

We strongly support abolishing the headcount test for the following reasons:

Shareholder rights and fairness

The headcount test deviates from the fundamental principle of "one share one vote" that is almost universal in the provisions dealing with shareholders' approval under the Companies Ordinance, except for the subject provision for schemes and a few minor exceptions.

Under the headcount test, the vote of each member present (in person or by proxy) at a meeting would have the same weight (e.g., 1% if there were 100 members attending the meeting) whether it has invested in, say, 0.01% or 60% of the shares. Small shareholders are thus given significant veto power, which is wholly disproportionate to their economic interest in the company.

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The headcount test is arbitrary now that corporate (as opposed to individual) holdings are common. Putting aside deliberate share-splitting, a large shareholder who has fortuitously been holding his shares through, say, 5 entities would have 5 times as much voting weight as that of another large shareholder who has historically used a single entity to hold all his shares. Clearly, there is no logic for favourable treatment to be given to the former shareholder.

Views of beneficial owners

The headcount test fails to reflect the decisions of the beneficial owners of the overwhelming majority of listed shares held in CCASS. For example, it was stated in the *Re PCCW Limited* (HCMP 2382/2008, 6 April 2009) case that about 93.7% of the shares held by disinterested shareholders eligible to vote at the meeting were held in CCASS through HKSCC Nominees Limited as the registered shareholder. However, HKSCC Nominees, acting on behalf of different beneficial shareholders, had to vote both in favour of and against the scheme. Therefore, effectively, its two votes (one for, one against) were cancelled out and had no impact under the headcount test.

Even when a scripless market is introduced and shareholders are offered the option to register their shares in CCASS in their own names and thus enjoy full voting rights (including by headcount), most shareholders may still prefer to hold shares in the names of their nominees and custodians for ease of trading and to save costs. Therefore, this concern about disenfranchisement of beneficial shareholders would likely remain, at best, partly resolved.

Share splitting and commercial reality

Our firm has handled many schemes of arrangement (for privatisations or other purposes) over the years. In many cases, because of the headcount test, the parties had to consider whether they should split their shareholdings, either as a proactive measure to increase their positive vote (by headcount), or as a defensive measure against the opposite camp doing so. Either way, this share splitting exercise would be artificial.

In our view, uncertainty as to when the court may exercise its discretion to dispense with the headcount test (in the absence of specific provisions in the Companies Bill on the appropriate circumstances for doing so) and difficulty in predicting the outcome of the vote (due to the almost unlimited potential number of headcount votes of shareholders, large or small) may deter companies from proposing a scheme given the time and cost involved in the procedure.

Sufficient safeguards under Companies Ordinance and Takeovers Code

We believe that there are sufficient safeguards under the Companies Ordinance and the Code on Takeovers and Mergers, <u>without</u> the headcount test, to protect the interests of minority shareholders. Under the Companies Ordinance, the court would still have a discretion not to approve the scheme in appropriate circumstances. The

dual requirement under the Takeovers Code of: (1) approval by 75% of the votes cast by disinterested shareholders; and (2) not more than 10% of the votes of all disinterested shareholders being cast against the scheme, is an effective means of protecting minority shareholders' interests.

Furthermore, the Companies Ordinance is not the appropriate regime to provide additional safeguards in public company transactions which clearly fall within the ambit of the Takeovers Code.

Public response to consultation

The *First Phase Consultation Conclusions of the draft Companies Bill* (August 2010) noted that 124 out of 144 (86%) of the respondents supported abolishing the headcount test, including in particular the two professional bodies representing the legal profession, namely the Law Society and the Bar Association of Hong Kong. The proposal under the Companies Bill is contrary to the collective wisdom of these and other professional bodies and respondents who oppose the headcount test.

* * *

We acknowledge and agree that our name and the contents of this submission may be published on the website of the Legislative Council in the terms as set out in your subject Invitation.

We have returned the reply slip attached to your subject Invitation, expressing our interest to make an oral presentation at the Bills Committee meeting on Friday, 23 March 2012. Please confirm the allocated time and duration of our oral presentation with the contact person on our reply slip.

Yours faithfully,
Baker & McKenzie
Baker & McKenzie