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A Consultative Document

On Review of Provisions Regulating Substantial Property Transactions, Disclosure Obligations and Loans to Directors

by the Corporate Law Reform Committee
for the Companies Commission of Malaysia

SURUHANJAYA SYARIKAT MALAYSIA
COMPANIES COMMISSION OF MALAYSIA

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COMPANY LAW

CORPORATE LAW REFORM COMMITTEE

A CONSULTATIVE DOCUMENT ON

REVIEW OF PROVISIONS REGULATING SUBSTANTIAL PROPERTY TRANSACTIONS, DISCLOSURE OBLIGATIONS AND LOANS TO DIRECTORS

JULY 2007

The Corporate Law Reform Committee invites comments, by **29 August 2007** on the issues set out in this consultative document.

You are invited to send comments, together with any supporting evidence on any part of this consultation. We would be grateful if you could refer to the recommendation number(s) and/or paragraph number(s) in your feedback, preferably by email, to:

Nor Azimah Abdul Aziz
Secretary,
Corporate Law Reform Committee
Companies Commission of Malaysia
17th Floor, Putra Place
100 Jalan Putra
50622 Kuala Lumpur
e-mail : azimah@ssm.com.my
Fax : 603-40476334

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Section A

Foreword

SECTION A - FOREWORD

This Consultation Document is a result of the collaboration between Working Groups B and C of the Corporate Law Reform Committee (CLRC) on issues pertaining to substantial property transactions with related parties. The purpose of this Consultation Document was to ascertain the continued relevance of the current regulations, to improve the current regulation where necessary, to provide clarity to the law and to ensure that the minority shareholders have sufficient protection under the law.

In 1999, the High Level Finance Committee released its Report on Corporate Governance. In this report, it was highlighted that steps needed to be taken to check abuses by controlling shareholders in relation with related party transactions, steps to achieve greater transparency of ownership and measures to enhance and raise standards of disclosure and protect creditors' rights.

The main areas of review covered by this Consultation Document are, the need to formulate statutory provisions for substantial property transactions with related parties, the need to define what constitutes 'persons connected to directors', the requirement for shareholders to obtain approval, defining what constitutes 'substantial non-cash asset', the effect of any arrangement or transaction entered into without the approval of the shareholders, clear demarcation of what are the exceptions to the substantial property transactions, reviewing section 132C of the Companies Act 1965, reviewing loans to directors and persons connected to directors under sections 133 and 133A of the Companies Act 1965, reviewing the requirements under section 131 of the Companies Act 1965 and the rule of disclosure by a shareholder.

We hope to receive views and comments on the recommendations stated in this Consultation Paper. Please reply to Nor Azimah Abdul Aziz of the Companies Commission of Malaysia (SSM) before **29 August 2007.**

Thank you

Dato K.C. Vohrah
Chairman
Corporate Law Reform Committee

Peter Lee Siew Choong
Chairman
Working Group B

Dr Nik Ramlah Nik Mahmood
Chairman
Working Group C

MEMBERS OF THE CORPORATE LAW REFORM COMMITTEE (CLRC)

1. Y Bhg Dato' K.C. Vohrah (Chairman)
   Consultant

2. Y Bhg Datuk Dr. Abdul Samad Hj Alias
   Commission Member, Companies Commission of Malaysia

3. Y Bhg Dato' Loh Siew Cheang
   Advocate & Solicitor

4. Y Bhg Datuk Simon Shim Kong Yip (w.e.f 1 October 2005)
   Advocate & Solicitor

5. Abdul Karim Abdul Jalil (w.e.f 1 November 2005)
   Chief Executive Officer, Companies Commission of Malaysia

6. Dr. Nik Ramlah Nik Mahmood
   Representative of the Securities Commission

7. Selvarany Rasiah
   Representative of Bursa Malaysia Securities Berhad

8. Charon Wardini Mokhzani
   Deputy Chief Executive, CIMB Investment Bank Berhad

9. Philip Koh Tong Ngee
   Advocate & Solicitor

10. Peter Lee Siew Choong
    Advocate & Solicitor

11. Cheong Kee Fong
    Advocate & Solicitor

12. Lim Tian Huat
    Chartered Accountant

13. Eric Kang Shew Meng
    Company Secretary Practitioner

14. Prof. Dr. Khaw Lake Tee
    Universiti Malaya

15. Assoc. Prof. Dr. Aishah Bidin
    Universiti Kebangsaan Malaysia

16. See Mee Chun (w.e.f 17 October 2005)
    Representative of the Attorney General's Chambers

17. Aslam Zainudin (w.e.f. 13 July 2004)
    Representative of the Prime Minister's Department

18. Ahmad Azhari bin Abd Hamid (w.e.f. 15 August 2006)
    Representative of the Prime Minister's Department

MEMBERS OF WORKING GROUP B

1. Peter Lee Siew Choong (Chairman)
   Advocate & Solicitor

2. Dato' Loh Siew Cheang
   Advocate & Solicitor

3. Selvarany Rasiah
   Representative from Bursa Malaysia Securities Berhad

4. Eric Kang Shew Meng
   Company Secretarial Practitioner

5. Puspha Rajadurai
   Investment Banker - AM Merchant Bankers Bhd.

6. Lim Tiang Siew
   Investment Banker - CIMB Group

7. Geetha Sivapathasundram
   Investment Banker - CIMB Investment Bank Berhad

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   Representative from the Securities Commission

9. Andy Tan Chee Kiong
   Chartered Accountant

10. Dr. Nordin Mohd Zain
    Executive Director, Malaysian Accounting Standards Board

11. Shanti Geoffrey
    Representative from the Securities Commission

12. Yew Yee Tee
    Representative from Bursa Malaysia Securities Berhad

MEMBERS OF WORKING GROUP C

1. Dr. Nik Ramlah Nik Mahmood (Chairperson)
   Representative from the Securities Commission

2. Dato' K.C. Vohrah (Chairman of CLRC)
   Consultant

3. Dato' Loh Siew Cheang
   Advocate & Solicitor

4. Datuk Simon Shim Kong Yip
   Advocate & Solicitor

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   Executive Chairman
   PricewaterhouseCoopers, Malaysia

6. Peter Lee Siew Choong
   Advocate & Solicitor

7. Philip Koh Tong Ngee
   Advocate & Solicitor

8. Assoc. Prof. Dr. Aishah Bidin
   University Kebangsaan Malaysia

9. Selvarany Rasiah
   Representative from Bursa Malaysia

10. Yew Yee Tee
    Representative from Bursa Malaysia

11. Peter Ling
    Advocate & Solicitor

12. Shanti Geoffrey
    Representative from the Securities Commission

13. See Mee Chun
    Representative of the Attorney General's Chambers

MEMBERS OF THE SECRETARIAT (CLRC)

Consultant

Assoc. Prof. Dr. Aiman Nariman Mohd Sulaiman
Ahmad Ibrahim Kulliyyah of Laws
International Islamic University Malaysia

Secretariat

Nor Azimah Abdul Aziz
Secretary

Norhaslinda Salleh
Section Head
Corporate Development and Policy Division

Norhaiza Jemon
Corporate Development and Policy Division

Sapiah Ambo
Corporate Development and Policy Division

Marina Nathan
Corporate Development and Policy Division

The Secretariat can be contacted at:-
+ 603 4047 6062 / 6063 / 6064
clrc@ssm.com.my

Section B
Executive Summary

SECTION B - EXECUTIVE SUMMARY

1. Background

1.1 This Consultation Document presents the views of Working Groups B and C in relation to substantial property transactions with related parties, disclosure obligations and loans to directors and person connected to directors. The review is carried out with the objective of:

- ascertaining the continued relevance of the current regulation,
- improving the current regulation,
- providing clarity to the law, and
- ensuring that there is sufficient protection of minority shareholders.

1.2 This Consultation Document proceeds on the basis that there is a need to regulate substantial property transactions with related parties due to a high probability that these transactions may result in the dissipation of the company's assets or asset-stripping by persons who are in control of the affairs of the company.[1] The disclosure of the directors' interest in company contracts is both a necessary and an efficient regulatory tool.

2. Proposals

2.1 *Formulating statutory provisions for substantial property transactions with related parties*

It is the recommendation of the CLRC to:

(a) delete section 132G as the total prohibition in this section imposes unnecessary hindrance to genuine commercial transactions; and

[1] These persons need not necessarily be the directors of the company but can also include the major shareholders of a company. It must also be pointed out that within the Malaysian context it is most likely that company directors would also be appointed by the company's major shareholders. Further, in the case of public listed companies that have evolved from family companies, there exists a strong tendency for concentrated family shareholdings in such companies. Concentrated family shareholding together with the practice of the major shareholders appointing company directors may result in those directors who are appointed by the family to act in the interest of the family as opposed to acting in the interest of the company especially when the interest of the family is in conflict with the interest of the company.

(b) clarify the law by stating that a company may not carry into effect any arrangement or transaction that is a substantial property transaction of a requisite value except with shareholders' approval.

2.2 *Identification of 'persons connected to directors' - review of sections 6A and 122A of the Companies Act 1965*

It is the recommendation of the CLRC:

(a) to amend section 122A(2) i.e. the definition of 'persons connected to directors' to state that:

In subsection (1)(a) 'the members of the director's family are his spouse, parent, child (including adopted child and step child), brother, sister and the spouse of his child, brother or sister.'

(b) that the definition of 'a body corporate is an associate of a director' requires clarification.

"For the purposes of subsection (1)(b) a body corporate is associated with a director if -

(a) the body corporate is accustomed or is under an obligation, whether formal or informal, or its majority of directors are accustomed, to act in accordance with the directions, instructions or wishes of that director; or

(b) that director has a controlling interest in the body corporate; or

(c) that director or person connected with him, or that director and persons connected with him, are entitled to exercise, or control the exercise of, not less than 20 per cent of the votes attached to voting shares in the body corporate."

(c) where 'controlling interests' under 122A(3)(b) is concern, the CLRC recommends that the meaning of 'controlling interest' or the concept of control be defined as follows:

'A person is deemed to have control or have a controlling interest in a body corporate if the person or persons connected to him or the person together with persons connected to him -

(a) holds more than 50 per cent of the issued share capital of the body corporate; or

(b) controls more than 50 per cent of the voting power of the body corporate; or

(c) is able to control the composition of the board of directors of the body corporate.'

Section 6(4) of the Companies Act 1965 should also be amended to state:

'A person shall be deemed to have an interest in a share where a body corporate has an interest in the share and -

(a) the body corporate, or a majority of its directors are accustomed, or is under an obligation, whether formal or informal, to act in accordance with the direction, instructions or wishes of that person in relation to that share;

(b) that person has a controlling interest in the body corporate; or

(c) that person or the associates of that person or that person and his associates are entitled to exercise or control the exercise of not less than 20 per cent of the votes attached to the voting shares in the body corporate.'

2.3 *Requirement to obtain shareholders' approval and restriction on related parties from voting*

It is recommended that:

(a) a company may not carry into effect a substantial property transaction with a related party unless shareholders' prior approval has been obtained.

(b) the restriction on related parties from voting on the transaction should be applicable for public companies only; and

(c) where a company enters into a substantial property transaction with a related party and the related party is -

- a director of its holding company; or
- a substantial shareholder of its holding company; or
- a person connected to the director or the substantial shareholder,

the prior approval of the shareholders of the holding company must also be obtained.

2.4 *Defining a 'substantial non-cash asset'*

It is recommended that:

(a) for the purpose of triggering the requirement to obtain shareholders' approval, there should be stated in the companies legislation, a common value for private and public non-listed companies. The substantial value of the transaction that should be specified in the company legislation is if the transaction -

(i) exceeds 10 per cent of the company's assets value and is more than RM50,000; or

(ii) exceeds RM500,000.

(b) for the purpose of triggering the requirement to obtain shareholders' approval, the value for the listed company is subject to the Bursa Malaysia Securities Berhad Listing Requirements.

(c) the 'net assets' test should be adopted and that the net assets are to be determined by reference to the most recent financial statements.

2.5 *Effect of any arrangement or transaction entered into without shareholders' approval*

It is the recommendation of the CLRC that:

(i) the transaction should be voidable at the option of the company;

(ii) the company may ratify the transaction;

(iii) the right to avoid the transaction will not be available in the case of *bona fide* third parties;

(iv) the company should not be liable for an offence if the section is contravened;

(v) an interested director or substantial shareholder of the company or its holding company or person(s) connected to such director or substantial shareholder with whom the company entered into the transaction should be held liable to account for the profit or to pay compensation to the company unless he shows that he is 'innocent' of the contravention or if he shows that he took all reasonable steps to secure the approval of the shareholders;

(vi) any director who authorised the transaction should be held liable to account for the profit or to pay compensation to the company unless the director shows that he is 'innocent' of the contravention.

2.6 *Carving out the exceptions to the substantial property transaction*

The CLRC recommends:

(i) to retain the current exceptions under section 132F;

(ii) to exempt a subscription for new shares for cash consideration (as is currently found under section 132G(6)(a)) from the requirement to obtain shareholders' approval; and

(iii) to state that an acquisition of shares or assets made by a company pursuant to a scheme or compromise or arrangement approved by the court under section 176 should not be exempted from the requirement to obtain shareholders approval.

2.7 *Review of section 132C of the Companies Act 1965*

It is the recommendation of the CLRC that section 132C should be amended:

(a) to specify that for the purpose of triggering the requirement to obtain the approval of the shareholders, there should be a common value for private and public non-listed companies in the company legislation. The substantial value of the transaction that should be specified in the company legislation is if the transaction -

(i) exceeds 10 per cent of the company's assets value and is more than RM50,000; or

(ii) exceeds RM500,000.

(b) for the purpose of triggering the requirement to obtain the approval of the shareholders, the value for a listed company is subject to the Bursa Malaysia Securities Berhad Listing Requirements.

(c) the net assets test should be adopted and that the net assets are to be determined by reference to the most recent financial statements.[2]

(d) that the section should not apply for the acquisition of an undertaking or property of a substantial value or the disposal of a substantial portion of the company's undertaking or property undertaken by any or with a banking corporation pursuant to an Islamic transaction involving contemporaneous acquisition and disposal of the same undertaking or property.

[2] This is similar to the proposed amendment to section 132E of the Companies Act 1965.

