Malaysian Company Law under the Companies Act 2016: Tightening or Relaxing the Capital Maintenance Mechanism?

BY

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Preservation of capital – capital maintenance rules

- Rationale for doctrine of maintenance of capital.
- Protection of creditors
- Protection of other investors
- Protection of other stakeholders, e.g. employees
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- Main capital maintenance rules at common law:
  - Rule in Trevor v Whitworth (1887) – Companies cannot purchase their own shares
  - Rule in Ooregum Gold Mining Co of India Ltd v Roper (1892) – Companies cannot issue shares at a discount
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• The rule in Trevor v Whitworth was put into statutory form under s. 67 CA 1965 which also prohibited companies from giving financial assistance for the purchase of its own shares subject to certain exceptions.

• The rule in Ooregum’s case was given statutory recognition in s 58 CA 1965, but allowed the issuing of shares at a discount subject to certain conditions.
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• The CA 1965 also regulated the issue of shares at a premium through s.60 by requiring the premium to be paid into an account called the share premium account which would be treated as capital and be subject to the rules relating to maintenance of capital. However, the share premium account could be utilised for specific purposes mentioned in the section.
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Introduction of no par value shares under CA 2016

• Under CA 1965 all shares carry a par or nominal value. The issued and paid up share capital reflects the total number of shares multiplied by its par/nominal value.

• Thus companies may issue shares at a discount or a premium. Where shares had been issued at a premium, such premiums must be paid into an account called the share premium account.
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Controls on issue of shares at a discount and at a premium under the CA 2016.

• Under the CA 2016, shares will no longer carry a par or nominal value – s 74

• There will no longer be a share premium account

• Transitional provisions are provided for in s 618 CA 2016

• S 618(3) allows companies a twenty-four month period from the coming into force of s 74 to utilise the money in the share premium account.
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• S. 618(3) states the purposes for which the share premium account may be utilised. These include:
  – Paying the premium payable on redemption of debentures or redeemable preference shares
  – For the issuing of fully paid bonus shares
  – Paying dividends in the form of shares
  – Paying up wholly or partly the balance unpaid on a previous issue of shares
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• Capital Redemption Reserve:
  - May be utilised within 24 months of coming into force of s74, for paying up unissued shares to be issued as fully paid bonus shares
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• Matters of Issue of shares at a discount and issue of shares at a premium will no longer be relevant under CA 2016

• The rule in Trevor v Whitworth and Purchase by company of its own shares –
  – The CA 1965 reinforced the Rule in Trevor v Whitworth under s 67 which did not provide for any exceptions. However following an amendment in 1997 a new section 67A was introduced.
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- S.67A of the CA 1965 permitted a company to purchase its own shares subject to a number of conditions:
  - It must be a public company with a share capital
  - It must be listed on the stock exchange
  - Its articles of association must permit the share buyback
  - It must be solvent both before and after the purchase
  - Purchase must be on the stock exchange on which the shares are quoted
  - Purchase must be in good faith and in the interests of the company
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• Today share buybacks will be governed by s 127 CA 2016. (NB: It refers to notwithstanding s 123, when s 123 does not contain any prohibition on purchase by a company of its own shares, unlike its predecessor s 67 CA 1965)

• Essentially same as under CA 1965.

• But s 127(3) allows a company to purchase its own shares otherwise than through the Stock Exchange, if the purchase is permitted under the relevant rules of the stock exchange and is made in accordance with such requirements as may be determined by the stock exchange.
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• Where the directors have resolved to retain the shares as treasury shares, such treasury shares must be held by the company in a securities account in accordance with the relevant rules of the stock exchange or the central depository as defined in s 146.

• Where the shares are held as treasury shares, the directors may deal with it as provided in s 127(7). In particular, s 127(7)(f) states that they may sell, transfer or otherwise use the treasury shares for such other purposes as the minister may by order, prescribe. (Therefore the categories are not closed)
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• Financial assistance by company for purchase of its own shares: ss 123 – 126 CA 2016
  – S 123(1) retains the previous prohibition under s 67 CA 1965
  – S 123(2) further prohibits the giving of financial assistance by a company for the purpose of discharging or reducing the liability if a person has acquired shares in the company or holding company AND the liability has been incurred for the purpose of acquisition of the shares. (a tightening of the rules?)
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Consequences of contravention of s 123(1) or (2)

• By s 123(3) officer commits offence liable to a fine not exceeding 3 million ringgit or max imprisonment 5 years or both

• By s 123(4) upon conviction under 123(3) can incur personal liability (similar to s 67(4) of CA 1965)

• By 123(5) company can recover the loan etc made in contravention

• S 124- validity of financial assistance given in contravention of this subdivision not affected only because of the contravention. (This section seems to negate s 123(5)) (Relaxing the rule? Why the contradiction?)
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– S 67(2)CA 1965 allowed for three exceptions. Those exceptions are retained under

– Additional New exception under 125(d)- Financial assistance by a company in the ordinary course of its business where the company’s activities are regulated by written law relating to banking, insurance or takaful or which are subject to the supervision of the Securities Commission- see the section
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• New provision on giving of financial assistance by unlisted companies for acquisition of shares - S 126 CA 2016

– Unlisted Company may by special resolution give financial assistance for acquisition of its shares or its holding company’s shares, or for the purpose of reducing or discharging a liability incurred for such an acquisition
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Conditions to be satisfied:

1. Company must be a non-listed one
2. The company must pass a special resolution
3. The directors must resolve, before the financial assistance is given, that:
   - The company may give the assistance
   - Such assistance is in the best interest of the company
   - Terms and conditions are just and reasonable to the company
4. Directors who voted in favour must, on the same day as the board resolution, make a solvency statement that complies with provisions in relation to the giving of the assistance.

