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Federal Court's decision on Sections 85 and 223 of Companies Act 2016 – Apex Equity Holdings Bhd v Concrete Parade Sdn Bhd

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On March 26, 2024, the Federal Court presided by Chief Justice Tun Tengku Maimun binti Tuan Mat, Justice Tan Sri Datuk Nallini Pathmanathan, and Justice Dato Rhodzariah binti Bujang overturned the decision of the Court of Appeal, on the interpretation of section 85 and section 223 of the Companies Act 2016.

This article focuses on the interpretation of sections 85 and 223 of the Companies Act 2016 and does not intend to delve into the merits or otherwise of allegations of minority oppression nor on the validation by the court of the exercise of share buy-back by Apex Equity Holdings Bhd.

History of the case

Apex Equity Holdings Bhd (Apex) sought to merge their business with Mercury Securities Sdn Bhd (Mercury) which minority shareholders challenged as being in contravention of provisions of the Companies Act 2016 (CA 2016).

As was normal then, the parties entered into heads of agreement (HOA) on Sept 21, 2018 which led to the execution of a Business Merger Agreement (BMA) and also Subscription Agreement (SA) on Dec 18, 2018.

Concrete Parade Sdn Bhd and other minority shareholders complained of non-compliance with their pre-emptive rights (section 85 of CA 2016) and also that the entering into the HOA was without a condition precedent and the execution of BMA was without shareholders' prior approval, in contravention of Section 223 of CA 2016.

The High Court handed down its decision on Aug 7, 2019 and on Sept 11, 2019 grounds were given, inter alia that on the true construction of s 223(1) of the CA, it sufficed if just one of the conditions in sub-paras (i) or (ii) was fulfilled. Since the BMA specified shareholders' approval as a condition precedent to completion of the proposed acquisition of Mercury's business, there had been no contravention of s 223(1) of the CA.

The High Court also held that the pre-emptive rights as stated under Section 85 of the CA 2016 had been complied with. Article 11 of Apex's constitution provides that, *"Subject to any direction to the contrary* that may be given by the Company in general meeting ..." . The High Court held that this provision (Art 11 in Apex's constitution) has the legal consequence that a resolution passed for a share placement suffices to satisfy Section 85. It was not necessary for the circular to the shareholders of Apex to expressly specify that approving the proposed acquisition of Mercury's business would amount to a waiver of the shareholders' right of pre-emption, a private placement must necessarily have the effect of diluting that shareholder's interest in Apex.

On Aug 18, 2021, the Court of Appeal (COA) accepted Concrete Parade's & Ors' appeal and overruled the High Court. This has the result that all the preliminary agreement(s) are not viewed as one composite agreement. The HOA (being the starting point / the entering into of the merger exercise) has to be made subject to and/or contain a condition precedent for the approval of the shareholders of the Company.

Whereas, the BMA (being the implementation and/or the carrying into effect of the HOA) requires prior approval of the shareholders before it is executed.

On the issue of pre-emptive rights, which is statutorily provided for under Section 85 of the CA, there were legal arguments in this case that the passage of a general meeting resolution simpliciter without specific reference to a "waiver" by shareholders is insufficient and this was upheld by COA. For a "direction to the contrary" to be operative, the proposed resolution must set out all the requisite information regarding the shareholders' pre-emptive rights under section 85 of Companies Act 2016.

An Appeal was made by Apex to the Federal Court and the decision of the Federal Court was delivered on March 26, 2024.

Background of the law on approval of shareholders at general meeting
Section 132C of the Malaysian Companies Act 1965, the precursor to Section 223 of CA 2016, had an important legislative background.

The two major organs of a company are the board of directors and the shareholders at a general meeting. Section 132C sought to circumscribe the authority and power of management as exercisable by the board. Following the important UK Company Law Committee 1962 (the Jenkins Committee), modern company law sought to balance the need to accept that while the management may conduct ordinary business without the shareholders' interference, the acquisition of or disposal of material assets and/or business would require the consent of shareholders.

However, Section 132C of the Malaysian Companies Act 1965 has the term "to execute" which carries an unequivocal sense that no business arrangements and agreements may be executed. This raised a constraint upon negotiations and entrepreneurial decisions on management.

In 2007, Parliament deleted the word "execute", signalling a legislative intention that parties are not so constrained that they cannot "execute" any HOA, memorandum of understanding or letters of intent.

