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Title: Apex Court's decision on shareholders' pre-emptive rights is principled yet pragmatic

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(March 26): The long-awaited ruling on the interpretation of Sections 85 and 223 of the Companies Act 2016 was delivered by the Federal Court on March 26, overturning the decision of the Court of Appeal (COA).

History of the case

Apex Equity Holdings Bhd sought to merge its business with Mercury Securities Sdn Bhd, which minority shareholders challenged as being in contravention of provisions of the Companies Act 2016 (CA 2016). This opinion does not touch on 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.

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 (among others), that on the true construction of Section 223(1) of CA 2016, 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 Section 223(1) of CA 2016.

A QR code for the judgement.

The High Court also held that the pre-emptive rights as stated under Section 85 of CA 2016 had been complied with. The Articles of Association of Apex have a clause that 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 (Article 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 COA accepted Concrete Parade’s & Ors’ appeal and overruled the High Court. This has the result that all the preliminary agreement(s) have to be categorised under different stages of “entering into” or “carrying into effect”, instead of being viewed as one composite agreement. The HOA (being the starting point/the entering into of the merger exercise) has to 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 CA 2016, 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 the 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 CA 2016.

An appeal was made by Apex to the Federal Court and the appeal hearings concluded on Aug 2, 2023. 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, the Federal Court presided by Chief Justice Tun Tengku Maimun Tuan Mat and judges Tan Sri Nallini Pathmanathan and Datuk Rhodzariah Bujang overturned the decision of the COA:

Section 85 of CA 2016: 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 statutory pre-emptive rights accorded by Section 85(1) as being subject to, or conditional upon the contents of the Article of Association of the company. 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. For "subject to directions" to be operative, it does not require that either pre-emptive rights to shares or Section 85(1) be explained to shareholders.

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)(ii) addresses the situation at a later stage, namely at the point when ownership of the asset is either acquired or divested. Before the underlying primary agreement becomes binding and enforceable and prior to actual transfer of ownership either to, or from the company, the directors are bound to obtain shareholders' approval. The need for two sets of shareholders' approval is unreasonable.

Legal implications 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, as long as it is understood between the company and the proposed vendor or purchaser that the acquisition or disposal will not go through unless and until shareholders' approval is obtained. The shareholders'

approval must be obtained before the actual transfer of the arrangement. Hence, there is no necessity to categorise the different preliminary agreement(s) under the different categories of “entering into” or “carrying into effect”.

The Federal Court recognises the contractual nature of the pre-emptive rights of the shareholders. On the disapplication of pre-emptive rights of the shareholders, it is contingent upon the constitution of the company. If the constitution of the company permits “direction to the contrary” to be made in the general meeting, a resolution simpliciter authorising private placement is sufficient to satisfy the requirement under Section 85 of CA 2016. The shareholders may pass resolutions to specify in the constitution if the shareholders want pre-emptive rights to be mandatory.

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 TN Koh, Wong Tat Chung, Yeap Chi Cheng and Alica Ng appeared at the Federal Court as amicus curiae (friend of the court) for the Malaysian Bar Council.