2.8 *Loans to directors and persons connected to directors under sections 133 and 133A of the Companies Act 1965*

The CLRC recommends:

(a) that a loan or security for a loan given to directors and persons connected to directors should be prohibited except in the case of exempt private companies;

(b) the section should not be extended to the substantial shareholder or persons connected to the substantial shareholder.

2.9 *Review of section 131 of the Companies Act 1965*

(a) The materiality of the interest

The principle of law embodied in section 131, that a director must disclose his direct or indirect interest in any contract or proposed contract with the company to the board of directors of his company where there exists a conflict or potential conflict of interest in respect to that contract or proposed contract, be retained.

(b) Director's knowledge of the interest

A director should only be made accountable for contravening section 131 if he is aware of the interest and intentionally does not disclose the interest.[3] It is only reasonable that a director who unintentionally contravenes section 131 should not be made accountable for his non-disclosure and that section 131 should be clarified on this point.[4]

(c) Method of declaration

The CLRC is of the view that any declaration under this section must be made in accordance to any of the following methods:

(i) at a meeting of the board of directors;

3 See *Lim Foo Yong v PP* [1976] 2 MLJ 259 where no offence is committed if the director could not have reasonably known about the conflict.
4 Section 162(3) of the Hong Kong Companies Ordinance expressly provides that a director is not guilty of an offence if he is not aware of the contract that gave rise to the conflict of interest.

(ii) by notice in writing; or

(iii) by giving a general notice of a future conflict of interest pursuant to section 131(4) of the Companies Act 1965.

(d) Consequences of contravention

The common law position should be preserved and a transaction entered into by a company in contravention of section 131 should be stated as voidable at the option of the company except in favour of a third party who acted in good faith, for value and without actual notice of the contravention.

2.10 *Review of disclosure by substantial shareholder*

(a) the current threshold of 5 per cent as is currently provided for by section 69D should be retained as it is a usual practice for countries to peg their threshold percentage between 3 to 5 per cent.[5]

(b) the current timeline of seven (7) days for giving the required notice to the company pursuant to sections 68E, 69F and 69G of the Companies Act 1965 should also be retained.

(c) there is no necessity to propose a threshold or a *de minimis* rule for section 69F of the Companies Act 1965.

[5] In Australia and Singapore the threshold is pegged to 5 per cent whilst in the United Kingdom it is pegged to 3 per cent.

Section C

Review of Provisions Regulating Substantial Property Transactions, Disclosure Obligations and Loans to Directors

SECTION C - REVIEW OF PROVISIONS REGULATING SUBSTANTIAL PROPERTY TRANSACTIONS, DISCLOSURE OBLIGATIONS AND LOANS TO DIRECTORS

PART I REVIEW OF PROVISIONS REGULATING SUBSTANTIAL PROPERTY TRANSACTIONS

INTRODUCTION

1.1 This Consultation Document is made up of two parts:

- substantial property transactions

  The term 'substantial property transaction' is used in reference to transactions involving the acquisition from or the disposal to related parties (i.e., directors, substantial or controlling shareholders or persons connected to them) of the company's non-cash assets of a certain value.
- loans to directors

A. REGULATING SUBSTANTIAL PROPERTY TRANSACTIONS

APPLICATION OF THE CURRENT LAW AND REGULATION

1.2 The current regulation on substantial property transactions is intended to prevent the acquisition of the company's assets at an inflated price from directors, substantial shareholders or persons connected with them i.e. related parties, or the disposal of the company's assets at an undervalue to these related parties. The current regulation is also intended to minimise the potential for a director's conflict of interest and to provide the shareholders with a mechanism to ensure the objectivity of transactions entered into by the company.

1.3 At common law, a director must not place himself in a situation where his personal interest may or actually conflict with his duty to act in the interest of the company. An example of a conflict of interest is where there is a disposal of the company's assets to or the acquisition of assets by a company from its director(s) or person(s) connected to such director(s). The common law states that directors may be held liable for a breach of fiduciary duty unless shareholders' approval or ratification at the general meeting has been obtained in respect of the conflict of interest transactions.[6]

1.4 Apart from the common law, sections 132E and 132F of the Companies Act 1965 also regulates the disposal or acquisition of property of substantial value transactions (i.e. substantial property transactions) to or from director(s) or person(s) connected to director(s). Under these sections, substantial property transactions involve the transfer of assets of a substantial value between a company and its director(s). In addition, there is also the Bursa Malaysia Securities Berhad Listing Requirements on 'related party transactions' which are applicable to listed companies.

1.5 Section 132E[7] prohibits an arrangement or transaction to acquire or dispose any non-cash asset of the requisite value between a company and:

- a director of the company; or
- a person connected to a director of the company;[8] or
- a director of the holding company; or
- a person connected to a director of the holding company,

6 See *Cooks v Deeks* [1916] 1 AC 554; *IDC V Cooley* [1972] 2 All ER 162; *Avel Consultants Sdn Bhd v Mohamad Zain Yusof & Ors* [1985] 2 MLJ 209, *Yukilon Manufacturing Sdn Bhd v Dato' Wong Gek Meng & Ors* [1998] 7 MLJ 551.

7 The section was incorporated into the Companies Act 1965 under the Companies (Amendment) Act 1986 (Act 657) section 10.

8 Section 122A of the Companies Act 1965 defines 'persons who are connected to a director of the company. This definition is applicable to sections 132E and 132G of the Companies Act 1965.

unless its members' prior approval has been obtained. The arrangement or transaction is voidable unless the transaction or arrangement has been ratified by the company within a reasonable time.[9]

1.6 A non-cash asset means any property other than cash (including foreign currency).[10] An acquisition or disposal of non-cash asset includes the creation or extinction of an estate or interests in any property. This also includes the discharge of any person's liability excluding liability for a liquidated sum.

1.7 Section 132E(5) defines the value of the non-cash asset which is the subject matter of the transaction as follows:

> *'A non-cash asset is of the requisite value if, at the time of the arrangement or transaction for the acquisition or disposal of the assets, its value is not less than ten thousand ringgit but (subject to that) exceeds two hundred and fifty thousand ringgit or ten per centum of the company's asset value.'*

1.8 If a company entered into an arrangement or transaction which falls within section 132E without first obtaining the approval from its shareholders, the arrangement or transaction is voidable unless the company ratifies the arrangement within a reasonable time. The director of the company or its holding company, or the person connected with such a director with whom the company entered into the arrangement or transaction, and any director of the company who authorised the arrangement or transaction is liable to account to the company for any gain that he has made directly or indirectly by the transaction, and jointly and severally with any person so liable under this section to indemnify the company for any loss or damage

[9] This is provided for by section 132E(2) of the Companies Act 1965. In *Omega Securities Sdn Bhd v Yeo Lee Hoe* [2000] LNS160, the court held that a transaction between the company and its directors to which the company purportedly gave a house to its directors was avoidable at the option of the company as the prior approval of the general meeting was not obtained as mandated by section 132E of the Companies Act 1965.

[10] Section 132E (7) if the Companies Act 1965.

resulting from the transaction.[11] The above-mentioned persons will also be guilty of an offence against the Companies Act 1965 which is punishable with imprisonment for 5 years or a fine of RM30,000 or both.

1.9 Approval of members as mandated by section 132E of the Companies Act 1965 is, however, not required in the four instances set out under section 132F of the Companies Act 1965. They include:

- transactions entered between a company and its wholly owned subsidiary;
- transactions by a company which is being wound up (except in the case of a members' voluntary winding up);
- arm's length transactions in the ordinary course of business; and
- arrangements and transactions that do not involve the transfer of cash or property and which will have no effect unless approved at a general meeting or by relevant authorities.

1.10 Another relevant section is section 132G of the Companies Act 1965. In essence, section 132G of the Companies Act 1965, prohibits a company (Acquiring Company) from entering into any arrangement or transaction to acquire the shares or assets of another company (Target Company) in which:

- A director or a substantial shareholder of the Acquiring Company has substantial shareholding;[12] or
- A person connected with a director or substantial shareholder of the Acquiring Company (Connected Person) has a substantial shareholding.

[11] Section 132E(3) of the Companies Act 1965.
[12] Section 69D of the Companies Act 1965 defines who qualifies to be a substantial shareholder and what constitutes substantial shareholding.

1.11 The transaction cannot be entered into unless a period of three (3) years has elapsed between:

- the date the arrangement or transaction was entered into and the date the director or a substantial shareholder of the Acquiring Company or Connected Person first held shares in a substantial way in the Target Company in the case of a share acquisition;
- the date the arrangement or transaction was entered into and the date the Target Company first acquired the asset in the case of an asset acquisition.

1.12 The prohibition imposed by section 132G of the Companies Act 1965 overrides sections 132C and 132E of the Companies Act 1965. Whilst section 132E enables companies to enter into substantial property transactions with related parties provided the prior approval of the shareholders has been obtained, section 132G completely prohibits a company from entering into certain types of transactions. If section 132G of the Companies Act 1965 is contravened, the acquiring company and its directors are guilty of an offence against the Companies Act 1965 and it is punishable with imprisonment for 3 years or fine of RM50,000 or both.

1.13 The term 'persons connected to directors' used in sections 132E and 132G is defined under section 122A of the Companies Act 1965. The term 'substantial shareholding' under section 132G is defined under section 69D of the Companies Act 1965.

1.14 The Listing Requirements also regulate transactions by listed companies involving the transfer of assets to or from directors or major shareholders or persons connected to them. Within the context of the Bursa Malaysia Securities Berhad Listing Requirements, these types of transactions are referred to as 'related party transactions' (RPT) and is regulated by Chapter 10 of the Bursa Malaysia Securities Berhad Listing Requirements.

The Bursa Malaysia Securities Berhad Listing Requirements defines a 'related party transaction' as a transaction entered into by the listed issuer or its subsidiaries which involves the interest, direct or indirect, of a related party.[13] The Bursa Malaysia Securities Berhad Listing Requirements defines transactions for the purposes of RPT to include:

- the acquisition, disposal or leasing of assets;
- the establishment of joint ventures;
- the provision of financial assistance;
- the provision or receipt of services; or
- any business transaction or arrangement entered into, by a listed issuer or its subsidiaries.

1.15 Hence, in contrast to transactions that are regulated by the Companies Act 1965, a wider range of transactions are in fact regulated by the Bursa Malaysia Securities Berhad Listing Requirements. This is in contrast to sections 132E, 132F and 132G of the Companies Act 1965 which are only confined to the acquisition and disposal of assets.

1.16 The Bursa Malaysia Securities Berhad Listing Requirements defines related party as 'a director (including a chief executive officer), major shareholder (similar to a substantial shareholder) or person connected with such director or major shareholder of the public listed company, its holding company, subsidiaries and subsidiaries of its holding company' and former directors or major shareholders for the preceding 12 months prior to the transaction. Persons connected to the abovementioned related parties for the purposes of the Bursa Malaysia Securities Berhad Listing Requirements are to a large extent similar to those persons connected

[13] Paragraph 10.2 of the Bursa Malaysia Securities Berhad Listing Requirements.

to directors for the purposes of the Companies Act 1965. Persons connected to directors for the purposes of the Companies Act 1965 are currently defined by section 122A of the Act.

1.17 Chapter 10 of the Bursa Malaysia Securities Berhad Listing Requirements regulates RPT in the following manner:

- by requiring the RPT to be disclosed to the shareholders and to the market;
- by mandating the public listed company to obtain the prior approval of its shareholders when the transaction exceeds a prescribed value;
- by specifying that certain minimum information is provided to the shareholders of a listed company to enable shareholders to make an informed decision in relation to a RPT. This is done by requiring a circular be sent to the shareholders prior to the meeting. In this respect, the minimum contents of that circular are prescribed under the Bursa Malaysia Securities Berhad Listing Requirements and must be submitted to Bursa Malaysia Securities Berhad for clearance prior to its issuance to the shareholders;
- interested parties are prohibited from participating and voting in the meeting of the board and shareholders convened to approve the RPT; and
- the listed company is required to appoint an independent corporate adviser who must satisfy certain criteria and on whom certain responsibilities are imposed in relation to the listed company and its shareholders.[14]

[14] See Chapter 10 of the Bursa Malaysia Securities Berhad Listing Requirements.

2. FORMULATING STATUTORY PROVISIONS FOR SUBSTANTIAL PROPERTY TRANSACTIONS WITH RELATED PARTIES

2.1 Within the Malaysian context, where most companies are controlled by substantial or major shareholders and where there is concentrated family shareholdings, there is a higher probability of substantial or controlling shareholders of a company or insiders, like directors, to appropriate the company's assets at the expense of the minority shareholders. Whilst control by an owner can be beneficial to monitor the company's performance, instances involving expropriation of the company's assets by controlling shareholders or insiders have an impact on corporate governance and minority shareholders' protection.[15] However, there are also views that these transactions are beneficial to a company as they fulfil certain economic needs, for example the company may benefit by engaging the controlling shareholders or insiders as there will be reduced information asymmetry.

2.2 The CLRC believes that there is a need to have statutory provisions within the Companies Act to regulate substantial property transactions with related parties. This is because although the common law already provides that a director has a duty to avoid conflict of interest situations which includes self-dealing transactions by directors, the common law fiduciary duty may be inadequate because such a duty would not be applicable where the director did not have a direct pecuniary interest in the transaction, or did not intend to cause any detriment to the company. In addition, under the common law there is no prohibition on the company entering into the transaction. There is also generally no prohibition on a director who is a shareholder from voting on the transaction in which the director has an interest and

[15] See *British Racing Drivers' Club v Hextall Erskine & Co* [1997] 1 BCLC 182 where Carnwarth J explained the purpose for the introduction of section 320 of the UK Companies Act 1985 which is in *pari materia* with section 132E of the Malaysian Companies Act 1965, 'The thinking behind the section is that if directors enter into substantial commercial transactions with one of their numbers, there is danger that their judgment may be distorted by conflicts of interest and loyalties, even in cases where there is no actual dishonesty. The section is designed to protect a company against such distortions. It enables members to provide a check.'

this may enable the director or related persons to use their voting power to expropriate the company's assets at the expense of the minority shareholders. Whilst a director may be held liable to account for the profits he accumulated as a result of the breach of duty under the common law, there is nonetheless no criminal liability. By incorporating the provision into the Companies Act, there will also be criminal liability for non-compliance and this punitive element will be a deterrent factor.[16]

2.3 As noted earlier, sections 132E, 132F and 132G of the Companies Act 1965 regulates substantial property transactions. The CLRC noted that there are several shortcomings in these sections. The shortcomings are, amongst others:

- another total prohibition as imposed by section 132G has the effect of preventing the company from entering into genuine commercial transactions. Prior to the enactment of section 132G, it was well-known that there were transactions involving the acquisition of shares and assets by public companies at a premium from people or companies who have just acquired the shares or assets, enabling these persons to make a very quick profit at the expense of the minority shareholders. The intention behind the enactment of section 132G of the Companies Act 1965 was to control such activities and to further prevent the stripping off of the company's assets and resources by those in control of the company. Whilst the section protects minority shareholders interests, the Finance Committee Report on Corporate Governance pointed out that the absolute prohibition imposed by section 132G of the Companies Act had the effect of capturing genuine transactions.