5. The aggregate amount of the assistance and any other financial assistance given under the section that has not been repaid does not exceed 10% of the aggregate amount received by the company in respect of the issue of shares and the reserves of the company, as such aggregate amount is disclosed in the most recent audited financial statements of the company.
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6. The company must receive fair value in connection with the giving of the assistance

7. The assistance must be given not later than 12 months after the day on which the solvency statement is made by the directors

NB: The resolution of the directors referred to above must set out in full the grounds for the conclusions made by the directors
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• A further procedural requirement is that the company must, within 14 days from the giving of the financial assistance, send to each member a copy of the solvency statement and a notice containing certain particulars as stipulated in s 126(5). (see the sub-section)

• Consequences of contravention? – See s 126(6). – Fine up to RM3 million and/or imprisonment not exceeding five years.
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Comment

• This certainly appears to relax capital maintenance regime by providing a new avenue for unlisted companies to provide financial assistance

• Inherent danger of abuse by majority shareholders to the detriment of the minority

• Shareholders need only to be supplied solvency statement and other info under 126(5) after the special resolution and after the financial assistance is given

• S 124 would make the financial assistance valid despite a contravention
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• Reduction of capital:
  – Under S.64 CA 1965 Capital can if authorised by its articles be reduced by special resolution and with confirmation by the court.
  – Under CA 2016 capital may be reduced through 2 routes- (a) By special resolution and confirmation by the court in accordance with s 116, OR
    (b) By special resolution supported by a solvency statement in accordance with s 117
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• Reduction of capital with confirmation by court is quite similar to the existing situation under s 64 CA 1965

• Reduction of capital by special resolution and solvency statement under s 117 CA 2016 is entirely new.

• The solvency statement for a reduction of capital must be by ALL the directors- see S 113(2)CA 2016
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• The solvency test for purposes of redemption of preference shares, reduction of capital and financial assistance is governed by s 112(1) while for share buy-back, it is governed by s 112(2) and (3) CA 2016. See the section.

• The solvency statement that is required to be made by the directors is governed by s 113 CA 2016. See the section.

• It is an offence for a director to make a solvency statement without reasonable grounds for his opinion. On conviction he could be fined a maximum of RM500,000 or imprisoned up to 5 years or both. See s 114 CA 2016.
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• **Dividends**

• Under s 365 CA 1965, dividends may only be paid from profits or pursuant to s 60 (which related to share premium account)

• Under CA 2016 this is governed by sections 131-133.
  
  – S 131 states that a company may only make a distribution to shareholders out of profits and if it is solvent. Contravention will result in the company, every officer, other person or individual committing an offence. Penalty: Max imprisonment- 5 years; Max fine RM3 million, or both
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- S 132 requires distribution to be authorised by the directors. The directors must be satisfied that the company will be solvent immediately after the distribution.
- If after distribution is authorised but before it is made directors cease to be satisfied of its solvency, they must take all necessary steps to prevent the distribution being made.
- Every director or officer who wilfully pays, permits or authorises the unlawful distribution is liable on conviction to up to 5 years imprisonment, or fine of RM3 million or both. Query? Can the director or officer be charged under both s 131 and 132 and face double punishment? - Clearly yes. –see 132(5); Under s 131 there is no requirement for wilful default.
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• Recovery of distribution – s 133
  – Company can recover from shareholder any distribution improperly/unlawfully made, UNLESS:
    • He received it in good faith; and
    • Has no knowledge that the company did not satisfy the solvency test under 132(3)
  – Company can recover from director or manager the excess distribution wilfully paid or permitted to be paid.- 133(2)
  – Such director or manager can seek contribution from others who may also be liable, if the company had recovered the whole amount from him alone.
  – Liability under this section does not extend to estate of deceased
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• Highlight on Prohibition on loans to directors.

• S.133 CA 1965 - now see s 224 CA 2016

• Changes in wordings

• Difficult to understand the purpose of sub section 4

• Section is poorly drafted and needs clarification and correction
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Conclusion:
It can be seen that the new provisions on the capital maintenance regime under CA 2016 are in some ways relaxed and yet in other ways tightened. While penalties for contravention have increased multifold the danger of abuse will always remain, especially for minority shareholders. The possibility that transactions done in contravention of some of the provisions would not affect the validity of those transactions is also a matter of concern.
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