

ORGANISATION: MINORITY SHAREHOLDER WATCHDOG GROUP

RESPONSE TO CONSULTATION QUESTIONS: CONSULTATIVE DOCUMENT ON REVIEW OF PROVISIONS REGULATING SUBSTANTIAL PROPERTY TRANSACTIONS, DISCLOSURE OBLIGATIONS AND LOANS TO DIRECTORS

Question 1:

Do you agree 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?**

Yes. Often enough, related party transactions are always concerned with all companies within the same group, associates and joint ventures, investors/shareholders for whom reporting entity is an associate or a joint venture, company's REIT schemes and directors as well as persons/ parties controlling the entity and connected to directors.

Materiality is always to be judged in relation to the reporting entity. For transactions with directors, key management and close family and entities connected to them, materiality must be judged in relation to their circumstances.

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 wished 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?**

Yes. However, the proposal should include:

- (i) a trustee of a trust under which that director or a member of his family is a beneficiary, a person deemed to be connected with a director;
- (ii) a partner of that director deemed to be connected with him; and
- (iii) a partner of a person deemed to be connected with that director.

A wider provision/ definition of related parties is likely to be more effective in dealing with transactions made by director through various nominees.

"Person(s) connected" with a director or a shareholder must be given a wider meaning.

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?**

Yes. Controlling interest denotes a means and powers of determining the policy and direction of a company.

In the Oxford Law dictionary, controlling interest means an interest in a company that gives a person control of it. For a person to have a controlling interest in a company, he is a shareholder who normally owns or controls more than half of the voting shares. In a legal sense, slightly over 50% of the voting stock will control any corporation and thus, constitute a controlling interest.

However, in a de facto sense, many corporations may still be controlled by a much smaller percentage of voting stock if the rest of the stock is widely dispersed and not active in voting. Hence, effective control can sometimes be exercised when less than 50% of the stock is owned. Hence, investors need to be aware of such situations.

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.'**

Yes. Companies in which a person or a director has a 20% equity interest are deemed to be connected persons under the company law. The practical problems of identifying such person or persons seem to be deciding whether there are any key managers beyond directors and where to draw the line with close family. The influence based on the threshold of the voting shares should go beyond the legal definition of family to members of the same household as well as a company, a trust, a director, another individual or a group acting in concert.

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?

Yes. It is important for such transactions with related party(ies) or substantial shareholder(s) to be referred to disinterested shareholders for approval before the transactions take place. It is also essential for this section to be clear and certain in regard to penalties, including criminal penalties for contravention of the provisions under this section.

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?

Yes. The effect of requiring the approval of shareholders in respect of these transactions and arrangements is to reduce the power of directors over matters which are likely potential grounds involving self-dealing. The shareholders function as a check and balance on directors who would otherwise have control over the company's assets relatively free from shareholders' scrutiny.

Question 7:

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

Yes. Disinterested shareholders voting can provide a more effective check on directors' self-dealing than the board of directors including independent, non-executive directors who may themselves be distracted by conflict of interest situations they may at times be involved in.

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?

Yes. Such transactions cannot be satisfied either prospectively or retrospectively. Voting rights of directors and interested shareholders must be restricted as well as persons connected with them where related party transactions are concerned.

The independent adviser should also advise whether such transactions are to the detriment of minority shareholders together with a circular to shareholders in relation to related party transactions.

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**
- (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?**

Yes. The phrase "common value" requires clarification.

Non-cash asset refers to any property or interest in property other than cash. A non-cash asset is defined as being of the requisite value if its value is not less than RM10,000 but (subject to that) exceed RM250,000 or 10 % of the company's asset value at the time of transaction. The legislation is necessary to clarify these issues to reflect the intention of Section 132E(5) of the Companies Act 1965.

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?

Yes.

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?

Yes. The net assets test can complement the no-conflict rule and the no-profit rule in order to ensure that directors and key management exercise good faith.

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?

Yes.

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?

Agreed. Besides the civil liability provided to account for the profit or to pay compensation to the company, the director and persons connected with him and the directors who authorized the transaction should be liable for criminal offences.

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?

Yes. This is to prevent errant directors from abusing their authority or defaulting directors failing to disclose the true situation of the transaction.

The penalties for the contravention of Section 132E of the Companies Act 1965 should be fairly severe, particularly criminal penalties for directors and persons connected to them.

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?

Yes. Often, not all directors or parties may have access to information on the company's proposed dealings committed by directors who intend to defraud. However, being innocent of the contravention requires proof in the interest of justice or proof that he or they have no knowledge of the relevant circumstances constituting the contravention at the time of the transaction.

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?

Yes, we agree provided that appropriate disclosure as to whom the new shares have been issued in number and value are in accordance to provisions under Section 132D of the Companies Act 1965.

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?

Yes, we agree provide that the scheme or compromise or arrangement is sanctioned by the Court for which shareholders have had given their approval at an earlier general meeting(s).

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?

Yes. Section 132C does not expressly deal with situations of self-dealing but such transactions can raise queries as to whether directors have acted and exercised their powers properly.

Shareholders' approval is needed to prevent directors from making proposals or executing any transactions for such disposals or acquisitions of assets which would materially and adversely affect the performance or financial position of the company.

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?

Yes, we agree provided that it is certified to be an Islamic transaction involving the contemporaneous acquisition and disposal of the same undertaking or property.

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?

Yes. The penalties for contravening these sections 133 and 133A must be severe, including heavy fines or imprisonment. Directors who authorize such loans are jointly and severally liable to indemnify the company against any loss incurred.

The auditors have a moral obligation to report this breach of directors' duties and contravention of the provisions under these sections of the Companies Act 1965.

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?

Yes. Loans can include guarantee or security given to a director of the company (including persons connected to him) or of a related company.

A related company is defined in Sections 4 and 6 of the Companies Act 1965.

Question 22:

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

Yes.

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?

Yes. Section 134 and 135 require the disclosure of directors' interests in the company.

Directors may hold shares in the company. There may be a possibility of a conflict between a director's fiduciary duty to the company and his interest as a shareholder.

The rationale for the disclosure is to act as a safeguard against a director's manipulation of his ownership of shares he holds or other interests in the company for which he derives personal gains or material benefits.

Section 134 requires companies to keep a register showing the interests held by directors in shares, debentures and other participatory rights/ interests in the company. This register must show the directors' rights or options to acquire or dispose of shares, debentures or participatory rights/ interests. How other directors would fully aware of the interests held by fellow directors will depend on this register and accountability to the proper maintenance of this register.

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?**

Disclosure should be made by notice in writing and should be kept in a register that is to be open for inspection.

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?

Yes. The company can render such arrangement or transaction null and void. However, the director is personally liable for such failure on his part to make proper and appropriate disclosure.

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?

Yes. Proof of good faith by the third parties is necessary to show that they have acted honestly and in the interest of the company.

Question 27:

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

Yes. The phrase "substantial shareholder" is defined in section 69D of the Companies Act 1965.

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?

Yes. Perhaps, the current timeline of seven (7) days for giving the required notice to the company can be shortened appropriately to four (4) or five (5) days later on.

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?

Yes, agreed.