[16] See for instance sections 131(8), 133(4), 132E (8) and 132G(5) of the Companies Act 1965.

- there is uncertainty in the application of section 132E(5) of the Companies Act 1965 in relation to the phrase 'requisite value'. This subsection is difficult to interpret and does not make sense if the words 'whichever is lesser' is not read into the section.[17]
- whether or not a company may enter into a provisional arrangement to acquire or dispose a non-cash asset in relation to section 132E.
- although section 132E imposes a liability on a director who has authorised the transaction, the section does not provide protection for directors who are not interested in the transaction and/or who are unaware of the relevant circumstances.
- uncertainty as to whether a conditional agreement falls within the purview of section 132E. There are views that it should be possible for a company to enter into a conditional agreement and that the conditional agreement should not fall within the purview of section 132E.[18]

2.4 In spite of the above shortcomings in the current statutory provisions on substantial property transactions, the CLRC is of the view that transactions of this kind may result in the dissipation of the company's assets or asset stripping by persons who are in control of the affairs of the company at the expense of the minority shareholders and therefore, the statutory provision on substantial property transactions should still be retained in the Companies Act with certain amendments. The CLRC supports the deletion of section 132G as the total prohibition in this section imposes unnecessary hindrance to genuine commercial transactions. Whilst the CLRC is of the view that transactions that benefit the director of that company or the director of the holding company or persons connected to those directors should be regulated, the CLRC

[17] See *Joint Receivers and Managers of Niltan Carson Ltd v Hawthorn* [1988] BCLC 298, at pp 320-321; see also Loh SC, *Corporate Powers: Controls, Remedies and Decision-making* (2002) LexisNexis Butterworths at 600.
[18] See Clause 22B(3) of the United Kingdom Company Law Reform Bill which states:
'An agreement by a company to enter into a transaction for which approval is required under this section does not itself require approval under this section if it is expressed to be conditional on the requisite approval being obtained for the transaction.'

submits that the better approach would be to ensure that there are better safeguards in terms of shareholders' approval rather than by providing a total prohibition for these types of transactions as is currently found under section 132G of the Companies Act 1965. The CLRC also recommends that the scope of section 132E be widened so as to apply to the substantial shareholder of the company and/or persons connected to the substantial shareholder.

2.5 The CLRC is also of the view that conditional agreements should not be caught by section 132E and proposes to clarify the law by stating that a company may not **carry into effect** any arrangement[19] or transaction that is a substantial property transaction except with the approval of the shareholders.

Cross-Jurisdictional study

2.6 The United Kingdom Companies Act 1985 has a provision similar to section 132E of the Companies Act 1965. However, there is no equivalent to section 132G of the Companies Act 1965. The United Kingdom Company Law Review's proposal to retain the statutory provision on substantial property transactions involving the transfer of assets to or from director(s) or person(s) connected to directors is reflected in sections 190 -196 of the United Kingdom Companies Act 2006. There is no distinction between private and public companies.

2.7 Chapter 2E of the Australian Corporations Act 2001 specifically requires that a public company and its controlled entities that seek to give a financial benefit to directors or other related parties to obtain the approval of shareholders. This provision is not intended to prevent 'full value, commercial transactions' with related parties.

[19] The word *'arrangement'* is used in order to cover transactions where an asset is transferred first to a third party and then on to a director. See *Re British Basic Slag Ltd's Agreement* [1963] 1 WLR 727; *Re Duckwari plc* [1999] Ch 253.

Instead, it is intended to prevent transactions that have the potential to adversely affect the interests of shareholders as a whole.[20] The object of chapter 2E is stated as 'being to protect the interests of a public company's members as a whole, by requiring member approval for giving benefits to related parties that could endanger those interests'.[21] Further, examples of transactions that would constitute the giving of a financial benefit are set out under the Australian Corporations Act 2001. They include:

- giving or providing the related party with finance or property;
- buying an asset from or selling an asset to the related party;
- leasing an asset from or to the related party;
- supplying services to or receiving services from the related party;
- issuing securities or granting an option to the related party; or
- taking up or releasing an obligation of the related party.

2.8 Under the Australian Corporations Act 2001, the definition of 'related parties' includes its directors, other persons who are in a position to influence the company's decision to give them a financial benefit and those within family relationships. The definition of a related party therefore includes -

(a) its directors and their immediate relatives as identified by the Act;
(b) a holding company, its directors and their immediate relatives as identified by the Act;
(c) a controlling entity and its constituents or governing officers (such as controlling shareholders); and
(d) entities under the common control of the public company.

[20] See the Explanatory Memorandum accompanying the Australian Corporate Law Reform Act 1992 which introduced the provision.
[21] Section 207 of the Corporations Act 2001.

2.9 There are also jurisdictions that do not have any statutory provision regulating substantial property transactions, e.g. New Zealand, Singapore and Hong Kong. In these jurisdictions, the regulations on transactions involving related parties are found in the stock exchange listing requirements.

2.10 In 1998, Singapore repealed its sections 160A-160D of the Singapore Companies Act (Chapter 50) which was in *pari materia* to section 132E of the Companies Act 1965. In Singapore related party transactions are regulated by the listing requirements.

2.11 New Zealand does not have a statutory provision similar to section 132E of the Companies Act 1965. Instead, under section 141 of the New Zealand Companies Act 1993, the company may set aside a transaction entered into by the company in which a director of the company is interested in at any time before the expiration of 3 months after the transaction is disclosed to all the shareholders (whether by means of the company's annual report or otherwise).

2.12 The Hong Kong Standing Committee on Company Law Review (SCCLR)[22] recommended that the Companies Ordinance should be amended based on section 320 of the United Kingdom Companies Act 1985 to provide that connected transactions should be subject to disclosure and shareholders' approval if the total consideration or value is greater than or equal to certain *de minimis* thresholds.[23] Although the Hong Kong Companies Ordinance does not have a statutory provision similar to section 132E of the Companies Act 1965, the listing rules of the Stock Exchange of Hong Kong contains a number of provisions dealing with connected transactions. Under the listing rules of the Stock Exchange of Hong Kong a 'connected transaction' is defined as including any transaction between a listed

[22] See Corporate Governance Review - *Consultation Paper on Proposals made in Phase II of the Review* (June 2003) p 26, Chapter 3.
[23] The SCCLR, Corporate Governance Review - *Consultation Paper on Proposals made in Phase II of the Review* (June 2003), Chapter 3 at pp 24-32.

issuer or any of its subsidiaries and a connected person. The Stock Exchange of Hong Kong will usually require shareholders' approval, with the interested person abstaining from voting. In particular, a transaction in this context includes, *inter alia,* an acquisition or realisation of assets by a listed issuer or any of its subsidiaries. Exceptions are made for transactions on normal commercial terms within specified limits which may nevertheless be subject to the disclosure requirements. The Hong Kong SCCLR also recommended that the term 'Connected persons' should include the following:

(a) director's or controlling shareholders' children or step-children;
(b) spouse;
(c) trustee of any trusts in which the director or controlling shareholder, his spouse, children or stepchildren are beneficiaries under the trust;
(d) any corporation associated with the director or controlling shareholder.

2.13 The SCCLR was also of the view that although the proposal will not be applicable to private companies, the common law position on the conflict of interest will still apply to private companies.

RECOMMENDATIONS

2.14 The CLRC recommends -

(a) to delete section 132G as the total prohibition in this section imposes unnecessary hindrance to genuine commercial transactions.
(b) to clarify the law by stating that a company may not carry into effect any arrangement or transaction that is a substantial property transaction of a requisite value except with the approval of the shareholders.

3. IDENTIFICATION OF 'PERSONS CONNECTED TO DIRECTORS' - REVIEW OF SECTION 122A OF THE COMPANIES ACT 1965

3.1 The CLRC is of the view that for the purpose of substantial property transactions, the related party should be:

- a director of the company or of its holding company; or
- a substantial shareholder of the company or its holding company; or
- a person connected to the director or the substantial shareholder.

3.2 The CLRC is of the view that to enable the effective implementation of the regulation relating to substantial property transaction, there should be proper identification of the phrase 'person connected to directors'. To complement the review of the substantial property transactions provisions, the CLRC is of the view that the definition of persons connected to directors under section 122A of the Companies Act 1965 must be revised.

3.3 The CLRC recommends to amend section 122A(2) to state that:
In subsection (1)(a) -
'the members of the director's family <u>are</u> his spouse, parent, child (including adopted child and step child), brother, sister and the spouse of his child, brother or sister.'

3.4 This amendment is based on the view that familial connections and relationships often gives rise to the ability to influence. In the cases where the director or substantial shareholder may not be aware that the transaction is entered into with persons connected to them, the CLRC is of the view that the proposal that parties who are 'innocent' of the contravention should not be made liable provides adequate protection for the director or substantial shareholder.

3.5 The CLRC is also of the view that the definition of 'a body corporate is an associate of a director' requires clarification. The CLRC noted that the section 254 of the UK Companies Act 2006 states as follows:

' Director connected with' a body corporate

(2) A director is connected with a body corporate if, but only if, he and the persons connected with him together-

(a) are interested in shares comprised in the equity share capital of that body corporate of a nominal value equal to at least 20% of that share capital, or

(b) are entitled to exercise or control the exercise of more than 20% of the voting power at any general meeting of that body.

(3) The rules set out in Schedule 1 (references to interest in shares or debentures) apply for the purposes of this section.'[24]

3.6 Whilst the CLRC would like to obtain views whether section 122(3)(c) needs to be retained or revised, at this moment, the CLRC recommends that section 122A(3) should be amended to state that:

"For the purposes of subsection (1)(b) a body corporate is associated with a director if -

(a) the body corporate is accustomed or is under an obligation, whether formal or informal, or its majority of directors are accustomed, to act in accordance with the directions, instructions or wishes of that director; or

[24] In Schedule 1,
'5 (1) A person is taken to be interested in shares if a body corporate is interested in them and -
(a) the body corporate or its directors are accustomed to act in accordance with his directions or instructions, or
(b) he is entitled to exercise or control the exercise of more than one-half of the voting power at general meetings of the body corporate.
(2) For the purposes of sub-paragraph (1)(b) where -
(a) a person is entitled to exercise or control the exercise of the relevant proportion of the voting power at general meetings of a body corporate, and
(b) that body corporate is entitled to exercise or control the exercise of any of the voting power at general meetings of another body corporate,
the voting power mentioned in paragraph (b) above is taken to be exercisable by that person.'

(b) that director has a controlling interest in the body corporate; or

(c) that director or person connected with him, or that director and persons connected with him, are entitled to exercise, or control the exercise of, not less than 20 per cent of the votes attached to voting shares in the body corporate."

3.7 Where 'controlling interests' under 122A(3)(b) is concerned,[25] the CLRC recommends that the meaning of 'controlling interest' or the concept of control be defined as follows:

'A person is deemed to have control or have a controlling interest in a body corporate if the person or persons connected to him or the person together with persons connected to him -

(a) holds more than 50 per cent of the issued share capital of the body corporate; or

(b) controls more than 50 per cent of the voting power of the body corporate; or

(c) is able to control the composition of the board of directors of the body corporate.'

[25] The CLRC noted that the UK Companies Act 2006 defines 'Right to exercise or control exercise of rights' as follows:
'4 (1) A person is taken to have an interest in shares if he is entitled -
(a) to exercise any right conferred by the holding of the shares, or
(b) to control the exercise of any such right.
(2)For this purpose a person is taken to be entitled to exercise or control the exercise of a right conferred by the holding of shares if he -
(a) has a right (whether subject to conditions or not) the exercise of which would make him so entitled, or
(b) is under an obligation (whether or not so subject) the fulfillment of which would make him so entitled.
(3)A person is not by virtue of this paragraph taken to be interested in shares by reason only that -
(a) he has been appointed a proxy to exercise any of the rights attached to the shares, or
(b) he has been appointed by a body corporate to act as its representative at any meeting of a company or of any class of its members.'

4. INTERESTS IN SHARES - REVIEW OF SECTION 6A OF THE COMPANIES ACT 1965

4.1 It is important to clearly understand what constitutes 'interest in shares' where substantial shareholding and directors' interest in shares is concerned in order to comply with the disclosure requirements.

4.2 The Companies Act 1965 expressly provides that the provisions of section 6A shall have effect for the purpose of Division 3A of Part IV (disclosure of interest in voting shares by substantial shareholders) and sections 134 and 135 (up keeping of Register of directors' shareholdings and disclosure of directors' interests).

4.3 For the purposes of the reporting of interests in shares by directors and substantial shareholders, as the disclosure relates to interests in shares as defined by section 6A and not just restricted to the legal ownership of the shares, it has become a normal practice to breakdown the interest in shares into 'direct interest' and 'indirect interest' although section 6A does not expressly use the terms 'direct interest' and 'indirect or deemed interest'.

4.4 Section 6A was inserted into the Companies Act 1965 by the Companies (Amendment) Act 1985 to provide the circumstances where a person is deemed to have an interest in a share when the obligation for disclosure of substantial shareholding was introduced. However, the CLRC is aware of the uncertainties in relation to the extent that a person is deemed to have an interest in shares of a company arising out of section 6A(4)(c) through interposed entities.

4.5 Section 6A(4) provides that a person (P) is deemed to have an interest in a share of a company (Co C) where a body corporate (Co B) has an interest and:

(a) the body corporate (Co B) is or its directors are accustomed, or is under an obligation, whether formal or informal, to act in accordance with the directions, instructions or wishes of that person (P) in relation to that share;

(b) that person (P) has a controlling interest in the body corporate (Co B); or

(c) that person (P), or the associates (A) of that person or that person and his associates (P+A) are entitled to exercise or control the exercise of not less than 15 per cent of the votes attached to the voting shares in the body corporate (Co B).

