A Consultative Document
On Members’ Rights and Remedies

by the Corporate Law Reform Committee
for the Companies Commission of Malaysia

Suruhanjaya Syarikat Malaysia
Companies Commission of Malaysia
# Contents

**Section A : Foreword**

1. Foreword

**Page**

5

**Section B : Executive Summary**

1. Background
2. Summary of Proposals

**Page**

11

**Section C : Members’ Rights and Remedies**

1. Part I – Remedy for Oppression under section 181 of the Companies Act 1965
2. Part II – Statutory Derivative Action
3. Part III – Variation of Class Rights
4. Part IV – The Remedy for Appraisal (Minority Buy-Out Rights) and Exit-Clause in the Articles
5. Part V – Class Action
6. Part VI – Statutory Injunction

**Page**

17
30
54
63
70
72
The Corporate Law Reform Committee invites comments, by 4 APRIL 2007 on the issues set out in this consultative document.

You are invited to send comments, together with any supporting evidence on any part of this consultation. We would be grateful if you could refer to the recommendation number(s) and/or paragraph number(s) in your feedback, preferably by email, to:

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A company is an association of more than one person and as such relationship problems are bound to arise between these various persons. In some instances these relationship problems may be settled amicably between the persons themselves yet there are also instances when an amicable settlement may not be reached or is not possible. This is usually the result of one party to that relationship having abused its dominant position over the weaker party or person.

In private companies where there exists a restriction in the transfer of shares and also a party that abuses its dominant position the ability of an abused person to exit from the company in a fair manner is highly unlikely. In such instances the abused party will seek to wind up the company although the company may prove to be profitable.

The Corporate Law Reform Committee, that is charged with the role to modernise the current regulatory framework for companies, firmly believes that an effective regulatory framework for companies can only exist provided the framework, amongst other things, effectively addresses relationship problems as mentioned above.

The CLRC, in making its recommendations was guided by the principle that whilst companies are controlled by the majority shareholder, a balance must be struck between the majority shareholder’s right to control the company and the minorities’ right to be treated fairly.

The fear that interest other than the interest of majority shareholder will be ignored or not fully recognised is a matter of concern for all including the majority shareholder. This is because if the regulatory framework does not adequately protect the interests of minorities this inadequacy may translate itself into higher cost of capital. Investors who invest in
companies where this risk is prevalent are more likely to demand financial compensation for running this risk and this is likely to be expressed in the price that investors are prepared to pay for the company’s securities. Hence, an effective regulatory framework for companies must therefore include provisions that are designed to ensure that all shareholders are treated fairly whilst the affairs of the company is being carried out.

The key recommendations made by the CLRC are the introduction of the statutory derivative action, the introduction of a statutory injunction to allow the regulatory authority or any aggrieved person to prevent breaches or contravention of the Companies Act, clarifying section 181 and recommending that the procedure for variation should be stated in the Companies Act itself.

We hope to receive views and comments on the recommendations stated in this Consultation Paper. Please reply to Nor Azimah Abdul Aziz of the Companies Commission of Malaysia (SSM) before 4 APRIL 2007.

Thank you

Dato’ K.C. Vohrah
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Section B

Executive Summary
SECTION B - EXECUTIVE SUMMARY

1. Background

1.1 This Consultation Paper focuses on the review undertaken by Working Group C of the CLRC on the following issues:
   • The Remedy for Oppression under section 181 of the Companies Act 1965
   • Statutory Derivative Action
   • Variation of Class Rights
   • The Remedy for Appraisal or Minority Buy-Out Rights and Exit-Out Clause in the Articles
   • Class Action
   • Statutory Injunction

2.0 THE REMEDY FOR OPPRESSION UNDER SECTION 181

2.1 In defining what constitutes oppressive conduct, the CLRC recommends that the remedy for oppression should not set out a list of factual situations where oppression is presumed to exist.

2.2 However, the CLRC recommends that section 181 should be clarified to state that the remedy is available where the effect of the conduct complained of persists at the time the application was made.

2.3 On the issue of standing, the CLRC recommends that the class of persons who may initiate an action under section 181 should be extended to include:
   (i) a person who is a former member but only if the oppression relates to the circumstances in which he ceased to be a member;
   (ii) a transferee of shares or a person entitled to them by operation of law whose membership has not yet been perfected (i.e. beneficial owner).
3.0 STATUTORY DERIVATIVE ACTION

3.1 The CLRC recommends the introduction of the statutory derivative action which should be made applicable to all types of companies.

3.2 It is the recommendation of the CLRC that in a situation where there is a statutory derivative action, the common law derivative action should not be allowed.

3.3 On matters concerning the costs of proceedings, the CLRC recommends that:
(a) the Court should be given wide powers to grant an order at any time by requiring the company to pay reasonable fees incurred by the complainant in connection with bringing the derivative action.
(b) the Court may exercise its discretion to refuse to make an order as to costs where the Court considers it unjust or inequitable for the company to bear those costs.
(c) the statutory derivative action may be brought by any member or director of the company;
(d) the criteria for the following the application are:
   • the company does not intend to bring the proceeding;
   • the applicant acts in good faith;
   • it is in the best interest of the company that the applicant be granted leave;
   • there is a serious question to be tried.
(e) unless the court otherwise orders, the applicant should give notice of the intention to bring a statutory derivative action to the company at least 28 days before commencement of the proceedings;
(f) the court should be given wide powers to grant an order at any time by requiring the company to pay reasonable fees incurred by the complainant in connection with bringing the derivative action;
(g) the court may also refuse to make an order as to costs where the Court considers it unjust or inequitable for the company to bear those costs;

(h) the Court should be allowed to order costs against the applicant if the suit was brought in bad faith or without reasonable cause;

(i) the applicant should be required to reimburse the company in the event the action was decided not in his favour; and

(j) the Court may make an order giving the complainant access to company’s records to allow him to gather evidence for the action to be brought.

4.0 VARIATION OF CLASS RIGHTS

4.1 The CLRC recommends that the procedure for variation should be stated in the Companies Act itself and that variation of class rights may be done if:

- a written consent is obtained from at least 75 per cent of the holders of shares whose rights are to be varied; or

- a special resolution is passed at a separate class meeting of shareholders whose rights are to be varied.

4.2 It is also the recommendation of the CLRC that the rights should be capable of being entrenched. However, entrenchment should not be absolute in that those rights can still be varied but only with the unanimous consent of that class of shareholders whose rights are to be varied.

4.3 The CLRC recommends that:

- section 65(6) and 65(7) of the Companies Act 1965 is to be retained;

- the present law that the statutory procedure applies only where the company has issued more than one type of shares to be retained;

- the redemption of preference shares (except for redeemable preference shares) is a variation of the rights of existing preference shareholders.
5.0 THE REMEDY FOR APPRAISAL OR MINORITY BUY-OUT RIGHTS AND EXIT OUT CLAUSE IN THE ARTICLES

5.1 The CLRC recommends that there is no necessity to introduce a statutory minority buy-out remedy.

6.0 CLASS ACTION

6.1 In view of the introduction of the statutory derivative action and the specific provision in the proposed statutory derivative action that will resolve the problems as to cost, the CLRC is of the view that there is no necessity to introduce a provision for class actions within the Companies Act.

7.0 STATUTORY INJUNCTION

7.1 The CLRC recommends the introduction of a statutory injunction to allow the Regulatory Authority or any aggrieved person to prevent breaches or contravention of the Companies Act.
Section C
Members’ Rights and Remedies
SECTION C - MEMBERS’ RIGHTS AND REMEDIES

INTRODUCTION

This Consultative Paper reviews the remedies available to shareholders under the Companies Act 1965 and the common law with particular reference to the following remedies:

(a) the remedy for oppression under section 181 of the Companies Act 1965;
(b) the derivative action under the exception to the rule in Foss v Harbottle;
(c) the protection given to members of a class under section 65 of the Companies Act 1965; and
(d) any other additional safeguards that may be considered to assist members in enforcing their rights.

PART 1 REMEDY FOR OPPRESSION UNDER SECTION 181

1.01 The remedy for oppression, which is a remedy available to shareholders under the Companies Act 1965 can also be found in the company legislation of various common law jurisdictions like UK, Australia, New Zealand, Singapore and Hong Kong and has been the subject of review in some of these jurisdictions. In the UK for example, the review was based on the need to consider the efficiency and costs of the remedy for oppression. Given this scenario, feedback is required on whether any changes are required to enable a better understanding and application of the remedy for oppression.

1 In the UK, the Law Commission has reviewed the remedy for oppression as part of its terms of reference to review shareholders remedies under Shareholders Remedies (LCCP 142) (October 1996) and Shareholders Remedies-Final Report (LC 246) (24.10.1997). The UK CLR has also reviewed the remedy for oppression under its Modern Company Law for a Competitive Economy-Completing the Structure URN001335 (2000) and the Final Report (March 2001). See also the UK DTI White Paper on Company Law Reform (Cm 6456). The UK Company Bill which is now being deliberated in the House of Lords retains the existing substantive contents of the remedy for oppression as is found under the UK Companies Act 1985. The Singapore CLRFC did not specifically deal with the remedy for oppression under the Singapore Companies Act (Cap 50). The Hong Kong Standing Committee on Corporate Law Reform did not make any specific comments on the remedy for oppression in the Hong Kong Companies Ordinance.
A DEFINING ‘OPPRESSIVE CONDUCT’

1.02 There is well-developed case law on section 181 and whilst the section is available to members of a company, case law shows that the majority of the cases under section 181 involve an application made by the minority shareholders. Common allegations made in petitions under this section include the exclusion of a shareholder from management or misappropriation or diversion of corporate assets. Other typical conducts which have been found to be oppressive include the failure to provide information, improper increases in share capital, denial of voting rights or participation at meetings, excessive remuneration and non-payment or payment of inadequate dividends.

1.03 The CLRC noted that sections 459-461 of the UK Companies Act 1985 provide a remedy for a shareholder where a company’s affairs are being conducted in a manner which is unfairly prejudicial to the interests of its members generally or to some part of its members (including him). However, despite well-developed case law on conduct which is oppressive in the UK, the UK Law Commission, in its review of the remedy for oppression, considered whether there should be a list of factual circumstances presumed to be unfairly prejudicial. It was recommended that the presumption should provide that, subject to the conditions present, the affairs of the company will be presumed to have been conducted in a manner which is unfairly prejudicial to the petitioner and where a shareholder has been excluded from

5 Re Chi Liung & Sons Ltd [1968] 1 MLJ 97.
6 Tuan Haji Ishak b Ismail v Leong Hup Holdings Bhd [1996] 1 MLJ 661.
8 The Law Commission, Shareholders Remedies [CP 142] (October 1996). The Law Commission recommended that the presumptions should apply where, immediately before the exclusion from participation in the management, (a) the petitioner held shares in his sole name giving him no less than 10 per cent of the rights to vote at general meetings of the company on all or substantially all matters, and (b) all, or substantially all of the members of the company were directors (for the purpose of (b), only joint holders should be counted as a member).
participation in the management of the company, the conduct will be presumed to be unfairly prejudicial by reason of the exclusion.\footnote{The Law Commission also recommended that there should be an amendment made to the provision on oppression (under sections 459-461 of the UK Companies Act 1985), whereby if the presumption is not rebutted and the Court is satisfied that it ought to order a buy-out of the petitioners’ shares, the Court should do so on a pro rata basis.}

1.04 However, the UK Company Law Review decided not to recommend this approach and was of the view that whether or not the conduct complained of is oppressive or unfairly prejudicial or discriminatory is fact-specific and specifying a list of conduct where oppressive conduct is presumed may be counterproductive as it may be construed as restrictive.

