

PROTECTING MINORITY SHAREHOLDERS IN MALAYSIAN PUBLIC LISTED COMPANIES AGAINST CONFLICTS OF INTEREST BY RELATED PARTIES: SOME IMPORTANT DEVELOPMENTS

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Abstract

The global financial crisis has highlighted instances of conflicts of interest and corporate abuse by company controllers. This has been the case in Malaysia and elsewhere, where weaknesses in the legal framework have enabled corporate misconduct to occur. This paper critically examines the legal framework protecting minority shareholders of Malaysian Public Listed Companies (PLCs) against controlling shareholders (also referred to as substantial shareholders) and directors being engaged in related party transactions (RPTs) and other conflict of interest situations. It considers gaps in the law which have enabled related parties to engage in improper transactions with their companies and outlines recent developments aimed at strengthening the rules protecting shareholders against improper RTPs. The paper considers the significance and likely effectiveness of recent reforms.

Keywords: conflict of interest, corporate governance, shareholders, law

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I. INTRODUCTION

This paper will critically examine the legal framework protecting minority shareholders of Malaysian PLCs from the actions of controlling shareholders (also referred to as substantial shareholders) and directors who are engaged in RPTs and other conflict of interest situations. We will show in this paper that while there have been some worthwhile reforms concerning RPTs in Malaysia in recent times the problem seems to be with implementation and enforcement. This could be due to a number of factors. It could be a funding and resource issue or cultural factors could come into play. Also relevant is the fact there is no tradition in Malaysia of standing reform committees which put into effect ongoing plans and structures and review the outcomes of previous initiatives to ensure proper compliance and enforcement.

This article is divided into three parts. Part I provides the introduction and background. Part II examines the legal framework regulating against conflict of interest by related parties in Malaysian PLCs, outlining the various legal principles and rules which have been developed and/or introduced in Malaysia, including those under the:

- i. common law;
- ii. *Companies Act 1965 (Act)*;
- iii. *Companies (Amendment) Act 2007*;³⁸
- iv. *Capital Markets and Services Act 2007*;
- v. Corporate Law Reform Committee (CLRC) recommendations,³⁹

- vi. Bursa Malaysia Listing Requirements (LRs);⁴⁰
- vii. Code of Corporate Governance 2000 (Code) and the revised Code 2007⁴¹ and
- viii. accounting standards.⁴²

The discussion of the shareholder protection rules will include reference to specific requirements for disclosure of conflicts or potential conflicts, the appointment of independent directors, the requirement of shareholder approval and other rules and standards to regulate against conflict of interest by related parties in Malaysian PLCs.

Part III provides the conclusion which considers the significance and effectiveness of the various reforms

³⁹ On 17 December 2003 the Companies Commission of Malaysia (CCM) announced that it was undertaking a comprehensive review of the *Companies Act* under its Corporate Law Reform Program a CLRC was established to implement the program. Key recommendations have now been synthesized in the Committee's Final Report, which was released in November 2008. See *Review of the Companies Act 1965-Final Report*. Available at: <http://www.ssm.com.my/en/docs/CLRCFinalReport.pdf> (viewed 28 October, 2009).

⁴⁰ See LR, online: <http://www.bursamalaysia.com/website/bm/> (visited Jan05, 2006).

⁴¹ The Code was issued in March 2001. The Code was revised in 2007.

⁴² The Financial Reporting Standards are drawn up by the Malaysian Accounting Standards Board (MASB).

³⁸ The Act came into effect on the 15th of August, 2007.

A. Background

The East Asian economic and financial crisis of 1997/1998 and now 10 years later, the global financial crisis, have both generated a significant amount of analysis and debate, particularly about macroeconomic issues such as exchange rate volatility and good corporate governance, in the region and globally respectively. In addition, the financial crises have also provoked increased awareness about issues concerning the role and function of regulators and the need for improved disclosure and good corporate governance. The crises brought to light various instances of corporate abuse and in some cases breakdown, attributable in part to ineffective corporate governance structures. Some instances of corporate abuse included:

- i. Related party transactions (RPTs);
- ii. Asset shifting;
- iii. Transactions involving clear conflict of interest, with no proper disclosure by directors like the taking up of corporate opportunities, and
- iv. Poor management by directors.

