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Court of Appeal publishes ruling in PCCW case

The Court of Appeal today published its reasons for allowing the appeal by the Securities and Futures Commission (SFC) in the PCCW Ltd (PCCW) case (Note 1).

In a landmark ruling, the Court of Appeal made it clear that share splitting for the purpose of manipulating the outcome in a scheme of arrangement is a form of abuse. Today's ruling also confirms the important role of the court in deciding whether or not to sanction a scheme of arrangement.

"This judgment makes it clear that share splitting in this context is a form of vote manipulation and the results of shareholder meetings achieved by manipulative devices may be struck down by the court," the SFC's Chief Executive Officer, Mr Martin Wheatley, said.

The SFC presented evidence to the court which questioned the way in which the PCCW scheme of arrangement meeting achieved the required majority of shareholders voting in favour of the privatisation scheme (Note 2).

The SFC argued that the evidence suggested the number of those who voted in favour was influenced significantly by the splitting of larger parcels of shares into single board lots which were then distributed to persons who became registered shareholders with the attached votes cast in favour of the PCCW scheme.

It also pointed out that share splitting and artificial arrangements have resulted in over 800 out of 1,404 shareholders, either in person or by proxy, voting in favour of the privatisation scheme. If these votes had not been cast, the required majority of persons voting in favour of the proposal would not have been met.

The SFC was of the view that the extent of the share splitting meant the court could not be satisfied that the result of the meeting was a fair representation of the interests of those attending the meeting (Note 3).

The judgment delivered by the three judges constituting the Court of Appeal unanimously upheld the SFC's arguments. In so doing, the Court of Appeal stated that:

- there was a clear manipulation of the vote and because of the extent to which that happened the court cannot be sure the vote was fair (Note 4);
- vote manipulation is a form of dishonesty (Note 5);
- the underlying objection to share splitting for the purpose of influencing a vote is that it frustrates the legislative intent in the Companies Ordinance (Note 6);
- vote manipulation can take many forms and share splitting is but one of them (Note 7);
- there is no need to have any further SFC directives or guidelines nor is there any need for there to be a criminal or other regulatory sanction in place before the court can find manipulative practices like this to be objectionable (Note 8).

“This is a landmark ruling confirming the authority and discretion of the court to uphold the purpose of the legislation and to ensure its provisions are not abused by manipulative or artificial means and that the legitimate interests of shareholders are not overridden by disreputable practices,” Mr Wheatley said.

“The SFC will continue to take appropriate steps, within the scope of its functions under the Securities and Futures Ordinance, to ensure the investing public is protected from abusive strategies like this,” Mr Wheatley added.

End

Notes:

1. The Court of Appeal comprised The Honourable Mr Justice Rogers VP, The Honourable Mr Justice Lam and The Honourable Mr Justice Barma. The court delivered a unanimous judgment on 22 April 2009 allowing the SFC’s appeal. The Court of Appeal published its reasons today.
2. PCCW was proposing a privatisation scheme under section 166 of the Companies Ordinance. A scheme of arrangement must be approved by the shareholders in a meeting convened by order of the court. The legislation requires the proposal to be accepted by a majority in number of those present and voting at the meeting who also hold a three quarters majority in value. If approved by the shareholders in this way, the scheme is then presented to the court for approval. The court has the final say.
3. Between the adjourned court meeting on 4 February 2009 and 17 March 2009 when the SFC was directed to file with the court any evidence it wanted to rely upon, the SFC interviewed 91 witnesses, transcribed, translated and summarised their statements; analysed over 6,000 voting records; analysed and examined approximately 2,000 further documents including relevant share certificates, PCCW shareholders lists, transfer journals, and other records such as telephone, computer and personal records; obtained and examined account opening documents and trading and settlement records for several hundred clients of five brokers; and prepared evidence for submission to the court, including a core affidavit of 49 pages with 33 box files of key evidence.
4. See paragraph 66 of the judgment.
5. See paragraph 71 of the judgment.
6. See paragraphs 148 and 179 of the judgment.
7. See paragraph 136 of the judgment.
8. See paragraph 148 of the judgment.
9. The Court of Appeal’s Reasons for judgment (CACV 85/2009) is available on the [Judiciary website](http://www.judiciary.gov.hk) (www.judiciary.gov.hk).

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