1.05 Under section 232 of the Australian Corporations Act 2001, the Court may make an order if the conduct of the company’s affairs (if the actual act or proposed act or omission by or on behalf of the company or a resolution or proposed resolution of the company) is contrary to the interests of the members as a whole or oppressive to, unfairly prejudicial to, or against members.\footnote{For the purposes of Part 2F.1 – Oppressive Conduct of Affairs, a person to whom a share in the company has been transmitted by will or by operation of law is taken to be a member of the company.} What amounts to an oppressive conduct is well-developed by case law.\footnote{See for example Wayde v New South Wales Rugby League Ltd [1985] 3 ACLC 799; Re Spargos Mining NL [1990] 8 ACLC 1,218; Jenkins v Enterprise Gold Mines NL [1992] 10 ACLC 136.}

1.06 In New Zealand, the remedy for oppression is provided for under section 174 of the Companies Act 1993.\footnote{Prior to the introduction of the Companies Act 1993, the relevant statutory provision is section 209 of the Companies Act 1955. See Re Empire Building Ltd [1972] NZLR 683; Thomas v HW Thomas Ltd [1984] 1 NZLR 686; Latimer Holdings Ltd v SEA Holdings New Zealand Ltd (2004) 9 NZCLC 263,694; Re Waitikiri Links Ltd [1989] 4 NZCLC 64,922.} However, whilst the section is similar to that found under the Australian Corporations Act 2001, the New Zealand Companies Act 1993 also identifies certain forms of conduct, for which failure to comply with the procedure in relation to these conducts, are deemed to be unfairly prejudicial conduct.\footnote{These are: \begin{itemize} \item Section 45-pre-emptive rights to the issue of shares \item Section 47-consideration to be decided by board \item Section 53-dividends \item Section 60-Board may make offer to acquire shares \item Section 61-special offers to acquire shares \end{itemize}}
facilitates the shareholder’s action as the shareholder only needs to prove that there is procedural failure to comply with these forms of conduct.

1.07 The CLRC is of the view that given the circumstances which may give rise to oppression is fact-specific and that there is well-developed case law on what amounts to conduct which is oppressive, it is not necessary to enact in the company legislation a list of factual circumstances which are presumed to be conduct which is oppressive.14

1.08 The CLRC also noted that the present drafting of section 181(1)(a) of the Companies Act 1965 may be literally interpreted to mean that the conduct complained about must be continuing in nature and must still be in existence at the time the application is made15 although the more favourable view is that section 181 looks at the cumulative effect of the conduct and not whether the conduct complained about is still continuing at the time of the application.16 Thus, the CLRC recommends that the section should be clarified to state that the remedy is available where the effect of the conduct complained about persists at the time the application is made. This will require a restatement of the section and the CLRC recommends a redrafting of section 181 along the lines of the Australian provision.

14 The CLRC is also aware of the recent decision O’Neill v Phillips in Re A Company [No 00709 of 1992] (1999) 1 W.L.R. 1092, concerning the issue whether or not a legitimate expectation may be a ground for a remedy for oppression. It was decided in the recent decision that it is no longer possible to base a petition merely on the petitioner’s reasonable expectations. There must be some breach of equitable principle or an agreement before a breach of a member’s legitimate expectation may give rise to a remedy for oppression. However, the CLRC is of the view that this case does not change the current case law in Malaysia in relation to whether or not members’ reasonable or legitimate expectation may be a ground to bring an action under section 181 due to the differences in the wording of section 459 of the UK Companies Act 1985 and section 181 of the Companies Act 1965; see Tuan Haji Ishak b Ismail v Leong Hup Holdings Bhd [1996] 1 MLJ 661; Jaya Medical Consultants Sdn Bhd v Island & Peninsular Bhd [1994] 1 MLJ 520; Tay Bok Choon v Tahansan Sdn Bhd [1987] 1 MLJ 433; Eric Lau Man Hing v Eramara Jaya Sdn Bhd & Ors [1998] 1 MLJ 661; Leong Hup Holdings Bhd [1996] 1 MLJ 661; Jaya Medical Consultants Sdn Bhd v Island & Peninsular Bhd [1994] 1 MLJ 520; Tay Bok Choon v Tahansan Sdn Bhd [1987] 1 MLJ 433; Eric Lau Man Hing v Eramara Jaya Sdn Bhd & Ors [1998] 1 MLJ 661.


B LOCUS STANDI

1.09 An action for oppression under section 181 of the Companies Act 1965 may be brought by:

• a member of the company, even if the act of oppression relates to an act or proposed act that is against:
  - the member in a capacity other than as a member as long as the oppressive conduct also affects him in his capacity as a member; or
  - another member in their capacity as a member.
• debenture holders.

Thus, the section gives locus standi only to members and debenture holders of the company.

1.10 The CLRC noted that because a person will only be a member of a company when his name is on the register of members or register of depositors, any beneficial owner will not be entitled to rely on the section. In addition, the CLRC noted there could be situations where a person ceases to be a member because of the oppressive conduct i.e. when his membership is wrongfully terminated by the company or where shares were wrongfully transferred. As section 181 is only applicable to members of a company, a beneficial owner and a former member will not be entitled to bring an action under section 181.

1.11 The CLRC noted there is judicial support for the view that the beneficial owner could be allowed to rely on section 181. In Owen Sim Liang Khui v Piasau Jaya Sdn Bhd\(^7\) the Federal Court decided that under section 181, a petitioner must be able to demonstrate that his name appears on the register of members at the date of the
presentation. The Federal Court then gave an example of where a person, whose name is not on the register of members, may rely on the section. The situation, as pointed out by the Federal Court, is one where a shareholder is treated by the company or the board as a member, prior to the application, though the shareholder’s name is yet to be inserted into the register of members. In this situation, the doctrine of estoppel will apply to prevent the company or the directors from saying that the complainant has no locus standi.

1.12 The CLRC noted there are other jurisdictions which recognises the right of a beneficial owner to bring an action under the provision for oppression. Under section 459 of the UK Companies Act 1985, (a transferee of shares or a person entitled to them by operation of law whose membership has not yet been perfected) is permitted to bring the same action as can be brought by a member. In addition, the UK Law Commission identified one example where former members may want to use the section. An example of this is where directors who are majority shareholders have made personal profit at the expense of the company and then induced a minority shareholder to leave, giving him a price for his shares which represents an under value because of their wrongdoing. Nonetheless, the UK Law Commission did not recommend that the application for a remedy for oppression be extended to former members because, in the situation stated above, the shareholder may obtain other remedies such as an actionable misrepresentation or by establishing that there is a duty to disclose.

1.13 Under section 234(a) of the Corporations Act 2001, an application for an order in relation to a company may be made by any member even if the application relates

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18 The UK Law Commission gave two other examples where a former member might want to take action under this section. They are firstly, where a shareholder has sold his shares at a price to be fixed by reference to future profits, and, thereafter, the remaining shareholders conduct the company’s affairs improperly so as to reduce its profits. However, the former member is only without a remedy if he has failed to obtain appropriate covenants and warranties. To provide a statutory remedy in these cases would be to interfere with the contractual situation. Another example is following a takeover in the event that shareholders are dissatisfied with the price received for their shares. See the Law Commission, Shareholders Remedies (CP 142) (October 1996), at para 20.35 and 20.37.
to the member in a capacity other than as a member and another member’s capacity as a member, persons who have been removed from the register because of selective capital reduction, persons who cease to be a member if the oppression relates to the circumstances in which they cease to be members, persons to whom shares have been transmitted by will or operation of law, or any other person that ASIC deems appropriate. However, debenture holders have no *locus standi*.

1.14 Section 174(1) of the New Zealand Companies Act 1993 states that in the case of prejudiced shareholders, the remedy is available to members and former members or any other entitled person. Thus, a former member whose interests may have been prejudiced prior to the transfer of the shares may apply under the section. Under section 238(1) of the Canada Business Corporations Act 1985 the persons who have *locus standi* to bring an action include registered holders, or beneficial owners, a former registered or beneficial owner of a corporation or its affiliates; a director or officer or former director or officer of the corporation or its affiliates, the Director (similar to Registrar) or any person, who in the discretion of the Court, is the proper person to make an application under the section. Nonetheless, *locus standi* is not given to debenture holders although conduct oppressive to security holders is a ground for bringing an action under the remedy for oppression.

1.15 The CLRC is of the view that the *locus standi* to bring an action under the provision for oppression should be extended to beneficial owners i.e. a transferee of shares or a person entitled to them by the operation of law whose membership has not been perfected and to members who have ceased to be members because of the oppressive conduct.
C  **ORDERS THAT MAY BE GRANTED BY THE COURT**

1.16 Whilst the Courts in Malaysia are given wide-ranging powers under section 181(2), an often-requested remedy is an order for the majority shareholders or the company itself to purchase the petitioner’s shares. Another often requested remedy is an order to wind up the company.

1.17 Other jurisdictions such as Singapore, United Kingdom, Australia and New Zealand that have a provision similar to our section 181 have a similar range of remedies. These include:
   (i) an order to purchase the petitioner’s shares,
   (ii) an order to regulate the future conduct of the company’s affairs,
   (iii) an order that the company be wound up (except for the UK),
   (iv) an order directing, prohibiting, setting aside or varying any act or transaction of the company.

1.18 However, in addition to the range of remedies mentioned above, some jurisdictions have added other remedies. This can be seen from the cross jurisdictional studies below.

1.19 In New Zealand, section 174(2) of the Companies Act 1993 provides for these remedies in addition to the ones stated above and these are:
   (a) the appointment of a Receiver,
   (b) the alteration or deletion of Articles,
   (c) direct rectification of records,
   (d) compensation to any person.
1.20 In Australia, section 233 of the Corporations Act 2001 provides for these additional remedies:

(a) for the company to institute, prosecute, defend or discontinue specified proceedings;
(b) authorising specific persons to take action on behalf of the company;
(c) appointing a Receiver or a Receiver and Manager.

1.21 Section 168A of the Hong Kong Companies Ordinance provides that the Court can make the following orders:

(a) make an order restraining the commission of any such act or the continuance of such conduct;
(b) order that such proceedings as the Court may think fit shall be brought in the name of the company against such person and on such terms as the Court may so order;
(c) appoint a Receiver or a Manager of the whole or a part of a company’s property or business and may specify the powers and duties of the Receiver or Manager and fix his remuneration;
(d) make such other order as it thinks fit, whether for regulating the conduct of the company’s affairs in future, or for the purchase of the shares of any member of the company by other members of the company or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company’s capital, or otherwise.

1.22 Despite the wording of section 181 which does not expressly provide for the appointment of Receivers and Managers, the Malaysian Courts have made orders regarding the appointment of a Receiver. There are also cases where the Courts have ordered the transfer of shares to the minority shareholders to ensure the proper
representation of the minority interests in the company’s management. This order was made as part of the Court’s authority under section 181 to regulate the company’s affairs.

1.23 The CLRC noted the views that section 181 should be redrafted to enable shareholders to take action on behalf of the company by expanding the order that the Court may make under section 181 to include an order authorising the minority shareholder to bring any proceedings in the name and on behalf of the company. A similar order can be found under the remedy for oppression in the UK, Australia and Hong Kong. The advantage of such an order is that this will facilitate an action for the company to sue directors or for the Court to authorise the minority shareholders who have brought the oppression proceedings to bring legal proceedings on behalf of the company.