According to Rita Bushon,⁴³ the Chief Executive Officer (CEO) of the Minority Shareholders Watchdog Group (MSWG), one of the major concerns of the 2008/2009 financial crisis involves RPTs.⁴⁴ She pointed to various recent scandals, including the 2009 scandal in India which led to the fall of Satyam Computer Services,⁴⁵ which appeared to be mainly due to improper RPTs. Closer to home she highlighted other instances of RPTs in Malaysian PLCs including those involving of Resorts World Bhd and Malaysian Mining Corporation (MMC) Bhd.⁴⁶ Minority shareholders in Malaysian PLCs encounter problems such as RPTs which are caused mainly by ownership concentration and exacerbated by the problematic legal remedies available⁴⁷ and ineffectual enforcement.⁴⁸ This establishes the need for greater protection of minority shareholders in Malaysian listed companies.

Controlling shareholders holding the position, for example, of CEO are usually in a position to enter into contracts that maximise shareholder wealth. These contracts can cover a broad range of transactions including raising capital, selling firm outputs, hiring employees and leasing assets, amongst others. Sometimes these contracts are entered into with someone who has a close and possibly privileged relationship with the company, including controlling owners or directors of the company, their immediate families and other companies that they control. Such contracts are commonly referred to as RPTs.

Given that related parties can use their influence to procure such contracts and influence the terms of the contracts in their favour, RPTs are usually viewed as being inconsistent with shareholder wealth maximisation.⁴⁹ Malaysia's Corporate Law Reform Committee (CLRC) was of the view that whilst control by an owner can be beneficial to monitor the company's performance, instances involving expropriation of the company's assets by controlling shareholders or insiders have an impact on corporate governance and minority shareholders' protection. Directors and controlling shareholders are positioned such that they can have enormous influence to enter into transactions that expropriate wealth from outside shareholders. Expropriation is said to occur when the company receives less net benefit from a RPT than could have been obtained from a transaction with an unrelated counterpart.⁵⁰ The CLRC⁵¹ recognised that PLCs in Malaysia are controlled by substantial shareholders and that where there are concentrated family shareholdings, there is a higher probability of substantial or controlling shareholders of a company or insiders, like directors, unfairly dealing with the company's assets at the expense of the minority shareholders.

The potential effects of RPTs have been examined in various academic studies. Scholars,

⁴³ Bushon, R.B., 'More Scrutiny on RPTs in Times of Crises', (2009), The Starbizweek, Saturday 21 February.

⁴⁴ Ibid.

⁴⁵ <http://news.bbc.co.uk/2/hi/business/7818220.stm>.

⁴⁶ These examples are further discussed below.

⁴⁷ The common law and statutory remedies available for minority shareholders are affected by numerous problems such as proving fraud on the minority under common law or 'oppressive' or 'unfairly prejudicial or discriminatory' acts under s 181 of the *Act*.

⁴⁸ The Credit Lyonnais Securities Asia (CLSA) 2010 survey showed that Malaysia's enforcement of laws is generally poor. They gave Malaysia a score of 38% for enforcement. This was far below Singapore, Hong Kong, Japan, Taiwan and Thailand. http://www.acga-asia.org/public/files/CG_Watch_2010_Extract_Final.pdf (viewed on 23rd June, 2011.)

⁴⁹ Emshwiller, J.R., 'Business Ties: Many Companies Report Transactions with Top Officers' *Wall Street Journal*, December 29, 2003.

