Hong Kong Bar Association's comments on
Rewrite of the Companies Ordinance -
Consultation Paper on Share Capital, The Capital Maintenance Regime, Statutory Amalgamation Procedure

Question 1

1. The Bar supports this proposal for the reasons stated in §2.1 to §2.8 of the Consultation Paper.

Question 2

2. It is not entirely clear what it is intended the companies should do during the period of 12 months, or what consequence will follow if the companies fail to "review their documents before the conversion is effected" within that period. Subject to that, the Bar considers the proposed period of 12 months is reasonable for companies to review their arrangements before migration to no-par.

Question 3

3. The Bar does not agree with the recommendation against legislating for any controls on the setting of issue price. The South African model discussed in §2.15 provides an objective and reasonable basis with regard to the minimum price upon which the shares can be issued. It also provides an important safeguard to the existing shareholders in that they will not find the value of their shares diluted or reduced without any satisfactory explanation put forward by the Board of Directors and without their consent on the issue.

4. As an alternative to the South African model, the minimum price can also be set by reference to the net asset value per share at the time of the proposed issue, which is a fair and objective basis in assessing the value of the shares in a company.

Question 4

5. The Bar supports the proposal under Question 4(b), that is, the application of merger relief to the amount in excess of the subscribed capital of the acquired company attributable to the shares acquired or cancelled. The Bar agrees that it would be unduly harsh to abandon the concept of merger relief entirely as the full amount of the consideration received for issuing the shares would be included within the restricted capital in the no-par regime. This recommendation is consistent with the present approach under the Companies Ordinance ("**CO**").

Question 5

6. The Bar supports the proposal under Question 4(b), for the same reason set out in Question 4.

Question 6

7. The Bar agrees with the proposals outlined in Question 6(a) to (d), which are the advantages of a no-par regime.

Question 7

8. The Bar supports this proposal.

Question 8

9. The Bar does not support this proposal. It is difficult to see what purpose is to be served by giving a choice to the companies to decide whether to retain or delete the authorised capital from their Articles of Association. It only serves to complicate rather than simplify the rules relating to share capital.

Question 9

10. The Bar does not support this proposal. We do not see any value in retaining the option of having partly paid shares.

    (1) We seldom in our practice came across a company having partly paid shares.

    (2) We do not see any reason why a shareholder who has been issued with shares in a company (and, therefore, enjoys all the right as a shareholder) should not be required to pay the full consideration at which he agrees to subscribe for the shares.

    (3) It will simplify the drafting of the relevant provisions without having to distinguish between fully paid and partly paid shares.

Question 10

11. The Bar considers that in respect of the amount unpaid on partly paid shares, the distinction between shares issued before and after migration to no-par should be maintained.

Question 11

12. The proposal under this Question is inapplicable, in light of our view on Question 9.

Question 12

13. The Question posed in this proposal is far too general. In any event, the Bar does not support the proposal. We do not see why a company should be allowed to pay dividends to its shareholder if it is insolvent, particularly if it is insolvent under the balance sheet test.

Question 13

14. The Bar supports this proposal and agrees that the solvency test should be modified to provide for a combined solvency approach.

Questions 14

15. The Bar supports this proposal and agrees with the concerns set out in §3.24.

(1) In our experience, the companies which require the Court's confirmation of reduction of capital are generally substantial companies with high level of paid-up capital. The directors and the companies concerned prefer certainty on the legality of the transaction. Certainty will be guaranteed in a court-sanctioned reduction of capital.

(2) The main purpose of requiring the companies to seek the sanction of the Court is to ensure that the companies are solvent and have sufficient funds to repay their debts as and when they fall due.

(3) It is undesirable to replace the court sanction with the solvency declaration made by the directors. It is by no means certain that the directors making the declaration would necessarily have a correct understanding of the concept of solvency for the purpose of the relevant statutory provisions; even accountants' solvency test is different from the statutory (cashflow) test.

Question 15

16. Not applicable.

Question 16

17. The Bar supports the proposal under Question 16(b).

Question 17

18. Yes. The Bar takes the view that an option should be given to the companies to hold the shares bought back in treasury, rather than requiring all shares bought back by the companies be cancelled.

Question 18

19. The Bar supports this proposal principally because the current financial assistance provisions are far too complicated.

Question 19

20. Not applicable.

STATUTORY AMALGAMATION PROCEDURE

21. The Bar does not agree with the analysis in Chapter 4.

22. First and foremost, the suggestion in §4.1 that there is no court-free procedure for amalgamation of companies is incorrect. In fact, section 168 and the Ninth Schedule to the CO together provide the mechanism for court-free merger and amalgamation of companies. Most of the merger and amalgamation in Hong Kong is done under section 168. Under section 168, the merger and amalgamation can be done if consent from 90% of the shareholders can be secured. This will be followed by a compulsory purchase of the shares held by the minority shareholders. If the dissenting shareholders do not wish to be bought out, they can challenge the proposed merger and amalgamation by making an application to the Court under paragraph 4 of the Ninth Schedule. Only on rare occasions when the acquirer anticipates that he would obtain less than 90% of the shares of the target company that section 166 procedure would be invoked in which case the Court, because of the lower threshold of 75%, would have to adjudicate on the fairness of the scheme.