1.24 The CLRC noted that whilst there are cases brought under the remedy for oppression that can also be brought under the common law derivative action, there are also cases which although are actionable under the remedy for oppression, are not actionable under the common law derivative action. For example, cases involving the misappropriation of the company’s assets or directors’ self-dealings transactions or a diversion of company’s business can give rise to both section 181 and the common law derivative action. However, cases involving a denial of voting rights or personal rights of members in relation to the Articles of Association are not actionable under the common law derivative action but are actionable under section 181. There is a possibility of confusion between what are the rights of a member which would enable the member to bring an action under section 181 and

21 The Law Commission, Shareholders Remedies (CP 142) (October 1996), at para. 10.8 and 10.9, states that “Section 461(2)(c) gives the Court power to make an order to “…authorise civil proceedings to be brought in the name and on behalf of the company by such person or persons and on such terms as the Court may direct”. In other words, it allows a petitioner who succeeds in proving unfairly prejudicial conduct under section 459 to then bring a derivative action in the name of the company. It appears that relief under section 461(2)(c) is rarely ordered in practice and few reported cases exist in which such an order has been made. Such a remedy can be a lengthy and potentially expensive procedure as the petitioner is required to prove his entire case under section 459 before an action on behalf of the company may be commenced.
what are the rights of the company which should be rightly dealt with by the exception to the rule in Foss v Harbottle i.e. the common law derivative action.

1.25 It is the view of the CLRC that there should be separation between the remedy for oppression which gives members the right to enforce their personal rights and the derivative action which confers *locus standi* to members to bring an action on behalf of the company.

**RECOMMENDATION**

1.26 The CLRC recommends that:

- section 181 should be clarified to state that the remedy is available where the effect of the conduct complained about persists at the time the application was made.
- section 181 should be amended to give standing to, in addition to the existing persons who can bring an action under the provision for oppression (i.e., members and debenture holders), the following persons:
  - a person who was a former member but only if the oppression relates to the circumstances in which he ceased to be a member.
  - a transferee of shares or a person entitled to them by operation of law whose membership has not yet been perfected (i.e., beneficial owner).

**Questions for Consultation**

**Question 1:**

Do you agree that apart from the persons currently given standing under section 181 i.e., members and debenture holders, the following persons should also be allowed to bring an action under section 181:
(i) a person who is a former member but only if the oppression relates to the circumstances in which he ceased to be a member?
(ii) a transferee of shares or a person entitled to them by operation of law whose membership has yet to be perfected?
(iii) a former member?

D THE WINDING UP UNDER ‘JUST AND EQUITABLE GROUND’ AND ITS RELATIONSHIP WITH SECTION 181 OF THE COMPANIES ACT 1965

1.27 Another statutory remedy available to minority shareholders is provided for under section 218 of the Companies Act 1965 where a member may apply to wind up a company under the just and equitable ground. There is also sufficiently well-developed case law in Malaysia on the types of situations for winding-up a company under the just and equitable ground.22

1.28 However, there is ambiguity in relation to the relationship between section 218 and section 181. One issue which arises is whether the submission of an alternative remedy is influential on the Court in making a decision to order the winding up of a company under section 218. The CLRC noted that under section 218, a winding up order is the only order that the Court may make, unlike an order to wind up a company under section 181. Thus, any alternative remedy is irrelevant when an application is made to wind up a company under section 218. However, whilst an order to wind up a company may be obtained under section 181, the order is discretionary and is often made as a last resort especially if the company is profitable.23

Another issue is whether an application under section 218 may be used as an alternative to section 181 and if the application under section 218 precludes a member from applying under section 181. Under section 181, a winding up order is already provided for as one of the orders that the Court may make although as stated earlier, the Courts will consider this to be a remedy of last resort. When a petition to wind up the company has been heard, a petition under section 181 will not be allowed. However, it is not clear whether a petition under section 218 and section 181 will be allowed to be applied for concurrently. The CLRC noted that under section 181, if the Court makes an order to wind up the company, section 181(3) will apply in which case there should not be any necessity to file a separate action to wind up the company. The CLRC is of the view that a winding up order should still be retained as one of the orders that a Court may make under section 181. However, the practice of filing a winding up petition under section 218 and concurrently, a petition under section 181 is made should not be encouraged as it is possible that this multiplicity of proceedings might be used to pressure respondents into a settlement.

Question for Consultation

Question 3:
Do you agree that a petitioner should not be allowed to file a petition under section 218 and section 181 simultaneously?

25 See Teh Chin Chuan v Chuan Hong Co & Ors [1999] 5 MLJ 459 where two petitions were allowed, one under section 218 and the other under section 181. However, see Lai Kim Lai v Dafuk Lai Fook Kim & Co [1989] 2 CLJ 107; Hoi Pak Kwal v Leong Kiong Fah & Ors [2005] 5 CLJ 179 where the Court held that the filing of two petitions under section 218 and section 181 simultaneously is an abuse of the Court’s process as this would result in the multiplicity of proceedings.
26 The UK Law Commission, Shareholders Remedies (CP 142) (October 1996) at para 8.21 where the Law Commission pointed out that although the provision for oppression does not allow the Court to make any order for winding-up, the remedy to wind up a company is often applied for as an alternative to the remedy for oppression as a tactic to pressure the respondents to settle the case as soon as possible. However, this matter is resolved through the introduction of a practice direction in the UK that discourages the filing of a petition to wind up a company at the same time that a petition under the provision for oppression is filed. See the Practice Direction (Ch D) [Companies Court: Contributory’s Petition] [1990] 1 WLR 490. The direction stated that it was undesirable to include as ‘... a matter of course, a prayer for winding up as an alternative to an order under section 459 ... It should be included only if that is the relief which the petitioner prefers or if it is considered that it may be the only relief to which he is entitled’.
PART 2 STATUTORY DERIVATIVE ACTION

2.01 At common law, the case of Foss v Harbottle
did not lay down the rule that the company is the only person who can take action to enforce the company's rights. A person who is a minority shareholder of the company does not have the right to act on behalf of the company to bring legal proceedings to enforce the company's rights. The rule is used to prevent frivolous litigation by disgruntled shareholders where legal proceedings may be used as a ploy to gain personal advantage, to avoid multiplicity of actions that will impede effective decision making by the company and to respect the will of the majority shareholders.

2.02 However, there is an exception to the rule which is known as the 'derivative action'. A 'derivative action' means an action brought by a member based on a cause of action which the company has, rather than a cause of action belonging to the member. The derivative action enables the minority shareholder to bring an action on behalf of the company in situations where the company does not take action because the person who is to be sued controls the company and prevents or is able to prevent the company from suing him.

2.03 Thus, the derivative action is considered as a corporate governance mechanism by minority shareholders. Nonetheless, there are certain problems in the application of the common law derivative action. These are:-

- Costs of proceedings - The shareholder bringing the action is potentially liable for the costs of the action even though he has no corresponding right to share the damages if the wrongdoer is held liable. Legal aid is not available, and in addition, the defendant (the wrongdoers) could be fighting the litigation with funds of the company. Also, the costs of the proceedings are not shared with the
other shareholders. Although the Courts have the power to order indemnity as to the costs of the action, this is discretionary and is usually granted after the conclusion of the case. Furthermore, the precise circumstances for the order are not clear.28

- **The problem of free rider** - The free rider problem is a disincentive for shareholders to utilise the remedy. In most cases, the cost of proceedings must be borne by the individual or minority shareholder who brings the action, although it may be possible for the complainant to obtain an indemnity from the Court when obtaining a judgement in favour of the company. However, the shareholder may be reluctant to commence proceedings as he will have to utilise his own funds to proceed whereas the damages awarded by the Court goes to the company and benefitting the whole body of shareholders. In such a case, the minority shareholders who may want to bring the action may not do so and instead decide to let other shareholders bring the action.29

- **The restrictive and ambiguous definition of ‘fraud’** - The term ‘fraud’ may include an abuse of power and is not limited to fraud at common law. ‘Fraud on the minority’ has been defined to include a breach of directors’ duty, although it will not cover cases involving negligence where the director does not obtain any benefit.30

- **The ambiguity in relation to the effect of ratification** - It is unclear what the actual impact of ratification by the shareholders is. Apart from the clear cases of misappropriation of company assets or abuse, the difficulty lies in discerning from case law when the Court will hold that misconduct may be ratified by the majority shareholders and when they cannot. Thus, the decision as to whether or not a transaction is capable of ratification might, under such circumstances, depend on the findings of fact by the Court.

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29 Prudential Assurance v Newman (No 2) [1982] 2 WLR 31 (CA).
30 See Pavides v Jensen [1956] 2 All ER 518. However, see Daniels v Daniels [1978] 2 All ER 89; Prudential Assurance Co Ltd v Newman Industries (No 2) [1980] 2 All ER 841.
• Access to information is very limited for shareholders who are not part of management and therefore it is difficult to commence proper action. Shareholders (who are not part of management) are likely to find that they are effectively prevented from taking action because they are unable to have access to information in order to commence a proper action.
• Procedural issue of ascertaining locus standi which results in a ‘trial within a trial’ (a voir dire).

2.04 In jurisdictions that have codified the derivative action, the codification is seen as a possible solution to the setbacks found under the common law derivative action.31

2.05 The Australian Corporate Law Economic Reform Program Act 1999 (CLERP)32 was of the view that a statutory derivative action:-
• would not impose a new form of liability on directors but rather would provide a more effective avenue of enforcement than previously available;
• would provide strong encouragement for company managers to be accountable to shareholders for decisions they make. In order for it to be effective, there should be an assurance that there is no abuse of the system and safeguards are needed to ensure management is not undermined by unjustified litigation;
• would remove the uncertainty in common law actions, e.g. issue of ratification of management actions with less than unanimous shareholders support, and in relation to the question of cost. This will be achieved by the introduction of clear statutory procedures;

31 Some of the common law jurisdictions that have codified the derivative action are Australia, Singapore and New Zealand. Eight out of ten provinces in Canada have since 1975 replaced the rule in Foss v Harbottle with a requirement that the shareholder obtain the leave of the Court. The Canada Business Corporation Act 1985, under section 239(1), sets out a statutory right to apply for leave to bring an action on behalf of a corporation or to intervene in an action to which the company is a party. Section 165 of the New Zealand Companies Act 1993 is similar to the Canadian Act which states that “the Court may, on the application of a shareholder or director of a company, grant leave to that shareholder or director to bring proceedings on behalf of the company or intervene in proceedings to which the company is a party for the purpose of continuing, defending or discontinuing the proceedings on behalf of the company.” See also South Africa – Companies Act No 61 of 1973.
would be a valuable tool to enhance corporate governance and to maintain investor confidence which can reduce agency costs between the directors/managers and the shareholders.

2.06 The UK Law Commission recommended that the right to bring a derivative action at common law should be replaced by a simpler and more modern procedure which should be set out in the Companies Act. However, the details of the procedure should be set out in the rules of Court so as to ensure maximum flexibility. This view has been endorsed by the UK Steering Committee Company Law Review (CLR).

