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Revolutionizing the Corporate Law Landscape in Malaysia – Key Changes Under the New Companies Bill

On 2 July 2013, the Companies Commission of Malaysia ("**CCM**") published a draft of the new Companies Bill ("**Bill**") for public consultation. The Bill sets out the legal framework that will replace the current Malaysian Companies Act 1965 ("**CA 1965**") and aims to introduce a modernized corporate legal framework for Malaysia; in line with current international standards.

This Alert highlights the key changes under the Bill.

Facilitating and Modernizing the Legal Framework to Incorporate and Run Companies in Malaysia

- **Unlimited Capacity for Companies:** Currently, the objects clause of a company defines a company's capacity to carry out commercial activities. Any acts of transactions entered into by a company outside its objects clause are ultra vires and cannot be ratified by the company. Under the Bill, a company may choose not to specify its objects. Effectively, this will give a company the powers of a natural person (i.e. unlimited capacity) and removes the burden on third parties to verify if a company has capacity to enter into a transaction.

- **Single Shareholder and Director:** The CA 1965 prohibits a company from carrying on business with fewer than 2 shareholders for more than 6 months. The only exception is a company whose issued shares, are wholly held by a holding company. A company is also currently required to have a minimum of 2 resident directors (i.e. individuals who have their only or principal place of residence in Malaysia). Under the Bill, companies can be incorporated and operated with a single individual or corporate shareholder and need only have one resident director (who can also be the sole shareholder of the company). This move will reduce incorporation and maintenance costs and doing business costs, generally.

- **No AGMs Necessary:** Currently, all companies (public and private) must hold an Annual General Meeting ("**AGM**") once every calendar year. The Bill dispenses with this requirement for private companies. To prevent minority shareholders from being disadvantaged, shareholders representing 5% of the paid-up capital of a company may request for a general meeting to be convened if a general meeting has not been held in the past 12 months. The abolishment of the AGM requirement will reduce the maintenance costs of Malaysian private companies.

- **Abolishing the Unanimity Rule for Written Shareholder Resolutions:** Section 152A of the CA 1965 allows resolutions in

writing to be passed, if signed by all shareholders and will be treated as duly passed at a general meeting. Efficacy is restricted as all shareholders need to sign and any single shareholder can prevent a resolution from being passed. The Bill abolishes the requirement for unanimity for private companies (but retains it for public companies) and allows for the passing of a written resolution by the same majority as required at a general meeting. As an additional safeguard however, any shareholder of a private company having 5% or more of the total voting rights of the company may require the company to circulate a resolution accompanied by a statement on the subject matter of the resolution prior to the passing of the written resolution.

Facilitating the Management and Restructuring of Share Capital

- **No-Par Value Regime:** Shares of Malaysian companies are currently issued with a par/nominal value. The Bill introduces a no-par value regime where all new shares issued by a company shall have no par/nominal value. The paid-up amount of any shares issued prior to the coming into force of Section 72 of the Bill, shall be the paid-up par value of such shares and shall exclude any premium paid above the par value. To ensure a smooth transition, the Bill provides for transitional provisions (such as a 24-month period to enable companies to utilize any amounts standing in its existing share premium account) and provisions to preserve the effect of existing contracts and other instruments which rely on the concept of par/nominal value.

  The adoption of a no-par value regime will (a) simplify the company's accounts (e.g. the concept of share premium accounts and reserves will no longer be required); (b) clarify the misleading perception that because of the par value, the company will have reserves and be able to pay its debts to creditors; and (c) enable a company to raise capital with greater flexibility (e.g. shares can be issued at a discount and profit can be capitalized without the issuance of new shares).

- **Alternative Procedures for a Reduction of Capital:** Under Section 64 of the CA 1965, if allowed by its Articles of Association, a company may reduce its capital if the reduction is approved by a special resolution and is confirmed by the Courts. The Bill does not move away from this concept but instead introduces an alternative capital reduction procedure based on a solvency test. The alternative procedure aims to facilitate quicker implementation of corporate exercises provided that the company is able to demonstrate than creditor's interests are protected by satisfying the solvency test.

  The solvency test will take into account (a) cash-flow solvency (i.e. there are no grounds on which the company could be found to be unable to pay its debts); and (b) balance-sheet solvency (i.e. the assets of the company are greater than its liabilities) of a company. All directors of a company must make a solvency statement to the effect that the company satisfies the solvency test in relation to the reduction of capital. Directors will however assume personal liability for any solvency statements made and if it is found that such statements were made without reasonable grounds, a director could be liable on conviction to imprisonment not exceeding 5 years or to a fine not exceeding RM500,000 or both.

- **Reforming Share Buy-Backs:** Section 67A of the CA 1965 allows a listed company to buy back its own shares if a majority of its directors declare that the company is solvent at the date of purchase and will not become insolvent as a result of the buy-back. Under the Bill, the

requirements of Section 67A are preserved but are further refined. The key refinements are as follows:

a) a similar solvency test (similar to the one proposed for a reduction of capital) will be applied to share buy- backs. Unlike a reduction of capital exercise however, only a majority (and not all) of a company's directors need to make a solvency statement; and

b) the directors may choose to automatically cancel any shares so purchased or retain such shares as treasury shares. A cancellation of shares further to the share buy-back will no longer be deemed to be a reduction of capital (and consequently subject to capital reduction rules). This eliminates any unnecessary and duplicative steps in the buy-back process.