23. Secondly, it appears from the discussions in §§4.14-4.19 that the rationale for proposing a court-free merger and amalgamation is the concern that the present court-sanctioned scheme of arrangement under sections 166 and 167 is too complex and costly. If it is thought that the complications and costs were generated because of the need to comply with the requirements under section 166 and 167, it is wrong.

24. The scheme documents nowadays become so lengthy (recently over 400 pages for English section alone), complicated and costly is not because of the need to comply with the requirements under section 166 and 167 or, for that matter, the Court. It is overwhelmingly attributed to the need to satisfy the requirements of the Securities Futures Commission ("**SFC**") and The Stock Exchange of Hong Kong Limited ("**HKEx**") including their requirements for updated financial information, property valuer's report and appointment of independent financial advisors who, in turn, will be advised by their own legal advisors.

25. It normally takes one to three months to prepare and obtain the approvals of the SFC and HKEx. The statutory explanatory statement normally runs to only 20 or 30 pages and much of it is filled with information required by the SFC and HKEx. We estimate that over 95% of the contents of the scheme documents are prepared to satisfy the requirements of the SFC and HKEx, particularly the Listing Rules and the Code on Takeovers and Mergers. Thus, much of the costs incurred in the preparation of the scheme documents and the engagement of professional advisors will still have to be incurred even in a court-free procedure. Many of the take-over and privatisation schemes involve hundreds of millions of dollars of which total legal (solicitors' and barristers') fees incurred by the applicant company in going through the statutory procedures seldom exceed a couple of million dollars.

26. The costs of a "short form amalgamation" of China Light & Power Co. Ltd. and of a "long form amalgamation" of the takeover by PCCW of Cable & Wireless HKT Limited were HK$345 million and HK$1,012 million respectively as shown in their scheme documents. In the latter case, the legal

costs of solicitors and counsel representing Cable & Wireless HKT Limited for obtaining sanction of the scheme were about HK$5 million or 0.49% of the total costs! The most recent "long form amalgamation" of China Unicom Limited and China Netcom Group Corporation (Hong Kong) Limited was RMB 100 million and the legal costs for the applicant in the court process was most probably less than 5% and this amount, like all other section 166 applications, is incurred primarily in drafting and settling the scheme documents to the satisfaction of the authorities.

27. Once the above misconceptions are cleared, it is difficult to see what advantages can possibly be gained by introducing the court-free procedure similar to the Singapore and New Zealand models.

28. **Long form amalgamation** §§4.5-4.10: The procedure described is complicated and can easily be abused. The suggestion that the solvency statement has to be accompanied by a report from its auditor is not workable in practice as it is difficult to see any auditors in particular the big four would give their support to the scheme in the manner suggested in §4.5. This is recognised to be the case in §4.16.

29. **Short form amalgamation** §§4.11-4.13: This form of amalgamation can be voted down by the shareholders. Thus, any dissenting shareholders can stop the scheme from going ahead whereas under section 166, the scheme can be implemented if consent from 75% of the shareholders present and voting can be secured. The fairness or otherwise of the scheme is under the scrutiny of the Court, which will review the scheme to ensure that the interests of the minority shareholders or members of the class will not be prejudiced. We note that short form amalgamation is the procedure used for all back door listing.

30. The Singapore model and the requirement as to solvency discussed in §§4.16-4.18 should <u>not</u> be followed. In an amalgamation or merger, it is the interests of the minority shareholders or the class which have to be looked after, hence the requirements of 90% shareholders' consent (in a court-free procedure under section 168) whereby dissenting minorities may appeal to the court and

75% shareholders present and voting and sanction by the Court in a court-sanctioned scheme under section 166. It is normally not a matter which concerns the creditors, as their interest will not be affected by the merger or amalgamation unless it is a merger of insolvent companies in which case the class may consist of creditors. In fact, the present statutory scheme does not require the scheme documents to be provided to the creditors and their consents to the scheme are not necessary. Hence, the whole basis for introducing the requirements as to solvency, which is to protect the interest of the creditors, is flawed. On the contrary, the Singapore model has omitted the most important legal criterion for deciding whether or not a scheme is fair on the members or creditors as established long ago in England (In re National Bank Ltd [1966] 1 WLR at 829) and followed in Hong Kong (Re South China Strategic Ltd [1997] HKLRD 131 at 135 and China Light & Power Co Ltd [1998] 1 HKLR 158 at 168).

31. The suggestion in §4.19 to eliminate the right for dissenting shareholders to veto the scheme is clearly wrong. There is no logical reason or basis in support of this suggestion. As discussed above, the main purpose of the present statutory scheme is to protect the interest of the minority or dissentient shareholders.

Question 20

32. For the above reasons, the Bar strongly disagrees with the proposals under Questions 20 and 21.

Hong Kong Bar Association
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