

Your Ref:
Our Ref: EY/20756

12 March 2012

BY EMAIL

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Dear Sir/Madam,

Re: Invitation for Submissions on the Retention of the Headcount Test for Members' Schemes (Clause 664)

EXECUTIVE SUMMARY

In relation to members' scheme for listed companies, the current provisions of the Companies Ordinance (s 166) requires that a majority in number of members (**the "Headcount Test"**) representing not less than three-fourths in value of the shares present at the meeting must have voted in favour of the scheme in order for the scheme to be sanctioned by the court. In addition, Rule 2.10 of the SFC's Takeovers Code requires the approval of the scheme by at least 75% of the votes attaching to the disinterested shares cast at the meeting and that there should not be more than 10% of the votes attaching to the disinterested shares cast against the scheme. In summary, the following three conditions must be satisfied in order for a scheme to be approved at a meeting:

1. More than 75% of the shares present at the meeting voting in favour of the scheme
2. A majority in number of members present at the meeting voting in favour of the scheme
3. Not more than 10% of the votes attaching to the disinterested shares cast against the scheme

We are of the view that the Headcount Test should be abolished for the following reasons:

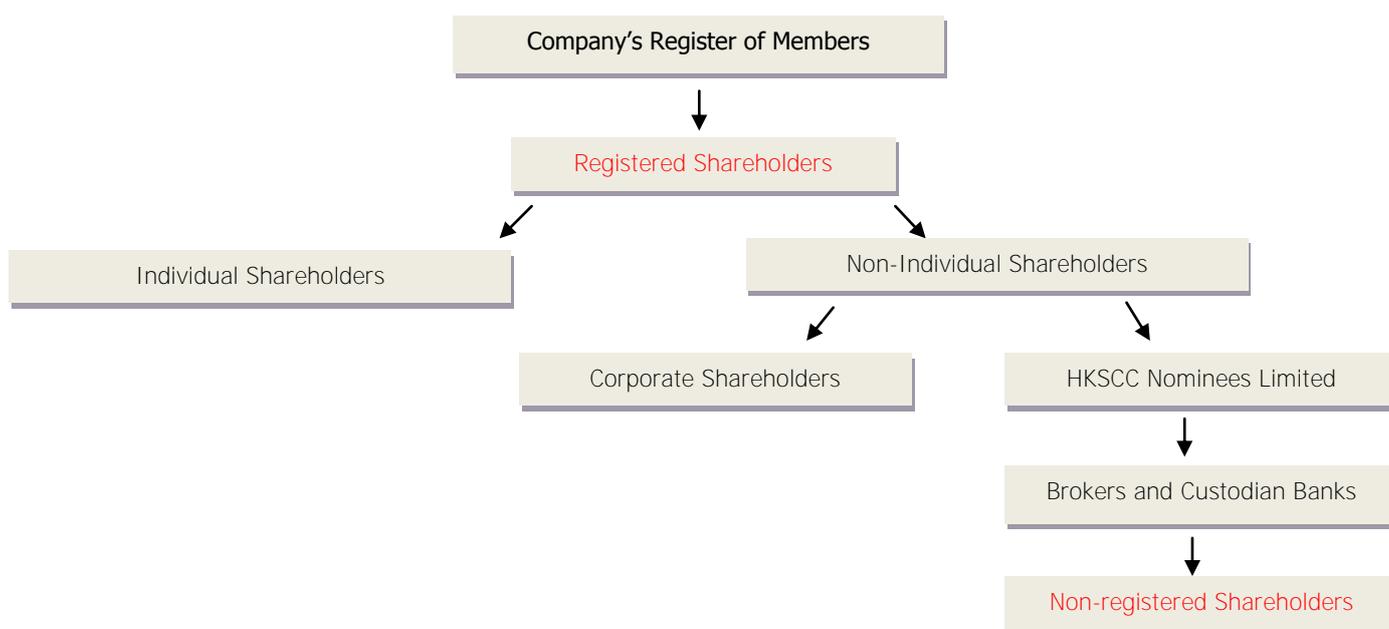
- Under the current market structure, the Headcount Test is prone to be manipulated through share splitting.
- The Headcount Test cannot effectively reflect the views of the shareholders whose shares are maintained through CCASS under the current market structure.
- There are already sufficient safeguards for minority shareholders.