⁵⁰ Ryngert, M. and Thomas, S., 'Related Party Transactions: Their Origins and Wealth Effects', (2007) Working Paper, University of Florida. Available at SSRN:

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=970689

⁵¹ The CLRC Report for the Companies Commission of Malaysia, *A Consultative Document on review of Substantial Property Transaction, Disclosure Obligations and Loan to Directors*, July 2007. Available at: <http://www.ssm.com.my/clrc/cd9.pdf> (viewed, January 2008). The CLRC was set up by the Companies Commission of Malaysia to provide recommendations on improving various areas of company law. However, the *Companies (Amendment) Act 2007* was introduced prior to the CLRC Final Report was handed down in November 2008.

like Cheung et al⁵² document that firms listed in Hong Kong experience negative abnormal stock returns when they announce that they are undertaking 'connected transactions'. Also, Jean and Wong⁵³ find that Chinese companies frequently engage in RPTs and the volume of RPT activity is negatively related to firm value. La Porta et al⁵⁴ are of the view that RPTs are more prevalent in emerging markets with poor law enforcement. In line with this negative perspective of RPTs is Kohlbeck and Mayhew's⁵⁵ view that firms who tend to report significant number of RPTs tend to exhibit 'weaker corporate governance practices'.

On the other hand, RPTs can have some positive effects and the CLRC expressed the view that these transactions may be beneficial to a company where they fulfil certain economic functions. They may be contract efficient for various reasons. For example, the parties are familiar with one another, complete information will be provided and contracts can be entered into without any time delay. In economic terms there will be reduced information asymmetry, thereby reducing transaction costs. Therefore, governments will not prohibit them absolutely as their potential value is too great. Instead, the approach is generally to subject RPTs to legal controls to minimise their negative impact. The CLRC stated that there is a need to have provisions within the *Companies Act* to regulate substantial property transactions with related parties. According to the CLRC, incorporating provisions into the Act will also provide criminal liability for non-compliance and this punitive element will be a deterrent factor.⁵⁶ The CLRC recommended that provisions should also apply to substantial shareholders. These recommendations have now been incorporated into the Act by the *Companies (Amendment) Act 2007*.⁵⁷

In order to understand the prevalence of RPTs in Malaysia it is useful to look at the nature and

structure of Malaysian PLCs. According to Thillainathan,⁵⁸ the shareholdings in PLCs in Malaysia are broadly concentrated. In his paper,⁵⁹ an analysis of a sample of companies comprising over 50% of Bursa Malaysia's market capitalisation showed that the five largest shareholders in these companies owned 60.4% of the outstanding shares and more than half of the voting shares.⁶⁰ Some 67.2% of shares were in family hands, 37.4% had only one dominant shareholder and 13.4% were state-controlled.⁶¹

Classens et al⁶² in their research found that in Malaysia, the top 10 families control about 25% of the total market capitalization. Samad et al⁶³ found that total shareholding of the five largest shareholders in Bursa Malaysia at December 1998 was 58.84%, a figure which has decreased slightly in recent times. The study conducted in 2006 and reported in 2007 by On Kit Tam et al⁶⁴ found the average concentration of the five largest shareholders in the top 150 Malaysian listed companies is 54.85%.

⁵² Cheung, Yan-Leung, Raghavendra Rau and Stouraitis, A., 'Tunnelling, Propping and expropriation: evidence from connected party transactions in Hong Kong' (2006) *Journal of Financial Economics* 82, 343-386.

⁵³ Wong, T.J. and Jian, Ming, 'Earnings Management and Tunnelling through Related Party Transactions: Evidence from Chinese Corporate Groups', (June 2003). EFA 2003 Annual Conference Paper No. 549. SSRN: <http://ssrn.com/abstract=424888> (visited March 08, 2007).

⁵⁴ Johnson, S., La Porta, R. Lopez-De Silanes, F. and Shleifer, A., 'Tunnelling', (2000) *The American Economic Review* 90, 22-27.

⁵⁵ Kohlbeck, M. and Mayhew, B., 'Agency Costs, Contracting and Related Party Transactions', (2004) Working Paper, University of Wisconsin- Madison. Available at SSRN: <http://ssrn.com/abstract=592582> (visited March 08, 2007).

⁵⁶ For example ss 131(8), 133(4), 132E (8) and 132G (5) Act.

⁵⁷ Section 132E *Companies (Amendment) Act 2007*.

