company. These companies were required to include the word "limited" in their name, to alert those dealing with the company to the fact that the liability of the members was limited.

Various reform proposals over the next six years resulted ultimately in the enactment of the *Companies Act 1862* (UK), consolidating the procedures for incorporation and winding up of companies and putting in place many of the key features of modern company law. The *Malaysian Companies Act 1965* was modelled on the *English Companies Act 1948* and *Australian Uniform Companies Act 1961*. Because of their common history, many English and Australian principles of company law still apply in Malaysia.

## ¶1-380 When were companies first used for small businesses?

Until this point we have been considering the historical development of the company as a means of bringing together providers of capital (investors) with specialist business managers or entrepreneurs in larger scale, collective enterprises. Typically they involved asking members of the public for investment, and required a separation of ownership of the enterprise (which was in the hands of a large, fluctuating membership) and its management. Company law developed in part for the protection of public investors, and adopted the large scale collective enterprise as its model.

However, the attributes of companies, in particular the limited liability conferred on their members, also made them an attractive form through which to carry on small businesses. Typically a company formed to carry on a small business would not have public investors, and would be controlled and managed by its main investor, often a person who had perhaps conducted the business as a sole trader prior to its incorporation.

The fact that the "corporation aggregate" model was adopted for company law was reflected in the fact that the companies legislation required that companies have a certain minimum number of members. Historically, incorporation required the coming together or association of more than one person to form a company.

### What was the significance of Salomon's case?

It was not clear until the landmark English case of *Salomon v Salomon & Co Ltd* in 1897 that the benefits of incorporation would extend to incorporated small businesses that were effectively under the control of a single entrepreneur. *Salomon's* case is discussed in Chapter 3. A business formed and operated by Mr Salomon as a sole trader had been transferred by him to a company which he had formed under the 1862 Act and in which he was the major shareholder and controller. To meet the then statutory requirement that a company have at least






seven shareholders, shares were issued to other members of his family but those family members did not have any real interest in the business.

Mr Salomon transferred his business to the company in order, among other things, to obtain limited liability. He intended that, if the business failed, his personal wealth would not be put at risk, as he would not be personally liable to satisfy the outstanding claims of the business's creditors.

The English Court of Appeal initially took the view that such an arrangement should not attract all the benefits of incorporation (including limited liability for Mr Salomon and the other family members). One judge said:

> "It would be lamentable if a scheme like this could not be defeated. If we were to permit it to succeed, we should be authorising a perversion of the Joint Stock Companies Acts . . . The transaction is a device to apply the machinery of the [Act] to a state of things never contemplated by that Act — an ingenious device to obtain the protection of that Act in a way and for objects not authorised by that Act, and in my judgment in a way inconsistent with and opposed to its policy and provisions." ([1895] 2 Ch 232 at 340–341, per *Lopes* LJ)

Another judge, *Lindley* LJ, took the view that:

> "If the legislature thinks it right to extend the principle of limited liability to sole traders it will no doubt do so, with such safeguards, if any, as it may think necessary. But until the law is changed such attempts as these ought to be defeated wherever they are brought to light. They do infinite mischief; they bring into disrepute one of the most useful statutes of modern times, by perverting its legitimate use, and by making it an instrument for cheating honest creditors."

Therefore the Court of Appeal held that Mr Salomon and his company should not be accorded the privileges of incorporation. Mr Salomon appealed and the Court's decision was reversed by the English House of Lords. The House of Lords said, in relation to small business:

> "It has become the fashion to call companies of this class 'one man companies'. That is a taking nickname, but it does not help one much in the way of argument. If it is intended to convey the meaning that a company which is under the absolute control of one person is not a company legally incorporated, although the requirements of the Act of 1862 may have been complied with, it is inaccurate and misleading: if it merely means that there is a predominant partner possessing an overwhelming influence and entitled practically to the whole of the profits, there is nothing in that I can see contrary to the true intention of the Act of 1862, or against public policy, or detrimental to the interests of the creditors." ([1897] AC 22 at 53)

The final decision was that the benefits of incorporation were capable of extending to small, private companies, even though such companies arguably

and other related areas. Furthermore, to preserve the independence of the audit committee, executive directors will no longer be allowed to become members of the committee.

## ¶2-410 Offshore Companies Act 1990

An offshore company or foreign company must be incorporated or registered respectively under the *Offshore Companies Act 1990* in order to carry on offshore business activities in or from Labuan and to enjoy the preferential tax treatment provided under the *Labuan Offshore Business Activity Tax Act 1990*. The *Offshore Companies Act* provides for the incorporation, registration and administration of offshore companies and foreign offshore companies and matters connected with that.

In summary, the objective of the *Offshore Companies Act* is to create a structure with minimal statutory requirements in which companies may operate. It allows for financial assistance to facilitate the purchase of the company shares, the option of whether or not to conduct annual general meetings within or outside Labuan, and the passing of resolutions by telex, fax and such other electronic means can be reproduced in print form without the physical presence of the members. However, there are also restrictions on participation by Malaysian residents either as shareholders or via any trading or business activity with the offshore company.

## ¶2-420 Anti-Money Laundering and Anti-Terrorism Financing Act 2001

The *Anti-Money Laundering and Anti-Terrorism Financing Act 2001* came into force on 15 January 2002. The key thrust of the Act is to criminalise money laundering as an offence and impose various obligations on reporting institutions (eg, reporting and record keeping). The Act stipulates the powers of investigation and enforcement as well as ancilliary powers of freezing, seizing and forfeiting proceeds of unlawful activities. The scope of money laundering under the Act covers all activities and procedures to change the identity of illegally obtained money so that it appears to have originated from a legitimate source.

The Act also provides general principles and policies to mitigate money laundering activities, penalties for non compliance with the Act (sec 22) and protection for informers from liabilities (sections 5, 8, 14 and 24).






# REGULATION OF COMPANIES

## ¶2-500 Overview

Companies are a special type of legal person, created by the government following an application for registration. The special status of companies as legal persons, and the special rights and protections (such as limited liability) conferred on participants in companies, mean that companies are treated as requiring special regulation. In addition, the complex provisions of the *Companies Act* require administration and enforcement. This part summarises the respective roles of the SC, Bursa Malaysia, SSM ("Suruhanjaya Syarikat Malaysia" or Companies Commission of Malaysia) and the courts in regulating companies.

## ¶2-520 Securities Commission

The SC is one of the regulators of companies. It is established and operates under the SCA.

As noted above, the SC has broad powers to administer securities laws in Malaysia. It has wide discretion with respect to the delegation of its powers and the establishment of committees to facilitate the performance of its functions. The SC has three basic administrative powers: rule making, adjudicatory and investigatory and enforcement. Apart from its quasi legislative responsibilities associated with the rule making process, the SC has regulatory oversight and quasi judicial powers over brokers, dealers and investment advisers and their representatives which it licenses under the SIA. In addition, it oversees the exchanges which were established either under the SIA and the *Futures Industry Act 1993*.

Accordingly, the SC also performs the function of enforcement which falls within the ambit of market supervision. There are four major departments in the SC — the issue and investment division, the market supervision division, the research and development division and the finance, human resources and administrative division.

## ¶2-540 Bursa Malaysia Securities Bhd (Bursa Malaysia)

We noted in Chapter 1 that some companies elect to have their securities listed for quotation on the stock market conducted by Bursa Malaysia. When they do so, they contract with Bursa Malaysia that they will comply with the Bursa Malaysia Listing Requirements. Bursa Malaysia acts as a "regulator" in the sense that it polices compliance by listed companies with those rules.

Following the demutualisation of the Kuala Lumpur Stock Exchange (effective from 5 January 2004), the listing requirements have been amended. The words "Kuala Lumpur Stock Exchange Berhad" have been substituted with "Bursa

Creditors may be able to recover money owed to them by a company from the company's directors or shareholders in certain circumstances, as discussed in *Vu Siew Chin v Wong Fah Yoon* [1981] 2 MLJ 221 below.)