SHAREHOLDING STRUCTURE IN HONG KONG

For listed companies in Hong Kong, the current structure of the equities securities market comprises of **shareholders who are holding physical share certificates (the "registered shareholders")**, and **shareholders who have their shares maintained through brokers and custodian banks (the "non-registered shareholders")**.

For registered shareholders, as they **are directly holding the company's shares**, their names would **appear on the company's register** of members.

For non-registered shareholders, their shares are normally being deposited into the Central Clearing and Settlement System (CCASS). Shares that are deposited into CCASS would be registered in the name of HKSCC Nominees Limited on the register of members of the listed companies. While HKSCC Nominees Limited is the registered shareholder of the company, the non-registered shareholders are the beneficial owners to the shares.



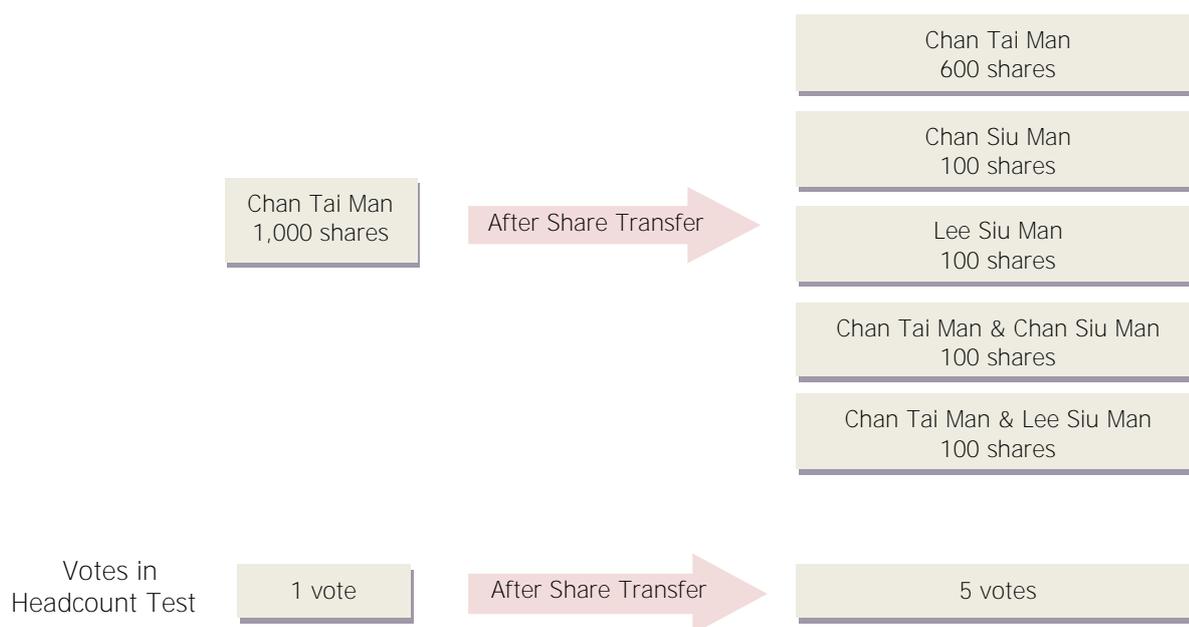
APPLICATION OF THE HEADCOUNT TEST

Registered Shareholders

Performing the Headcount Test for registered shareholders is a straightforward matter. A registered shareholder who is present either in person, by proxy, or by appointing a representative (for corporate shareholders) and has voted at the meeting will be considered as having one vote in the Headcount Test.

While the system appears to be fair, it is not without its loophole. The Headcount Test can lead to vote manipulation by way of share splitting and transfers to multiple ownerships prior to a meeting.