2.07 In Hong Kong, the Standing Committee on Company Law Reform (SCCLR) was of the view that statutory clarification would not impose new forms of liability on directors. In fact, it would remove uncertainties and provide a more effective means of enforcing the duties of the directors and other wrongdoings committed in relation to the company. It is intended to provide an effective mechanism by which shareholders can protect themselves. In addition, clarifying the derivative action in the statute could create a valuable tool to enhance corporate governance and maintain investors' confidence. The SCCLR was of the opinion that the derivative action is intended to allow shareholders or directors of the company to bring an action on behalf of the company for a wrong done to the company where the company is unwilling or unable to do so. This recommendation has been incorporated into the Hong Kong Companies Ordinance which introduced a new statutory right to commence a derivative action for 'misfeasance' committed against the company.

2.08 In Malaysia, the High Level Finance Committee Report on Corporate Governance recommended that consideration should be given for the enactment of a provision

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34 See sections 186BA-168BK of the Hong Kong Companies (Amendment) Ordinance No 30 of 2004.
to allow the relevant regulatory body to conduct civil proceedings on behalf of any company or individual in the following circumstance:-

- that it is in the public interest;
- that a cause of action has been ascertained following an investigation or examination by the relevant regulatory body; and
- that a cause of action has been ascertained arising out of a request by a company or individual concerned.

2.09 The High Level Finance Committee also proposed, as a long term measure, a statutory derivative action should be introduced incorporating the safeguards as proposed by the American Law Institute (ALI). ALI provides that a shareholder will only have standing to maintain a derivative action if the shareholder acquired the shares before the material facts related to the wrong-doing were publicly disclosed, known or specifically communicated to the shareholder, or the shareholder obtained it by devolution of law from a prior holder of the security.

2.10 ALI also recommends that the shareholder makes a written demand upon the Board of Directors, requesting the Board to commence an action or to take suitable corrective measures. The company has to reject the demand, before the shareholder can commence the derivative action. This provides the Board with an opportunity to pursue other remedies or take other remedial actions, or to take over the suit. Another safeguard is to require for an Attorney’s certification that the suit was not filed for an improper purpose, to harass, cause unnecessary delay or needless increase in the cost of litigation. The Court can also award costs against the shareholder if it finds that the suit was made in bad faith or without reasonable cause.

2.11 The CLRC is of the view that there is a case for the codification of the derivative action.
A SHOULD THE COMMON LAW DERIVATIVE ACTION BE REPEALED BY THE STATUTORY DERIVATIVE ACTION?

2.12 In Australia and New Zealand, the derivative action under the common law is no longer available to members. The Companies and Securities Advisory Committee (CASAC) Report of Australia stated that by abrogating the common law derivative action, there would be certainty in the applicable law.

2.13 Canada has a statutory derivative action. However, it is not expressly stated in the Canada Business Corporations Act 1985 that the common law derivative action has been repealed. Nonetheless, the Courts in Canada have held that the common law derivative action has been impliedly prohibited by legislation. 36

2.14 However, Singapore, which has codified the common law derivative action, still allows the members to rely on the common law derivative action. This is because the statutory derivative action is only available for private companies and not to listed companies. 37 Hong Kong, on the other hand, did not abolish the right at common law for a member to bring proceedings on behalf of a company or to intervene in any proceedings of which the company is a party. 38

2.15 The CLRC is of the view:-
- that to ensure certainty in the law, the common law derivative action should no longer be allowed if and when the derivative action is codified.

38 See 168BC(4) of the HK Companies Ordinance ‘Subject to other provisions in this Part, this Part shall not affect any common law right of member of a specified corporation to bring proceedings on behalf of the specified corporation, or intervene in any proceedings to which the specified corporation is a party.’
• that there should not be a distinction between private and public companies in relation to the statutory derivative action.

2.16 The CLRC is of the view that members of public companies should not be prohibited from relying on the statutory derivative action since incidents of breaches of duties and abuse of the powers of the directors potentially exist in private as well as public companies. The CLRC noted that the derivative action is relied on by members in closely held corporations or private companies. In these companies, shares are not freely transferable since there is often some form of restriction on the transferability of the shares. Members of public companies are often able to sell their shares. However, to deny the members of a company of the derivative action procedure merely because he has the option to dispose of his shares, goes against the fact that a statutory derivative action is intended to empower minority shareholders and that the shareholder may wish to remain in the company.

B SCOPE OF THE STATUTORY DERIVATIVE ACTION

2.17 At common law, the derivative action involves cases where a breach of directors’ fiduciary duty has occurred. Mere negligence or breach of duty of care where there is no pecuniary benefit obtained by the director does not amount to ‘fraud on the minority’ and, thus, is not covered by the common law derivative action. This is because, at common law, ‘fraud on the minority’ requires proof that the wrongdoer must have obtained a benefit at the expense of the company.

2.18 In some jurisdictions like Australia, New Zealand and Hong Kong, the scope of the statutory derivative action covers breaches of directors’ duties, including breach of
fiduciary duty, duty of care, skill and diligence as well as conflict of interest. It has been suggested that the inclusion of the breach of duty avoids the complex distinction under the ‘fraud on the minority’ exception at common law between negligence per se and negligence which benefited the wrongdoer.40

2.19 The UK Law Commission recommended that the procedure for a derivative action should be available if the cause of action arises as a result of an actual or threatened act or omission. These include negligence, default, breach of duty or breach of trust by a director; or a director putting himself in a position where his personal interest conflicts with his duties to the company. The UK Law Commission recommendation of restricting the statutory derivative action to claims arising out of the breaches of directors’ duties was intended to minimise the potential of increased shareholder litigation in the management of public listed companies as well as the potential for risk-averse directors to flee the board. The UK CLR endorsed this view and further clarified that a derivative action would be restricted to breaches of director’s duties, including the duty of care and skill. The CLRC agreed with this approach.

2.20 The CLRC also noted that in some jurisdictions like Australia, New Zealand and Canada, the scope of the statutory derivative action covers the breach of duty in a related corporation.41 This means that a member in a company may be allowed to bring an action on behalf of a related company where the cause of action arose in the related company. However, the UK CLR felt that it is the holding company which should bring the action and not the members of the holding company, thus, not recommending the statutory derivative action for a related corporation. The CLRC would like to seek views on this issue.

41 Note that the definition of a related company is similar to the holding-subsidiary relationship under the Companies Act 1965.
C THE ISSUE OF STANDING TO USE THE STATUTORY DERIVATIVE ACTION

2.21 An important issue under this area is whether the right to bring a statutory derivative action should be limited to the existing members of a company. The CLRC noted that whilst a widely worded provision on standing may encourage directors to be more vigilant in managing the company’s affairs, this may also increase the potential for legal suits which in turn may deter persons from becoming directors.

2.22 It was noted by the CLRC that the Finance Committee referred to ALI’s concern on expanding the *locus standi* to other persons other than existing members of the company.\(^{42}\) ALI was concerned that there may be situations where the action is brought by a person who became a shareholder for the sole purpose of bringing the action. This may result in the harassment of the company for example by a person who used the derivative action to manipulate the price of the shares or for the purpose of obtaining a fee or being bought off. To overcome this problem, ALI recommends that the shareholder must have bought the shares before the facts that gave rise to the wrongdoing were publicly disclosed, known or specifically communicated to the shareholders, or if the shareholder obtained it by devolution of law from a prior holder. The shareholder must also continue to hold the shares during the action and if his shareholding ceases as a result of a corporate action, the derivative action must have been commenced prior to the corporate action terminating his shareholding.

2.23 It has been argued by the UK Law Commission in its Consultation Paper that there was no justification in permitting former members to bring derivative actions.\(^{43}\) This is because, there is bound to be a current member (if the wrong has not been ratified)

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\(^{43}\) The UK Law Commission, Shareholders Remedies [CP No 142] (October 1996), at para 20.33.
who could maintain the proceedings. The Commission saw no reason why a former member should be able to bring a derivative action claim if the current members were not willing to do so, hence its recommendation that the derivative action should be available only to the present members of the company.

2.24 In Australia, the Companies and Securities Law Review Committee (CSLRC) put forward the recommendation that there should be an allowance in the legislation allowing for a derivative action to be brought by members, former members and persons entitled to be registered as members. The CSLRC was of the view that the status of the person in respect of the company should not be the main consideration, rather, whether or not it is appropriate for the applicant to be given locus to sue. However, the Companies and Securities Advisory Committee (CASAC) disagreed with the inclusion of the category of former members as the CASAC was of the view that this would create too wide a category of persons who could apply. Despite this reservation, section 236 of the Australian Corporations Act 2001 provides that a derivative action may be brought by members, former members, and persons entitled to be registered as members.

2.25 Section 165 of the New Zealand Companies Act 1993 states the Court may, on the application of a shareholder or director of a company, grant leave to that shareholder or director.

2.26 Canada allows a derivative action to be brought under section 239 by the registered holder, former registered holder or beneficial owner, director/former director or officer, the director or any other person who at the discretion of the Court is deemed a ‘proper person’. However, most cases under the Canadian legislation are brought by shareholders since Canadian Courts have been reluctant in granting leave when other persons make the application.
2.27 In Hong Kong, the Consultation Paper on the introduction of the statutory derivative action contained a provision providing standing to the Securities and Futures Commission enabling it to bring a derivative action on behalf of a company.\(^{46}\) This is similar to the standing given to the Regulatory Authorities in Australia and Canada. However, this proposal was later dropped and the new section 168BC of the HK Companies Ordinance only gives *locus standi* to the members of a company and does not give *locus standi* to the Regulatory Authority to bring the derivative action on behalf of the company.

2.28 The Malaysian High Level Finance Committee Report on Corporate Governance\(^{47}\) has recommended that consideration should be given to the enactment of a provision allowing the relevant regulatory body, apart from the members of a company, to conduct civil proceedings on behalf of any company or individual. On this point, reference can be made to the Securities Industry Act 1983 which allows the regulator to commence a civil action on behalf of parties who have been aggrieved by conduct amounting to insider trading. Currently, there is no equivalent provision under the Companies Act 1965.

2.29 Whilst the CLRC is of the view that the statutory derivative action should be available to members, former members or persons entitled to be registered as members to bring proceedings on behalf of the company and directors of a company, the CLRC would like to seek views on giving *locus standi* to the Regulatory Authority.

**D AVAILABLE SAFEGUARDS AGAINST ABUSE OF UNJUSTIFIED LITIGATION**

*Company’s Inaction and the Requirement to Give Notice of Proceedings to the Company*

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2.30 In Australia and New Zealand, the Courts are required to consider whether or not the company will take any action. This criterion is closely related to the requirement to give notice of proceedings to the company as it is meant to provide the company time to address the applicant’s concerns prior to the Court hearing the matter. The notice enables the directors of the company to remedy the situation by allowing them time to decide on whether or not the company itself wants to proceed with the bringing of an action. In Australia for example, the failure by the company to take action within the timeline stated may support the Court in arriving at the conclusion that it is probable the company would not itself bring an action. The applicant may also rely on the fact that the alleged wrongdoer has a dominant influence on the Board of Directors to discharge this requirement.

2.31 The UK Law Commission proposed that in order to pursue the statutory derivative action, notice to the company must be given at least 28 days before the proceeding commences.\(^{48}\) However, flexibility is introduced for cases of great urgency since the Court is authorised to make an order in such cases to waive the requirement to give notice.\(^{49}\)

2.32 In Australia and Hong Kong at least 14-days notice is required to be given by the applicant to the company before making the application to the Court.\(^{50}\) The applicant must also state the reasons for applying. However, the time frame need not be complied with if it is appropriate for the Court to grant leave even though notice was not given to the company.