Debts of a partnership are the debts of the partners themselves. In contrast, debts of a company are not the debts of its shareholders. The reason is that in the former case, a partnership does not have a legal existence which is separate from its partners. In the latter case, an incorporated company's legal entity stands between its creditor and its shareholders. In *Fairview Schools Bhd v Indrani Rajaratnam & Ors* [1998] 1 CLJ 285, *Mahadev Shanker* J said that: "Limited companies are formed so that its shareholders are not exposed to unlimited liability for the company's debt. In exchange for this immunity, share capital is pumped into the company which thus becomes available to the company's creditors."

***A company can sue and be sued in its own name:*** Since a company is a separate legal entity, it follows that it is liable for its own debts and may sue or be sued in its own name. In *Re Application by Yee Yut Ee* [1978] 2 MLJ 142 per *Choor Singh* J, the Singapore High Court stated that except in cases of fraud, breach of warranty of authority and other exceptional circumstances, a director is not liable for the debts of an incorporated company. Nevertheless, this view was not shared in *Vu Siew Chin v Wong Fah Yoon*, where *Wan Suleiman* FJ, held that the law allows a person who is the sole owner of the company to be sued in the company's name.

A company can also incur liabilities and be sued by other parties. The liabilities are not liabilities of the members. In a company limited by shares, members' liabilities are limited to the amount, if any, unpaid on the nominal value of the share (sec 18(1)(d) *Companies Act*). As decided in *Foss v Harbottle* (1843) 2 Hare 461 as a separate person in law, a company must normally enforce its rights by itself in its own name. As such, from that time it can sue or be sued in its own name. This means that it is not necessary for the members of the company or its officers to be named as parties to legal proceedings where the proceedings only involve the company.

***A company has perpetual succession:*** This means that the company is a continuing entity in law with its own identity regardless of changes in its membership.[6] It continues in existence, unchanged, even if its original members die, sell their shares to others, or otherwise cease to participate as shareholders. The company continues in existence until it is deregistered under the statutory procedure set out in the *Companies Act*. A company may also be dissolved under sec 208 of the *Companies Act* which empowers the Registrar of Companies (ROC)

6 See *Abdul Aziz bin Atan v Ladang Rengo Malay Estate Sdn Bhd* [1985] 2 MLJ 165. The company may even continue to exist despite the death of all its shareholders and directors; see also *Re Noel Tedman Holdings Pty Ltd* [1967] Qd R 561.






to cancel the registration of and to dissolve a company where it has reasonable cause to believe that the company is not carrying on business or is not in operation.

***A company's property is not the property of its participants:*** As a result of the separate entity rule, a company may own property distinct from the property of its members. Unlike the beneficiaries of a trust, the participants in a company have no proprietary (legal or equitable) interest in the company's property. They therefore have no "ownership" rights in respect of it. For example, in *Macaura v Northern Assurance Co Ltd* (1925) AC 619, Mr Macaura transferred his interest in a timber plantation to a company controlled by him. He had insured the timber in his own name but failed to transfer the insurance policy to the company. When the timber was destroyed by fire, the insurance company refused to pay out under his policy because he did not have an "insurable interest" in the timber, as he was not its owner. The company was the owner of the timber. Members only own shares in the company. A change in the ownership will not affect the ownership of the property.[7]

***A company can contract with its controlling participants:*** Because they are separate legal entities, a company and its participants can enter into contracts with each other. For example, we have seen from *Salomon's* case that a company can lend money to or borrow money from its controlling shareholder.

> In *Lee v Lee's Air Farming Ltd* (1961) AC 12, the controlling shareholder and managing director of a company that operated a business which involved aerial top-dressing of farm land was killed in a flying accident. His widow successfully argued that she was entitled to a pay-out under worker's compensation insurance for her husband's death because her husband was a "worker", that is, that he had entered into a contract of service with the company. Unless the company and its controller were separate legal entities, the finding that a contract existed between them would not be open to the court, because a contract requires at least two separate parties.

***A company has the power to hold land:*** This power is usually incorporated in the memorandum of association of the company. For example, the power to purchase, lease, hire or acquire any property and any rights or privileges which the company thinks necessary or convenient for the purpose of its business (eg, land, buildings, easements, machinery, plant and stock in trade). However, the right to hold land is subject to certain restrictions as stated under

7 See *Abdul Aziz bin Atan & Ors v Ladang Rengo Malay Estate Sdn Bhd* [1985] 2 MLJ 165 where it was held that the transfer of ownership of the entire shares in the company to new owners, does not affect the identity or personality of the company. It continued to own all assets of the estate which was an integral part of the business for the purpose for which the members were employed.

association and cannot be distributed to the individual members of the association.

As mentioned earlier, an unincorporated association is not a separate legal entity. This means that under the common law, it cannot hold property in its own name (property must be held in the names of the individual members of the association) and the association is unable to enter into contracts in its own name. Neither can the association sue or be sued in its own name. A lack of separate legal entity causes inconveniences to both the incorporated associations and third parties dealing with them.

In Malaysia, all non-profit[1] clubs and societies, having not less than seven members, with certain exceptions such as clubs and societies in schools, must be registered under the *Societies Act 1966*. Similarly, all trade unions must be registered under the *Trade Unions Act 1959*. In view of the inconveniences caused by the common law position for unincorporated associations, the *Societies Act 1966* and the *Trade Unions Act 1959* contain specific provisions allowing a registered society and registered trade union to sue and be sued, respectively, through a registered public officer (sec 9, *Societies Act 1966*) or in its registered name (sec 25, *Trade Unions Act 1959*). A registered society is allowed to hold real estate[2] while a trade union must vest its properties with its trustees.

The members of an unincorporated association do not have the benefit of limited liability.

### Co-operatives

A co-operative is defined as an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise. It can also be defined as a business owned and controlled by the people who use its services. It is a legal entity owned and democratically controlled by the members. The members have a close association with the cooperative as producers or consumers of its products or services or as its employees. Co-operatives legislation in Malaysia include the *Co-operative Societies Act 1993*, *Cooperative Societies Regulations 1995*, and *Cooperative Societies (Fees) Regulations 1999*.

Co-operatives are based on the values of self help, self responsibility, democracy, equality, equity and solidarity. Such legal entities have a range of unique social characteristics. Membership is open, which means anyone who satisfies certain non-discriminatory conditions may join. Most co-operatives are governed on a strict "one member one vote" basis to avoid concentration in an elite. Economic

1 It is not possible to form clubs and societies for profits.

2 Section 9(b) of the *Societies Act 1966*: provided all instruments relating to the real estates are executed by any three of its president, secretary, treasurer, members of the committee or governing body. In addition, the instruments must carry the seal of the registered society.







benefits are distributed proportionately according to each member's level of economic interest in the co-operative.

In Malaysia, all co-operatives from the various industries are united into one national movement known as the National Co-operative Organisation of Malaysia (Angkatan Koperasi Kebangsaan Malaysia or "ANGKASA").

## ¶4-120 Key differences between companies and other forms of business organisations

In Chapter 3, we analysed some of the particular legal and functional characteristics of companies that differentiate them from other forms of business organisations.

Many businesses are not conducted by a company. Other forms of business organisations are available, and the advantages and disadvantages of using a company over one of these other forms are discussed below, along with the key characteristics of these other main forms of business organisations.

### Sole proprietorship

The expression "sole proprietorship" or "sole trader" is used to describe the situation where an individual person carries on a business in his or her own name. Where a sole proprietorship exists, there is no separation between the business and personal assets or obligations of the person conducting the business. The sole proprietor signs all the contracts relating to the business, owns its assets and is personally liable for all its debts. Management rests on that one person and his liability is unlimited. One of the advantages of this form of business is that there are fewer formalities in terms of its formation and registration.