As an example, a registered shareholder by the name of Chan Tai Man holding 1,000 shares in a listed company may decide to transfer 100 shares to his brother, Chan Siu Man; 100 shares to his wife, Lee Siu Man; 100 shares to the joint name of Chan Tai Man & Chan Siu Man; and another 100 shares to the joint name of Chan Tai Man and Lee Siu Man, and so on. In effect, there will be five different names registered on the register of members of the company (Chan Tai Man, Chan Siu Man, Lee Siu Man, Chan Tai Man & Chan Siu Man, and Chan Tai Man & Lee Siu Man), meaning that for a single holding of 1,000 shares, the registered shareholder has successfully created four additional votes in the Headcount Test, as illustrated in the following diagram:



This kind of vote-rigging activities can be carried out by either those proposing the resolution or those who are against it. The end result is that the interests of the other shareholders would be distorted and not being properly expressed through the headcount test.

Non-Registered Shareholders

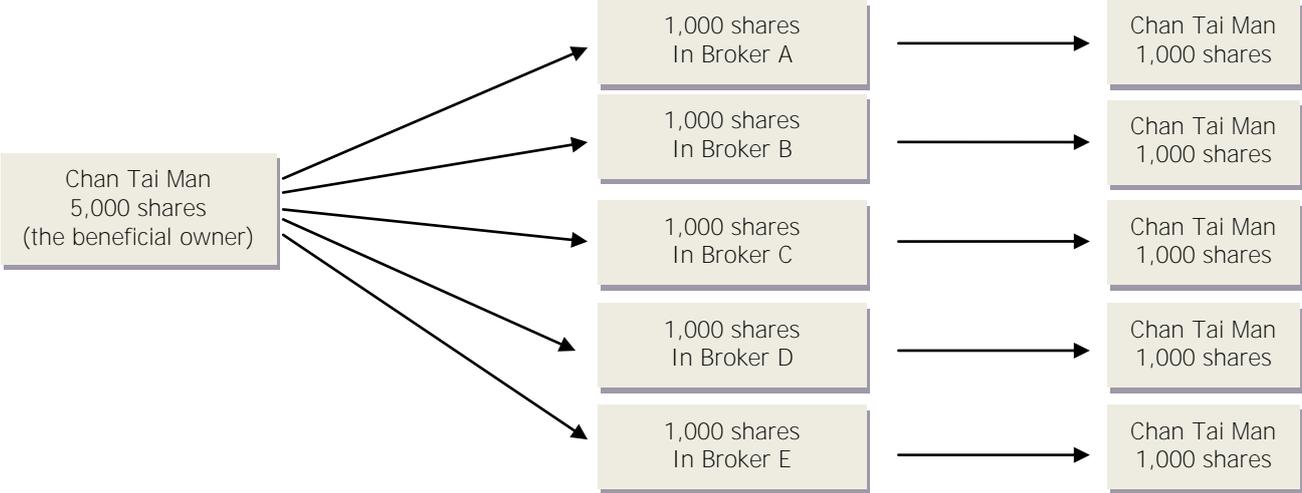
In order for non-registered shareholders to vote at a meeting, they will have to submit their votes to CCASS through their brokers or custodians, or alternatively, if they wish to attend and vote at the meeting in person, they can request CCASS through their brokers or custodians for an appointment of themselves as the corporate representatives of HKSCC Nominees Limited. For the votes being submitted to CCASS, HKSCC Nominees Limited will consolidate all the voting instructions and vote at the meeting by either appointing a representative to the meeting venue to vote (for meetings that are held in Hong Kong), or by submitting a proxy form (for meetings that are held overseas).

As shares held by non-registered shareholders are registered in the name of HKSCC Nominees Limited and HKSCC Nominees Limited is only one registered shareholder of the listed company, technically it will only be considered as having one vote. In practice, however, as has been the case for a majority of Court Meetings held in the past, because the vote submitted by HKSCC Nominees Limited contains a **certain number of shares in favour of the members' scheme and a number of** shares opposing the scheme, HKSCC Nominees Limited will usually be considered as having voted one vote in favour of the scheme and one vote against the scheme for the purpose of the Headcount Test. This is not reflective of the interests of individual non-registered shareholders because there can be hundreds of non-registered shareholders behind the CCASS vote.