4.6 Under section 6A(4)(a), P is deemed to have an interests in the shares of a company (Co C) where a body corporate (Co B) has interest, if it can be shown that the body corporate (Co B) or the directors of the body corporate (Co B) are accustomed to act in accordance with the directions, instructions or wishes of P in relation to the shares that Co B has in Co C. The CLRC recommends for the retention of this subsection.

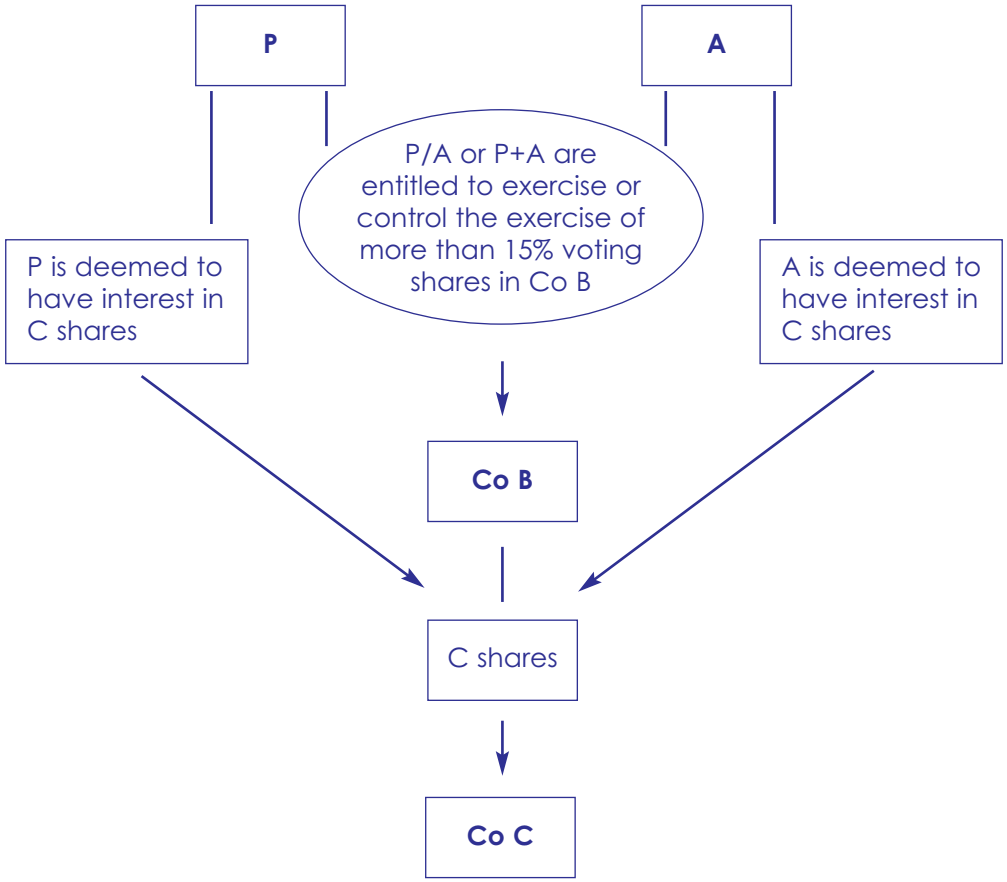
4.7 Under section 6A(4)(b), P is deemed to have an interest in the shares of company (Co C) where a body corporate (Co B) has interest, if it can be shown that P has a controlling interest in the body corporate (Co B). The CLRC recommends that the meaning of 'controlling interest'[26] or the concept of control be defined as follows:

> 'A person is deemed to have control or have a controlling interest in a body corporate if the person or persons connected to him or the person together with persons connected to him -
>
> (a) holds more than 50 per cent of the issued share capital of the body corporate; or
>
> (b) controls more than 50 per cent of the voting power of the body corporate; or
>
> (c) is able to control the composition of the board of directors of the body corporate.'

4.8 Where section 6A(4)(c) is concerned, P and A respectively are deemed to have interest in the share of Co C held by Co B where P or his associates A or P and A are entitled to exercise or control the exercise of not less than 15 per cent of the votes attached to the voting shares in the body corporate (Co B). This is explained in Figure I.

[26] The CLRC noted that the United Kingdom Companies Act 2006, Schedule 1 defines 'Right to exercise or control exercise of rights' as follows:
'4 (1) A person is taken to have an interest in shares if he is entitled -
(a) to exercise any right conferred by the holding of the shares, or
(b) to control the exercise of any such right.
(2)For this purpose a person is taken to be entitled to exercise or control the exercise of a right conferred by the holding of shares if he -
(a) has a right (whether subject to conditions or not) the exercise of which would make him so entitled, or
(b) is under an obligation (whether or not so subject) the fulfilment of which would make him so entitled.
(3)A person is not by virtue of this paragraph taken to be interested in shares by reason only that -
(a) he has been appointed a proxy to exercise any of the rights attached to the shares, or
(b) he has been appointed by a body corporate to act as its representative at any meeting of a company or of any class of its members.'

Figure 1



Thus, P and A have a disclosable interest in Co C.

It is important to understand who would constitute an associate of a person who is entitled to exercise or control the exercise of not less than 15 per cent of the votes attached to a body corporate which has an interest in a share, who shall then be deemed to have interest in that share for the purposes of section 6A(4)(c). Section 6A(5) provides that a person (A) is an associate of another person (P):

(a) if A and P are related corporation;[27]

(b) if A is a person whose directions, instructions or wishes P is accustomed or is under an obligation (whether formal or informal) to act in relation to the share in question ('the shares in Co C held by Co B') - i.e. the appointer of the nominee;[28]

(c) if A is accustomed or is under an obligation (whether formal or informal) to act upon the directions, instructions or wishes of P in relation to the C shares - i.e. the nominee of that other person;[29]

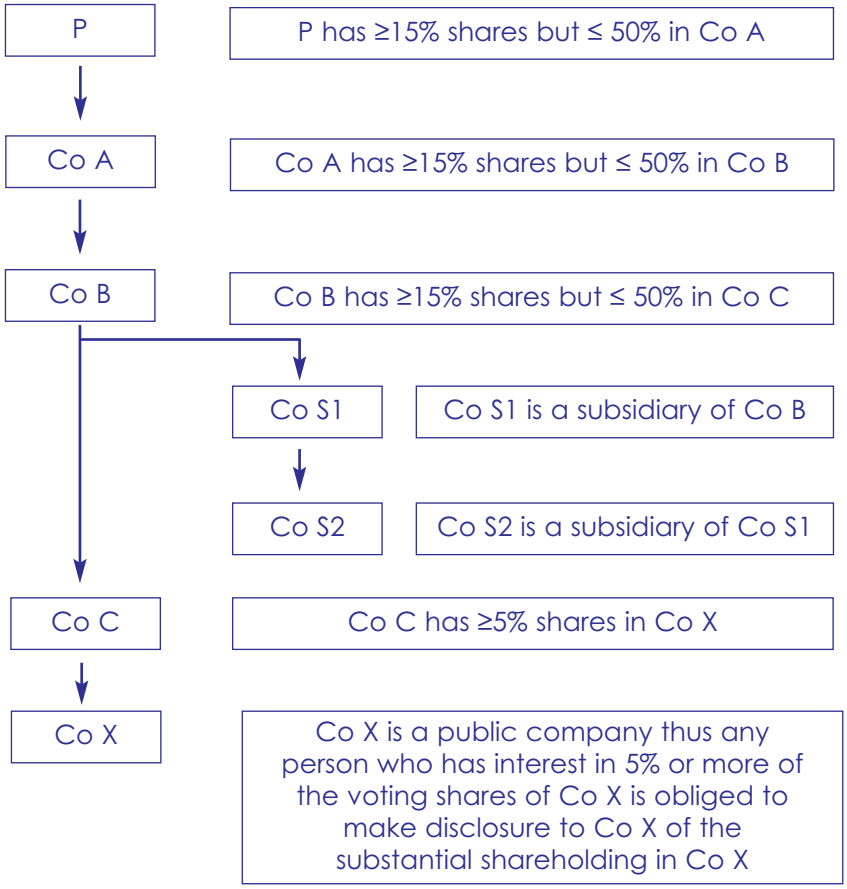
(d) (where A is a body corporate), if A is, or its directors are, accustomed or under an obligation (whether formal or informal) to act in accordance with the directions, instructions or wishes of P in relation to the C share[30] - i.e. where P is a 'shadow director' of A;[31] and

(e) (where A is a body corporate), if A's or its directors' directions, instructions or wishes P is accustomed or under an obligation whether formal or informal to act in relation to the C share - i.e. where P is the nominee or representative of A.[32]

Where the levels of holding involved is only 2 tiers, the disclosable interest can be easily identifiable as illustrated in Figure I. However, there are different views in relation to the disclosure obligation imposed on companies arising out of section 6A(4)(c) where there are several interposed entities for example as shown in Figure II.

[27] Companies Act 1965 section 6A(5)(a). For meaning of related corporation, see Companies Act 1965 section 6.
[28] Companies Act 1965 section 6A(5)(b).
[29] Companies Act 1965 section 6A(5)(c).
[30] Companies Act 1965 section 6A(5)(d).
[31] To borrow the term of the UK Companies Act 1985 section 741(2). The term 'shadow director' means a person whose directions or instructions the directors of the company are accustomed to act but he is not a director of that company. Under the Companies Act 1965, the definition of 'director' includes such a person but without calling him a 'shadow director, see Companies Act 1965 section 4(1).
[32] Companies Act 1965 section 6A(5)(e).

Figure II



For disclosure of substantial shareholding:

(1) Co C has a disclosable interest in Co X as substantial shareholder of Co X

(2) Co B has a disclosable interest in Co X as substantial shareholder of Co X by virtue if section 6A(4)(c) because Co B is entitled to exercise more than 15 per cent of the voting shares in Co C, thus Co B is deemed to have interest in the shareholding of Co C in Co X.

(3) Co S1 has a disclosable interest as substantial shareholder of Co X by virtue of section 6A(4)(c) reading together with section 6A(5)(a), because the associate of Co S1 i.e. its associate, the related company Co B which is its holding company, is entitled to exercise more than 15 per cent of the voting shares in Co C, thus Co S1 is deemed to have interest in the shareholding of Co C in Co X.

(4) Co S2 has a disclosable interest as a substantial shareholder of Co X by virtue of section 6A(4)(c) read together with section 6A(5)(a), because the associate of Co S2 i.e. its associate, the related company Co B which is its ultimate holding company, is entitled to exercise more than 15 per cent of the voting shares in Co C, thus Co S2 is deemed to have interest in the shareholding of Co C in Co X.

(5) Co A does not have a disclosable interest in Co X. Co A does not have interest in shares of Co X, because Co B is not a related corporation to Co A, thus is not an associate of Co A, thereafter Co A is not entitled to exercise or control the exercise of any voting shares in Co C to give rise to any situations as stipulated under section 6A(4).

(6) Similarly for P, P has no disclosure interest in Co X. Co A, Co B or Co C is not an associate of P.

However, it is noted that there are some who hold the view that the disclosure obligation arises so long as the 15 per cent shareholding exists consecutively at every layer all the way up to the last person who holds 15 per cent or more shares of the apex company, in which case P has a disclosable interest in Co X.

The CLRC is of the view that the correct position to determine whether a person who does not hold shares can be deemed to have a disclosable interest in a share of a company for the situation as stipulated by section 6A(4) depends on the existence of an associate of such a person who is entitled to exercise or control the exercise of not less than 15 per cent of the voting shares in a body corporate within the definition of section 6A(5).

4.9 The CLRC is of the view that section 6A(4)(c) of the Companies Act 1965 should also be amended by increasing the threshold of the voting shares exercisable from 15 per cent to 20 per cent:

'A person shall be deemed to have an interest in a share where a body corporate has an interest in share and -

(a) the body corporate, or a majority of its directors are accustomed, or is under an obligation, whether formal or informal, to act in accordance with the direction, instructions or wishes of that person in relation to that share;

(b) that person has a controlling interests in the body corporate; or

(c) that person or the associates of that person or that person and his associates are entitled to exercise or control the exercise of not less than 20 per cent of the votes attached to the voting shares in the body corporate.'

Questions for Consultation

Question 1:

Do you agree that that for the purpose of the substantial property transaction, the related party should be the following persons:

- **a director of the company or of its holding company; or**
- **a substantial shareholder of the company or its holding company; or**
- **a person connected to the director or the substantial shareholder?**

Question 2:

Do you agree with the proposal to amend section 122A(3) as follows:

'For the purposes of subsection (1)(b) a body corporate is associated with a director if-

(a) the body corporate is accustomed or is under an obligation, whether formal or informal, or its majority of directors are accustomed, to act in accordance with the directions , instructions or wishes of that director, or

(b) that director has a controlling interest in the body corporate; or

(c) that director or person connected with him, or that director or persons connected with him, are entitled to exercise, or control the exercise of, not less than 20 per cent of the votes attached to voting shares in the body corporate.'?

Question 3:

Do you agree that the meaning of 'controlling interest' in section 122A(3)(b) should be clarified by introducing a new subsection as follows:

' 'A person is deemed to have control or have a controlling interest in a body corporate if the person or persons connected to him or the person together with persons connected to him -

(a) holds more than 50 per cent of the issued share capital of the body corporate; or

(b) controls more than 50 per cent of the voting power of the body corporate; or

(c) is able to control the composition of the board of directors of the body corporate?

Question 4:

Do you agree that the threshold of the voting shares exercisable should be increased from 15 per cent to 20 per cent as follows?

> **'A person shall be deemed to have an interest in a share where a body corporate has an interest in share and -**
>
> **(a) the body corporate, or a majority of its directors are accustomed, or is under an obligation, whether formal or informal, to act in accordance with the direction, instructions or wishes of that person in relation to that share;**
>
> **(b) that person has a controlling interests in the body corporate; or**
>
> **(c) that person or the associates of that person or that person and his associates are entitled to exercise or control the exercise of not less than 20 per cent of the votes attached to the voting shares in the body corporate.'**

5. REQUIREMENT TO OBTAIN SHAREHOLDERS' APPROVAL AND RESTRICTION ON RELATED PARTIES FROM VOTING

5.1 The CLRC is of the view that by putting in place in the Companies Act a 'process' that mandates a company to obtain the prior approval of its shareholders before carrying into effect any substantial property transaction will have the effect of preventing and minimising the potential abuse of power by the directors or substantial shareholders of a company.