As the income generated by the business is the income of the proprietor, the proprietor is the taxpayer and the business' losses or profits can be offset against the proprietor's other income.

### General partnership

A partnership is an association of people carrying on business in common with a view to a profit. The relationship between partners and partners, and partners and third parties is governed by the *Partnership Act 1961*.

There is no need to take any formal legal steps to create a partnership — it simply arises as a matter of law where two or more people are in this relationship. However, usually the terms of the agreement between partners are recorded in a formal legal document referred to as a "partnership agreement".

Unless otherwise provided in the partnership agreement, whether specifically or impliedly, the following rules contained in sec 26 and sec 27 of the *Partnership Act 1961* will apply:

project and to set it going, and who takes necessary steps to accomplish this purpose. He is also a person who is a joint adventurer and who will benefit from the incorporation of a company even though he does take an active part in the formation of the company.[23] However, a person who works purely in a ministerial capacity is not automatically to be considered as a promoter. More importantly, the courts have decided that the test to be applied to determine whether a person was a promoter or not would depend on the question of facts to be decided by the court.[24]

Whether a person is a promoter or not is important under two circumstances. Firstly, in the event the company makes a public offering of securities, it is necessary to disclose the benefits given to the promoter. Secondly, promoters owe certain fiduciary duties to the company and it is necessary to ascertain whether a person is a promoter in order to determine if he has breached his duty against the company.

## LISTING ON BURSA MALAYSIA

### ¶4-400 What is listing?

In Chapter 1, we noted that some companies elect, by entering into a contract with Bursa Malaysia to be admitted to the Official List of the Bursa Malaysia and have one or more classes of their securities granted Official Quotation for trading on the stock market conducted by Bursa Malaysia. Such companies are usually referred to as "listed companies". Once the company is listed and its securities quoted, those securities can be bought and sold by investors through the electronic marketplace conducted by Bursa Malaysia.

As at 3 January 2008, there are 988 listed companies in Malaysia. This includes 637 companies listed on the Main Board, 227 listed on the Second Board and 124 companies listed on the MESDAQ market. All listed companies are public companies, but not all public companies are listed.

In this section, we look briefly at the reasons why a company might choose to apply for listing, the eligibility criteria adopted by the Bursa Malaysia, and the process of listing.

23 *Tracy v Mandalay Pty Ltd* (1953) 88 CLR 215.

24 *Mohd Latiff bin Shah Mohd & Oors v Tengku Abdullah ibni Sultan Abu Bakar & Ors and other actions* [1995] 2 MLJ 1.







### ¶4-410 Bursa Malaysia Listing Requirements: Function and Principles

To be admitted to the Official List of Bursa Malaysia and to secure official quotation of their securities on Bursa Malaysia, companies must, in addition to compliance with the relevant provisions of the *Securities Commission Act 1993* and the *Companies Act 1965*, comply with the Bursa Malaysia Listing Requirements.

The Bursa Malaysia Listing Requirements set out the requirements which apply to applicants for listing, the manner in which any proposed marketing of securities is to be conducted and the continuing obligations of listed companies.

The Listing Requirements enable Bursa Malaysia to facilitate the admission of only suitable qualified entities. Once listed, the Listing Requirements provide guidelines to ensure that the entities conduct themselves in a proper manner that will give due regard to investor protection and at the same time, enable them to achieve there corporate objectives.

The Bursa Malaysia Listing Requirements serve to embrace the interests of listed entities, maintain investor protection and protect the reputation of the market. The principles set out to achieve these goals include:

- minimum standards of equality, size, operations and disclosure must be satisfied;
- securities must have rights and obligations attached to them that are fair to new and existing security holders;
- timely disclosure must be made of information which may affect security values or influence investment decisions and information in which security holders, investors and Bursa Malaysia have a legitimate interest must be disclosed;
- information produced must be of the highest standards and, where appropriate, enable ready comparison with other similar information;
- the highest standards of integrity, accountability and responsibility of entities and their officers must be maintained;
- practices must be adopted and pursued which protect the interests of security holders, including ownership interests and the right to vote;
- security holders must be consulted on matters of significance; and
- market transactions must be commercially certain.

The Bursa Malaysia Listing Requirements promote the growth of capital markets and the maintenance of an orderly and fair market, thus instilling confidence in the market place.

# THE ROLE OF COMPANY OFFICERS

## ¶6-500 Overview

Every company must have at least two directors who are usually responsible for managing (or supervising the management of) the company.[9] Every company must also have a secretary. Larger companies may also have executive officers who, while not directors, are involved in their management.

The discussion in the previous part illustrates that, company law assumes a "division of labour" in operating a company. Its members are the company's proprietors, and the people who provide equity capital to it. However, management of the company's operations is in the hands of the company's officers. This part describes the respective roles of the various officers in that division of power. In particular, it looks at the roles of the company's directors, secretary, and executive officers.

## ¶6-520 What is the directors' role?

A company's directors are those people appointed in accordance with the company's articles to manage the business of the company. As noted in Chapter 1, only a natural person over the age of 18 years can be appointed as a director of a company (sec 122(2), *Companies Act*).

Every company must have at least two directors and each director must either have his principal or only place of residence in Malaysia (sec 122(1), *Companies Act*).

The functions actually undertaken by the directors of a company vary enormously depending on the size and type of the company and the role of the director in it. In a small business, the director or directors may truly "manage" the company's business in the sense that they work in the business and make the day-to-day decisions involved in running it.

In larger companies, the directors may assume a more supervisory function, with responsibility for the day-to-day decision making left to the company's executive management. The role and composition of the board of directors in a large, listed public company has been described in the following terms:

> "The board of directors . . . usually consists of non-executive (ie, part time) directors as well as executive directors (who are employed as full time officers of the company). The board, as an organ, would very rarely manage the business of such a company. In practice, the board of the average [listed] company delegates to the chief executive (or 'managing director') and other executive directors the responsibility for the day-to-day management of the company's business. It is the executive directors and other executive officers (who are not also members of the board), collectively called the executive management, who manage the company's business. The company's strategy is developed by the executive management, although it is normally necessary for the approval of the board to be obtained for major transactions or changes in strategy, and sometimes necessary for shareholder approval to be obtained as well. The board usually meets monthly, and performs (or is supposed to perform) the functions of reviewing strategy and monitoring the performance of executive management. This division of functions between the shareholders, the board and executive management is an inevitable consequence of the large size and scale of operation of most [listed] companies."[10]

So in larger companies, directors are to concentrate on setting the broad strategic goals for the company, appointing managers to devise and implement strategies to meet those goals, supervising those managers, and reviewing progress towards those goals.[11]

Chapter 10 describes the process by which a person may be appointed or removed as a director. It also outlines the circumstances in which the ROC or the SC or a court may ban a person from acting as a director of a company. The duties of company directors are discussed in Chapters 11 and 12.

## ¶6-540 How does the board discharge its role?

The management powers exercised by the board of directors are exercised collectively through the board acting as an organ of the company. The decisions of the board in its capacity as an organ of the company must be decisions reached collectively by the directors acting properly, for example, through properly constituted board meetings. Single directors do not have the power individually to manage the company's business. The exception to the general principle that the board exercises its powers collectively, is where the board has delegated some or all of its powers to a managing director or to a committee of the board (Art 86 and 93 of Table A, *Companies Act*).

### Appointment and role of the managing director

A company's articles of association may provide for the appointment of a managing director as the company's chief executive officer. Article 93 of Table A states that the directors of a company may appoint one or more of themselves as managing director. This provision allows the board to confer upon the managing director any of the powers that the board itself can exercise.

9 Paragraph 15.02 of the Bursa Malaysia Securities Listing Requirements specifies the composition of listed companies' boards. Under this rule, at least 2 or 1/3 of the members of the board of listed companies must be independent directors.