⁵⁸ Thillainathan, R., *Corporate Governance and Restructuring in Malaysia - A Review of Markets, Mechanisms, Agents & The Legal Infrastructure*, (1999), Paper prepared for the joint World Bank/OECD Survey of Corporate Governance arrangements in a selected number of Asian countries.

⁵⁹ Ibid.

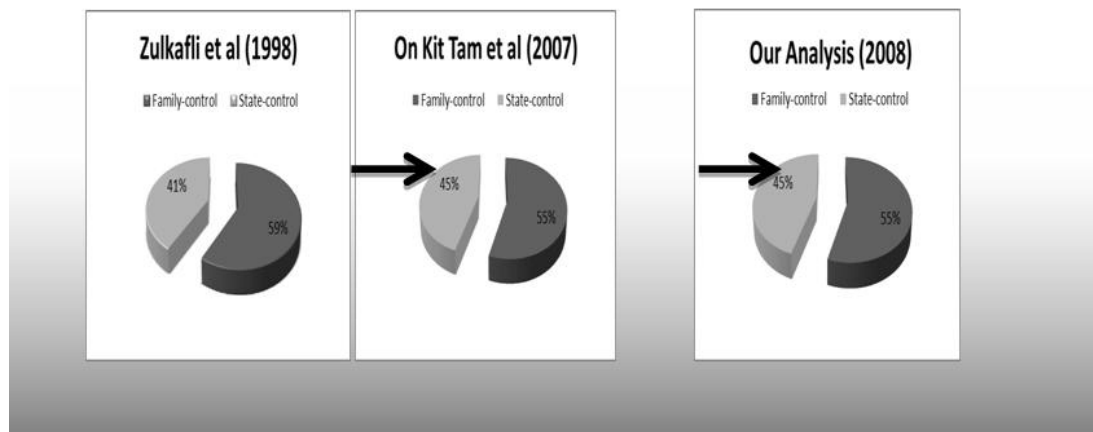
⁶⁰ Ibid.

⁶¹ Ibid.

⁶² Claessens, S., Djankov, S., Fan, J. and Lang, L., 'Disentangling the Incentive and Entrenchment Effects of Large Shareholdings' (2002) 57 *Journal of Finance* 2741-71.

⁶³ Abdul Hadi bin Zulkafli, M.Fazilah bt. Abdul Samad and Md Ishak Ismail, 'Corporate Governance In Malaysia' (2005) *Malaysian Institute of Corporate Governance*, article on internet. Available at: <http://www.micg.net/research/> (visited April 2007)

⁶⁴ Tam, On Kit and Tan, Monica Guo-Sze, 'Ownership, Governance and Firm Performance in Malaysia' (2007) 15 *Corporate Governance- An International Review*, Vol. 15, No. 2, 208-222.

Figure 1. Concentration of Family Control and State Control in Malaysian PLCs

Source: Abdul Hadi bin Zulkafli, M.Fazilah bt. Abdul Samad and Md Ishak Ismail, 'Corporate Governance In Malaysia' (2005) *Malaysian Institute of Corporate Governance*.

On Kit Tam and Monica Guo-Sze Tan, 'Ownership, Governance and Firm Performance in Malaysia' (2007) *Corporate Governance -An International Review*, Vol.15 No. 2, 214.

As an update to the above literature, in 2008, a study was conducted of the top 50 PLCs in *Bursa Malaysia*. Our analysis in Figure 1 shows that the five largest shareholders in the top 50 Malaysian PLCs own an average of 55.09% of the total shares.⁶⁵ Among these 50 companies, 31 (62%) have concentrated shareholding with their five largest shareholders controlling more than 50% of the company. Of the same 50 companies surveyed, 10% had only one dominant shareholder (more than 50% control) and 24% were state-controlled.⁶⁶ Nineteen of these 50 companies were Chinese family businesses in 2008, with approximately 49.58% of shares in family hands.⁶⁷

This ownership concentration is said to create 'agency cost' problems, well-known to those familiar with company law.

