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SHAREHOLDER ACTIVISM, DIRECTORS' DUTY

CLASH OF PRESUMPTIONS

ON the last trading day of 2021, the market was taken aback by the twists and turns of events in SC Estate Builder Bhd (SCBuild).

The company saw the reappointment of eight ousted directors despite the rejection from shareholders of their re-election during its 17th annual general meeting (AGM) on Dec 31.

Shareholder activism meets directors' fiduciary duty

This is a classic case of shareholder activism meeting directors' fiduciary duty and creating an impasse.

The two remaining directors on the board have a fiduciary duty to act in the best interest of the company.

Presumably, they thought that reappointing the eight directors was acting in the best interest of the company.

One cannot fault them for that if they truly believed their decision was in the best interest of the company.

(As an aside, two days before the AGM, a spokesman for the majority shareholders had accused the 10 directors of acting unlawfully in rejecting the nominations of eight candidates aspiring to be new directors of the company).

The majority of shareholders who voted out the eight directors were exercising their rights at an AGM.

But directors are not bound by the mandate of the shareholders at the AGM if they feel that the mandate is not in the best interest of the company.

The board is at liberty to disregard the shareholders' mandates through resolutions in the board's quest to act in the best interest of the company — the board's fiduciary duty.

This is the affirmed Federal Court decision in the Petra Perdana case.

The Petra Perdana case

On Dec 14, 2017, in the case of Tengku Datuk Ibrahim Petra Tengku Indra Petra v Petra Perdana Bhd (2018) 2 MLJ 177 ("Petra Perdana"), the Federal Court delivered its grounds of judgment.

The case relates to questions in company law on governance and management of a company as between its directors and shareholders in general meetings.

The case gives guidance on the division of powers between the shareholders and directors on managing the affairs of a company.

Petra Perdana had some investments in another listed company, Petra Energy Bhd.

There was a possibility that Petra Perdana may have to dispose of Petra Energy shares. As such, Petra Perdana's shareholders had, by resolution, placed some mandates as to the price and volume at which the Petra Energy shares could be disposed of.

As it turned out, the directors of Petra Perdana, due to the urgent cash flow needs of the company, disposed of the Petra Energy shares, disregarding the shareholders' mandate as to the price and volume of shares.

Division of powers

One of the main issues here was the division of powers between the shareholders in a general meeting and the board of directors.

The question posed to the Federal Court was whether the powers of management conferred on the directors by the Companies Act 1965 and the articles of association could be overridden by an ordinary resolution passed by a simple majority of shareholders at a general meeting.

In other words, whether the shareholders' divestment mandate could override the powers of the directors to divest the Petra Energy shares held by Petra Perdana.

The Federal Court held that shareholders may only override

the powers of the directors by altering the articles to take away the powers of the directors, or, by refusing to re-elect the directors of whose actions they disapprove.

Statutory force to this legal position can be found in Section 131B of CA 1965 which provides that "the business and affairs of a company must be managed by, or under the direction of, the board of directors", subject to "any modification, exception or limitation contained in the Act or in the memorandum or articles of association of the company".

Coming back to SCBuild

As far as shareholder activism is concerned, the shareholders who want change at the board level will have to propose the requisite changes through the tabling of resolutions at an extraordinary general meeting.

This may involve appointing new board members and removing all or some of the existing board members.

Meanwhile, it is the codified statutory duty of directors to act in the best interest of the company, at all times.

The writer is chief executive officer of the Minority Shareholders Watch Group

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