5.2 However, the CLRC is also aware that in some jurisdictions, the substantial property transaction can only be approved by disinterested shareholders. This means that the interested parties i.e., the related parties in that transaction cannot vote at that shareholders general meeting which has been convened to approve that transaction.

5.3 The CLRC noted that whilst there is no requirement for the relevant transaction to be approved by disinterested shareholders' under the Companies Act 1965, the Bursa Malaysia Securities Berhad Listing Requirements requires that disinterested shareholders approve the relevant transaction. However, the disinterested shareholders' vote under the Bursa Malaysia Securities Berhad Listing Requirements is only applicable if the related party transaction equals to or exceeds the 5 per cent ratio. If the related party transaction is less than the 5 per cent ratio, there is no requirement to obtain the shareholders' approval.

5.4 There are several concerns about restricting shareholders voting rights. One view is that requiring disinterested shareholders voting enables minority shareholders to veto *bona fide* transactions which are in the company's interest, or to turn a minority stake into a majority stake.[33] There is also the view that since the right to vote is a proprietary right, it should not be restricted. Nevertheless, at common law there is already equitable restriction on voting rights in situations where the majority attempts to oppress the minority or to obtain an advantage for themselves which would have gone to the company and not just to the majority shareholders.[34]

5.5 Another concern about disinterested shareholders' voting is whether this requirement will be a hindrance to the management of private companies. The view is that the shareholding structure in private companies may make it impractical for a private company to find disinterested shareholders to vote and if this issue is not addressed this requirement may impede a private company's business.

[33] Loh SC, above n 19 at p 591.
[34] *Allen v Gold Reefs* [1900] 1 Ch 656 at p 671; *Peters' American Delicacy Co Ltd v Heath* (1939) 61 CLR 457 at pp 504-5; [1939] ALR 124; *Clemens v Clemens Bros Ltd* [1976] 2 All ER 268.

5.6 Taking into account the above views, the CLRC recommends the retention of the existing requirement under section 132E that the prior approval of shareholders is required for the substantial property transaction. The CLRC also recommends that the requirement for disinterested shareholders' vote i.e., that related parties cannot vote, should only be applicable to public companies.

5.7 The CLRC noted that section 132E of the Companies Act 1965 already requires that a substantial property transaction entered into by a company with a director of its holding company or with a person connected to such a director must also obtain the prior approval of the shareholders of the holding company. The CLRC also noted that in such cases the Bursa Malaysia Securities Berhad Listing Requirements only requires the listed company to obtain its shareholders' approval. If the listed company has a holding company which is also listed, the Bursa Malaysia Securities Berhad Listing Requirements does not require the listed holding company to obtain its' shareholders' approval. However, the CLRC recommends retaining the requirement that where a substantial property transaction is to be entered into by a company with a director of its holding company or with a person connected to such a director, the approval of the shareholders of the holding company is required, as is currently found in section 132E. This is to ensure that there is no circumventing the requirement to obtain the approval of the shareholders by the use of interposed entities.

Cross-jurisdictional study

5.8 Section 320 of the United Kingdom Companies Act 1985 which is in *pari materia* to section 132E of the Companies Act 1965 does not require disinterested shareholders voting. The United Kingdom Companies Act 2006 has retained this position.

Section 173 states that:

'a company may not enter into an arrangement under which

(a) a director of the company or its holding company, or a person connected with such a director, acquires or is to acquire from the company (directly or indirectly) a substantial non-cash asset, or

(b) the company acquires or is to acquire a substantial non-cash asset (directly or indirectly) from such a director or a person so connected,

unless the arrangement has been approved by a resolution of the members of the company or is conditional upon such approval being obtained.'

5.9 Section 173(2) states that if the director or connected person is a director of its holding company or a person connected with such a director, the transaction must also be approved by a resolution of the members of the holding company.

5.10 Australia, on the other hand, has mandated that in the case of a public company, the shareholders' approval must be by way of disinterested shareholders' voting.[35] The shareholders approval of the holding company must also be obtained. Specific exceptions to the requirement are set out under the Act.[36] Approval of the shareholders is not however, necessary if the financial benefit is given on terms that:

(a) would be reasonable in the circumstances if the public company or entity and the related party were dealing at arm's length; or

(b) are less favourable to the related party than the terms referred to in paragraph (a).

[35] Section 224 of the Australian Corporations Act 2001. The section provides that neither the related party nor its associate can vote at the general meeting to approve the RPT.
[36] Section 210 of the Australian Corporations Act 2001.

5.11 The Hong Kong SCCLR proposed that the Hong Kong Companies Ordinance should incorporate a provision to regulate substantial property transactions. The SCCLR is of the view that the Companies Ordinance should be amended in accordance with the current Listing Rules (Rule 14.26 of the Main Board Rules and Rule 20.42 of the GEM Rules) to make it a requirement that any connected person (including connected persons in relation to controlling shareholders) having an interest in a transaction shall abstain from voting at the general meeting whereby the transaction is considered for the purpose of approving it. Where several companies are interposed between the subsidiary and the ultimate listed holding company, the provision should be applied so that only the approval of the shareholders of the ultimate holding company is necessary, unless the subsidiary itself is a listed company, in which case, the approval of the shareholders of the subsidiary should also be required.

RECOMMENDATIONS

5.12 It is the recommendation of the CLRC that:

(a) a company may not carry into effect a substantial property transaction with a related party unless shareholders' prior approval has been obtained;

(b) the restriction on related parties from voting on the transaction should be applicable for public companies only;

(c) where a company enters into a substantial property transaction with a related party and the related party is -

- a director of its holding company; or
- a substantial shareholder of its holding company; or
- a person connected to the director or the substantial shareholder,

the prior approval of the shareholders of the holding company must also be obtained.

Questions for Consultation

Question 5:
Do you agree that section 132E of the Companies Act 1965 should be extended to include transactions entered into with a substantial shareholder of the company or a substantial shareholder of the holding company or persons connected to that substantial shareholder?

Question 6:
Do you agree that a company may not carry into effect any substantial property transaction with a related party unless shareholders' prior approval has been obtained?

Question 7:
Do you agree that 'disinterested shareholders voting' should only be required in relation to public companies?

Question 8:
Do you agree that where the related party is:-

- **a director of its holding company; or**
- **a substantial shareholder of its holding company; or**
- **a person connected to the director or the substantial shareholder,**

the prior approval of the shareholders of the holding company must be also obtained?

6. DEFINING A 'SUBSTANTIAL NON-CASH ASSET'

6.1 The substantial property transaction provisions in the Companies Act 1965 involve the transfer of a non-cash asset of a certain value i.e., a substantial value. Section 132E(5) of the Companies Act 1965 provides that shareholders approval is required

when the non-cash asset that is to be acquired from or disposed to its director or director of its holding company or to a person connected to that director is of a value that is not less than RM10,000 but (subject to that) exceeds RM250,000 or 10 per centum of the company's asset value. As highlighted earlier, this subsection is confusing and needs to be clarified. The CLRC is also of the view that this threshold is not reflective of the current business environment as it may be too low. However, the CLRC is aware that since the substantial property transaction provision is also applicable to private companies, the threshold that will trigger the requirement to obtain shareholders' approval must not be too low so as to impede commercial transactions of private companies nor too high so as to be ineffective in regulating substantial property transactions in private companies.

6.2 As a comparison, the United Kingdom Companies Act 1985 defines 'non-cash asset' in section 739(1) as any property or interest in property other than cash. An asset is 'of the requisite value' if at the time the arrangement is made its value exceeds £100,000 or 10 per cent of the company's net assets (subject to a *de minimis* in relation to transactions with a value of £2,000 or less). However, the United Kingdom Companies Act 2006 states that the triggering figure be as follows:

(i) exceeds 10 per cent of the company's assets value and is more than £5,000; or

(ii) exceeds £100,000.[37]

6.3 The Hong Kong SCCLR also favoured a *de minimis* rule but was unable to come up with a specific threshold.[38] The Hong Kong SCCLR referred to the consultation of the Hong Kong Exchange and Clearing Limited Consultation Paper which proposed the following threshold:

[37] Section 191(2) of the United Kingdom Companies Act 2006.
[38] See Corporate Governance Review - *Consultation Paper on Proposals made in Phase II of the Review* (June 2003) para 9.05 referring to Hong Kong Exchange and Clearing Limited *Consultation Paper on Proposed Amendments to the Listing Rules relating to Corporate Governance Issues*.

'(a) a connected transaction will normally be exempt from all the relevant reporting, announcement and shareholders' approval requirements if it is on normal commercial terms where the total consideration or value is less than the higher of:

(i) HK$1,000,000; or

(ii) 0.01 per cent of the total asset of the issuer, and

(b) a connected transaction will normally be subject to all the reporting and announcement requirements if it is on normal commercial terms where the total consideration or value is less than the higher of:

(i) HK$10,000,000; or

(ii) 1 per cent of the total asset of the issuer.'

6.4 On the issue of defining the 'net asset test', the CLRC also noted that the Hong Kong Exchange and Clearing Limited's consultation[39] proposed the use of the 'net asset' test but gave allowance for companies to choose the 'total asset' test. This was because some respondents preferred the 'net asset' test rather than a 'total assets' to avoid the uncertainty of the inclusion of intangible assets or other inappropriate accounting methods whilst some respondents were of the view that 'total asset' test might be acceptable in certain circumstances due to the differing financial structures of companies.

6.5 The United Kingdom Companies Act 2006 on the other hand, included the 'net asset' test which is determined by reference to the most recent statutory accounts.

[39] Hong Kong Exchange and Clearing Limited Consultation Conclusions on Proposed Amendments to the Listing Rules relating to Corporate Governance Issues (January 2003) para 57-63.

If the accounts have not been prepared and sent to members, the net asset is determined with reference to the amount of the company's called-up share capital.[40]

6.6 The CLRC is of the view that a *de minimis* rule should apply in relation to the 'substantial value' that should be specified as otherwise the provision will be prohibitive to businesses. However, in relation to ascertaining what should be the value of the transaction for which shareholders' approval is required, the CLRC noted that that there are two available options that may be considered:

- Option 1 - to specify a common value in the Companies Act for all types of companies, irrespective of whether or not the company is private, public non-listed or listed.
- Option 2 - to specify a common value in the Companies Act for private and public non-listed companies whilst the value of the transaction in relation to listed companies is to be subject to the Bursa Malaysia Securities Berhad Listing Requirements.

6.7 The CLRC prefers Option 2. The CLRC also recommends the value that should be specified in the company legislation that will be applicable to private and non-listed public companies is as follow:

(i) If the transaction exceeds 10 per cent of the company's assets value and is more than RM50,000; or

(ii) If the transaction exceeds RM500,000.[41]

[40] Section 191 of the United Kingdom Companies Act 2006.
[41] These wordings are derived from section 191(2) of the United Kingdom Companies Act 2006.

RECOMMENDATIONS

6.8 The CLRC recommends that:

(a) for the purpose of triggering the requirement to obtain shareholders' approval, there should be a common value for private and public non-listed companies in the company legislation. The substantial value of the transaction that should be specified in the company legislation is if the transaction -

(i) exceeds 10 per cent of the company's assets value and is more than RM50,000; or

(ii) exceeds RM500,000.

(b) for the purpose of triggering the requirement to obtain shareholders' approval, the value for the listed company is subject to the Bursa Malaysia Securities Berhad Listing Requirements.

(c) the net assets test should be adopted and that the net assets is to be determined by reference to the most recent financial statements.[42]

Questions for Consultation

Question 9:

Do you agree that:-

(i) there should be a common value for all types of companies, irrespective of whether or not the company is private, public non-listed or listed?

OR

[42] The most recent financial statement of a company comprises the profit and loss account which must comply with the requirement of Accounting Standards as stated under section 169 of the Companies Act 1965. However, corollary amendments to section 169 will have to be made in view of the proposal to waive AGM for private companies and if accepted mandatory audit for certain private companies. This phrase is defined under the Singapore Companies Act by reference to section 201, which is similar to section 169 of the Companies Act 1965. Note also section 201(1A). Subject to subsections (14) to (14C), the profit and loss account referred to in subsection (1) shall comply with the requirements of the Accounting Standards, and give a true and fair view of the profit and loss of the company for the period of accounting as shown in the accounting and other records of the company.

(ii) there should be a common value for private and public non-listed companies in the company legislation whilst the value for the listed companies is as set out in the Bursa Malaysia Securities Berhad Listing Requirements?

Question 10:

Do you agree that the triggering figure that should be specified in the company legislation is if the transaction:

(i) exceeds 10 per cent of the company's net assets value and is more than RM50,000; or

(ii) exceeds RM500,000?

If not, what would be the appropriate threshold?

Question 11:

Do you agree that the 'net assets test' should be adopted? If yes, do you agree that the net assets is to be determined by reference to the most recent financial statements?

7. EFFECT OF ANY ARRANGEMENT OR TRANSACTION ENTERED INTO WITHOUT SHAREHOLDERS' APPROVAL

7.1 Section 132E(2) provides that any arrangement or transaction which is entered into without shareholders' approval is voidable. The CLRC noted that the Finance Committee had recommended this provision be reviewed to consider stating that the transaction is valid despite contravening the section.

7.2 The CLRC is of the view that the threat of nullification serves as an important control to prevent abuse of the approval process. This is especially true in cases where the transaction is made or entered into with persons who are able to dictate the approval process or the outcome of the approval process. Nonetheless, the CLRC

noted that nullification may be costly for parties who failed to obtain the approval on a *bona fide* basis.

7.3 It is the recommendation of the CLRC that the company should be allowed to avoid an arrangement or transaction that has been entered into without shareholders' approval.[43] Nevertheless, the CLRC also recommends that ratification should be possible and that if there is ratification, the requirement for disinterested shareholders voting will apply in the case of a public company. Ratification usually is required for commercial decisions that need to be made by the company expeditiously and if ratification is prohibited, a company may be constrained from conducting business. The CLRC however, believes that since changes are being made to the existing section 132E by stating that the transaction may not be carried into effect without shareholders' approval, ratification will not be the norm. This is because the changes to the wording of section 132E will mean that transactions entered into with the condition that shareholders' approval be obtained are not caught by the section and more often than not the company will enter into conditional agreements of this nature.

