香 港 上 市 公 司 商 會
THE CHAMBER OF HONG KONG LISTED COMPANIES

March 12, 2012

By Fax and by post
Fax no.: 28400797

Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Sirs

Re: Views on the retention of the headcount test for members' schemes

The Chamber of Hong Kong Listed Companies is a member organization representing over 220 member companies on the Stock Exchange of Hong Kong. Our listed company members represent close to 40% of the market in terms of market capitalization.

Our objective is to provide an effective channel of communication between listed companies and market regulators, especially on issues related to the regulatory environment of Hong Kong. We aim to help ensure Hong Kong enjoys a sound regulatory regime balancing the interests of all market participants.

The Chamber is pleased to learn that the Bills Committee on Companies Bill will consider the issue of Headcount Test for members' schemes for listed companies again. Last year, the Chamber has made a submission on this issue. Our views remain valid to this day. We are pleased to restate them here in this submission.

Our views are as follows:

1. The majority of respondents to previous consultation supported the abolition of the headcount test

香港灣仔皇后大道東183號合和中心21樓2102室
Room 2102, 21st Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong
電話 Tel: (852) 2970 0886 傳真 Fax: (852) 2970 0555 網址 Website: http://www.chklc.org

Like many other mainstream business and professional bodies such as Hong Kong General Chamber of Commerce, Law Society of Hong Kong, Hong Kong Bar Association, Hong Kong Institute of Certified Public Accountants, Hong Kong Institute of Chartered Secretaries, Hong Kong Institute of Directors, the Chamber of Hong Kong Listed Companies opposes retaining the headcount test. In addition, the majority of members of the Government's own advisory committee on company law, the Standing Committee on Company Law Reform, have said the test is unnecessary to protect independent shareholders.

Even those organisations which supported retaining the headcount test but giving the court the discretion to dispense with it also agreed to the need for "one share, one vote", the Chinese Manufacturers' Association is an example. Others such as the Hong Kong Association of Bankers, ACCA and CPA Australia noted the inherent risk of the "headcount test" and the "possibility of manipulation" through "share splitting".

2. <u>Headcount test contradicts a just and fair principle</u>

We oppose retaining the headcount test because it contradicts the fair and just principle of "one share, one vote", a principle that is recognized by the Company law. Under this principle, the more a person has invested in a company, the more influence he or she should have in shareholder decisions. This one share, one vote principle is also upheld by the HKEx for all general meeting resolutions. Consistency should be maintained here. Under the headcount test, however, the will of the vast majority of minority shareholders can be defeated by a few shareholders who between them may have invested very little. It also creates a loophole for vote manipulation, such as share splitting to unfairly influence the voting results by *any* shareholder groups, large and small shareholders alike.

3. <u>The headcount test does not protect the owners of most of the minority shares: it actually harms their interests</u>

The headcount test has the purported purpose of protecting minority shareholders. But in fact it only serves the interests of a select few, and harms the interests of the owners of most of the minority shares. Certain minority shareholders with a small percentage of shares may engage in acts such as share splitting to wield disproportionate influence over the voting results, putting themselves above the wishes of the other minority shareholders, thus hampering the interests of the larger group of minority shareholders. The unfairness of the headcount test is magnified by the fact that the vast majority of shares in Hong Kong are held, not directly by the beneficial owners, but through a nominee company, which only counts as one 'head' in the headcount test. This grossly distorts the voting process, and means that the outcome of the headcount test is not representative of true wishes of the owners of the majority of the minority shares.

4. <u>Adequate shareholder protection is provided for under other legislation and regulatory measures</u>

There are adequate safeguards to protect minority shareholders interests without the headcount test. For example, the Takeovers Code stipulates that the number of votes cast against the resolution in the scheme shall not be more that 10% of the voting rights attached to shares not held by controlling shareholders or their connected parties. Since only disinterested shares count, this is a very effective way to empowering minority shareholders to determine the results of the scheme, affording them strong protection, and giving due weight to the number of shares they have bought (i.e. amount they have invested) in the company. This is a much fairer form of protection for minority shareholders than the headcount test, as it is consistent with the principle of 'one share, one vote', unlike the headcount test.

In addition, a Committee of Independent Non-Executive Directors has to be appointed to advise minority shareholders on whether the offer is fair, and this Committee in turn has to seek the advice of an independent financial adviser for this purpose. And a further safeguard arises from the fact that court's approval has to be sought for the scheme to be implemented- and the court will not approve the scheme if it is not satisfied it is fair to minority shareholders.

It should be noted that in many other jurisdictions where the headcount test is still in force, the UK and Australia for example, there is no such provision as the Takeovers Code that is found in Hong Kong.

5. <u>Court intervention could only take place after the fact and the outcome uncertain and Hong Kong's status as a healthy financial market may be hampered</u>

Although the Government is proposing under the Bill that the Court has the discretion to dispense with the headcount test in the case of abuse (provided such abuse could be detected), this can only be done after the fact. The market conditions might have changed and the proposal might have missed the best timing. Moreover, the judicial process could be lengthy and costly, and the final ruling of the Court uncertain. The level of uncertainty and the time and monetary costs could deter companies from proposing a scheme in the first place.

The efficiency of Hong Kong as a capital market would be unduly hampered by such uncertainties. A capital and financial market can only thrive if business decisions can be carried out in a lawful and orderly manner, without being subject to potential manipulation after the event. The headcount test, whether or not the court has the power to dispense with it in particular circumstances, will leave many corporate restructurings that could bring positive effects to all shareholders in a limbo. Companies may choose not to proceed with a restructuring lest they get caught in lengthy legal proceedings. This will not serve the long term interests of the shareholders concerned and is not productive to the status of Hong Kong as a healthy capital and financial market.

The objective of updating and modernising the Companies Ordinance is to make it more user-friendly and facilitate the conduct of business to enhance Hong Kong's competitiveness and attractiveness as a major international business and financial centre. It is fair to say abolishing the headcount test would do exactly that.

6. <u>The introduction of a scripless securities market would not solve the problems with the headcount test</u>

Although the proposed scripless securities market would allow investors to hold shares under their own names within CCASS, it is uncertain how many investors would utilize this facility to become registered shareholders. The investors would need to weigh the advantages of having their own account against the costs and time involved. The take-up is yet to be seen. Therefore the scripless system may still not solve the issue of minority shareholders not active in voting their shares in person. Even if it did result in more shareholders holding their shares directly rather than through nominees, it would still not resolve the fundamental unfairness of the headcount test, due to the fact that it is contrary to the "one share, one vote" principle under company law.

For all of the above reasons, the opportunity should be taken now to abolish the headcount test. Although the headcount test was retained in the UK and Australia, as noted above, the specialist government advisory committees in those jurisdictions have recommended that it be abolished. The headcount test does not exist in Canada, has recently been abolished in New Zealand, Sri Lanka, and it's likely to be abolished in Ireland and India under proposed legislation currently under discussion. Against this background, Hong Kong should not be swimming against the tide of international developments. Hong Kong should use this opportunity to be a leader rather than a follower. Hong Kong has the opportunity now to abolish the headcount to stay in line with the international trends. If we miss it, it would be a long while before the opportunity comes again and we that will leave us far behind other jurisdictions.

Yours truly,
For and on behalf of
The Chamber of Hong Kong Listed Companies

Mike Wong
Chief Executive Officer