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\(^{48}\) UK Law Commission, Shareholders Remedies (LCCP 142) (October 1996) and Shareholders Remedies-Final Report (LC 246) (24.10.1997). See Appendix B: Draft Rule 50.4(1), in accordance with draft Rule 50.4(2): ‘The notice must (a) set out the cause of action and a summary of the facts on which it is based, and (b) state that, if the company does not take proceedings in respect of the cause of action, the claimant proposes to commence a derivative claim’. See also UK Company Law Reform, Modern Company Law for a Competitive Economy-Completing the Structure (URN001335 (2000), the Final Report (March 2001) and UK DTI White Paper on Company Law Reform (Cm 6456).


\(^{50}\) Section 237 of the Australian Corporations Act 2001; section 168BD of the HK Companies Ordinance.
2.33 In some jurisdictions, no precise period is mentioned. For example, section 239(2)(a) of the Canada Business Corporations Act 1985 refers only to the need to give 'reasonable notice to the directors' of the intention to bring an action if the directors fail to do so. Section 165(4) of the New Zealand Companies Act 1993 refers only to a mandatory requirement to serve a notice on the company.\(^5\) The company may then appear and be heard and inform the Court whether it intends to bring, continue, defend or discontinue the proceedings.

2.34 In the US, it was recommended by ALI that the shareholder must make a written demand to the board, requesting the board to commence an action or to take suitable corrective measures. The company's Board has to reject the demand before the applicant may bring an action. In addition, the Board or a properly delegated committee should be authorised to request for a dismissal of the derivative action in specified circumstances. An Attorney's certification is also required to ensure that the suit was not filed for an improper purpose to harass, cause unnecessary delay or needless increase in the cost of litigation. This requirement recognises that a company may have sound business reasons for not pursuing a legal action open to it and that its directors might have legitimately decided that the best interest of the company would be served by not taking legal action. For example, a breach of duty by a director may result in only a very small loss or even no loss to the company. The costs of taking legal proceedings against the director would outweigh any benefit to the company so that it may not be in the best interest of the company to allow the Court to grant the applicant permission to bring the proceedings.\(^5\)

\(^5\) Thus, leave will be granted only if the Court is satisfied that companies or related companies has no intention to bring, diligently continue or defend, or discontinue proceedings.

2.35 However, the requirement of having to prove that the company does not intend to commence proceedings, as required in the US, may be used as a delaying tactic, particularly since the law requires proof that the company has indeed refused to bring an action. Thus, in the US, it is often the case that companies concerned will announce and appoint independent non-executive directors to consider whether or not to bring proceedings. Although the independence of these non-executive directors is relied on by the Courts in deciding whether or not the decision not to bring the action is made *bona fide*, this makes it cumbersome for the minority shareholders/applicant to have recourse to the Courts. In most cases, the independent committee will decide that it is not in the best interest of the company to take action and this will be relied on by the Court when refusing the application for leave.

2.36 The view of the CLRC is that a time frame would be helpful in minimising the potential for the section being abused and to reduce delay since the company is given a specific period to respond and if it does not commence action within this period, the applicant may commence proceedings to obtain the leave of Court. This should be sufficient without having to require the applicant to prove that the company has decided not to bring an action. However, the CLRC is aware that there is criticism against specifying the time frame as some companies may not be able to respond in the time specified, especially if further investigations on the part of the company are required and meetings necessary.  

53 Nonetheless, it is the view of the CLRC that a time frame should be specified and recommends that unless the Court otherwise orders, the applicant should give notice of the intention to bring a statutory derivative action to the company at least 28 days before the commencement of the proceedings.

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Applicant’s good faith

2.37 The applicant’s good faith is relevant for the Court to decide whether or not an order for leave may be granted. The differences in the jurisdictions under review are, in some jurisdictions, good faith is treated as a prerequisite for the granting of leave so that the lack of good faith is a ground for the leave to be refused. However, in some jurisdictions, good faith is presumed to exist if the application is in the best interest of the company.

2.38 The UK Law Commission considers that although the applicant’s ‘good faith’ should not be a prerequisite for leave it is a relevant factor to be taken into account. It was decided by the Law Commission that ‘good faith’ should not be defined in the rules of the Court, on the assumption that there is no great debate on this matter since the meaning of good faith is ‘generally readily recognisable’. However, there is the view that by not defining ‘good faith’ this leaves open the term to subjective interpretation which might lead to a difference of opinion and hence, to the increased complexity of case law.

2.39 The New Zealand provision does not seem to require good faith as a prerequisite to bringing an action whilst the Australian legislation states that the applicant’s good faith is a prerequisite that must be satisfied before the Court can make an order to grant leave to commence an action. The Canadian Courts have not given leave when the applicant has delayed pursuing the matter, has declined to listen to any information provided by the alleged wrongdoers or has strategic, selfish motives for applying. This is quite similar to the position found under common law where the application will not be entertained where the parties do not ‘come with clean hands’.

54 It also means that there isn’t a minimum time period for a shareholder to have been a shareholder in order to pursue such an action since a shareholder is not acting in good faith if he had purchased his shares solely for the purpose of commencing the litigation.


2.40 Given that the applicant’s ‘acting in good faith’ requirement is designed to prevent proceedings being used to further the private and personal agenda or interest of the applicant rather than the company, the CLRC is of the view that this is an important prerequisite for the granting of an order for leave. However, the motives of the applicant should not be the main reason for denying the application as long as the applicant can show that the application is in the best interest of the company. In addition, good faith should not be defined, as what amounts to good faith should be decided according to the facts of each case.

Best interests of the company

2.41 The UK Law Commission’s Draft Rule 50.8(3) provides that ‘The Court must refuse leave and dismiss the derivative claim if it is satisfied that the claim is not in the interest of the company’. The UK Law Commission was of the view that in order to consider the best interest of the company, the view of the directors on commercial matters must be taken into consideration. This does not mean that the Court would be bound to accept the views of the directors. The existence of a conflict of interest may affect the weight to be given to such views, and the Court would give no weight to views which no reasonable director in that position could hold. This proposal has been endorsed by the UK CLR.

2.42 The New Zealand legislation, on the other hand, provides that although the Court must have regard to the interests of the company, in making the order, the Court must be satisfied that the application must be in the best interest of the company or that the company does not intend to bring the action. The Canadian Courts, for example, have been satisfied if the relevant document shows that the corporation’s rights have been infringed or that there is a case to argue.57

2.43 Under the HK Companies Ordinance, section 168BC(3)(b) states that the Court must be satisfied that if the member is applying for leave to bring an action on behalf of the company, there must be a serious question to be tried and that the corporation has not itself brought the action.

2.44 The Australian provision states that in addition to the Court being satisfied that the company does not intend to bring the action, the action must also be in the best interest of the company. Therefore, the Australian legislation sets out a list of situations where there is a rebuttable presumption that granting of leave is not in the best interest of the company. One of the rebuttable presumptions arises when an action is to be brought by the company against a third party.

2.45 The CLRC is of the view that whilst it must be shown that the action is in the best interest of the company, a rebuttable presumption similar to the Australian approach is not necessary. This is because the rebuttable presumption in the Australian legislation has been criticised as being a significant hurdle for shareholders. It has been pointed out that the majority of cases would have involved a director who was a wrongdoer who would have resigned prior to the action being brought. This means that under the section, it would not be in the best interest of the company to bring the action as the proceedings are to be taken against a third party. Thus, since the former director is a third party and since the rebuttable presumption is that bringing an action against a third party is not in the best interest

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58 A rebuttable presumption that granting leave is not in the best interests of the company arises if it is established that:
(a) the proceedings are:
   (i) by the company against a third party; or
   (ii) by a third party against the company; and
(b) the company has decided:
   (iii) not to bring the proceedings; or
   (iv) not to defend the proceedings; or
   (v) to discontinue, settle or compromise the proceedings; and
(c) all of the directors who participated in that decision:
   (vi) acted in good faith for a proper purpose; and
   (vii) did not have a material personal interest in the decision; and
   (viii) informed themselves about the subject matter of the decision to the extent they reasonably believed to be appropriate; and
   (ix) rationally believed that the decision was in the best interests of the company.

of the company, this may undermine the codification of the derivative action as shareholders will not be able to sue the director on behalf of the company for the breach of duty by the director(s). This approach also goes against the accepted principle that it does not matter whether or not the person being sued is still a director at the time the action is brought, as long as he is a director at the time the breach of duty occurred. The CLRC also endorses the UK CLR view that the Court should be aware that the existence of a conflict of interest may affect the weight given to the director’s decision not to bring an action on behalf of the company.

E COSTS OF PROCEEDINGS

2.46 Cost is an important consideration for minority shareholders when deciding whether or not to take/bring an action on behalf of the company. The uncertainty as to indemnity for cost and whether it may be awarded prior to the conclusion of the proceedings are disincentives to minority shareholders to sue on behalf of the company. Currently, an indemnity for cost is awarded only at the successful conclusion of the action.

2.47 Under the New Zealand Companies Act 1993, section 166 gives the Court the right to order that the costs for a derivative action is to be met by the company if there is an application by a person to whom leave has been granted by the Court to bring or intervene in any proceedings by the Court under section 165 of the Act. The order may include the whole or part of the reasonable cost of bringing or intervening in the proceedings. This includes any costs relating to a settlement, compromise, or discontinuance approved under section 168. However, the Court is given the discretion to refuse to make orders as to costs if the Court considers that it would be unjust or inequitable for the company to bear those costs.
Nonetheless, in New Zealand, the decision in *Vrij v Boyle* where the New Zealand High Court refused to hear an application for costs under section 166 of the New Zealand Companies Act 1993 until after the full hearing and the conclusion of the action, created a dilemma for minority shareholders. This was because it is uncertain whether the minority shareholders would be able to obtain indemnity or orders as to costs prior to the conclusion of the proceedings. Since the main problem of a common law derivative action is the issue of costs, the Court’s decision in *Vrij v Boyle* is a disincentive for the minority shareholder to rely on the statutory derivative action.61

Section 240(d) of the Canada Business Corporations Act 1985 gives the Courts wide power to grant an order at any time by requiring the company or its subsidiary to pay reasonable fees incurred by the complainant in connection with bringing the derivative action. Section 242(3) states that there would be no security for the costs required in bringing a derivative action and that the legal fees and disbursements would be included in the interim costs. However, the complainant may be held accountable for such interim costs on final disposition of the application.

Given that cost is one of the problems faced by minority shareholders, the order for costs should be available at any stage of the proceedings. Further, the order for costs should also include, an order for indemnity for reasonable legal costs. It should also be stated that if the order for cost is made during the application for leave or during the proceeding and subsequently, the application for leave is not granted by the Court or if the proceeding was decided not in favour of the applicant, the applicant should be required to reimburse the company.

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2.51 In addition, since there may also be cases where the leave might be used to harass the company, the Court should be allowed to make an order for costs against the applicant in such a situation or to refuse an order as to costs where it thinks fit. The New Zealand provisions expressly state that the Court may refuse to make an order as to costs where the Court considers it unjust or inequitable for the company to bear those costs. ALI on the other hand, recommended that the Court should be allowed to order costs against the applicant if the suit was brought in bad faith or without reasonable cause. It was recommended by the High Level Finance Committee that the ALI safeguard be incorporated if the derivative action were to be codified.

2.52 It should be noted that although the Court may make an order as to costs, this does not reduce the risk that the complainant faces if the application for leave is not granted or if the complainant was not successful in the action brought on behalf of the company. The applicant should be indemnified only if he is successful. Given that the order as to costs may be applied at any stage of the proceedings, even at the stage of applying for leave, the applicant should be required to reimburse the company in the event the action was not decided in his favour.