7.4 In addition, *bona fide* third parties must be protected and hence the CLRC proposes that a transaction or arrangement entered into without shareholders' approval cannot be avoided by a company in the following instances:

(a) where restitution of any money or other asset that was the subject matter of the transaction is no longer possible;

(b) where the company has been indemnified for any loss or damage resulting from the transaction; or

[43] This is similar to the current position under section 132E of the Companies Act 1965. Section 132E(2) of the Companies Act 1965 provides that an arrangement or transaction that has been entered into in contravention of section 132E of the Companies Act 1965 is voidable at the instance of the company unless that arrangement or transaction is ratified by the shareholders thereafter within a reasonable time.

(c) where rights are acquired in good faith, for value and without actual notice of the contravention by a person who is not a party to the transaction.

7.5 The CLRC noted that the above recommendation is similar to the United Kingdom Companies Act 2006.[44] The United Kingdom Companies Act 2006 states that the transaction is voidable unless -

(a) restitution is no longer possible;

(b) the company has been indemnified for any loss or damage resulting from the transaction;

(c) if rights acquired by a third party in good faith and for value would be affected by the avoidance.

7.6 However, any director of the company or its holding company or person connected to such director with whom the company entered into the transaction and any director who authorised the transaction are liable:

(a) to account for any profit he made directly or indirectly by the transaction, and

(b) jointly and severally liable with any other person liable under this section to indemnify the company for any loss or damage resulting from the transaction.

7.7 There is a defence available to a director in cases where the transaction is entered into by the company with the person connected to the director if the director can show that he took all reasonable steps to secure the company's compliance with the requirement imposed on the company to obtain shareholders' approval. The person so connected or a director who authorises the transaction is not liable if he shows that at the time the transaction was entered into he did not know of the relevant circumstances constituting the contravention.

[44] See section 195 of United Kingdom Companies Act 2006.

7.8 In June 2003, the Hong Kong's SCCLR recommended that the Hong Kong Companies Ordinance should be amended to state that the transaction or arrangement is voidable unless:-

(a) restitution is no longer possible;

(b) there is ratification (where permissible) within a reasonable time by disinterested shareholders;

(c) if there are rights acquired by *bona fide* third parties who have provided value.

7.9 The director or connected person should also be liable to account to the company for any profits and to indemnify the company against any loss or damage resulting from the breach of the provision. The liability of the director or connected person must be without prejudice to any other liability which may be imposed by law. Criminal penalties may be imposed on officers involved in the breach of this provision if the company is wound up within one year after the transaction.

7.10 In contrast, the Australian Corporations Act 2001 states that a transaction entered into by a public company with a related party without prior shareholders approval does not affect the validity of the transaction.[45] However, persons involved in the breach are subject to civil penalties or orders for compensation by the court.[46]

7.11 Under the repealed section 160A of the Singapore Companies Act, transactions in contravention of this provision would be voidable at the instance of the company[47] unless the rights to avoid the transaction have otherwise been lost.[48]

[45] Section 209 of the Australian Corporations Act 2001.
[46] Section 1317E of the Australian Corporations Act 2001.
[47] Section 160C of the Singapore Companies Act.
[48] By ratification at general meeting within a reasonable time (section 160C(2)(c)), where a rights have been acquired *bona fide* by a third party (section 160C(2)(b)) or where *restitutio ad integrum* is not possible (section 160C(2)(a)).

7.12 The CLRC is of the view that the company should not be made accountable for the contravention of section 132E. The current legislative text of section 132E(1) of the Companies Act 1965 appears to give the impression that since the company must obtain the prior approval of its shareholders and should the company fail to do so the company may be guilty of an offence against the Act. The CLRC is of the view that the 'related party' with whom the transaction was entered into and the directors who knowingly authorised that transaction in the first place should be held liable. This approach is currently reflected under sections 132E(3) and 132E(6) of the Companies Act 1965. The CLRC thus recommends that sections 132E(3) and 132E(6) be retained and that section 132E of the Companies Act 1965 be clarified to expressly state that in the event there is a contravention of section 132E, the company is not guilty of an offence against the Act.

7.13 The CLRC noted that the United Kingdom Companies Act 2006 incorporates a provision which expressly states that in the event there is a contravention of the section (this provision is in *pari materia* with section 132E of the Companies Act 1965) the company itself is not subject to any liability.[49] This approach is similar to what has been adopted by the Australian Corporations Act 2001.

7.14 The CLRC also recommends that parties who are 'innocent' of the contravention should not be made liable in the event there is an unintentional contravention of section 132E of the Companies Act. As discussed above, when there is a contravention of section 132E of the Companies Act 1965, the approach taken by section 132E of the Companies Act 1965 is to impose liability (civil as well as criminal) on the person with whom the transaction is entered into and the director(s) who authorised that transaction.[50]

[49] Section 190 of the United Kingdom Companies Act 2006.
[50] See sections 132E(3) and 132E(6) of the Companies Act 1965.

7.15 The CLRC noted that it is possible that in some instances the director(s) who authorised the transaction may not be aware that the transaction involved a person connected to the director or substantial shareholder. In this respect, the United Kingdom Companies Act 2006 states that a person who is so connected, or a director who authorised the transaction, is not liable if he shows that at the time the transaction was entered into, he did not know the relevant circumstances constituting the contravention.[51] The United Kingdom Companies Act 2006 states that in respect to a transaction entered into by a company with a person connected with a director of the company or its holding company, the director is not liable if he shows that he took all reasonable steps to secure the company's compliance with section 173.[52] The CLRC recommends that the same approach be adopted for Malaysia.

7.16 The CLRC also noted that the United Kingdom Companies Act 2006 states that if a company goes into insolvent liquidation within one year after the shareholders' resolution was passed, the shareholders' resolution is effective only if (a) the procedure for independent valuation of the transaction has been complied with or (b) the director or person connected with them was not involved in the passing of the resolution. On the other hand, the Hong Kong SCCLR propose that should the company be wound up within one year of entering into the substantial property transaction, there are criminal liabilities imposed on the officers involved in breach of the provision. In Malaysia, the existing section 132E of the Companies Act 1965 already imposes criminal liability for non-compliance of the section irrespective of whether or not the company goes into insolvent liquidation. The CLRC is of the view that the current position should be retained.

[51] Section 195 of the United Kingdom Companies Act 2006.
[52] Section 195 of the United Kingdom Companies Act 2006.

RECOMMENDATIONS

7.17 The CLRC recommends:

(j) the transaction should be voidable at the option of the company;

(ii) the company may ratify the transaction;

(iii) the right to avoid the transaction will not be available in the case of a *bona fide* third party;

(iv) the company should not be liable to an offence if the section is contravened;

(v) an interested director or substantial shareholder of the company or its holding company or person connected to such director or substantial shareholder with whom the company entered into the transaction should be held liable to account for the profit or to pay compensation to the company unless he shows that he is 'innocent' of the contravention or if he shows that he took all reasonable steps to secure the company's approval;

(vi) any director who authorised the transaction should be held liable to account for the profit or to pay compensation to the company unless the director shows that he is 'innocent' of the contravention.

Questions for Consultation

Question 12:

Do you agree that the current legal position as currently expressed in the Companies Act 1965, that the arrangement or transaction is voidable at the option of the company in the event that shareholders' prior approval was not obtained, should be retained?

Question 13:

Do you agree that the company's right to avoid a transaction entered into in contravention of section 132E of the Companies Act 1965 should be qualified? If so would the CLRC's recommendation be sufficient?

Question 14:

Do you agree that in the event section 132E of the Companies Act 1965 is contravened the company should not be liable for an offence against the Act?

Question 15:

Do you agree that the parties who are 'innocent' of the contravention should not be made liable in the event there is an unintentional contravention of section 132E of the Companies Act?

8. CARVING OUT THE EXCEPTIONS TO THE SUBSTANTIAL PROPERTY TRANSACTION

8.1 Both sections 132E and 132G provide for transactions which are excluded from the purview of the respective sections. The excepted transactions are specified under sections 132F and 132G(6).[53] In general, the exceptions include:

(a) transactions with or between wholly owned subsidiaries;

(b) transactions entered into in relation to a compulsory winding up of a company;

(c) transaction entered into in the ordinary course of business and on terms not more favourable than those generally available to the public or employees of the company;

(d) acquisition of shares or assets made pursuant to section 176; and

(e) acquisition of shares under a takeover scheme.

[53] Sections 210-216 of the Australian Corporations Act 2001 provides for certain exceptions to the requirement from obtaining shareholders' approval. These include the following:
(a) reasonable remuneration as an officer or employee of the public company or an entity which controls or is controlled by the public company;
(b) repayment of expenses incurred by a related party in performing duties as an officer or employee of the public company or a controlling or controlled entity;
(c) payment of reasonable insurance premiums in respect of a liability incurred as an officer of the public company;
(d) payments in respect of legal costs incurred by an officer in defending an action involving a liability incurred as an officer of the public company;
(e) amounts of money given to the director or spouse of less than AUD 2000;
(f) financial benefits to or by a closely held subsidiary;
(g) benefits given to the related party as a member of the public company and the benefits do not discriminate unfairly against the other members.

8.2 The CLRC is of the view that the transactions currently exempted under section 132F should be retained and should be excluded from the requirement to obtain shareholders' approval. The CLRC is also of the view that a subscription for new shares for cash consideration (as is currently found under section 132G(6)(a)) should also be excluded/exempted from the requirement to obtain shareholders approval.

8.3 The CLRC is also of the view that an acquisition of shares or assets made by a company pursuant to a scheme or compromise or arrangement approved by the court under section 176 should not be exempted from section 132E.

RECOMMENDATIONS

8.4 The CLRC recommends:

(i) to retain the current exceptions under section 132F;

(ii) to exempt a subscription for new shares for cash consideration (as is currently found under section 132G(6)(a)) from the requirement to obtain shareholders approval;

(iii) to state that an acquisition of shares or assets made by a company pursuant to a scheme or compromise or arrangement approved by the court under section 176 should not be exempted from the requirement to obtain the approval of the shareholders.

Questions for Consultation

Question 16:
Do you agree that a subscription for new shares for cash consideration (as is currently found under section 132G(6)(a)) should be exempted from the requirement to obtain shareholders approval?

Question 17:
Do you agree that an acquisition of shares or assets made by a company pursuant to a scheme or compromise or arrangement approved by the court under section 176 should be exempted from having to obtain shareholders approval?

PART II REVIEW OF SECTION 132C OF THE COMPANIES ACT 1965

9.1 Section 132C does not allow the directors of a company to carry into effect or execute any transaction for:

(a) the acquisition of an undertaking or property of a substantial value; or

(b) the disposal of a substantial portion of the company's undertaking or property,

that would materially and adversely affect the company's performance or financial position unless the shareholders have approved the transaction. The requirement for shareholders' approval cannot be set aside by the company's Articles or Memorandum.

9.2 Cross-jurisdictional study shows that there are some common law jurisdictions that have a provision similar to section 132C of the Companies Act 1965. Section 160 of the Singapore Companies Act is similar to section 132C of the Companies Act 1965. However, section 160 of the Singapore Companies Act provides that the shareholders' approval is required if the transaction involves the disposal of *the whole or substantially the whole of the company's undertaking or property*.

9.3 Section 155A of the Hong Kong Companies Ordinance provides that shareholders' approval is required for the disposal of fixed assets exceeding a certain level i.e 33 per cent of the company's fixed assets. This section is applicable to listed companies only. The Hong Kong SCCLR in its 2000 report recommended that the section be repealed.[54] However, the SCCLR in its 2003 review recommended that section 155A should not be applicable to private companies.[55] The SCCLR is of the view that if section 155A is to remain within the company legislation, it should be made mandatory for listed companies, including overseas companies and if this approach is adopted, the Listing Rules should at least mirror or have a wider application than companies legislation. As for section 155A, the SCCLR noted that the section is aimed at setting out the division of authority between shareholders and management where the disposal of substantial assets are concerned. The SCCLR, however, was of the view that the threshold set out at 33 per cent cannot effectively deal with a fundamental change in business direction, in contrast to section 160 of the Singapore Companies Act.

[54] The Standing Committee on Company Law Reform, Report on the Consultancy Report of the Review of the Hong Kong Companies Ordinance (February 2000), p 152, recommendation 103.
[55] The Standing Committee on Company Law Reform ,Consultation Paper on Proposals made in Phase II of its Corporate Governance Review (June 2003) pp 87-92, Chapter 4.

9.4 The CLRC noted that section 160 of the Singapore Companies Act ensures that shareholders' approval is obtained where the company wants to carry out fundamental changes to its business. On the other hand, section 155A of the Hong Kong Companies Ordinance, according to the Hong Kong SCCLR,[56] sets out the division of authority between shareholders and management where the disposal of substantial assets are concerned.

9.5 Where section 132C is concerned, there are criticisms as to the usefulness of this section. The criticisms, amongst others are:

- It is the directors' who will normally make the decision whether or not the transaction is one that would adversely and materially affect the company's financial position and this wide discretion does not ensure that the shareholders' rights are protected. Directors could resolve that the transaction does not adversely and materially affect the company's financial position to circumvent the requirement to obtain shareholders' approval thus undermining the relevance of this section as a means of keeping the directors' authority in check. The phrase 'adversely and materially affect the company's financial position' is ambiguous and leaves too much discretion on directors.
- This section is unclear in the usage of the words 'an undertaking or property of a substantial value' and 'substantial portion'. As a result, there are views that section 132C should be amended by specifying a *de minimis* rule similar to the approach in section 132E to clarify the substantial value of the undertaking or property.

[56] The Standing Committee on Company Law Reform ,Consultation Paper on Proposals made in Phase II of its Corporate Governance Review (June 2003) pp 87-92, Chapter 4.

- There are also concerns as to whether the transaction may be ratified by the company as is found under section 132E. The concern is similar to that raised in relation to section 132E that there may be situations where the transaction needs to be entered into expeditiously and if shareholders' prior approval is required, this may affect the company to take advantage of available business opportunities.
- There are also concerns that the section may impede the implementation of Islamic transactions by financial intermediaries.