10 G Stapledon, *Institutional Shareholders and Corporate Governance*, (1996), pp 7–8.

11 See also *AWA Ltd v Daniels* (1992) 10 ACLC 933 at 1,013; (1993) 7 ACSR 759 at 865–866, per *Rogers* CJ.

## ¶8-370 Meetings of one

Generally speaking, the concept of a meeting requires that more than one person be in attendance.[8] As with determining whether a quorum is present, a person cannot be counted more than once simply because they are attending in more than one capacity.[9] However, sometimes the law evidences an intention that a meeting could occur with only one participant, such as where a class meeting is required and the class has only one member.[10]

A one-man meeting is invalid unless it is a meeting of a class of members or creditors where there is only one member of the class or one creditor of the company. In addition, under sec 147(6) of the *Companies Act* a wholly owned subsidiary may have a meeting comprising one member only that is the corporate representative of the holding company. The court also has power to order a one-man meeting in special circumstances (*Low Son Siang v Lee Kim Yong* [1999] 1 CLJ 529).

# MEMBER VOTING

## ¶8-400 Voting by members

This part looks at members' entitlement to vote, and the rules governing exercise of members' voting rights at company meetings.

At a meeting, members will be requested to vote on resolutions put before the meeting for its consideration. Voting is done in one of two ways — by a show of hands or by a poll.

If a company adopts Table A, then Art 51 states that a resolution put to the vote at a general meeting must be decided on a show of hands unless a poll is demanded. The usual way of conducting a vote by show of hands, at common law, was that the number of people who indicate their vote by raising their hand is counted and the result is declared, regardless of the number of shares held by each of the people voting and without counting proxies. In the case of a company limited by shares, each member personally present and entitled to vote has one vote if the voting is by a show of hands.

Article 51, Table A of the *Companies Act* states that a poll can be demanded before or on the declaration of the result of voting by a show of hands. The persons who can demand a poll under the company's articles are:

- the chairman;
- at least three members present in person or by proxy;

8 *Sharp v Dawes* (1876) 2 QBD 26.

9 For example, as a member themselves and as a proxy for another member. See *Re Sanitary Carbon Co* [1877] WN 223.

10 *Re Hastings Deering Pty Ltd* (1985) 3 ACLC 474; 9 ACLR 755.






- any member present personally or by proxy who represents not less than 10% of the total voting rights of all members having the right to vote at the meeting;
- any member or members holding shares which confers voting rights where the shares are those on which an aggregate sum has been paid up equal to not less than 10% of the total sum paid up on all the shares conferring that right.

Section 146 of the *Companies Act* provides that a poll may be demanded on any resolution, except on a resolution for election of the chairperson or to adjourn the meeting.

Under sec 146(1)(b) of the *Companies Act*, any provision in the company's articles is void if it makes ineffective a demand for a poll on a question that is made by:

- not less than five members having the right to vote at the meeting;
- a member or members representing not less than 10% of the total voting rights of all members having the right to vote at the meeting;
- a member or members holding shares which confers voting rights where the shares are those on which an aggregate sum has been paid up equal to not less than 10% of the total sum paid up on all the shares conferring that right.

In a poll, the number of votes cast for or against the resolution (rather than the number of people voting for or against it) are counted. In the absence of any provision to the contrary in the articles, each member has one vote per share in a voting by poll. If the share capital consists of stock or units of stock each member has one vote per stock or unit of stock (sec 147(1)(c)(ii), *Companies Act*)

Sometimes in a private company a member is given weighted voting rights. In this situation his votes may be more than the number of shares he actually holds. However, weighted voting rights is not possible in a public company limited by shares or a subsidiary of such public company. In these types of companies, each equity share carries one voting right: sec 55(1) and sec 55(5) of the *Companies Act*.

## ¶8-420 Members' entitlement to vote

Members have a right to vote at a general meeting of the company, unless the company's constitution denies that right (*Pender v Lushington* (1877) 6 Ch D 70 at 81). A member's right to vote is usually provided for in the company's articles of association. However, an ordinary shareholder enjoys full voting rights except where Art 57, Table A applies. In this situation, the member cannot vote unless all calls or other sums payable by the member in respect of the members' shares have been paid. Where a company has issued more than one class of shares, the company's constitution or the terms of issue of the share may provide for the different classes to have different voting rights. For example, a preference shareholder has no right to vote except in certain situations. The voting right is

hold office for more than three years without being re-elected.[13] However, a company that has Table A of the *Companies Act* as its articles of association usually excludes the managing director from having to comply with the rule relating to retirement by rotation (Art 63): Art 91. The Bursa Malaysia Listing Requirements do not have any provision on the managing director. In this case, it is necessary to consider whether the three-year period may be excluded from applying to the managing director. Since the Bursa Malaysia Listing Requirements makes it mandatory on listed companies and companies applying for listing to ensure that the contents of the company's articles comply with Chapter 7 of the Bursa Malaysia Listing Requirements, it is not possible for listed companies to include Art 91 of Table A in their articles of association. This means that Art 91 of Table A of the *Companies Act* is only capable of being included in the articles of private companies.

Normally, most companies adopt Table A of the *Companies Act* as its articles of association or would have an articles with provisions that are similar to that in Table A. As such, Art 63, Table A will normally apply. If it does, the first directors of a newly incorporated company, hold office until the first annual general meeting where they will automatically retire. They may however be re-elected.

## ¶10-340 Can a director resign?

A director of a company may resign at any time by giving proper notice to the company. Article 72(e), Table A provides that a director of a company may resign as director by giving a written notice of resignation to the company. However under sec 122(6) none of the directors can resign if that will cause the number of directors to be less than two. In this situation, the resignation is invalid.

## ¶10-350 How can a director be removed?

It may be that a dispute in the company leads to either some of the directors or members wanting to remove a director from office. A director may have a service contract with the company. If the company terminates the director's appointment in breach of the contract, the director may be entitled to damages. The rights that a director may have under a contract will depend upon the provisions contained in the contract. In this section, we examine the corporate law rules applying to the removal of directors.

### Removal by other directors

It is not possible for directors of a public company to remove another director. This is prohibited by sec 128(8). The situation is different for private companies.

13 Bursa Malaysia Listing Requirements, para 7.28.






It is possible for the constitution of a private company to have a provision that allows directors to remove another director.

In *Khoo Choon Yam v Gan Miew Chee* [2000] 3 AMR 3074 a director was asked to sign an undated resignation letter. When he was removed using the letter of resignation, he successfully argued that there was duress.

### Removal by members

Where members attempt to remove a director, the rules differ according to whether the company is a public or private company.

In the case of a ***public company***, sec 128(1) provides that the members of a public company may remove a director by ordinary resolution before the expiration of his period of office. This provision applies notwithstanding anything stated in the memorandum, articles or any contract entered into with the director. Nonetheless, sec 128(8) goes on to say that a director of a public company may not be removed by any resolution, request or notice of the board or other directors, notwithstanding anything stated in the articles or any agreement.

Sometimes, a director who is about to be removed, may rely on sec 181 of the *Companies Act* (the oppression provision) to prevent his removal by arguing that he has a legitimate expectation to be involved in the company's management. This section provides a remedy to members or debenture holders where the affairs of the company are being conducted in an oppressive manner or some act has been done or proposed to be taken, which if carried out, would be unfairly prejudicial.[14]

If there is a stipulated method for the removal of directors in the articles, sec 128 can still be relied on to remove a director. This means that sec 128 is a provision that cannot be excluded from being used by the shareholders of a public company. However, sec 128 is not the only method of removal so that in the event the company follows the method of removal as specified in its articles, the removal is also valid. In *Soliappan v Lim Yoke Fan* [1968] 2 MLJ 21 the court held that sec 128 is not the only method of removal of a director.