F ACCESS TO INFORMATION

2.53 Access to information enables shareholders to obtain evidence. However, the problem is that the information that is required is not available since it could be in board documents and shareholders do not have access to these documents.

2.54 The Australian Corporations Act 2001 provides that the Court has the power to appoint an independent person to report to the Court. Section 241(1)(d) gives the Court the power to appoint an independent person to investigate and report to the Court on matters concerning the financial affairs of the company or the facts or
circumstances which gave rise to the cause of action which is the subject of the proceedings or the costs incurred in the proceedings by the parties to the action and the applicant. The independent investigator is entitled to inspect any books of the company for any purpose connected with their appointment.62

2.55 Under the Singapore Companies Act, section 216A(5) allows the Court to make an order giving the complainant access to the company’s records which would allow him to gather evidence against the defendants.

2.56 Given the difficulty of assessing the information, the CLRC is of the view that shareholders should be able to have access to any information which would enable the bringing of an action under the statutory derivative action and this should be by way of an order that may be granted by the Court.

G EFFECT OF RATIFICATION OF BREACH OF DUTY ON THE STATUTORY DERIVATIVE ACTION

2.57 An important point that is to be addressed in relation to the statutory derivative action is the implication of ratification on the action.

2.58 The UK Law Commission Report stated that there ought to be no change to the law on ratification whereby no leave should be granted where ‘effective’ ratification has occurred.63 The implication is that where there is an effective ratification there would be no cause of action against the wrongdoer. This means that the question whether ratification is ‘effective’ will have to be addressed at the leave stage in the proceedings and this will reintroduce pleadings similar to those necessary under the current law to establish fraud by the wrongdoers who are in control.

63 This expression is used in the recommendation (para. 6.86) but not in the Draft Rule 50.8(4).
2.59 The Steering Committee of the UK CLR was of the view that whether or not ratification will prevent the action being taken will depend on the validity of a decision by members to ratify a wrong on the company/by the board not to pursue the wrong, i.e., whether the necessary majority was reached without the support of wrongdoers or those under their influence. 64

2.60 In other jurisdictions, this approach has been rejected and even the fact of ratification is not fatal to the derivative action. 65

2.61 Section 239 of the Australian Corporations Act 2001 also contains a provision of similar effect, i.e. ratification does not preclude the granting of leave or pursuance of the action but is a relevant factor when deciding what order is to be made. In the Australian legislation, it is at the order stage that the Court has regard to questions relating to the validity of the ratification resolution.

2.62 The CLRC is of the view that ratification should not be a bar to the derivative action being brought.

RECOMMENDATION

2.63 It is the recommendation of the CLRC that:
(a) the statutory derivative action should be applicable to all types of companies;
(b) the common law derivative action should not be allowed if there is a statutory derivative action;

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64 See paragraph 5.82 to 5.86 of Completing the Structure.
65 For example, section 242 of the Canada Business Corporations Act 1985 provides that the action shall be stayed or dismissed on the basis that the wrong has been ratified but it can be taken into account by the Court when deciding on the appropriate remedial order. See also the Dickerson Committee Report, supra n 11, para 6.85. The Dickerson Committee in Canada was of the view that ‘If, for example the alleged misconduct was ratified by majority shareholders who were also the directors whose conduct is attacked, evidence of shareholder ratification would carry little or no weight. If, however, the alleged misconduct was ratified by a majority of disinterested shareholders after a full disclosure of the facts, that evidence would carry much more weight indicating that the majority of disinterested shareholders condoned the act or dismissed it as a mere error of business judgement’.
(c) the statutory derivative action may be brought by any member or director of the company;

(d) the criteria for allowing the application are:
   • the company does not intend to bring an action;
   • the applicant acts in good faith;
   • it is in the best interest of the company that the applicant be granted leave;
   • there is a serious question to be tried.

(e) unless the Court otherwise orders, the applicant should give the company notice of at least 28 days before the commencement of the proceedings on the applicant’s intention to bring a statutory derivative action;

(f) the Court should be given wide powers to grant an order at any time by requiring the company to pay reasonable fees incurred by the complainant in connection with bringing the derivative action;

(g) the Court may also refuse to make an order as to costs where the Court considers it unjust or inequitable for the company to bear those costs;

(h) the Court should be allowed to order costs against the applicant if the suit was brought in bad faith or without reasonable cause;

(i) the applicant should be required to reimburse the company in the event the action was not decided in his favour; and

(j) the Court may make an order giving the complainant access to the company’s records to allow him to gather evidence for the action to be brought.

Questions for Consultation

**Question 4:**
Do you agree that the statutory derivative action should be available to all types of companies?
Question 5:  
Do you agree that persons other than members for example, former members, beneficial owners, directors, former directors and/or the regulatory authorities should be given the standing to bring a statutory derivative action?

Question 6:  
Do you agree that the statutory derivative action should be extended to the cause of action in a related company?

Question 7:  
Do you agree that unless the Court otherwise orders, the applicant should give notice of the intention to bring a statutory derivative action to the company at least 28 days before commencement of the proceedings?

Question 8:  
Do you agree that the company may be ordered to pay reasonable fees incurred by the complainant in connection with bringing the derivative action at any stage of the proceedings? Do you agree that the applicant may be held liable to reimburse the company if he fails in the proceeding?

Question 9:  
Do you agree that costs should include an order for indemnity and any reasonable legal fees of the proceedings?

Question 10:  
Do you agree that the orders that the Court may make should include an order giving access of information to the applicant?

Question 11:  
Do you agree that ratification should not be a bar to the application for leave?
PART 3 VARIATION OF CLASS RIGHTS

3.01 A company that has share capital can issue shares with different rights. This power is to be provided for by the company’s Articles of Association.\(^{66}\) The Companies Act 1965 however, requires that rights attached to preference shares be stated either in the company’s Articles or Memorandum.\(^{67}\) Normally, the rights attached to a specific class or group of shares are stated by the terms of issue of those shares and would be provided for in a resolution, agreement or in the company’s Constitution. The rights attached to the specific class are known as ‘class rights’. 

3.02 Company law recognises that there are valid reasons for a company to issue shares with different rights. However, a paramount concern is the protection of the shareholders from arbitrary changes or a variation of their rights. Generally, ‘class rights’ may not be changed or varied except with the consent of the class. Since the consent of the members of the class is required, a class right is an invaluable element to protect minority shareholders.

3.03 This part of the Consultative Document considers whether the current safeguards as provided for by the Companies Act 1965 in relation to the variation of class rights are adequate as a means of protecting the minority shareholders.

A PROCEDURE FOR VARIATION OF CLASS RIGHTS

3.04 There are, currently, three procedures for the variation of class rights:-
(a) where the class rights are stated in the Memorandum;
(b) where the class rights are stated in the Articles and where the Articles include a provision authorising for the variation of class rights (modification of rights clause);
(c) where the class rights are stated in the Articles and where the Articles make no provision authorising for the variation of class rights (modification of rights clause).

3.05 Where class rights are provided for in the company’s Memorandum, those class rights cannot be altered. This is because section 21(1B) of the Companies Act 1965 provides that nothing in section 21(1A) permits the alternation or deletion of a provision of the Memorandum that relates to class rights. Hence, the class rights provided for in the company’s Memorandum will become entrenched and remains unalterable. Whilst this will guarantee that the shareholders’ rights will not be changed, this may cause difficulty for the company in relation to re-organising their capital structure.68

3.06 Where class rights are provided for in the company’s Articles, then the class rights may be varied depending on whether the Articles contain a provision that allows or authorises the company to vary those class rights. Such a provision is known as a modification of rights clause. An example of a modification of rights clause is found in Table A under Article 4.69

3.07 If the company’s Articles contain a ‘modification of rights’ clause,70 the statutory procedure under section 65 of the Companies Act 1965 shall apply. Section 65 requires that prior to any variation of class rights, the company is required to obtain the approval of a separate class meeting i.e., shareholders of the class whose rights are being varied, where the proposal must be approved by the requisite number of

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68 Note that it is still possible to achieve the same effect as a variation of rights by way of a scheme of arrangement.
69 Where class rights are provided for in a company’s Articles then the variation of those rights must be in accordance with the procedure prescribed by the company’s Articles and not otherwise: Crompton v Marine Hall Pty Ltd [1987] 5 ACLC 451.
70 This is a clause in the Articles specifying the voting percentage or method for passing the proposal to vary the class rights: Article 4 of Table A is an example.
shareholders votes as stated in the Articles of Association. The variation may be challenged by the holders of 10 per cent of the issued shares of that class. Where the challenge to variation is made, the variation is not effective unless confirmed by the Court. The requisite number of shareholders votes is specified in Table A under Article 4. But before a company can proceed with a proposal to vary the class rights, the company must:

- First, convene a separate class of shareholders meeting. That meeting is to be attended by the holders of that class of shares whose rights are to be varied; and
- In the meeting, the holders of three-quarter \((\frac{3}{4})\) of the issued shares of the class whose rights are to be varied must give their consent in writing or pass a special resolution consenting to the proposed variation of class rights.

### 3.08

If the company does not have a ‘modification of rights’ clause, the class rights which are stated in the Articles may be varied by following the procedure for the alteration of the Articles under section 31. Section 31 of the Companies Act 1965 provides for the procedure to alter the company’s Articles whereby it provides that the company’s Articles can be altered by the passing of a special resolution.\(^{71}\) In such a case, there is no requirement for a separate class meeting as required under section 65. In addition, the right to contest as provided under section 65(1) does not exist.

### 3.09

It is the view of the CLRC that the current framework for the variation of class rights requires rationalisation. This is because:

(i) Whilst section 65 provides for a statutory protection that cannot be contracted out of by a company, the section contains several shortcomings. This section, however, applies only when:

- there is a modification of rights clause in the Articles, i.e., a provision allowing the company to vary class rights.

\(^{71}\) Section 152 of the Companies Act 1965 prescribes the procedures that must be complied with in order to pass a special resolution.
• the company has more than one class of shares.

3.10 Given the wording of section 65, it is possible to circumvent the section where the company’s Memorandum or Articles does not contain a ‘modification of rights’ clause. The overlap between Article 4 and section 65(1) is also confusing.

(ii) Whilst there is a statutory right to challenge the variation under section 65(1), this right is not available when section 65 is not applicable in cases where the company does not have a ‘modification of rights’ clause.

(iii) Whilst there is enhanced statutory protection where the class rights are stated in the Memorandum, this may cause unnecessary burden to companies that may want to reorganise its capital structure.

3.11 The CLRC noted that the UK,72 HK73 and Singapore74 legislations provide different procedures depending on where the class rights are stated. If the rights are conferred otherwise than in the Memorandum, and the Articles do not provide a procedure, the holders of at least 75 per cent of the shares of that class must consent in writing to the variation or the company must pass an extraordinary or special resolution of a separate class meeting where at least 75 per cent voted in favour of the variation. If the rights are stated in the Memorandum, it is only alterable by the consent of all members. If the rights are stated in the Articles, the procedure must be strictly followed.

