

**The Stock Exchange of Hong Kong Limited**

**Hong Kong Exchange and Clearing Limited Concept Paper on Weighted Voting Rights**

**Response by Davis Polk & Wardwell, Hong Kong**

**In relation to paragraphs 69 - 73 and Appendix V of the Concept Paper**

**Introduction**

1. The following represents a response to one aspect of the Concept Paper, namely arguments that might suggest that the absence of a US-style class action procedure is a material reason why WVR structures should not be permitted for companies currently listed or seeking to list on the Exchange.
2. In our view, the absence of a US-style class action procedure should not be regarded as a material reason why WVR structures should not be permitted for companies currently listed or seeking to list on the Exchange.

**Commentary**

3. The relevant parts of the Concept Paper are paragraphs 69 - 73 and Appendix V.
4. These refer to observations to the effect that there is better investor protection for minority shareholders in the US because of, in good part, the availability of class action litigation procedures.
5. However, it is important to note that the US class action regime is procedural in nature only. It does not generally provide for substantive enhanced shareholder rights in itself. Rather, when it works at its best (and it is well known for controversy), the US class action regime facilitates the procedural enforcement of minority shareholders' rights.
6. The Concept Paper correctly identifies the obvious point that Hong Kong does not yet have a similar class action regime.
7. However, it is important to bear in mind that, in our view, Hong Kong company law, supplemented by the Securities and Futures Ordinance and the Exchange's Listing Rules provides fully adequate substantive rights for

minority shareholders, relative to the US jurisdiction and other modern jurisdictions in which leading stock markets operate. Although not within the scope of this response, presumably the Exchange's Listing Rules could be amended and enhanced to the extent considered appropriate in the case of listed companies with WVR.

8. Further, as the Concept Paper partly acknowledges, the SFC has extensive and broad powers to take action by way of public interest litigation to protect minority shareholders' rights.
9. The most important point we want to emphasize is that the SFC's powers to take action by way of public interest litigation to protect minority shareholders' rights are available to address not just management misconduct at the time of an IPO but management misconduct, resulting in minority shareholder oppression and unfair prejudice, at any time during the life of a listed company.
10. Further, although not particularly highlighted in the Concept Paper, the SFC has demonstrated the use of such powers in a number of important cases concerning the ongoing management of Hong Kong listed companies, including. These cases include *Mandarin Resources Corporation Limited* (Stock Code 0070.HK); *GOME Electrical Appliances Holding Limited* (Stock Code 0493.HK); and *CITIC Limited* (formerly *CITIC Pacific Limited*) (Stock Code 0267.HK). The SFC's proceedings in respect of CITIC Limited have only started relatively recently, so it remains to be seen whether they will be successful. However, we believe the SFC would say that, on any basis, the litigation in the other two cases was very much successful.
11. In respect of *Mandarin Resources Corporation Limited*, the SFC claimed on behalf of minority shareholders that management had been guilty of serious misconduct, including "value shifting" (to use the terminology used in paragraph 68 of the Concept Paper) and lack of transparency in respect of undisclosed connected transactions. Following trial, the SFC obtained a judgment upholding all of its claims, and then reached a settlement pursuant to which management paid compensation to the minority shareholders:[http://www.sfc.hk/web/doc/EN/general/general/press\\_release/00/2207\(eng\).pdf](http://www.sfc.hk/web/doc/EN/general/general/press_release/00/2207(eng).pdf).
12. The SFC claimed on behalf of *GOME Electrical Appliances Holding Limited*'s minority shareholders that a share buy-back exercise had been arranged for the private benefit of the management of the company, and involved "value shifting" and non-disclosure of the connected aspects of the exercise. Before trial, following a mediation, the litigation settled on the basis of full compensation being paid to minority shareholders by management and payment of the SFC's costs of the litigation:<http://www.sfc.hk/edistributionWeb/gateway/EN/news-and->

[announcements/news/doc?refNo=14PR29.](http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=14PR29)

13. Similarly in the cases of *Styland Holdings Ltd* and *Medical China Limited*, mentioned in footnote 53 to paragraph 71(c) of the Concept Paper, the SFC obtained orders requiring the founder and former chairman of the listed company and his wife, a former executive director, to pay compensation for misconduct. See <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=12PR23> and [http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=12PR103.](http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=12PR103)
14. As the Concept Paper indicates in paragraph 71(c), the SFC has also been successful in obtaining court orders disqualifying individuals from being directors, including
15. We would suggest that there is no reason at all why, in the discharge of its statutory duties and in an effective and proportionate use of its resources and funding, the SFC could not stand ready to, and whenever appropriate, utilize its powers to bring actions for management misconduct against listed companies with WVR.
16. We would also suggest that for the SFC to devote time and resource to listed companies with WVR would be an appropriate course. We doubt it would prove costly.
17. First, there may not be many listed companies with WVR even if such a structure is permitted. Secondly, in any event, we would suggest that the prospect of the SFC exercising such powers would likely be an effective deterrent against management misconduct in respect of listed companies with WVR, without the need for any litigation to be commenced. Thirdly, even if it proved necessary for the SFC to litigate, the cases decided so far indicate that the SFC has been able to resolve them successfully on the basis that all or a substantial proportion of its costs are recovered. We would suggest that there is no reason why that would not continue to be the case with any SFC litigation in respect of listed companies with WVR.
18. Accordingly, we would suggest that, given the SFC's powers, and its abilities to use them effectively, the absence of an effective class action in Hong Kong should not be regarded as a real obstacle to permitting the listing in Hong Kong of companies with WVR.

Conclusion

19. We would observe (specifically by reference to paragraph 6 of Appendix V of the Concept Paper) that the primary reason why shareholder litigation in the US is relatively commonplace is in fact the availability of contingency funding of litigation. As reflected in Law Reform Commission's Consultation Paper on Class Action Procedures in Hong Kong (see paragraphs 3.18 – 3.28), there are significant risks and disadvantages in permitting contingency funding of litigation. It seems most unlikely that in the foreseeable future there will be support for contingency funding of litigation. For the reasons set out above, the absence of a US-style class action litigation process, either now or for the foreseeable future, should not in our view weigh as a material factor in consideration of whether to permit WVR structures for listed companies.
20. For any questions in relation to this response, please contact our [REDACTED] [REDACTED] on +852 [REDACTED] or [REDACTED].

DAVIS POLK & WARDWELL  
HONG KONG  
NOVEMBER 30, 2014