

ORGANISATION: MINORITY SHAREHOLDER WATCHDOG GROUP

RESPONSE TO CONSULTATION QUESTIONS: CONSULTATIVE DOCUMENT ON CAPITAL MAINTENANCE RULES AND SHARE CAPITAL: SIMPLIFYING AND STREAMLINING PROVISIONS APPLICABLE TO THE REDUCTION OF CAPITAL, SHARE BUY BACK AND FINANCIAL ASSISTANCE

Question 1:

Do you agree that the current procedure of obtaining the court's confirmation which is provided for under section 64 of the Companies Act 1965 should still be retained?

Yes.

The existing procedure under section 64 of the Companies Act 1965 should still be retained and not replaced by the new alternative procedure. Creditors may hold the view that the court's confirmation is legally binding and that the court would ensure that the terms and conditions are fair and reasonable pertaining to a reduction of the company's capital to any possible creditors before the court approves an order confirming the reduction of capital.

The court is therefore required to establish who are the creditors of the company and for what amounts, and shall provide all such creditors the opportunity to object to the proposed reduction by a special resolution.

Question 2:

Do you agree to the introduction of an additional alternative procedure that a company may reduce its capital provided it satisfies the solvency test?

Yes.

The introduction of a solvency test will protect the interests of creditors in that it ensures the company has available and sufficient assets to pay its creditors. This will also give the company a choice in undertaking capital reduction, either through the existing court confirmation or the solvency statement procedure. The alternative procedure may also be less time consuming compared to obtaining the court's confirmation for reduction in share capital. Nevertheless, the interest of creditors must be protected under both circumstances and creditors must be allowed to challenge the reduction on reasonable grounds.

Question 3:

Do you agree that the solvency test should be as follows:

“The company is able to satisfy the solvency test if:

- (i) the company is able to pay its debts as they become due in the normal course of business (“cash-flow solvency”); and**
- (ii) the value of the company’s assets is greater than the value of its liabilities including contingent liabilities (“balance sheet solvency”).**

In determining whether the value of the company’s assets is not less than the value of its liabilities, the directors,

(a) must have regard to –

- (i) the most recent financial statement of the company; and**
- (ii) all other circumstances that, the directors know or ought to know, affect or may affect the value of the company’s assets and the value of the company’s liabilities, including its contingent liabilities;**

(b) may rely on valuations of assets or estimates of liabilities that are reasonable in the circumstances”.

Yes.

The creditors are not entitled to look to directors or shareholders personally for payment of the company's debts. It is therefore, necessary to ensure that directors act in good faith in regard to the company's financial position in this respect. Directors must be made to incur personal liability to make good the loss if they are found to act negligently.

Besides the need to look at the company's recent audited financial statements, directors need to conduct a proper review of the company's business and operations in order to understand why it is making the reduction of capital and to put in place measures to protect the interests of both shareholders and creditors.

Question 4:

Do you agree that the directors should be required to make a declaration of solvency? If yes, should the solvency test be made by all the directors or a majority of the directors? Should the solvency statement be supported by an auditor's report (in the case of a company that must have its accounts audited)?

Yes.

The solvency test must be made by **all** the directors and the solvency statement must be supported by an auditor's report including the company's accounts to be audited.

This will be even so if the shareholders are also directors of the company and the rules relating to the solvency test with directors have been fully complied with.

This provision is important in the interests of minority shareholders as well as all other stakeholders.

Question 5:

Do you agree that the creditors of a company (whether private or public) that is reducing its capital under the alternative procedure should be given the right to object to the reduction?

Yes.

The general principle of the company law is that the share capital must not normally be returned to shareholders, being intended as a permanent fund which is available for the benefit of creditors to meet the company's debts. As such creditors of the company (whether private or public) must be given the right to object to the reduction under the alternative procedure. An appropriate time frame must also be provided for the creditors to facilitate any objection that may arise. This provision is important especially to those unsecured creditors if they are not treated fairly.

Question 6:

Do you agree that the grounds for objections should be that the creditors have not been offered security for the debts or any other safeguards or that the company does not have sufficient assets?

Yes.

As shareholders incur no further personal liability for the company's debts beyond the amount paid on their shares, it is obviously important that the share capital be maintained so that there is at least some fund or assets against which the creditors can have recourse. This includes the company's purchase of own shares which could tantamount to utilization of funds at the expense of its obligations to creditors.

Question 7:

Do you agree that a creditor who did not have reasonable grounds for the objection should be liable to pay costs?

Yes.

The principle objective of creditor protection lies behind the capital maintenance doctrine. A company may sometimes desires to reduce its issued and paid up share capital which no longer in fact exists for the benefit of creditors.