- **Liberalizing the Financial Assistance Prohibition:** At present, the CA 1965 contains a close-to-absolute prohibition against a company giving financial assistance for the purchase of its shares or the shares of its holding company. This restricts debt pushdowns and prohibits acquirers from obtaining credit lines secured by the target company's assets. The Bill however introduces a financial assistance whitewash. Under the whitewash procedure, companies (private and public) may give financial assistance for (i) the purpose of acquisition of its shares; or (ii) for the purpose of reducing or discharging liability incurred for such an acquisition, if the financial assistance is:

  a) approved by at least 75% of the shareholders of the company;

  b) approved by a majority of the directors of the company;

  c) each director who voted in favour of the financial assistance makes a 'solvency statement' (similar to the statement made for a reduction of capital); and

  d) the company receives fair value in connection with the giving of assistance.

  A whitewash is however only possible if (a) the aggregate amount of the assistance; and (b) any other financial assistance previously given that has not been repaid, does not exceed 10% of the company's current shareholders funds. This new financial assistance regime is long overdue and will provide much greater flexibility to implementation of corporate exercises.

Strengthening the Corporate Governance Structure of Malaysian Companies

- **Extending the Definition of "Director" to include 'Shadow Directors':** Section 4(1) of the CA 1965 defines a director to include 'a person in accordance with whose directions or instructions the directors of a corporation are accustomed to act'. This definition is arguably wide enough to encompass a 'shadow director'. That said, the current definition makes it practically impossible to hold such persons accountable to the company since it must first be proven that the entire Board is accustomed to act in accordance to the person's instructions or directions. The new Bill remedies this deficiency by providing that a person is to be regarded as a director of a company if 'the majority of directors of a corporation are accustomed to act in accordance with the person's instructions and directions'. This is consistent with public policy that a person who is able to give instructions to the Board on how it should act should also be subject to the same duties and responsibilities as the directors.

- **Director's Remuneration to be Approved by Shareholders:** The CA 1965 is silent on the approval of a director's remuneration. At common law however, directors have no authority to approve their own remuneration as this would amount to a conflict of interest. It is the shareholders who have the authority to approve a director's remuneration.

  Under the Bill, the remuneration of directors of public companies and any benefits payable shall be approved by the shareholders at a general meeting. The Bill also prescribes that the service contract of a director of a public company should be made available for inspection at the company's registered office. These provisions promote greater transparency and accountability of directors. In contrast, the remuneration of directors of private companies may be approved by the board of directors. Shareholders holding at least 10% of the voting rights of the company may however request that a director's remuneration be subject to shareholders' approval instead if they view the remuneration determined by the board of directors as being unfair.

- **Exemption and Indemnification of Directors:** Section 140 of the CA 1965 voids any contract by which a company exempts or indemnifies any of its officers (including a director) or its auditor in respect of any negligence, default, breach of duty or breach or trust. The Bill preserves this restriction. A company is however currently permitted to indemnify a director for any costs of defending legal proceedings but only if the director is successful in his defense or is acquitted. The Bill modifies this position and distinguishes between proceedings involving the company and those involving third parties. For civil (and not criminal) proceedings brought by a third party, the company may indemnify its directors against any liability and costs of such proceedings whilst proceedings are ongoing. This is crucial as litigation in Malaysia tends be a lengthy and costly process.

  Under Section 140, there is also some ambiguity on whether a company may contribute to premiums payable for Directors' & Officers' Insurance taken out for their directors. Under the Bill, a company may with prior approval of its Board, purchase insurance for its directors against any civil (and not criminal) liability and costs incurred by the person in his capacity as a director. It is however unclear from the Bill if the company can purchase insurance on behalf of its directors only in respect of claims involving a third party (or if this includes claims brought by the company itself), though it is likely the former.

Modernizing the Insolvency Laws Applicable to Malaysian Companies

- **Corporate Rescue Mechanisms:** Under the CA 1965, there are limited options available to an insolvent company i.e. it can enter into receivership, wind-up or undertake a scheme of arrangement with its creditors. To facilitate the rescue and rehabilitation of companies in financial difficulties instead, the Bill introduces 2 alternative mechanisms, Judicial Management and the Corporate Voluntary Arrangement.

  a) **Judicial Management:** Briefly, under the judicial management process, if there is a reasonable probability of rehabilitating an insolvent company as a going concern, the shareholders, directors or creditors of the company may apply to Court to place the management of the company in the hands of an independent and qualified Judicial Manager. Once a judicial management order is granted, a moratorium of 180 days takes effect during which the company cannot be wound-up, no receiver can be appointed, no security can be

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enforced, no shares can be transferred etc.. During this period, the Judicial Manager will prepare a workable restructuring plan which must be approved by a majority of 75% in value of creditors present and voting at a creditor's meeting. Once approved by the creditors and sanctioned by Court, the restructuring plan will be implemented.

b) **Corporate Voluntary Arrangement ("CVA"):** Similar to a scheme of arrangement ("**SOA**") under the current Section 176 of the CA 1965, the CVA allows the directors of a company to propose a scheme to creditors. Unlike a SOA however, the CVA relies on the involvement of a nominee who must be a qualified insolvency practitioner who will supervise and implement the scheme. The scheme however will originate from management, making a CVA suitable in situations where the shareholders and creditors still have confidence in existing management. Similar to judicial management, the company may apply for a moratorium of between 28 and 60 days during which the company cannot be wound-up, no Judicial Manager can be appointed, no security can be enforced, no shares can be transferred etc.. Unlike judicial management however, a secured creditor may appoint a receiver to deal with the charged property of a company during the moratorium. Any restructuring scheme must be approved by a simple majority of shareholders and at least a majority of 75% in value of creditors present and voting at a creditor's meeting .

Conclusion

The Bill also outlines many other areas of change including amongst others, the revamp of the financial reporting framework, simplification of the winding-up process, an update to the sanctions and enforcement procedures and integration of elements of corporate responsibility. All in all, the Bill promises modernization of existing company legislation and useful fine-tuning of existing laws.