Hong Kong Bar Association's comments on Clause 664 of the Companies Bill

1. The Hong Kong Bar Association has previously given its comments on the desirability of retaining the headcount test in s. 166(2) of the Companies Ordinance in the First Phase Consultation in April 2010. The Bar's position was that the headcount test should be abolished in relation to members' schemes of listed companies, and if the headcount test were to be retained, provisions should be made to recognize and count votes cast by HKSCC Nominees on behalf of the beneficial shareholders for such purpose.

2. The Bar notes that the Administration has opted for retention of the headcount test subject to a new power given to the court to dispense with the test ("unless the Court orders otherwise") for all members' schemes (listed and unlisted companies).

3. The Bar reiterates its concern that the headcount test, in the context of listed companies in Hong Kong where the vast majority of shares held by the public are registered in the name of HKSCC Nominees but the latter only counts as **one** shareholder for the purpose of the headcount test, is prone to lead to results that are artificial and unfair.

4. The Administration has advanced 2 reasons for its current proposal (paragraphs 14 and 15 of the First Phase Consultation on Draft Companies Bill - Consultation Conclusions), namely:-

   (1) the problem presented by the registration of listed shares in the name of HKSCC Nominees can be addressed by the proposed introduction of a scripless market in Hong Kong; and

   (2) the headcount test has been retained in other common law jurisdictions, including the UK, Australia, Singapore, Bermuda and the Cayman Islands.

5. The Bar does not believe these reasons provide a sound basis for the retention of the headcount test.

6. First, although a joint consultation was launched by the SFC, the HKEx and the Federation of Share Registrars Limited in 2009 and the conclusions of the consultation was published in September 2010[1], little progress has been made so far, other than certain proposed technical amendments in the Draft Companies Bill to remove limitations arising from the provisions on scrip-based shares and debentures, for their implementation. In any event, it is envisaged that a dual system will be created (paper-based and scripless systems in parallel), and

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1 http://www.sfc.hk/sfc/doc/EN/speeches/consult/ConsultationConclusions_Paper_Final_Eng.pdf

hence the problem posed by legal title of the shares vesting in HKSCC Nominees is likely to remain for a long time.

7. Second, while the Bar acknowledges that certain common law jurisdictions continue to retain the headcount rule, it must be recognized that in some of these jurisdictions – notably Australia and the UK (in the case of UK, Irish, Jersey, Guernsey and Isle of Man securities)[2] – their central securities depositories (Australia - CHESS; UK - Euroclear UK & Ireland which operates CREST) are structured in a such a way as to enable individual shareholders to be registered as legal owners of their listed shares. As such, the objection arising from the interposition of HKSCC Nominees is not a matter of significant concern in those cases, and those cases are not apt comparables.

8. Further, the Bar observes that the Administration's proposal is only a partial adoption of the Australian position, which leaves out the mandatory involvement of the regulator (the ASIC in that case) in the process. In the Bar's view, the involvement of the regulator is essential, as the court will otherwise be placed in a difficult if not an impossible position if it is required to investigate into and determine whether the headcount test should be waived.

   (1) Australian Corporations Act s.411(2) provides that the court must not make an order sanctioning a scheme unless it is satisfied that the ASIC has had a reasonable opportunity to examine the terms of the proposed scheme and to make submissions to the court. See also s.411(17). In the case of a takeover, the ASIC is further empowered to exempt or modify provisions with respect to compulsory acquisition: see s.669 and the cases discussed in Re PCCW Limited, HCMP 2382/2008 (*unrep.*, 6 April 2009), para.137, *per* Kwan J (as she then was).

   (2) The headcount test (and the corollary use of share-splitting) can be manipulated by the company and the objecting minority alike. Whether the test has been inappropriately manipulated is however not easy to detect, for there can be perfectly legitimate reasons why a shareholder may not become registered until shortly before the proposed court meeting – a shareholder could have acquired shares in the company for many years but only chose to register when he became aware of the proposed scheme for which he wished to exercise his voting right. Unless

[2] The Bar understands the position in the UK to be that (a) the vast majority of the "domestic" (UK, Ireland, Jersey, Guernsey and the Isle of Man) securities are dematerialized which legal title vests in the shareholders; (b) there is still a small percentage of "domestic" securities which are not yet dematerialized; and (c) the international securities are held by CREST International Nominee Limited, a wholly-owned subsidiary of Euroclear UK & Ireland, which acts as depository/custodian for international securities settled in CREST and issues CREST Depository interests to the market participants: see the IMF Country Report No.11/236 ("United Kingdom: Observance by CREST of the CPSS-IOSCO Recommendations for Securities Settlement Systems Detailed Assessment of Observance") dated July 2011 at http://www.imf.org/external/pubs/ft/scr/2011/cr11236.pdf.

the regulator is involved and has carried out an investigation into the circumstances in which the shareholders came to be registered (as in the case of PCCW), in the majority of cases the company and/or the objecting minority (as the case may be) and the court will have very little information to go by save perhaps the share register and the timing at which the shareholders came to be registered. The sparseness of the information available will make the court's task a most difficult one, taking into account also the procedure is summary in nature, with no general discovery and rarely any cross-examination of deponents, and it is not anticipated that the court will engage in a detailed fact-finding exercise. See also the sentiments expressed by Kwan J in PCCW para.147. The court's role in waiving the headcount test only makes sense in the context where the court will be provided with full, or at the least fuller, information for an informed decision to be made.

9. Accordingly, the Bar is of the view that the current proposal relating to the headcount test is unworkable in practice. If it is decided to retain the headcount test for members' scheme of listed companies, the Bar considers that provisions should be made to enable individual shareholders whose shares are registered in the name of HKSCC Nominees to vote and be counted separately.

Hong Kong Bar Association

28th March 2012