However, if a director has a contract of employment as an executive director of the company, the director may be entitled to damages for breach of contract under sec 128(7). The director's removal under sec 128 does not prevent the director from obtaining any damages in accordance with any contract he may have with the company.

There are some special procedural requirements contained in sec 128. Where members intend to move a resolution to remove one or more directors, notice of this intention must be given to the company at least 28 days before the meeting at which the resolution is to be considered and the company must notify the

14 This was raised in *Tuan Haji Ishak v Leong Hup Holdings* [1996] 1 MLJ 661. The court held that sec 181 does not apply to prevent the removal of the directors of the company in this proceeding.

### Outline of chapter

The structure of this chapter is as follows. First, we examine the common law rules and discuss the extent to which the statutory duty has replicated the common law duties. Second, we examine the ways in which the constitution of a company can affect the duty to avoid conflicts of interest. Third, we examine the statutory regulation of conflicts of interest which is in addition to the common law duties. Finally, we examine the different consequences resulting from a breach of the duty to avoid conflicts of interest and the statutory provisions.

## THE DUTY TO AVOID CONFLICTS OF INTEREST

### ¶12-100 Interaction between the common law rules and statutory duty

The main common law rule relating to conflicts of interests is that directors must not place themselves in a position of conflict where a personal interest conflicts with their duty to act in the interests of the company. A director can only place himself in a position of conflict with the permission of the company. The rule under the common law is that the company can give its consent only through a resolution of the shareholders in general meeting. Permission of the company can be given after there has been full and frank disclosure of the interest. When the company ratifies the conflict of interests, the director will not be held liable for breach of duty. Ratification, however, must not be oppressive. But, in practice, some companies have a clause in their constitution under which the board of directors has power to permit a director to place himself in a position of conflict. The clause in the constitution overrides the common law rule that shareholders' approval is necessary. This is discussed in ¶12-200.

There are a number of situations where this rule applies. It most commonly applies where a director enters into a transaction with the company: see ¶12-140. For example, the director may want to sell some property which the director owns to the company. In this situation there will be a conflict of interest for the director. The director has a personal interest which is to ensure that the director obtains the highest possible price for the property the director owns when selling the property to the company. However, the director also has a duty to act in the interests of the company and this means ensuring that the company buys the property at the lowest possible price.

Another common law rule concerns directors taking property, information or business opportunities which belong to the company. When a director does this without the permission of the company, the director is placing his personal interest above his duty to act in the interests of the company. This is discussed in ¶12-160 to ¶12-175.






Although the common law conflict rule applies most often where a director's personal interest conflicts with the director's duty to act in the interests of the company, the common law conflict rule also applies where a director has conflicting duties. For example, a person may be a director of two companies and the two duties conflict in relation to a particular matter or transaction: see ¶12-180. Finally, there may be other potentially conflicting interests such as competing companies and nominee directors. These are discussed in ¶12-190.

The *Companies Act* has embodied the above common law duty to avoid conflicts of interest in sec 132(2) which states that:

> A director or officer of a company shall not, without the consent or ratification of a general meeting—
>
> (a) use the property of the company;
>
> (b) use any information acquired by virtue of his position as a director or officer of the company;
>
> (c) use his position as such director or officer;
>
> (d) use any opportunity of the company which he became aware of, in the performance of his functions as the director or officer of the company; or
>
> (e) engage in business which is in competition with the company,
>
> to gain directly or indirectly, a benefit for himself or any other person, or cause detriment to the company.

Section 132(5) further provides that the duty stated under sec 132 is in addition to and not in derogation of any other written law relating to the duty and liability of directors or officers of a company.

### ¶12-120 What is the common law conflict rule?

The common law conflict rule states that a director must not place himself in a position where there is an actual or substantial possibility of a conflict between a personal interest and his duty to act in the interests of the company unless the permission of the company is obtained. The test is whether a reasonable man looking at the facts would think that there was a real sensible possibility of conflict. (See *Hospital Products Ltd v United States Surgical Corp* (1984) 156 CLR 41 at 103; *per Lord Upjohn* in *Boardman v Phipps* (1967) 2 AC 46 at 124.)

> In *Coleman v Myers* (1977) NZLR 225, where the New Zealand Court of Appeal cited *TSC Industries Inc v Northway Inc* 426 US 438 (1976), the test adopted was "those considerations which can reasonably be said in the particular case, to be likely materially to affect the mind of the vendor or purchaser". The interest is material depending on whether there is a substantial likelihood that a reasonable shareholder would consider the interest to be important in deciding to vote. However, there is no need to prove that the shareholder would have changed his vote, only that the

the right as well as any event whereby a corporation becomes an associated corporation of the listed corporation where immediately after the event he has an interest in the securities of the associated corporation.

### Effect of complying and not complying with the statutory disclosure requirements

We saw in ¶12-200 that the constitution of a company can allow a director to have a conflict in relation to a matter affecting the company provided the interest is disclosed. Where sec 131 applies, the director's disclosure to the board will exonerate him from liability for breach of statutory duty but not for breach of the common law duty. This is because the common law requires disclosure to be made to the shareholders at general meeting. Thus, even if a director discloses to the board but not to the shareholders, he may still be held liable to account for the profits he made, as this is the common law remedy. He is however not guilty of any contravention of the *Companies Act*.

Where sec 135 applies, failure to comply is an offence under the *Companies Act* punishable by fine or imprisonment.

Where sec 317 of the CMSA applies, failure to comply is an offence under the CMSA, punishable with a fine not exceeding RM1 million or imprisonment or both.

## ¶12-330 Prohibited transactions with directors or persons connected to the directors

There are transactions under the *Companies Act* which cannot be entered into by a company because it involves a director or persons who are connected to the company's directors: sec 133 prohibits the giving of loans to directors while sec 133A prohibits the giving of loans to persons connected to directors.

### Definitions

The persons connected with a director as defined in sec 122A include:

- a member of that director's family which includes a spouse, parent, child (including adopted child and step-child), brother, sister, and the spouse of the director's child, brother or sister;
- a body corporate which is associated with that director;
- a trustee of a trust under which the director or a member of the director's family is a beneficiary; and
- a partner of that director or a partner of a person connected to that director.

A body corporate is associated with a director:

- if the director or persons connected to the director are entitled to exercise or control the exercise of not less than 15% of the voting shares of a company;






- if the body corporate is accustomed to or under an obligation or its directors are accustomed to act in accordance with directions, instructions or wishes of the director; and
- if the director has a controlling interest in the body corporate.

## ¶12-340 Loans to directors or persons connected to directors under sec 133 and sec 133A

Under sec 133, the company except an exempt private company is prohibited from:

- giving a loan to its director or a director of a company which is deemed related to that company; and
- giving a guarantee or security for the loan given to its directors or a director of a company which is deemed related to that company.

The provision applies to any loan transaction given by the company to any of its directors, shadow directors or any director of a company related to the company giving the loan.

Under sec 133A, a company, except an exempt private company, cannot give a loan or guarantee or security to any person connected with the director of the company or its holding company.

### Exemptions

The following loans are exempted if given for the following reasons:

- If the loan is given to a director or persons connected to a director for expenditure incurred for the purpose of the company's business and in the performance of the director's functions as a company officer (under sec 133(1)(a)) or the loan, guarantee or security is made to an executive director of the company or its holding company or to a person who is related to its director to provide funds for the purchase or acquisition of a home (under sec 133(1)(b)). However, these transactions require the prior approval of shareholders at general meeting where the purpose and extent of the loan, guarantee or security is disclosed, with the condition that the loan shall be repaid or the liability under the guarantee or security shall be discharged if the transaction is not approved by shareholders at the general meeting or at or before the following general meeting. The time for repayment of the loan or discharge of liability under the security or guarantee is within six months after that general meeting.
- Under sec 133(1)(c), the giving of the loan is not prohibited if it is related to an employee loan scheme which is given by the company in accordance to a scheme which has been approved by the general meeting and given in accordance to the terms of that scheme.

