Submissions to the Legislative Council Bills Committee on the Retention of the Headcount Test for Members' Schemes (clause 664)

We take the view that, in the context of members' schemes (i.e. shareholders' scheme for most practical purposes), the Headcount Test is an anachronism and should be abolished.

Interference with Shareholder Democracy

The cornerstone of shareholder democracy, as opposed to political democracy, is the principle of "one share, one vote". Just as it is wrong to allow individuals with economic strengths to interfere with the democratic process in a political context, it is equally wrong to allow political considerations to interfere with the shareholder democratic process in the company law context.

A company is essentially an entity formed by its shareholders for economic purposes. Clause 664, to the extent that it regulates rights among shareholders, should therefore take into account economic considerations and economic considerations only.

We are not talking about, for example, rights as between a company and its employees. Such rights are, quite rightly, dealt with by other legislations. There is simply no reason that a shareholder of say 5,000 shares in a company should be accorded, as a matter of course and in the absence of bad faith, less right than 4 shareholders each with 1,000 shares. However, this is exactly what the "Headcount Test" does.

Based on the same principle of shareholder democracy (i.e. one share, one vote), the corporate governance code applicable to Hong Kong listed companies requires that shareholder votes on significant issues should all be conducted by way of poll, not by show of hands which is another form of headcount test.

The Headcount Test is not about Real Headcount

Further, the "Headcount Test" as it now stands does not relate to real headcount at all. Under accepted company law practice, beneficial owners of shares are entitled to, and do often, register their shares in the names of nominees. This is a usual way for beneficial owners of shares to manage their proprietary interests in the company. Indeed, this is such a prevalent and accepted practice that, where the identity of the beneficial owners of shares is relevant for legal or regulatory purposes, specific statutory requirements (such as those under the Securities and Futures Ordinance) have been created for their disclosure.

A beneficial owner of shares may have legitimately registered his shares under the names of 3 different nominees, and when applying the "Headcount Test", he would be regarded as 3 shareholders. The "Headcount Test", therefore, does not even relate to real headcount.

Protection of Minority

It should be noted that minority shareholders are already adequately protected against unfair treatment under the existing statutory and regulatory regime. The court retains the discretion not to approve a scheme, and the Takeovers Code administered by the Securities and Futures

Commission provides for various measures to protect minority shareholders against unfair treatment.

Diversion of Regulatory and Judiciary Resources

In the context of the "Headcount Test", there have been questions in past cases as to whether additional headcount was created through share splitting. While a beneficial owner of shares may legitimately register his shares under the names of different nominees, it is quite often extremely difficult to determine whether such action was taken for the purpose of share splitting or for other legitimate purposes. It would therefore be a waste of regulatory and judiciary resources should the "Headcount Test" form part of the equation at all. Instead, resources should be directed to the question of whether disinterested minority shareholders have been taken unfair advantage of.

Creditors' Scheme and Court's Discretion to Dispense of the Headcount Test

Research has indicated that the "Headcount Test" originated from the days when the procedure applied only to compromises or arrangements with creditors, presumably to place a check on the ability of creditors with large claims to carry the day. When the provision was extended to compromises with members in 1900 in the UK, the composition of required majority remained unchanged. We believe that while the "Headcount Test" may continue to serve a useful purpose for creditors' schemes, the test is out of place in the context of shareholders' schemes.

In any case, if the "Headcount Test" were to be retained, we would suggest that the option of giving the court the discretion to dispense with the test be provided to avoid abuse by minority shareholders.

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