9.6 There are two options available in amending section 132C:

(a) Option 1 - if the section was intended to restrict the powers of the directors to deal with the company's property or undertaking and to enable shareholders to approve transactions which could affect the company's performance or financial position or where there is a fundamental change in a company's business, then the section needs to be amended to state that shareholders approval is required for the disposal of the whole or substantially the whole of the company's undertaking or property. This approach does not require a *de minimis* rule to be introduced into section 132C.

(b) Option 2 - if the section is intended to provide a check against unfettered powers of directors to dispose off the assets of the company or acquire assets, the section should be amended to specify the value of the transaction that requires shareholders' approval and to state that there must be a *de minimis* rule as to the value of the transaction.

9.7 The CLRC recommends that the section needs to be amended to specify the value of the transaction that requires shareholders' approval and to state that there must be a *de minimis* rule as to the value of the transaction. For this purpose the CLRC recommends that the same threshold as proposed for section 132E be adopted for section 132C. This means that for the purpose of triggering the requirement to obtain shareholders' approval, there should be a common value for private and public non-listed companies in the companies legislation. The substantial value of the transaction that should be specified in the companies legislation is if the transaction -

(i) exceeds 10 per cent of the company's assets value and is more than RM50,000; or

(ii) exceeds RM500,000.

In addition, for the purpose of triggering the requirement to obtain shareholders' approval, the value for the listed company is subject to the Bursa Malaysia Securities Berhad Listing Requirements. Furthermore, the net assets test should be adopted and the net assets are to be determined by reference to the most recent financial statements.[57]

9.8 In addition, due to the concerns that section 132C in its current form may impede Islamic transactions, the CLRC is of the view that there should be an express provision stating that the section does not apply to the acquisition of an undertaking or property of a substantial value or the disposal of a substantial portion of the company's undertaking or property undertaken by any or with a banking corporation pursuant to an Islamic transaction involving the contemporaneous acquisition and disposal of the same undertaking or property.

[57] This is similar to the proposed amendment to section 132E of the Companies Act 1965.

RECOMMENDATIONS

9.9 It is the recommendation of the CLRC that:

Section 132C should be amended as follows:

(a) to specify for the purposes of triggering the requirement to obtain the approval of the shareholders, a common value for private and public non-listed companies in the companies legislation. The substantial value of the transaction that should be specified in the companies legislation are as follows, where the transaction -

(i) exceeds 10 per cent of the company's assets value and is more than RM50,000; or

(ii) exceeds RM500,000.

(b) for the purposes of triggering the requirement to obtain the shareholders' approval, the value for the listed company is subject to the Bursa Malaysia Securities Berhad Listing Requirements.

(c) the net assets test should be adopted and the net assets are to be determined by reference to the most recent financial statements.

(d) that the section should not apply to the acquisition of an undertaking or property of a substantial value or the disposal of a substantial portion of the company's undertaking or property undertaken by any or with a banking corporation pursuant to an Islamic transaction involving the contemporaneous acquisition and disposal of the same undertaking or property.

Questions for Consultation

Question 18:

Do you agree that section 132C should be amended to state that shareholders' approval is required for the disposal or acquisition of assets if the value of the transaction is of a certain amount?

Question 19:

Do you agree that the section should not apply to the acquisition of an undertaking or property of a substantial value or the disposal of a substantial portion of the company's undertaking or property undertaken by any or with a banking corporation pursuant to an Islamic transaction involving the contemporaneous acquisition and disposal of the same undertaking or property?

PART III LOANS TO DIRECTORS AND PERSONS CONNECTED TO DIRECTORS UNDER SECTIONS 133 AND 133A OF THE COMPANIES ACT 1965

10.1 Under the Companies Act 1965, loans to directors or persons connected to directors are prohibited except in the case of exempt private companies i.e., companies which have not more than 10 shareholders all of whom are not body corporate. Case law states that although the word 'loan' is not currently defined by the Companies Act 1965, it would encompass any transaction which in substance involves the giving of money by the company with the promise that it would be repaid.[58] The phrase 'directly or indirectly' will also include transactions where a

[58] In *Chow Yoong Hong v Choong Fah Rubber Manufactory* [1962] MLJ 74, Lord Devlin emphasised that what mattered to the courts is the substance of the transaction and not its form. Hence, provided the substance of the transaction in question involved a promise to repay the company, that transaction shall be treated as a loan for the purposes of sction 133.

company provides security for a loan that has been granted to its director by a third party.[59]

10.2 The general restrictions imposed by the above provisions are subject to several exceptions. The prohibition / restriction imposed by section 133 does not extent to:

- Providing directors with funds to meet expenditure incurred or to be incurred for the purposes of the company;[60]
- Providing directors with funds to enable him or her to properly perform his or her duties as a director;
- Providing salaried directors of the company or salaried directors of the holding company with funds for the purposes of enabling that director to acquire a home;[61] or
- Providing loans to salaried directors of the company or salaried directors of its holding company in accordance to an approved loan[62] scheme to company employees.[63]

10.3 The prohibition/restriction imposed by section 133A(1) does not extend to:

- a loan made or a guarantee or security provided, for the benefit of a related company;[64]
- anything done in the ordinary course of business, where the company's ordinary business includes the lending of money or the giving of guarantees in connection with loans.[65] The activities of these types of companies must be regulated by written law relating to banking, finance or insurance;[66]

[59] See cases such as *Che Wan Development Sdn Bhd v Co-operative Central Bank* [1990] 2 MLJ 365. *Co-operative Central Bank Ltd v Feven Development Sdn Bhd* [1995] 3 MLJ 313.
[60] Section 133(1)(a) of the Companies Act 1965.
[61] Section 133(1)(b) of the Companies Act 1965.
[62] The approval must be given by the general meeting.
[63] Section 133(1)(c) of the Companies Act 1965.
[64] Section 133A(2)(a) of the Companies Act 1965.
[65] Section 133A(2)(b) of the Companies Act 1965.
[66] The written law referred to here should include the Insurance Act 1996 and BAFIA.

- a loan for the purpose of acquiring a home made to a person connected with a director engaged in full-time employment with the company or its related company;[67] or
- a loan made in accordance with an approved employee loan scheme made to a person connected with a director engaged in full-time employment with the company or its related company.[68]

10.4 In addition, under the Bursa Malaysia Securities Berhad Listing Requirements, a listed company may only:

(a) lend or advance any money; or

(b) guarantee, indemnify or provide collateral for a debt,

(these transactions are known as 'giving financial assistance[69]') to or in favour of the following:-

(i) directors or employees of the listed issuer or its subsidiaries, as the case may be, in such manner as may be permitted under the Companies Act 1965 or the relevant laws of the place of incorporation (as may be applicable);

(ii) persons to whom the provision of financial assistance is necessary to facilitate the ordinary course of business of the listed issuer or its subsidiaries, as the case may be, such as the provision of advances to its sub-contractors; or

(iii) the subsidiaries or associated companies of the listed issuer, the listed issuer (in the case of the subsidiaries providing the financial assistance) or its immediate holding company which is listed.[70]

[67] Section 133A (2)(c)(i) of the Companies Act 1965.
[68] Section 133A (2)(c)(ii) of the Companies Act 1965.
[69] It is worth noting that the phrase 'financial assistance' has a specific meaning under section 67 of the Companies Act 1965 and the CLRC is of the view that for consistency, the phrase should be used with care under the Bursa Malaysia Securities Berhad Listing Requirements.
[70] Para 8.23 of the Bursa Malaysia Securities Berhad Listing Requirements

10.5 The types of transactions which are prohibited under the Listing Requirements are wider in scope as the prohibition under the Listing Requirements includes indemnity[71] and forgiving a debt, releasing or neglecting to enforce financial obligations of another, or assuming the financial obligations of another.[72]

10.6 In reviewing sections 133 and 133A, the issues that were considered by the CLRC are as follows:

(1) whether the total prohibition under these sections should be maintained;

(2) if the sections are to be maintained, whether the types of transactions which are currently prohibited need to be expanded; and

(3) whether the prohibition should be extended to substantial shareholders and persons connected to substantial shareholders.

1. Whether the total prohibition under these sections should be maintained.

10.7 It is noted that the rationale for the prohibition is to prevent abuse of loans and similar transactions involving directors in public companies. The CLRC noted that historically, the issue of whether or not companies should be prohibited from lending money to its directors or persons connected to its directors, was raised by the Greene Committee which recommended that although it would not be practicable or desirable to prohibit a company from lending money to its directors there must be adequate disclosure of such loans in the company accounts.[73] However, subsequently both the Cohen Committee and the Jenkins Committee

[71] Para 8.23 of the Bursa Malaysia Securities Berhad Listing Requirements.
[72] Para 10.02 of the Bursa Malaysia Securities Berhad Listing Requirements.
[73] Paragraphs 48 and 49 of the Greene Committee Report (1926). In fact the Greene Committee Report that resulted in the enactment of the English Companies Act of 1929, had proposed that it would not be practicable or desirable to prohibit a company from lending money to its directors.

recommended that there should be an express provision prohibiting a company from lending money to its directors or persons connected to its directors. The Cohen Committee and the Jenkins Committee made this recommendation due to several cases where directors have borrowed money from their companies on inadequate security and have been unable to repay the loans. The Jenkins Committee also recommended that the prohibition should be extended so as to prohibit loans by a company to another company in which the directors of the lending company hold a majority interest.

10.8 Within the Commonwealth jurisdictions there appears to be two different approaches in regulating loans to directors and to persons connected with directors and these are as follows:

- Imposing a general restriction subject to certain exceptions on the company's ability to give loans to its directors and to persons connected with its directors. This restriction applies **to all Commonwealth jurisdictions** except to private companies in the UK and exempt private companies in Malaysia;
- Allowing companies to give loans/benefits to its directors and to persons connected with the directors subject to the shareholders' approval.

10.9 The CLRC noted that Australia and New Zealand are two jurisdictions that no longer totally prohibit the giving of loans to directors or persons connected to directors.

10.10 The Australian Corporations Act 2001 contains a provision prohibiting a public company or an entity that the public company controls[74] from giving a financial benefit to directors and persons connected to directors, unless shareholders approval has been obtained and where the related party abstains from voting.

[74] See sections 9 and 64B of the Corporations Act 2001.

10.11 The New Zealand Companies Act 1993[75] enables the board to set the remuneration and benefits that is to be received by the directors of the company. Benefits, includes amongst others, the giving of loans and guarantees for loans given to directors. Loans or benefits or any material financial interest received by the director must however be disclosed to the shareholders through the interest register[76] that is to be maintained by the company and through the company's annual report. Further, the directors who authorised the loan or benefit must certify that they have exercised due diligence and are of the view that the giving of the loan or benefit is fair to the company by stating the grounds for their decision. The interest of members is protected through a disclosure regime (by ensuring that it is disclosed in the interest register and the company's annual report) and by the provisions on directors' duties.

10.12 The CLRC also noted that whilst the UK Companies Act 1985 generally restricts loans, quasi-loans[77] or credit transactions[78] to directors of public companies or a company which is a part of a group, one of which is a public company, the United Kingdom Companies Act 2006 changes the existing law in the following manner:

(a) these transactions may be entered into subject to shareholders' approval with appropriate disclosure to members;

(b) the requirement to obtain shareholders' approval applies to all types of companies.

[75] Section 161(1)(c) and (d) of the New Zealand Companies Act 1993.

[76] Malaysia does not have this type of register. This register does not exist in the United Kingdom, Singapore and Australia. It is interesting to note that the United Kingdom Company Law Review Steering Committee when reviewing its section 317 (our section 131) was of the view that there was no need for a company to maintain this type of register. If we were to accept that there is a need to maintain an interest register, there may be no need to create a new one as the application of section 134 can be extended to director's interest in contracts with the company.93.

[77] See section 199 of the United Kingdom Companies Act 2006 where ' a 'quasi-loan' is a transaction under which one party (the creditor) agrees to pay or pays otherwise than in pursuance of an agreement, a sum for another (the borrower) or agrees to reimburse otherwise than in pursuance of an agreement, an expenditure incurred by another party for another (the borrower) -
(a) on terms that the borrower (or a person on his behalf) will reimburse the creditor; or
(b) in circumstances giving rise to liability on the borrower to reimburse the creditor.

[78] See section 202 of the United Kingdom Companies Act 2006 which states that 'A 'credit transaction' is a transaction under which one party ('the creditor') -
(a) supplies any goods or sells any and under a hire purchase agreement or conditional sale agreement,
(b) leases or hires any land or goods in return for periodical payments. or
(c) otherwise disposes of land or supplies goods or services on the understanding that payment (whether in lump sum or instalments or by way of periodical payments or otherwise) is to be deferred.'

10.13 However, the CLRC is of the view that the rationale of this provision to prevent loan transactions by directors in their favour at the expense of the company should be maintained. The CLRC accordingly is of the view that except in the case of an exempt private company, a company is not allowed to give loans or security for a loan given to its directors or directors of its holding company or persons connected to such directors.

2. *If the sections are to be maintained, whether the types of transactions which are currently prohibited need to be expanded.*

10.14 Another issue considered by the CLRC is whether the types of transactions which are currently prohibited need to be expanded. The CLRC is made aware of attempts to circumvent the prohibition under sections 133 and 133A by providing other types of financial benefits to directors or persons connected to them. Thus there are concerns that the scope of the sections should be widened to include prohibiting not only the giving of loans or security for loans given to directors but also to any other 'financial benefits' for example quasi-loans or other credit transactions to directors. Whilst the Bursa Malaysia Securities Berhad Listing Requirements are wider in scope, it does not regulate unlisted public companies and thus there are concerns that these companies may be able to circumvent the intention of sections 133 and 133A. However, since these sections categorically prohibit loans to directors or persons connected to directors, except if the transactions come under the exception to the sections, the CLRC is of the view that the ambit and scope of sections 133 and 133A are sufficient.