3.12 However, the UK proposed a simplification of the procedure so that a three-quarter (3/4) majority should always be required overriding any provision in the Articles but that it should be possible for the Memorandum to entrench the class rights by a higher majority than the three-quarter (3/4) majority. In such a case, the entrenched
provision may only be altered with such higher majority or the unanimous decision of all members. The UK CLR also retains the position that the procedure is only applicable where the company’s capital is expressly divided into separate classes of shares but recommended that the provision be applicable to all types of companies which presumably meant companies without share capital as well.75

3.13 In Australia, where there is a procedure for the variation of rights in the company’s Constitution, such a procedure will prevail and must be followed. If the company does not have a Constitution or no procedure is stated in the Constitution, variation can be done by 75 per cent votes of the members of that class.76 The issuance of a new class of shares where the company only has one (1) class of shares is also a variation if the rights attached to the new shares are not the same as those of the existing shares.

3.14 The New Zealand legislation77 states that a special resolution of each group whose rights are being varied is required. A special resolution means a resolution approved by a majority of 75 per cent or, if a higher majority is required by the Constitution, that higher majority.

3.15 In view of the above, the CLRC proposes that the procedure for the variation of class rights should be simplified by a redrafting of the existing section 65 so that reliance need not be placed on the existence of a ‘modification of rights’ clause for the statutory provision to apply.78

3.16 It is also proposed that the statutory procedure for the variation of class rights should be as follows:

75 UK CLR, Final Report, Para 7.28.
77 Section 117 of the New Zealand Companies Act 1993.
78 This therefore would mean that reliance need not be placed on a modification of rights clause to enable a company to vary the class rights.
• if written consent is obtained from at least 75 per cent of the holders of shares whose rights are to be varied; or
• a special resolution is passed at a separate class meeting of shareholders whose rights are to be varied.

3.17 The CLRC is also of the view that the rights should be capable of being entrenched. However, entrenchment should not be absolute whereby those rights can still be varied but only with the unanimous consent of that class of shareholders whose rights are to be varied.  

B CLARIFYING ‘VARIATION’

3.18 Currently in Malaysia, what corporate action amounts to a variation of class rights is to be determined with reference to common law, section 65 and case law.

3.19 Under the common law, a variation of class rights occurs only when the strict legal rights attached to a class of shares are varied and not when the economic value attached to that class of shares is effected. In other words, there is no variation of class rights if the rights attached to a class of shares remain exactly the same as they were before a corporate action was taken: Greenhalgh v Arderne Cinemas Ltd [1946] 1 All ER 512. Hence, at common law the issue of new shares ranking equally with existing shares is not deemed as a variation of class rights.

3.20 The Companies Act 1965 has, however, provided that a later allotment of preference shares ranking equally with existing preference shares is a variation of rights of the holders of existing preference shares unless if at the time the existing shares were issued, the company’s Memorandum or Articles authorised a later issue of equal

79 This will also require amendment to section 21 of the Companies Act 1965, specifically subsection 21(1B).
rank: section 65(6). Section 65 also provides that any alteration to the modification of rights clause shall also be deemed to be a variation of class rights.  

3.21 Nonetheless, it was noted by the CLRC that there is an uncertainty as to whether a repayment of preference shares is normally treated as a variation of rights. However, if the Articles of the company state that the preference shareholder has a right to a share in the surplus assets upon the winding up (whether in priority or not) there are cases stating that the repayment is a variation and section 65 should be complied with. The CLRC noted that the Bursa Malaysia Securities Berhad Listing Requirements makes it mandatory for the Articles of each listed company to include a provision stating that any repayment of capital other than redeemable preference shares requires a special resolution of the preference shareholders concerned or consent in writing from the holders of three-quarter \((\frac{3}{4})\) of the preference capital.

3.22 The CLRC is of the view that where the cancellation of preference shares is concerned, this should be treated as a variation of preference shareholders’ rights except in the case of the redemption of redeemable preference shares.

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80 See section 67(7).
82 See Bursa Malaysia Securities Berhad Listing Requirements:
  
  7.08(3) A holder of a preference share must be entitled to the same rights as a holder of an ordinary share in relation to receiving notices, reports and audited accounts, and attending meetings.

Further, para 7.15 of the Listing Requirements of Bursa Malaysia Securities Berhad reads as follows:

7.15 Modification of rights

The repayment of preference capital other than redeemable preference capital or any other alteration of preference shareholders’ rights, may only be made pursuant to a special resolution of the preference shareholders concerned, provided always that where the necessary majority for such a special resolution is not obtained at the meeting, consent in writing, if obtained from the holders of three-fourths of the preference capital concerned within 2 months of the meeting, shall be as valid and effectual as a special resolution carried at the meeting.

This provision must be inserted into the Articles of Association of all listed companies; see para 7.01 of the Listing Requirements of Bursa Malaysia Securities Berhad:

7.01(1) Parts B to N of this Chapter set out the provisions which an applicant or a listed company must ensure are contained in its articles of association and those of its subsidiaries (where applicable).
3.23 The CLRC also noted that where the issue of new shares is concerned, other than the issuance of new preference shares which is governed by section 65(6), the common law position is that it is not a variation. However, it is to be noted that Article 5 of Table A also provides that an issue of new shares of any class ranking equally with the existing shares is a variation of the rights of existing shares unless the terms of issue of the existing shares expressly states otherwise. This means that the common law position can be modified by the inclusion of a provision similar to Article 5 of Table A.

3.24 On this issue, the Australian legislation provides that all new issues are deemed as a variation of existing shares unless the Constitution permits the issuance of new shares ranking equally with existing shares. There is also a provision similar to section 65(6) of the Companies Act 1965 in relation to preference shares. In addition, the Australian legislation states that where a company issues a new class of shares where the company only has one class of shares, this is also a variation if the rights attached to the new shares are not the same as those of the existing shares. The New Zealand legislation also states that all new issues are deemed a variation of existing shareholders unless the Constitution permits for the issuance of new shares ranking equally with existing shares or if the new shares were issued under the pre-emption rights (pre-emption rights may be negated by the Constitution).

3.25 The CLRC is of the view that although Article 5 of Table A would be able to deal with the issue of new shares other than preference shares, it is possible that a company may not adopt Article 5 of Table A. In such a case, the CLRC is of the view that there is merit in providing by way of a statutory provision that the new issue of shares is a variation of the existing shareholders of that class and requires their approval.
**RECOMMENDATION**

3.26 The CLRC recommends that:

(a) the procedure for variation of class rights should be provided for in the Companies Act 1965 and that variations may be done:-
   • if written consent is obtained from at least 75 per cent of the holders of shares whose rights are to be varied; or
   • a special resolution is passed at a separate class meeting of shareholders whose rights are to be varied.

(b) the class rights should be capable of being entrenched in the Memorandum. However, entrenchment should not be absolute in that those rights can still be varied but only with the unanimous consent of that class of shareholders whose rights are to be varied.

(c) the present law that the statutory procedure applies only where the company has issued more than one type of shares be retained.

(d) section 65(6) and 65(7) of the Companies Act 1965 is to be retained.

(e) the redemption of preference shares (except for the redeemable preference shares) is a variation of the rights of existing preference shareholders.

Questions for Consultation

**Question 12:**
Do you agree that the variation of class rights can be done:-:
   • if written consent is obtained from at least 75 per cent of the holders of shares whose rights are to be varied; or
   • a special resolution is passed at a separate class meeting of shareholders whose rights are to be varied?
Question 13:
Do you agree that the new procedure need not rely on whether there is or is not a modification of rights clause in the company’s Memorandum and Articles?

Question 14:
Do you agree that the proposed statutory procedure as stated above be extended to all companies, including companies without share capital? If yes, should it be applicable irrespective of whether or not the company has issued more than one type of shares?

Question 15:
Do you agree that section 65(6) should be retained?

Question 16:
Do you agree that the company legislation should expressly provide that the redemption of preference shares (except for redeemable preference shares) is a variation of the rights of existing preference shareholders?

Question 17:
Do you agree that the company legislation should expressly provide that the issue of all new shares (and not just preference shares) is a variation of the rights of existing shareholders of the same class?

PART 4 THE REMEDY FOR APPRAISAL (MINORITY BUY-OUT RIGHTS) AND EXIT-CLAUSE IN THE ARTICLES

4.01 Conceptually, a remedy for appraisal or a buy-out remedy is a remedy available to minority shareholders who have unsuccessfully opposed certain events that involve
fundamental changes to the company's structure or operations. Where these events occur, the minority shareholders may require the company to ‘buy out’ the minority shareholding at a fair price. Thus, a remedy for appraisal provides an avenue for the dissenting minority shareholders to exit out of the company.

4.02 An exit clause in the Articles of a company is intended to enable the minority shareholders to require the company to buy out their shares at a fair price upon certain events occurring. In this sense, an exit clause in the Articles achieves the same purpose as a remedy for appraisal. The difference is that a remedy for appraisal is normally mandatory in nature and provided for by statute and cannot be contracted out of unlike a provision in the Articles that a company may decide whether to adopt or not.

4.03 Several jurisdictions like New Zealand and Canada have a statutory remedy for appraisal or a minority buy-out remedy. The remedy for appraisal is considered, as a corporate governance mechanism, to promote the protection of minority shareholders. Arguments in favour of the remedy for appraisal are:

- the appraisal remedy gives shareholders the option to cash out their shares for cash in the event of certain transactions that change the shareholders’ initial risk and expectation of the returns on investment;
- the appraisal remedy can be seen as a significant protection for minority shareholders against being bought out at an inadequate price.83

The appraisal remedy (known as the minority buy out remedy) in New Zealand was first introduced in 1993 and has recently been the subject of a review by the New Zealand Law Commission.84

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84 New Zealand Law Commission, Minority Buy-Outs, Report 74 (NZLC R 74) (August 2001); also published as Parliamentary Paper E 3174.
4.04 Section 110 of the New Zealand Companies Act 1993 states that the minority buy-out remedy is available to shareholders who have unsuccessfully voted against a special resolution in relation to the ‘triggering events’. These ‘triggering events’ are:

(i) alterations to the constitution that imposes or removes a restriction on the company’s activities; or

(ii) fundamental changes to the company (through amalgamation, transactions involving major assets or the removal of restrictions on the powers of the company).

If the minority shareholders have voted against the proposal, the minority shareholders may require the company to purchase their shares. The minority shareholders must notify the company within 10 days of the passing of the resolution to invoke this procedure. The board must, within 20 days of receiving the shareholders’ notification decide to choose any of the following actions and notify the shareholders accordingly. The actions that may be elected are the purchase of the minority shareholders’ shares,85 the arrangement for purchase by a third party,86 obtain an exemption from buy-out from the Court,87 or have the special resolution rescinded.

4.05 However, the New Zealand minority buy out remedy has been reviewed by the New Zealand Law Commission in relation to the (lack of) guidelines on its procedures especially in relation to the procedure for valuation.88 The New Zealand Law Commission whilst recommending retaining the remedy found that there was unclear law regarding the valuation of the shares of the company in relation to the remedy.

85 If the company agrees to buy the shares, it must notify the shareholder of the price and if the shareholder disagrees, the matter must be referred to arbitration where the arbitrators’ decision is final.
86 The same procedure in relation to price determination as in the purchase of the shares by a company applies.
87 Sections 114 or 115 of the New Zealand Companies Act 1993.
for appraisal and proposed the clarification of the procedure for valuation in relation to the minority buy-out remedy.

4.06 Although the UK does not have any remedy of appraisal similar to the New Zealand and Canadian legislations, the UK Law Commission and the UK CLR had considered the introduction of a remedy for appraisal. The United Kingdom Law Commission in its Consultation Paper, proposed to introduce a new remedy for small-owner managed companies. The proposed remedy is:-

- the Court would make an order that the member’s shares be purchased by other members or by the company itself if the petitioner had been excluded from participating in management or had been removed as a director.