However, Section 223 of CA 2016 nonetheless retained the wording of "entering into the arrangement or transaction" which gave rise to the contention by Concrete Parade that even the entering into HOA has to be made subject to shareholders' approval. The COA so held that as the law.

The Federal Court's Decision
On March 26, 2024, the Federal Court in reversing the Court of Appeal decision, ruled in gist that:

Section 223 of CA 2016:
Section 223(1)(b)(i) offers or details an additional option available to the directors whereby at the point of entry into any such agreement, the directors may make such agreement, which is subject to shareholders' approval. Section 223(1)(b)(i) of the Act would be satisfied if at least one of the agreements forming the composite transaction contains an express condition precedent requiring a resolution of the shareholders of the company for the said arrangement or transaction.

Section 223(1)(b)(ii) addresses the situation at a later stage, namely at the point when ownership of the asset is either acquired or divested. Section 223(1)(b)(ii) of the Act would be satisfied by the passing of a resolution of the company in a general meeting approving the said arrangement or transaction before the arrangement or transaction becomes unconditional and binding on the parties to the arrangement or transaction and is carried into effect.

The Court of Appeal erred in ruling that section 223(1)(b)(i) and (ii) was to be read conjunctively. Section 223 (1)(b)(i) and (ii) of the CA 2016 shall be read disjunctively. Before the underlying primary agreement becomes binding and enforceable and prior to the actual transfer of ownership, the directors are bound to obtain shareholders' approval. The need for two sets of shareholders' approval is unreasonable.

Section 85 of CA 2016:

The Court of Appeal erred by failing to consider the purpose and intent of the CA. With the express words "subject to constitution" in section 85(1) of CA 2016, the Act does not confer absolute mandatory pre-emptive rights. The right of pre-emption in relation to a proposed allocation and issue of new shares is subordinated to the content of the constitution of a company. Parliament has determined that the pre-emptive rights of shareholders can be disapplied or not, depending on the free contracting will of the shareholders, as expressed in the constitution.

The Federal Court further ruled that the approval of the private placement resolutions obtained in the general meetings amounted to a "direction to the contrary", satisfying the requirements under Article 11 of the Constitution of Apex. If the shareholders wish to assert their pre-emptive rights then they may do so by voting against the resolution for the proposed business merger which involves part payment by way of private placement.

The term 'subject to direction', means subject to instruction or order or stipulation. Applied to Article 11 of Apex's constitution, which means where the shareholders at general meeting 'direct' or instruct, or command, or communicate that they do not oppose the business merger or the private placement for purposes of part payment; or do not want to exercise their pre-emptive rights under Article 11 and section 85(1). For "subject to directions to the contrary" to be operative, it does not require that either pre-emptive rights to shares or section 85(1) be explained to shareholders.

Legal Implication on Capital Market Practices

The recent definitive ruling by the Federal Court regarding the interpretation of sections 85 and 223 of the CA 2016 now provides clear guidance for capital market practitioners.

The law does not require the acquirer to first convene a general meeting to obtain its shareholders' approval even before committing the vendor to the sale. The relevant point in time to procure the shareholder's approval for the acquisition or disposal of property is now clear. The shareholders' approval must be obtained before the actual transfer of the arrangement. There is no necessity to categorise the preliminary agreement(s) under the different categories of "entering into" or "carrying into effect".

The Federal Court recognizes the contractual nature of the pre-emptive rights of the shareholders. Except that it is so required in the company's constitution, the proposed resolution need not expressly set out the shareholders' pre-emptive rights under section 85

and the consequences of the ceding of such pre-emptive rights in full. The passing of a proposed resolution simpliciter for private placement amounts to a disapplication of those pre-emptive rights. If the shareholders intend to have their pre-emptive rights to be mandatory, they may pass a resolution to amend the constitution to that effect.

This significant decision is laudable and demonstrates that our courts apply a principled pragmatism to corporate commercial cases and while cognisant of protection to shareholders' rights, the balance with business efficacy is also affirmed.

Philip Koh Tong Ngee and Yeap Chi Cheng from Mah-Kamariyah & Philip Koh appeared at the Federal Court as amicus curiae (friend of the court) for the Malaysian Bar Council.

We help you put the right pieces in place.