This provision is important so as not to delay any restructuring/ re-organisation plan of the company. The objection under this circumstance must be genuine.

Question 8:

Do you agree that there should be criminal liability for directors in relation to the declaration of solvency?

Yes.

Directors who are knowingly parties to the declaration of solvency which is false would possibly be guilty of criminal liability for carrying on the company's affairs fraudulently or with intent to defraud creditors.

This provision is important for the protection of minority shareholders in situation where directors who commit the criminal offence are also shareholders in control of the company.

Question 9:

Do you agree that it should be possible for the company to recover from shareholders the amount that they have received in relation to the reduction except where they have received the distribution in good faith?

Yes, where the shareholders who are parties to the transaction are also directors, the prospects of recovery are in order.

However, where the shareholders are not parties to the transaction and are also not directors, directors of the company who are deemed to have acted negligently shall be personally liable.

Question 10:

Do you agree to the introduction of the solvency test as stated above as part of section 67A?

Yes.

The introduction of the statutory solvency test is in large measure to ensure that directors act in good faith in the interests of the company.

Moreover, in deciding whether the reduction of capital is appropriately made requires a considerable element of judgment on the part of directors. The judgment must be acted in good faith above directors' duty of care and reasonable skills.

Question 11:

Do you agree that the declaration of solvency for a share buy back is to be made by only a majority of the directors?

Yes.

The declaration of solvency test for a share buy back to be made by only a majority of the directors provided that the share buy back is made out of distributable profits or out of the proceeds of a fresh issue of shares.

As a commercial decision it is necessary for the majority of directors to ask whether the share buyback is genuinely made in the best interest of the company.

Question 12:

Do you agree that the words “on the market of the Stock Exchange on which the shares are quoted in section 67A(3B)(b)” should be removed to enable the treasury shares to be sold not just on the stock exchange but via direct business transaction?

Yes.

The directors must always remember that in recommending direct business transaction and approving it for the treasury shares to be sold, they are required to act in the best interests of the company. In cases involving treasury shares to be sold not just on the stock exchange but via direct business transaction, the law must ensure that the relevant requirements as stipulated under the Listing Requirements of Bursa Malaysia Securities Berhad are also complied with.

Question 13:

Do you agree that if the company decides to re-sell the treasury shares, a time frame should be stated for the treasury shares to be resold and that the treasury shares are to be cancelled if not resold within this time frame? If yes, what would be the appropriate time frame?

Yes.

The company should re-sell or cancel the treasury shares if not re-sold, within two (2) years. The company must also decide on the appropriate way to determine the price of the treasury shares for re-sale.

Generally, the price is fixed at a mark up over and above the average price of the last 12 to 18 months as practised in India.

Question 14:

Do you agree that:-

- (a) a company should be allowed to give financial assistance in relation to the acquisition or purchase of its shares subject to the company satisfying the solvency test?**
- OR**
- (b) only a private company is allowed to give financial assistance in relation to the acquisition or purchase of its shares subject to the company satisfying the solvency test?**

Yes.

Public companies can purchase its own shares out of distributable profits or out of the proceeds of a fresh issue of shares.

Private companies may be allowed to purchase its own shares out of distributable profits subject to certain safeguards including the solvency test provided under the Companies Act 1965.

The financial assistance in relation to the acquisition or purchase of its own shares should not exceed 10% of the total paid-up share capital as currently allowed.

Question 15:

Do you agree that (subject to compliance with the solvency test) a company may give financial assistance only if the company obtains a special resolution from the shareholders?

Yes.

A special resolution has to be passed in general meeting of the shareholders.

Directors of the company giving the financial assistance are required to make a statutory declaration including the solvency test giving particulars in respect of that assistance.

Failure to comply with this requirement must render the resolution null and void.

Question 16:

Do you agree that (subject to compliance with the solvency test) a company may also give financial assistance without obtaining the shareholders' approval if the board so resolves? If yes, do you agree that the amount of the financial assistance, inclusive of the amounts of any other financial assistance by the company must not exceed 5 per cent of the aggregate of amounts received by the company in respect of amounts received by the company in respect of the total paid-up capital of the company and reserves as disclosed in the most recent financial statements of the company?

No. We are of the view that shareholders' approval at a general meeting must be obtained before a company can give financial assistance.

Directors must ensure that the net assets of the company are not reduced by the giving of the financial assistance or the funds must be provided from distributable profits.

Persons (or shareholders) holding at least 10% of the company's shares should be allowed to petition the court for the cancellation of this resolution by directors.

In this matter, directors must be seen to be acting in good faith in the best interests of the company.