The new remedy would only apply if there was a minimum of two and a maximum of five shareholders, the company was formed on the basis of a personal relationship involving mutual confidence, and prior to the exclusion from management there was an agreement or understanding between all shareholders that the petitioner would participate in the conduct of business.

4.07 Nonetheless, there were criticisms against this proposal whereby since this new remedy would cover the same circumstances under the remedy for oppression, this would further complicate proceedings either by being a duplication of the existing remedies or by making it difficult for the minority shareholders in deciding which remedy should be relied upon.

4.08 Thus, in its Final Report, the Law Commission recommended amending sections 459-461 to raise two presumptions. The proposal was that:

- the Court would make an order that the member’s shares be purchased by

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other members or by the company itself if:-

(i) a shareholder has been excluded from participation in the management of
the company, the conduct will be presumed to be unfairly prejudicial by
reason of the exclusion; and

(ii) if the presumption is not rebutted and the Court is satisfied that it ought to
order a buy out of the petitioner’s shares, it should do so on a pro rata basis.

• the new remedy would only apply if there was a minimum of two and a maximum
of five shareholders, the company was formed on the basis of a personal
relationship involving mutual confidence, and prior to the exclusion from
management there was an agreement or understanding between all
shareholders that the petitioner would participate in the conduct of business.

4.09 The UK CLR90 however, did not recommend the introduction of a statutory minority
buy-out provision as in some cases the illegal or improper behaviour of the minority
shareholder precipitated the minority’s exclusion from management. The UK CLR was
of the view that it would be unfair to presume that the minority’s exclusion was due
to the misconduct of the majority since the petitioner’s conduct may have justified
the exclusion from management. Instead, the UK CLR proposed to include in the
Articles of Association of a private company an exit rights clause in line with the
proposal that there is to be a separate model for the Articles of Association for private
and public companies.91

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90 Modern Company Law for a Competitive Economy – Final Report Volume I.
91 The UK Steering Committee Final Report proposed to include exit rights clause in the Articles. The following requirement must be met before the
right is exercisable by any member. These are:
1. the exit rights must be conferred by an ordinary resolution;
2. every shareholder must be named in the resolution and must consent to the exit agreement;
3. the resolution must identify the events which trigger the exercise of the exit rights (including death resulting in the exercise of the exit rights
by the decedent’s personal representatives);
4. one shareholder may require another named shareholder to buy his shares at fair market value;
5. the shares must be held when the resolution was passed;
6. the resolution must indicate how the “fair price” is to be calculated;
7. the purchase must be completed within three months;
8. the resolution comes to an end when one of the named shareholders dies or disposess of the shares; and
9. the company cannot amend the resolution without the consent of the named shareholder.
4.10 The view of the CLRC is that whether or not to introduce the remedy for appraisal or minority buy-out remedy in Malaysia is dependent on whether there currently exists a comparable remedy under the Companies Act. The CLRC is concerned that there could be confusion by the introduction of a new remedy which is essentially already provided for under the current company's legislation. The CLRC noted that the existing section 181 of the Companies Act 1965 already provides for a minority buy out remedy. Under section 181, a buy out is available as one of the discretionary remedies that the Court may grant when an act of 'oppression' is proven. The circumstances or events that gave rise to the appraisal remedy are already recognised under section 181 of the Companies Act 1965 as giving rise to oppression and have been utilised by private companies successfully. Section 181 is also a better option since an automatic at-will exit rights may have serious drawbacks. Shareholders often need to rely on the long-term commitment of services, property, and capital by investors. If automatic exit rights are allowed, there will be a premature withdrawal of capital that could bring a devastating effect to a company and its business.

4.11 The CLRC has noted that the UK CLR proposal to introduce an additional remedy for shareholders of smaller companies in the form of an exit out clause is based on the perceived difficulty faced by the minority shareholders who have been excluded from management in proving oppression based on the existence of a legitimate expectation and its breach. In such cases, the only remedy available to the minority shareholder is to apply to Court to wind up the company under the just and equitable ground, which may not be in the best interest of the company especially if the company is a going concern and is profitable. However, in Malaysia, legitimate expectation and its breach is recognised as giving rise to oppression under
Thus, the rationale for the proposal to introduce the additional remedy similar to a minority buy-out in the UK does not exist for Malaysia.

4.12 The CLRC also noted that whilst the New Zealand Companies Act 1993 provides for both a statutory remedy for oppression and a remedy for appraisal (minority buy-out rights), the New Zealand remedy for oppression provides a list of specific situations where oppression is deemed to exist which makes what amounts to ‘oppression’ quite restrictive. This is not the case under section 181 of the Companies Act 1965 which is widely worded. The CLRC therefore, does not recommend the introduction of a remedy for minority buy-out.

RECOMMENDATION

4.13 The CLRC recommends that there is no necessity to introduce a statutory remedy for minority buy out.

Questions for Consultation

Question 18:
What are your views on the introduction of a statutory minority buy-out right?

Question 19:
What are your views on the use of the Articles by providing for an exit right clause to reduce the reliance on the Court process to resolve disagreements between the shareholders of a company?

See Kitnasamy s/o Manudapan v Nagatheran s/o Manogar [2000] 2 SLR 598 on section 216 of the Singapore Companies Act (Cap 50) which is in pari materia with section 181 of the Malaysian Companies Act 1965. See also Jaya Medical Consultants Sdn Bhd v Peninsular Bhd [1994] 1 MLJ 520.
PART 5 CLASS ACTION

5.01 Another alternative to the shareholders protection mechanism is the class action. The relevance of a class action to minority shareholders is that there may be cases where several minority shareholders are affected by the conduct of the directors or majority shareholders. Pooling their resources may provide a better outcome for the minority shareholders in terms of reducing the costs of bringing separate proceedings and/or increasing the amount of compensation/damages that they may obtain.

5.02 Within the Malaysian civil procedure system, a representative action is available under Order 15 rule 12 of the Rules of the High Court (RHC). In relation to the proceedings brought by the minority shareholders on behalf of a company, Order 15 rule 12 of the RHC must be complied with when the minority shareholder brings an action under the common law derivative action.93

5.03 The issue on class action within the context of company legislation was considered by the Report on Corporate Governance (CG Report). There are several shortcomings under Order 15 rule 12 in relation to its use by the minority shareholders:

(a) where the relief requested is for damages, it will still be necessary for the persons represented to bring a separate action to establish the damage suffered by each of them;

(b) since the representative persons and those represented are not parties to the proceedings, the Court has no power to order any represented person to make discovery of documents;

(c) the represented persons are not liable for costs which would discourage many would-be plaintiffs from undertaking the role of the representative plaintiff.

5.04 The CG Report stated that in the case of a common law derivative action, the concern about each individual shareholder having to bring a separate action to establish damage suffered by each of them does not arise as the minority shareholder will be suing in the company’s name and all damages goes to the company.\(^\text{94}\) There would then be no need for proving the damage suffered by the minority shareholders individually. The CG Report pointed out that if the class of shareholders is described with sufficient clarity under a section 181 application, this will not be a bar to a representative action under Order 15 rule 12 of the Rules of High Court. However, the issue of cost is a valid concern which should be addressed if the minority shareholders are to be able to bring an action on behalf of the company. Due to this, the CG Report recommended that to balance between preventing the floodgates of class action suits and facilitating minority shareholders’ protection, statutory provision(s) should be considered to simplify civil procedures and to permit shareholders to undertake representative actions to obtain pro rata damages.

5.05 The CLRC noted that section 173 of the New Zealand Companies Act 1993 provides that where a shareholder of a company brings proceedings against the company or a director, and there are other shareholders who have the same or substantially the same interest in relation to the subject-matter of the proceedings, the Court may appoint that shareholder to represent all or some of the shareholders having the same or substantially the same interest, and may make such orders in relation to:
\begin{itemize}
  \item the conduct of the proceedings,
  \item the costs of the proceedings,
  \item the distribution of any amount ordered to be paid by the company or director.
\end{itemize}

\(^{94}\) The High Level Finance Committee on Corporate Governance, ‘Report on Corporate Governance’, para 5.12, at pp 192-193.
5.06 In view of the introduction of the statutory derivative action and the specific provision in the proposed statutory derivative action that will resolve the problems as to cost, the CLRC is of the view that there is no need to introduce a provision for class action suits within the Companies Act.

RECOMMENDATION

5.07 The CLRC recommends that there is no necessity to introduce a provision for class action under the Companies Act.

Question for Consultation

Question 20:
Do you agree on the inclusion of a statutory provision in the company legislation to allow class/representative action by shareholders?

PART 6 STATUTORY INJUNCTION

6.01 The CG Report recommended for the introduction of a provision that allows shareholders or the relevant regulatory body to make an application to Court to seek injunctions to halt or prevent breaches of the law.

6.02 Presently, an injunction is available to the shareholders in relation to sections 132C and 132E of the Companies Act 1965. It is also possible for a shareholder to apply for an injunction under the Specific Relief Act although this remedy is available in relation to common law rights and not in relation to the contravention of any statutory provision.
6.03 In contrast, section 1324 of the Australian Corporations Act 2001 allows the Court to grant an injunction to halt or prevent a contravention of the Corporations Act 2001 and its Regulations. 95 Similarly, section 409A of the Singapore Companies Act also allows for an injunction restraining conduct which contravenes or attempts to contravene the Companies Act. 96 A similar provision has also been enacted into the Hong Kong Companies Ordinance. 97

6.04 The CLRC is of the view that there is a need to enact a statutory injunction to allow the Regulatory Authority or any aggrieved person to prevent breaches or contravention of the Companies Act.

RECOMMENDATION

6.05 The CLRC recommends the introduction of a statutory injunction to allow the Regulatory Authority or any aggrieved person to prevent breaches or contravention of the Companies Act.

Question for consultation

Question 21:
What are your views on the inclusion of a statutory provision in the company legislation to allow the shareholders or the relevant regulatory body to make an application to Court to seek an injunction to halt or prevent breaches of the law?

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95 Section 1324 of the Australian Corporations Act 2001(1) Injunctions – Where a person has engaged, is engaging or is proposing to engage in conduct that constituted, constitutes or would constitute:
(a) a contravention of this Act; or
(b) attempting to contravene this Act; or
(c) aiding, abetting, counselling or procuring a person to contravene this Act; or
(d) inducing or attempting to induce, whether by threats, promises or otherwise, a person to contravene this Act; or
(e) being in any way, directly or indirectly, knowingly concerned in, or party to, the contravention by a person of this Act; or
(f) conspiring with others to contravene this Act.

96 Section 409A(5) Injunctions - Singapore Companies Act [Injunction to restrain person engaging in conduct of a particular kind] Where an application is made to the Court for the grant of an injunction restraining a person from engaging in conduct of that kind, the power of the Court to grant the injunction may be exercised-
(a) if the Court is satisfied that the person has engaged in conduct of that kind - whether or not it appears to the Court that the person intends to engage again, or to continue to engage, in conduct of that kind; or
(b) if it appears to the Court that, in the event that an injunction is not granted, it is likely the person will engage in conduct of that kind - whether or not the person has engaged in conduct of that kind and whether or not there is an imminent danger of substantial damage to any person if the first-mentioned person engages in conduct of that kind.

97 Section 350B of the HK Companies Ordinance.
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