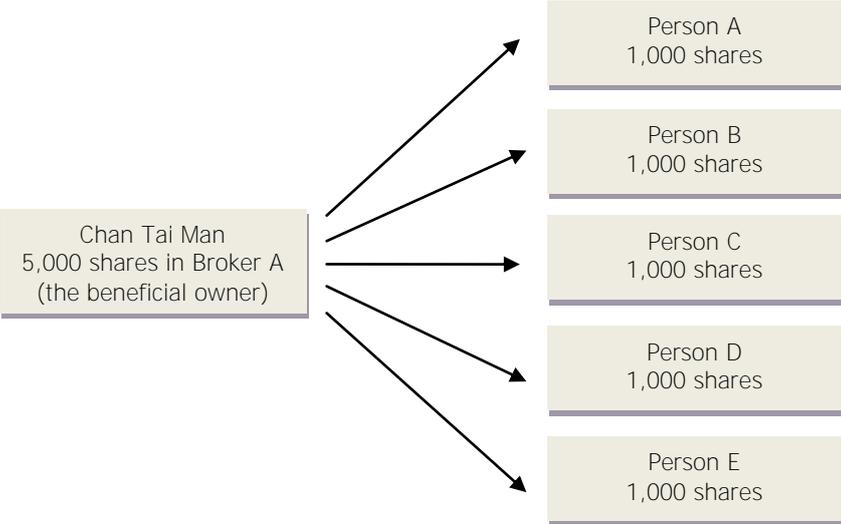
The practice of treating HKSCC Nominees Limited as having one vote "for" and one vote "against" is supported by a court case in the UK in 2001 (*Re Equitable Life Assurance Society*), where it was ruled that for split votes in the scheme of arrangement for Equitable Life Assurance Society (i.e., a shareholder having voted some of the shares in favour and some of the shares against), the shareholder should be counted as both in favour and against the scheme. The judge recognized that this would in effect result in more members of the company being counted, but at the same time the judge stated that "since that person would be on both sides of the head count, both in the 'yes' and the 'no' lobbies, that makes no difference to the calculation of the majority in number, whereas it permits an appropriate way to achieve and calculate the true majority in value".

Non-registered shareholders who are to attend a meeting in person would be attending in the capacity as an appointed representative of HKSCC Nominees Limited, who is the registered shareholder of the listed company. When applying the Headcount Test, the votes by the non-registered shareholders who are attending the meeting in person are usually considered together with those of the other representatives of HKSCC Nominees Limited on a collective basis and not individually. HKSCC Nominees Limited is only one registered shareholder in the company. As mentioned above, in most of the cases HKSCC Nominees Limited on the whole would be considered as having one vote in favour and one vote **against the members' scheme in the headcount test.**

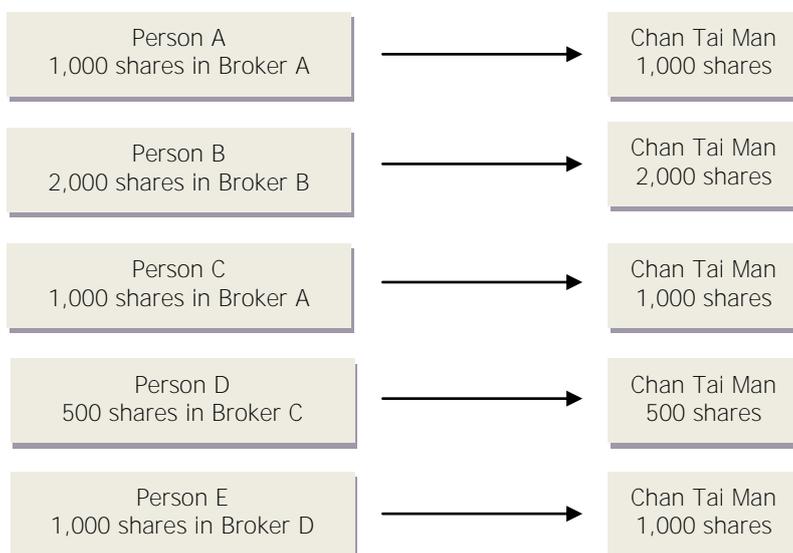
Even if non-registered shareholders were to be counted individually for the purpose of the Headcount Test, vote-rigging activities would still be possible. A person by the name of Chan Tai Man can have securities accounts maintained with five different brokers. If Chan Tai Man were to attend the meeting in person, there will be five separate appointments from HKSCC Nominees Limited. As the instructions would be coming from five different brokers separately and each instruction would only contain the name "Chan Tai Man" and the number of shares represented, HKSCC Nominees Limited would not be able to determine whether Chan Tai Man is actually one and the same person.