A member may also apply for a statutory injunction against the company, restraining it from entering into a contract which is covered by sec 132C and sec 132E.

What is an example of a circumstance where a court might grant an injunction against a director?

> A director of a company establishes another company in which the director is the majority shareholder and which competes with the first company. Over several months the director diverts business opportunities from the company of which he is a director to his new company. The director is breaching his duty by diverting the corporate opportunities (see Chapter 12). A court would grant an injunction to stop the director from diverting the business opportunities and harming the first company and its shareholders.

## ¶13-230 Compensation or damages

Where a director breaches their fiduciary duty, and this causes loss to the company, the company can apply to the court for the equitable remedy of compensation. The objective is to compensate the company for the loss it has suffered because of the breach of duty.

When a director has breached their common law duty of care and the company has suffered loss, the company can apply to the court for the common law remedy of damages. What is an example of common law damages resulting from a breach of the duty of care?

> A director is found to have been negligent for not properly supervising an employee of the company who stole RM50,000 from the company. The employee cannot be found. As the company has suffered a loss of RM50,000, and it is proved that the director was negligent, the director can be ordered to pay common law damages to the company in the sum of RM50,000.

Some provisions in the *Companies Act* carry with it a compensation order where the court may order that the person who contravenes the provision compensates the company or any aggrieved person for damage or loss suffered. An example would be sec 67(4) in relation to the prohibition against giving financial assistance. Another example is sec 132A, where an officer of a company deals in the securities of the company, by improperly using confidential information gained by reason of his position as such officer, and reasonably expecting his action to affect the price of the security.

## ¶13-240 Account of profits

A director who makes a profit because of a breach of fiduciary duty may have to pay that profit to the company. This remedy can be appropriate where the company has not suffered any loss as a result of the breach of duty. In these






circumstances, the company cannot obtain equitable compensation or common law damages because the company must establish that it has suffered loss or damage. This remedy is often applied in cases where the director has made a secret profit.

Even though the company has not suffered any loss or damage, the court can still order the director to pay any profit the director made because of the breach of duty to the company. The director will have to account for the profit to the company. Even though the company suffered no loss, it still obtains the profit because it is thought very important that directors not be able to profit by breaching a duty. What is an example of a director breaching a duty and making a profit while the company does not suffer any loss or damage?

> In Chapter 12 we discussed the case *Regal (Hastings) Ltd v Gulliver* (1967) 2 AC 134. In that case, directors of the company took an opportunity which the court held was an opportunity that belonged to the company. The opportunity was being able to invest in some shares of another company and sell them a short time later for a substantial profit. It was an opportunity that the company could not itself have used because the company did not have the funds to make the investment in the shares of the other company. This meant that the company did not suffer any loss or damage from the actions of the directors because it could not have used the opportunity. However, the directors were held to have breached their duty to the company because they took the opportunity. They had to account to the company for the profit they made on the sale of their shares.

An account of profits is a remedy given under equity. However, this equitable remedy has been given statutory recognition in sec 132. A breach of the statutory duty under sec 132 will render the director liable to the company for any profit that the director makes or for any damage suffered by the company because of the breach of that statutory duty.

In some cases, the director is held liable for breach of duty to avoid conflict of interest by establishing a competing company. It is possible for the director to be held liable only for the profit he had made and to deduct reasonable expenses incurred by him. In *Mohd Zain Yusof & Ors v Avel Consultants Sdn Bhd & Anor* (2007) MSCLC 93,273, the main issue before the Court of Appeal was whether the respondents (Avel Consultants) were only entitled to profits, and not gross income derived by the appellants (Mohd Zain Yusof & Ors) from their breach.

> In this case, the senior assistant registrar of the High Court ("the SAR") assessed damages representing the gross income derived by the appellants from their breach. Both parties appealed to the High Court judge against the SAR's decision. The appellants contended that the SAR should have only awarded the respondents the profits, instead of the gross income derived by the appellants from their breach. The respondents on the other hand contended that the SAR should have awarded them a higher sum for

The just and equitable ground to wind up a company that is available to a member, usually exists in companies which are set up as a "quasi-partnership" or "an incorporated association". Usually before the court makes an order on this ground, it must be proven that the company is set up as a "quasi partnership".

> In *Ebrahimi v Westbourne Galleries Ltd* [1973] AC 360, E and N were partners in a partnership which imported and sold carpets. They then established a company to take over the business of the partnership and became equal shareholders and the company's two directors. Later, N's son became a director and shareholder. The company was very successful in its business and all profits were distributed as directors' remuneration. The profits were not used to pay dividends. There was a major disagreement between E and N. N and his son voted at a meeting of members to remove E as a director. N and his son had the legal power to do this because both the company's constitution and the company legislation allowed a majority of members to remove a director from office. E commenced a legal action to wind up the company on the basis that it was just and equitable to do so. The court found that the company was established on the understanding that:
>
> — E and N were to be in a personal relationship involving mutual trust and confidence; and
>
> — both E and N were to participate in the management of the company.
>
> N breached this understanding by dismissing E from his position as a director and excluding him from management of the company. Because all of the profits of the company had been distributed as directors' remuneration and not as dividends, although E continued to be a member of the company, his financial return was significantly affected as he no longer received any remuneration as a director. The court held that it was appropriate to wind up the company as N had acted contrary to the common understanding on which the company was established and there was no longer any mutual trust and confidence.

The parties must establish that the relationship falls within the *Ebrahimi* type of relationship. In some cases, the petitioner may try to rely on the argument that there are other agreements between the members which are not stated in the memorandum and articles of association. However the fact that there is an *Ebrahimi* type of relationship does not mean that members can disregard the memorandum and articles as a contractual agreement.

> In *Indrani a/p C Rajaratnam & Ors v Fairview Schools Bhd* (1997) 3 MLJ 267, the company was incorporated by the founder members to provide an alternative international school. The membership was confined to parents only, where they were required to have a shareholding of RM50 each. Membership was transferable from a parent whose child is withdrawn from or leaves the school. The number of students increased and the board of






> directors of the company proposed an expansion of the school's premises. The company had already acquired a piece of land which was subsequently sold at a loss since the presiding chairman believed that the land was not suitable for development. The company then proposed to increase the shareholding in the company. The increase of capital was to be used to fund the expansion of the school premises. Each existing member was required to take up a minimum subscription of the increased capital. The directors also proposed that if the minimum subscription could be achieved, the shares were to be taken up by an educational institution or persons who are not parents of the existing students. Essentially the company had to find financial resources to fund the company's operation. However there were certain members who disagreed with the way the board managed the company and at an Extraordinary General Meeting some of the members proposed to vote out the existing board. The chairman and several board members resigned at the meeting and the meeting continued since it was not adjourned. A new board was appointed at this meeting.
>
> The petitioner petitioned for the company to be wound up on the grounds of sec 218(1)(f): the directors having acted in their own interest, and sec 218(1)(i): the just and equitable ground for winding up. The trial court ordered the winding up of the company under sec 218(1)(i) and sec 218(1)(f). It was held that the equitable considerations of *Ebrahimi v Westbourne Galleries Ltd & Ors* were applicable in this case because the company was a domestic company formed by an association of families. It was formed on the basis of personal relationship involving mutual trust and confidence and the understanding that saw at least one founder member serving on the board of the schools. There was also a restriction on the right to transfer shares. It was just and equitable to wind up the company since the resolution to increase the shareholding of the members of the company and to bring in a new shareholder resulted in a situation "which was outside what the members of the respondent contemplated by the arrangement they had entered into when they became members". The directors had also acted in their own interests in the conduct of the company's affairs under sec 218(1)(f) specifically in relation to conduct of the company meeting.
>
> However, on appeal (*Fairview Schools Bhd v Indrani a/p C Rajaratnam & Ors (No. 2)* [1998] 1 MLJ 110), the Court of Appeal held that this case did not involve an *Ebrahimi* type relationship. Fairview was a public company and there was no restriction on the right to transfer shares in its Memorandum and Articles of Association. There was also no evidence that the new board has obtained any personal or secret profit in managing the affairs of the company.

than adequate to cover the cost of carrying the debt (that is, interest and principal repayments). However, if the company's income falls, shareholders in a more highly geared company face a greater risk that the carrying costs of the debt will swallow all of the company's profits (leaving none available for dividends) or exceed the company's ability to pay, resulting in insolvency.