3. *Whether the prohibition should be extended to substantial shareholders and persons connected to substantial shareholders.*

10.15 The CLRC also noted that currently, sections 133 and 133A of the Companies Act 1965, does not apply to substantial shareholders and persons connected to substantial shareholders. However, the Bursa Malaysia Securities Berhad Listing Requirements provides that loans and certain 'financial benefits', except to directors and persons connected to directors, may be given with shareholders' approval. There are views that the lack of any such restriction within the company legislation enables substantial/controlling shareholders to circumvent the law. Nonetheless, cross-jurisdictional study indicated that in the United Kingdom, under the Companies Act 2006,[79] provides that members' approval is required for loans, quasi-loans and credit transactions to directors or person connected to directors. It does not apply to substantial shareholders and persons connected to the substantial shareholder. In Australia, for the purposes of the prohibition that a public company cannot give any financial benefit to a related party, the Australian Corporations Act 2001 does not include substantial shareholders or persons connected to shareholders in their definition of 'related parties.'[80] Section 161 of the New Zealand Companies Act 1993 applies in relation to remuneration and other benefits, which includes amongst others, the giving of loans and guarantees for loans given to directors. Based on the cross-jurisdictional study, the CLRC is of the view that the section should not be extended to the substantial shareholder or persons connected to the substantial shareholder.

[79] See section 197 and 198 of the United Kingdom Companies Act 2006.
[80] See section 228 of the Act which states that related parties are:
- Controlling entities
- Directors and their spouses
- Relatives of directors and spouses
- Entities controlled by other related parties
- Related party in previous 6 months
- Entity has reasonable grounds to believe it will become related in the future
- Acting in concert with related party.

RECOMMENDATIONS

10.16 The CLRC recommends that:

(a) the loan or security for a loan given to directors and persons connected to directors should be prohibited except in the case of exempt private companies; and

(b) the section should not be extended to the substantial shareholder or persons connected to the substantial shareholder.

Questions for Consultation

Question 20:

Do you agree with the retention of the current prohibition under sections 133 and 133A that a company (except an exempt private company) cannot provide loans or security for loan to directors or to persons connected to its directors?

Question 21:

Do you agree that the scope of the section should be extended to cover certain types of 'financial benefits' for example quasi-loans, indemnity and credit transactions?

Question 22:

Do you agree that the sections should not be extended to the substantial shareholder or persons connected to the substantial shareholder?

PART IV REVIEW OF SECTION 131 OF THE COMPANIES ACT 1965

11.1 Historically, section 131 was intended to counter Articles which gave a dispensation to directors from having to disclose their interest in contracts entered into with the company. Section 131 mandates for the disclosure of the director's interest in company contracts and this duty cannot be contracted out.[81] The review on the disclosure of directors' interest in company contracts starts on the premise that the disclosure of contracts in which a director is interested in is mandatory and that such disclosures must be made to the board. This is the principle of law currently reflected by section 131 of the Companies Act 1965.[82] The CLRC acknowledges that the disclosure of directors' interest in company contracts is both necessary and an efficient regulatory tool. Hence, the CLRC proposes that section 131 should be retained with some modifications.

RECOMMENDATION

The materiality of the interest

11.2 The CLRC is of the view that the principle of law embodied in section 131, that a director must disclose his direct or indirect interest in any contract or proposed contract with the company to the board of directors of his company where there exists a conflict or potential conflict of interest in respect of that contract or proposed contract, be retained.

[81] See HAJ Ford, *'Ford's Principles of Corporations Law* (6th Edn), Butterworth stated that the Australian equivalent to our section 131 is derived from provisions enacted to counter articles that gave a dispensation to directors from having to disclose their interest in contracts entered into with the company. The Australian provision also added another dimension to the disclosure principle by imposing a penalty for failure to declare interest.

[82] Comparative jurisdictional sections includes Australia Uniform Companies Act 1961 section 123, United Kingdom Companies Act 1948 section 199, Singapore Companies Act (Chapter 50) section 156, Hong Kong Companies Ordinance section 162 and Companies Act (South Africa) 1973 section 237.

11.3 The CLRC noted that some jurisdictions only require for the disclosure of the directors' interest in company contracts provided that the directors' interest in that company contract is material. Whilst the word 'material interest' is not found in the existing section 131(1), section 131(2) provides that a director does not have to declare his interests in a company contract if the interest is of him being a shareholder or creditor of a corporation, which is interested in a contract or proposed contract with the company and where such interest may be regarded as *not material.*

11.4 The CLRC was informed that it is an established commercial practice to couple 'materiality' of interest for the purposes of section 131(2) with the 5 per cent threshold.[83] Hence, if a director has an indirect interest in a contract or proposed contract with his company because he is a member of another corporation that is going to enter into a contract with his company and his interest in that other corporation is less than 5 per cent, he shall not be subjected to the disclosure requirement as set out in section 131(1). However, whilst this is taken as good practice, the interpretation is a matter of convenience and should not be stated as a principle of law since what is important is whether the interest may give rise to a conflict of interest. The CLRC also noted that the United Kingdom CLR did not agree to setting a monetary limit below which the interest is considered as immaterial (*de minimis* rule). By stating that disclosure is only required if there is a 'material interest', directors would most likely disclose their interests in any transaction to the company as this is relatively easy to do whilst the court will be able to exercise its discretion to decide on the facts of the case whether or not the interest is material. The CLRC is in agreement with this view.

[83] The 5 per cent threshold is derived from section 69D of the Companies Act 1965.

11.5 The CLRC noted that in some judicial decisions, the court has stated that there is no need to formally declare a director's interests in situations where the director proves that the other directors are aware of the interest.[84] The United Kingdom Companies Act 2006 has addressed this issue and states that a director need not disclose his interest, if or to the extent that the other directors are aware of it.[85] Section 191(2)(b) of the Australian Corporations Act 2001 states that there is no obligation to disclose in the proprietary company where all the directors are aware of the nature and extent of the interest. The CLRC is of the view that such a provision will remove unnecessary compliance with formality although such a provision will still require a director to prove that the other directors are aware of the interest so as not to necessitate a formal disclosure by the interested director.

11.6 The CLRC also noted that the disclosure scheme as provided for by sections 131(1) and 131(4) only compels a director to disclose his interest in a company contract. The CLRC proposes that the disclosure obligation be extended to cover the interests held by the director's immediate family members.[86]

(b) Director's knowledge of the interest

11.7 The current legislative text of section 131(1) suggests that a director is only required to disclose his interest in a company contract provided he has knowledge of that interest and that he will only be made accountable if he fails to disclose his interest in a company contract after the relevant facts have come to his knowledge.[87] The

84 *Tan Bok Seng v Sin Be Seng & Co (Port Weld) Sdn Bhd* [1995] 4 CLJ 795; *Tneu Beh v Tanjong Kelapa Sawit Sdn Bhd & Ors* [1995] 1 CLJ 741; see also *Woolsworth v Kelly* [1991] 9 ACLC 539.

85 Section 195(6) of the United Kingdom Companies Act 2006.

86 Section 156(8) of the Singapore Companies Act (Chapter 50) provides that:
'An interest of a member of a director's family shall be treated as an interest of the director and the words 'members of a director's family' shall include his spouse, son, adopted son, step-son, daughter, adopted daughter and step daughter.'

87 The relevant legislative text of section 131(1) reads as follows '....shall as soon as is practicable after the relevant facts have come to his knowledge declare the nature of his interest...'.

CLRC is of the view that this is a correct principle of law as a director should only be made accountable for contravening section 131 if he is aware of the interest and intentionally does not disclose the interest.[88] The CLRC is of the view that it is only reasonable that a director who unintentionally contravenes section 131 should not be made accountable for his non-disclosure and that section 131 should be clarified on this point.[89]

(c) Method of declaration

11.8 The CLRC is of the view that any declaration made under this section must be in accordance with any of the following methods:

(i) at a meeting of the board of directors - this declaration may be made at a physically held board meeting and the company secretary is under a duty to record that declaration in the minutes of the meeting at which it was made;[90]

(ii) by notice in writing - the interested director may give written notice of his interest in a company contract to the company (as opposed to making a declaration of his interest at a board meeting only as set out in section 131 of the Companies Act 1965). Upon receiving this notice, the company shall send a copy of that notice to all the other directors of the company.[91] Further, the company secretary shall note that the interested director has given that notice;

[88] *See Lim Foo Yong v PP* [1976] 2 MLJ 259 where no offence is committed if the director could not have reasonably known about the conflict
[89] Section 162(3) of the Hong Kong Companies Ordinance expressly provides that a director is not guilty of an offence if he is not aware of the contract that gave rise to the conflict of interest.
[90] Section 131(7) of the Companies Act imposes this duty on the company secretary.
[91] These wordings are derived from section 135(3). Section 135 imposes a general duty on directors to make disclosures of matters set out in section 135(1) to the company.

(iii) by giving a general notice of future conflict of interest pursuant to section 131(4) of the Companies Act 1965. In such a case, upon receiving this notice, the company shall send a copy of that notice to all the other directors of the company. Further, the company secretary shall note that the interested director has given that notice.

Ideally, the notice which is provided for by the interested director under options (ii) and (iii) above should be given to the board before the board makes its decision to enter into that interested contract or before the next meeting of the board after the director becomes aware of his interest in a company contract.[92]

11.9 However as proposed earlier, there is no necessity to formally declare a director's interests in situations where the director proves that the other directors are aware of the interest.

(d) Consequences of contravention

11.10 The CLRC noted that section 131 is silent as to the consequences of a transaction which is entered into in contravention of section 131. At common law, a contract entered into by a company where its director has an interest in that contract and where the director has failed to disclose that interest to the company is voidable at the option of the company.[93] However, the CLRC noted that in some jurisdictions, such transactions are valid and that contravention of the statutory duty to disclose does not give rise to civil liability.

[92] The CLRC proposes that notice be given before the next meeting of the board after the director becomes aware of his interest in a company contract because there may be instances where the director will only become aware of his interest in a company contract after the board has approved the transaction.

[93] *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 46 and see *Transvaal Lands Co v New Belgium (Transvaal) Land & Development Co* [1914] 2 Ch 488.

11.11 The CLRC is of the view that the common law position should be preserved and thus recommends that a transaction entered into by a company in contravention of section 131 should be stated as voidable at the option of the company except in favour of a third party who acted in good faith, for value and without actual notice of the contravention.

Questions for Consultation

Question 23:

Do you agree that the Companies Act should contain a provision stating that there is no need to formally declare a director's interests in situations where the director proves that the other directors are aware of the interest?

Question 24:

What are your views on the appropriate method of disclosure by a director who wants to disclose his interests? For example, do you agree that disclosure may be made in any one of the following manner:

(i) at a meeting of the board of directors;

(ii) by notice in writing, or

(iii) by giving a general notice of future conflict of interest?

Question 25:

Do you agree that where a director has failed to disclose his interest in an arrangement or transaction entered into by a company, the arrangement or transaction is voidable at the option of the company?

Question 26:

Do you agree that the arrangement or transaction is not voidable if entered into in favour of third parties who acted in good faith, for value and without actual notice of the contravention?

PART V REVIEW OF DISCLOSURE BY SUBSTANTIAL SHAREHOLDERS

12.1 Disclosure of the identity of the substantial shareholders is often used by a company and other persons, particularly the shareholders, to ascertain who are its main shareholders, who are shareholders who have sufficient votes to veto any special resolution of the company and identify who may be in the process of building a stake in the company to gain control of the company. From the securities laws perspective, there is also the view that imposition of this duty of disclosure on substantial shareholders also aids in the promotion of an informed market and prevents market manipulation. The CLRC is of the view that the disclosure obligation imposed on a substantial shareholder to disclose its substantial shareholding or changes to his substantial shareholding to the company and to the respective regulators as provided for in Division 3A of Part IV of the Companies Act 1965, should be retained as it promotes governance and protects stakeholders' interest.

12.2 The CLRC noted that the Corporate Governance Report (CG Report) recommended the current timeline of seven (7) days for giving the required notice to the company pursuant to sections 68E, 69F and 69G of the Companies Act 1965 should be shortened. However, the CLRC is of the view that shortening the above timelines can result in compliance problems for the business community.

12.3 In addition, there are also views that section 69F should be revised as the current drafting of section 69F does not specify a *de minimis* rule as to changes in the substantial shareholding that should give rise to the obligation to notify the company or the regulatory authorities. Section 69F requires a substantial shareholder to notify his company and the regulators whenever he acquires or disposes his voting shares when there are changes in the substantial shareholding. The CLRC noted that there are recommendations made by the Singapore CLRFC and the United Kingdom CLR to require a substantial shareholder to notify his company only where there is a change in the prescribed percentage level of the interest or interests in the voting shares held by the substantial shareholder. The Singapore CLRFC recommended that reporting of changes in substantial shareholdings should be required when the shareholding exceeds the discrete 1 per cent threshold above the current minimum 5 per cent threshold for example when the shareholding crosses 6 or 7 per cent. The UKCLR[95] also recommended that the initial disclosure thresholds (3 per cent for 'material' and 10 per cent for 'non-material' interests) would stay, and:

- notification would still be required at a percentage point from these figures up to 15 per cent;
- thereafter, the intervals would be widened above 15 per cent to 20 per cent, 25 per cent, 30 per cent, 50 per cent and 75 per cent.

[95] Modern Company Law for a Competitive Economy : Developing the framework, March 2000. Paragraph 4.179, p 149.

12.4 Nonetheless, the CLRC does not propose the adoption of this approach as the CLRC is of the view that there is less confusion in the current approach of requiring disclosure whenever there are any changes in the substantial shareholding. There is also less risk of unintentional non-disclosure due to miscalculations. Hence, the CLRC sees no reason to change the law and practice in this area.

RECOMMENDATIONS

12.5 The CLRC recommends that:

(i) the current threshold of 5 per cent as is currently provided for by section 69D should be retained. The CLRC noted that it is the usual practice for countries to peg their threshold percentage between 3 to 5 per cent.[96]

(ii) the current timeline of seven (7) days for giving the required notice to the company pursuant to sections 68E, 69F and 69G of the Companies Act 1965 should be retained.

(iii) there is no need to propose a threshold or *de minimis* rule for section 69F of the Companies Act 1965.

Questions for Consultation

Question 27:

Do you agree that the current threshold of 5 per cent as is currently provided for by section 69D should be retained?

[96] In Australia and Singapore the threshold is pegged to 5 per cent whilst in the United Kingdom it is pegged to 3 per cent.

Question 28:

Do you agree that the current timeline of seven (7) days for giving the required notice to the company pursuant to sections 68E, 69F and 69G of the Companies Act 1965 should be retained?

Question 29:

Do you agree that there is no necessity to propose a threshold or *de minimis* rule for section 69F of the Companies Act 1965?

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