On the other hand, under the current market operations, it is also possible for non-registered shareholders to appoint proxies to attend and vote at a meeting on their behalf. In that case, Chan Tai Man can appoint five different persons to attend and vote at the meeting, which will appear to have a clear distinction on the identity of the voters in the headcount test when in actuality the "separate" holdings are beneficially owned by one individual only.



Taking this from a different angle, five different non-registered shareholders may also appoint Chan Tai Man to attend and vote at a meeting, meaning that one cannot prohibit Chan Tai Man to have five votes because he is actually representing five different parties.



An individual can also be both a registered shareholder and a non-registered shareholder of a listed company at the same time. That person would have the added advantage of having more than one vote if CCASS-appointed representatives or proxies were to be counted individually in the Headcount Test.

The Companies Ordinance was established long before the introduction of CCASS in June 1992. The introduction of CCASS has completely changed the market structure in Hong Kong. Ever since the introduction of CCASS, there has been an increasing trend of shareholders holding shares through brokers and custodians, not to mention the **increasing number of sophisticated institutional investors both locally and overseas** from the mid-1980s, in which most of them are also holding shares through brokers and custodian banks. This change in market structure and environment makes the Headcount Test becoming ineffective in attempting to reflect the views of these non-registered shareholders.

PROTECTIONS FOR MINORITY SHAREHOLDERS

Currently, there are various provisions in place to protect the interests of the minority shareholders. Section 168A of the Companies Ordinance states that "any member of a specified corporation who complains that the affairs of the specified corporation are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of some part of the members (including himself) or, in a case falling within section 147(2)(b), the Financial Secretary, may make an application to the court by petition for an order under this section."

In addition to section 168A of the Companies Ordinance, section 142 of the Companies Ordinance allows the Financial Secretary to appoint one or more competent inspectors to investigate the affairs of a company. In the case of a company having a share capital, not less than 100 members or members holding not less than one-tenth of the shares issued may make such an application.

Similar provisions can be found in the Bermuda Companies Act (section 111 on rights for shareholders to appeal and section 110 on inspections into the affairs of the company) and the Cayman Companies Law (section 64 on inspections into the affairs of the company). Most of the companies listed on the Hong Kong Stock Exchange are incorporated in Bermuda and the Cayman Islands, besides Hong Kong and the People's Republic of China.

Moreover, **Rule 2.10(b) of SFC's Takeovers Code** stipulates that the number of votes cast against the scheme shall not be more than 10% of the voting rights attached to all disinterested shares. This requirement renders an additional safeguard for minority shareholders, irrespective of whether the listed company is incorporated in Hong Kong or anywhere else.

RECOMMENDATIONS

Having considered all the factors, it is apparent that the Headcount Test is not an ideal or necessarily fair method under the current market structure. **It deviates from the "one share one vote" principle** and is prone to be circumvented by shares splitting. In addition, with the various provisions already in place, it is believed that the interests of the minority shareholders will continue to be protected and taken care of in the absence of the Headcount Test. We are therefore in favour of abolishing the Headcount Test for listed companies.

Yours faithfully
For and on behalf of

COMPUTERSHARE HONG KONG INVESTOR SERVICES LIMITED



JAMES WONG
Chief Executive Officer