In practice, the optimum level of gearing for most companies would appear to be one involving the maximum amount of debt that can be serviced, without affecting the company's ability to pay dividends, on conservative projections of the company's future profitability. However, company managers may in practice be limited in making the funding decision by conditions imposed by financiers or by conditions in the financial markets. For example, a bank may require as a condition of lending to a company that the company's total indebtedness not exceed 60% of the company's total assets.

It is important to understand the legal rules relating to company finance against this background of capital decision making.

### What are the sources of company finance?

The principal sources of finance for companies limited by shares include:

- share capital;
- debt finance;
- off-balance sheet funding such as equipment leasing and project finance;
- trade finance; and
- retained earnings.

***Share capital.*** A company's share capital is made up of the money or assets contributed to the company by people proposing to become members of the company. The amount contributed becomes the property of the company and the contributor is issued with shares in the company, which may be "ordinary shares" or shares with particular rights attached. The nature of share capital is discussed in greater detail below.

***Debt finance.*** Debt finance is money lent to the company, in the expectation that the company will pay interest throughout the term of the loan, and repay the principal (the original amount loaned) by the end of the term. The lender may be an outsider, such as a bank, or an insider such as a member of the company.[2] Term loans (such as those often made by banks) and overdraft facilities are examples of debt finance. Others include promissory notes, bills of exchange and letters of credit. Interest-free loans by shareholders are also common. Debt finance is discussed in detail in Chapter 18.

2 For example, as in *Salomon's* case, discussed in Chapter 3.






***Trade finance.*** Trade credit is a term used to describe the situation where a company has received goods or services in advance of paying for them, or has received payment in advance of delivering goods or services.

***Retained earnings.*** Retained earnings are earnings from previous periods that have not been distributed to the company's members, and is an important source of working capital for many companies.

## ¶16-110 Islamic share capital

Besides the conventional share capital and debt capital, the Islamic equity market has become an important part of the capital market development. In relation to Islamic equity securities, the Syariah Advisory Council (SAC) of the Securities Commission has approved an updated of list of securities which have been classified as Syariah-approved securities. These securities are also listed in Bursa Malaysia.

The SAC applies a standard criterion in classifying securities as approved securities, ie, by focusing on the core activities of the companies listed on Bursa Malaysia. Hence, companies whose core activities are not contrary to the Syariah principles are classified as approved securities. The securities that are excluded from the list of approved securities are based on the following criteria:

- operations based on *riba* ("interest") such as activities of financial institutions like commercial and merchant banks and finance companies;
- operations involving gambling;
- activities involving the manufacture and or sale of *haram* ("forbidden") products such as liquor, pork and meat not slaughtered according to Islamic rites; and
- operations containing elements of *ghara* ("uncertainty") such as conventional insurance.

The SAC also takes into account the level of contribution of interest income received from conventional and fixed deposit by the company as part of the criteria in the analysis of the approved securities. Approved securities include ordinary shares, warrants and transferable subscription rights (TSRs). This would mean that warrants and TSRs are classified as approved securities from the Syariah perspective provided the underlying shares are also approved. On the other hand, loans, stocks and bonds are non-approved securities unless their issuances are based on Islamic principles. (See *Resolution of the Securities Commission Syariah Advisory Council*, 2002, Kuala Lumpur, Securities Commission.)

In addition to the criteria set by the SAC, any person who issues, offers for subscription, or purchases or makes an invitation to subscribe for or purchase Islamic securities must obtain the approval of the Securities Commission (sec 32,

### Capital Markets and Securities Act 2007 (CMSA)

Under the CMSA, which came into operation on 28 September 2007, a licensed institution in Malaysia that holds a Capital Market Services Licence must comply with certain conditions under the Act, namely:

- the production of books to the SC (sec 348, CMSA). The books specified are those relating to the business or affairs of the company or the exchange, any dealing in securities or trading in futures contracts, any advice concerning any securities or futures contract, the character or financial position of the business or an audit report;
- to comply with the form and manner of submission prescribed by the SC (sec 350, CMSA). Submission may be made in writing, by means of a visual recording, by means of sound recording or by means of any electronic, magnetic, mechanical or other recording whatsoever;
- disclosure of information relating to dealing in securities or trading in futures contracts (sec 353, CMSA).

The CMSA also provides a general duty of disclosure to the SC under sec 352. In the event the book mentioned under sec 348 contains a privileged communication made by or on behalf of or to the advocate and solicitor in his capacity as an advocate and solicitor, such person can refuse to comply with the requirement and claim privilege under sec 351 of the Act

## ¶17-320 When is disclosure required?

For a public company, that is subject to the prospectus requirements, a prospectus needs to be prepared and approved by the SC before the issue, offer for subscription or purchase of, or invitation to subscribe or purchase of the new shares.

For both public and private companies, the return of allotment of shares must be lodged within one month of the allotment of the new shares, except where it is made to certain offerees such as sophisticated investors, professional investors, and investors closely connected with the company.

A more detailed discussion of the prospectus requirements is continued in Chapter 23.

# CAPITAL MAINTENANCE

## ¶17-400 Overview

This part of the chapter explains the principle of capital maintenance. Broadly speaking, company law prevents a company from reducing its equity capital (or doing things that have a similar effect, such as paying dividends out of capital, or acquiring shares in itself) or giving financial assistance in connection with an






acquisition of shares in itself, while the company is in operation. A limited exception to this rule is redeemable preference shares, which were discussed in Chapter 16, and which can be redeemed out of profits or the proceeds of a new issue of shares. The law also permits a company to reduce its equity capital in other limited circumstances, through:

- the giving of permitted financial assistance;
- permitted share buy-backs; and
- permitted reductions of capital.

These rules are discussed below at ¶17-420–¶17-980.

## ¶17-420 What is the principle of maintenance of capital?

### The original common law rule

It is an underlying principle of company law, dating back over a hundred years, that a company's share capital should be maintained during the life of the company. In *Trevor v Whitworth* (1887) 12 App Cas 409, decided in 1887, the English House of Lords took the view that:

> "Paid up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a limited company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business." (pp 423–424, per *Lord Watson*)

The original common law rule is now supplemented by modern statutory rules designed to preserve a company's capital.

### The modern statutory rules

In modern company law, this requirement that companies maintain their share capital finds its expression in these rules:

- Dividends must be paid out of profits.
- There are restrictions on a company acquiring its own shares or those of its holding company.
- There are restrictions on a company giving financial assistance to a person to acquire shares in the company or its holding company.
- There are restrictions on a company issuing shares at a discount;
- A company is not permitted to reduce its share capital except:

### Why does the law recognise apparent authority?

The rationale for apparent authority is that if Philip acts in a way that gives a reasonable person (Teresa) the impression that Philip is appointing Amy as his agent with a certain range of authority, and Teresa then deals with Amy within that range of authority, Philip is not allowed to deny that Amy was authorised to contract for him.[11]

## ¶19-260 What are the requirements for apparent authority to exist?

The requirements to establish apparent authority in relation to companies was applied in *Woodland Development Sdn Bhd v Chartered Bank and PJTV Denson (M) Sdn Bhd* [1986] 1 MLJ 84. In that case, it was held that the existence of apparent or ostensible authority are based on the following:

(i) That a representation, that the agent had the authority to enter on behalf of the company into a contract of the kind sought to be enforced, was made to the contractor;

(ii) That such representation was made by a person or persons who had "actual" authority to manage the business of the company either generally or in respect of those matters to which the contract relates;

(iii) That he (the contractor) was induced by such representation to enter into the contract, that is, that he in fact relied upon it; and

(iv) That under its memorandum or articles of association the company was not deprived of the capacity either to enter into the contract of the kind sought to be enforced or to delegate authority to enter into a contract of that kind to the agent.[12]

The fourth requirement in *Woodland Development Sdn Bhd* has limited application to companies: see ¶3-340. Under sec 20 of the *Companies Act*, an *ultra vires* transaction is still binding on the company in relation to third parties. This means that even if the memorandum and articles do not confer authority to the person to enter into a particular contract, this will not affect the validity of the transaction. The fact that the transaction is *ultra vires* can only be relied on by members of the company in any proceedings against the company or the present or former officers of the company and in a petition to wind up the company by the Minister.

***A "holding out".*** A representation must be made to the outside contracting party that the agent has authority to enter on behalf of the company into a contract of the type in question. That is, the agent must be "held out". The representation may consist of words or conduct. The sort of conduct that can create implied

11 See Ford, Austin and Ramsay, above footnote 2, [13.040].

12 Citing *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480.






actual authority (see above) can also amount to a representation for the purposes of apparent authority. For example, acquiescence by the board (see above) can amount to a representation by the board.

***By someone with actual authority.*** The representation must be made by the company, or someone with actual authority to act for the company either generally (for example, the CEO) or in relation to the things to which the contract relates. A representation by someone who only has apparent authority is not enough, the person making the representation must have actual authority (*Crabtree-Vickers Pty Ltd v Australian Direct Mail Advertising and Addressing Co Pty Ltd* (1975) 133 CLR 72; (1995–1996) CLC ¶40-244). However, it does not need to be express actual authority. If the person making the representation has a sufficient amount of implied actual authority, they can make the representation. Usually a representation by the board will be sufficient.

Consider the facts of *Dart Sum Timber (Pte) Ltd v Bank of Canton Ltd* [1982] 2 MLJ 101:

> Wong, a director of a company, Dart Sum, executed a guarantee on behalf of Dart Sum, to guarantee the debts of another company. Wong was the chairman of the board and not the managing director. However, there was no representation by any other directors that Wong had authority to act as managing director. Dart Sum cannot be made liable on the guarantee because Wong had no actual authority to give the guarantee on behalf of Dart Sum. Wong also did not have apparent authority because there was no representation made by the other directors.

***Reliance.*** The outsider must be induced by the representation to enter into the contract. In other words, the outsider must rely on the representation.

An example of apparent authority is where Philip is the CEO of Company A, and Amy is an employee of Company A. Amy has been negotiating a contract with Teresa. Amy has told Teresa that she (Amy) is an employee of Company A and is authorised to negotiate the contract on the company's behalf. Teresa phones Philip to check whether Amy has power to negotiate the contract for Company A. Philip says "Yes, Amy is an employee of our company and she has authority to negotiate this deal." Teresa relies on what Philip said on the phone when she signs the contract.

Here, Company A is bound by the contract because Amy had apparent authority:

- there was a holding out (Philip's statement on the phone);
- the holding out was by someone with actual authority (Philip, as CEO, has a high level of implied actual authority); and
- the holding out was relied on by the outsider (Teresa relied on Philip's statement when she entered the contract).

Assets in category (2) include:

- compensation recovered by the liquidator from any director who has breached the fraudulent trading provision (sec 304), or another duty, causing loss to the company;
- funds received from contributories (eg, owners of partly paid shares) after the liquidator has made a call on them (see ¶16-240);
- funds that the liquidator has "clawed back" — via court proceedings — under the "voidable transactions" provisions (see ¶22-170); and
- funds recovered from the holders of void charges (see ¶22-180).

So, the liquidator is faced with the decision of whether to spend company funds on legal proceedings, for example, against directors who appear to have acted in breach of duty, or firms that appear to have entered voidable transactions with the company. The liquidator must weigh up the likely chances of the legal action succeeding and the likely amount of compensation if the action does succeed.[11]

## ¶22-170 What are voidable transactions?

A voidable transaction is a certain kind of transaction entered into by a company in the period leading up to its winding up. A liquidator can apply to the court to try to prove that a transaction is voidable. If the liquidator is successful, the court has power to make orders including:

- an order "undoing" the transaction; or
- an order that money be paid to the company equal to the amount of the voidable transaction:

The net result is that the funds available for distribution by the liquidator can be increased.

Accordingly, sec 293 lists various types of transactions amounting to voidable transactions. These include any transfer, mortgage, delivery of goods, payments, execution or other acts relating to property made or done by or against a company which would be void or voidable under the law of bankruptcy if an individual was concerned, rather than a company.

### Undue preference

An undue preference is a transaction between a company and an unsecured creditor that results in the creditor receiving more from the company than the creditor would have received if the creditor had to prove for the debt in a winding up: sec 293 of the *Companies Act* which should be read together with sec 53 of the *Bankruptcy Act*. The preference rule operates so as to prevent a creditor from jumping to the front of the queue of the general unsecured creditors, all of whom should be paid equally. In some instances, liquidators of insolvent

11 See Aishah Bidin, "Liabilities of directors under Malaysian insolvency law and recovery of asset during corporate insolvency", [2004] 8 *Malaysian Journal of Law and Society*, 1, UKM.






companies are able to recover disposals of properties made by the company before the commencement of winding up. When the business of the company deteriorates there is often a period of time between the onset of insolvency and the winding up proceedings. During this period, an insolvent company may repay debts due to certain creditors in preference over others.

By virtue of sec 293(1), preferences are regarded as void or voidable under the *Companies Act*. The Malaysian courts have held that the section even excludes transactions made in favour of a creditor in good faith and for valuable consideration (see *Bensa Sdn Bhd v Malayan Banking Bhd* [1993] 1 MLJ 119 and *Sime Diamond Leasing (M) Sdn Bhd v JB Precision Moulding Industries Sdn Bhd (in liq)* [1997] 1 MLJ 499).

In *Sime Diamond Leasing (M) Sdn Bhd v JB Precision Moulding Industries Sdn Bhd* [1998] 4 MLJ 560[12] it was held that to establish fraudulent preference, the liquidator must prove five conditions namely:

- that the transaction took place within six months prior to the commencement of winding up;
- that it satisfies the description of one of the types of transaction mentioned in sec 53(1) of the *Bankruptcy Act*;
- that it took place at a time when the company was insolvent;
- that the person in whose favour the transaction was effected stood in the relation of creditor to the company; and
- the effect of the transaction was to confer on that person a preference, priority or advantage over other creditors in the winding up.

In such situation the onus is on the creditor to rebut the presumption[13]

### Are there any exceptions?

As sec 293 of the *Companies Act* incorporates sec 53 of the *Bankruptcy Act 1967*, the exception to sec 53 also applies to sec 293. Section 53(2) excludes certain transactions, namely, if the dealings are made in good faith and for a valuable consideration. A person is deemed not to be a creditor in good faith if the relevant transaction was made under circumstances which lead to the inference that the creditor knew or had reason to suspect:

- that the company was insolvent;
- that the effect of the transaction would give the creditor a preference priority or advantage over other creditors.

12 See also *Arab Malaysian Merchant Bank Berhad v Orient Apparel Berhad* [2001] 4 AMR 4705.

13 See *Lian Keow Sdn Bhd (In liquidation) & Anor v Overseas Credit Finance (M) Sdn Bhd* [1988] 2 MLJ 449 at p 454.