An 'agency cost' is an economic concept that relates to the cost incurred by entities, such as companies, associated with problems such as divergent management-shareholder objectives and information asymmetry. The agency costs prevalent in the concentrated shareholding PLCs in Malaysia involve the conflict between the owners who possess the majority or controlling interest in the company and the minority or non-controlling owners.⁶⁸ Here the non-controlling owners are the

principals and the controlling owners are the agents. The costs lie in ensuring that the controlling shareholders do not expropriate assets from the non-controlling shareholders or take up corporate opportunities for themselves.

Hansmann and Kraakman,⁶⁹ explaining agency costs, observed:

[t]he core of the difficulty is that, because the agent commonly has better information than does the principal about the relevant facts, the principal cannot costlessly assure himself that the agent's performance is precisely what was promised. ... the value of the agent's performance to the principal will be reduced either directly [by shirking on the part of the agent] or because, to assure the quality of the agent's performance, the principal must engage in costly monitoring of the agent.

It has been said in defence of concentrated shareholding companies, that the large shareholders, referred to as block shareholders, can benefit the minority shareholders through indirect use of their power and self-interest to prevent expropriation by management.⁷⁰ However, there are also situations in which these controlling shareholders might be in pursuit of objectives inconsistent with those of the minority shareholders.⁷¹ The controlling shareholders, acting

⁶⁵ Sourced from shareholdings analysis in annual reports 2006/2007 of respective companies.

⁶⁶ EMIS database, accessible via <http://site.securities.com>.

⁶⁷ Sourced from shareholdings analysis in annual reports 2006/2007 of respective companies

⁶⁸ The other agency cost involves problems in dispersed shareholding. See Hansmann, H. and Kraakman, R., 'Agency problems and Legal Strategies' in Kraakman, R., Davies, P., Hansmann, H. and Hertig, G., (eds), *The Anatomy of Corporate law, A Comparative and*

Functional Approach, New York, (2004), Oxford University Press, 22.

⁶⁹ Ibid.

⁷⁰ Mitton, T., 'A cross-firm analysis of the impact of corporate governance on the East Asian financial crisis', (2002) *Journal of Financial Economics* 64, 215-241.

⁷¹ Morck, R., Yeung, B. and Wayne Yu, 'The Information Content of Stock Markets: Why Do

as agents, also enjoy certain internal benefits of control like siphoning out cash and other assets without any business justification or implementation of transactions which benefit the controlling shareholders but may not benefit the company. Internal benefits of control can be defined to include all benefits a controlling shareholder can extract from the company as an insider. Here, the agent as insider means that the agent has access to the company's assets, information and opportunities, at prices more favourable than at arms' length negotiation.

In the decade following the Asian Financial Crisis many instances involving one or more of these improper practices came to light. Well known examples include the Renong case.⁷² In 1998, the purchase by United Engineers (M) Bhd (UEM) of shares in its associate company Renong Bhd (Renong) was an example of how weakness in public governance affects corporate governance. Both companies were public listed companies. UEM bought a substantial stake in its associate company, Renong whose executive chairman Halim Saad was closely associated with the top leaders of UMNO (the Malay component of the coalition ruling party). The price which UEM paid for Renong's shares (which was double the prevailing market price) amounts to 86% of the UEM's shareholders funds at that time and raised UEM's debts from RM300 million to RM2.7 billion

The Securities Commission nevertheless allowed this transaction to go through and granted UEM a waiver from having to make a mandatory general offer for the remaining shares of Renong in accordance with the law.⁷³ UEM's share price fell 48% in the week following the announcement of the purchase.⁷⁴ This is an example of a related party transaction in a state controlled company which was viewed as a "bailout" of politically connected businessmen and allowed to proceed by both the regulatory bodies, Bursa Malaysia and the Securities Commission.

Other examples of cases involving improper practices include cases involving Malaysian

Airlines⁷⁵ and the United Malayan Banking Corporation (UMBC).⁷⁶

Despite calls for reform in the aftermath of the Asian Financial Crisis, problems with RPT are still occurring. As we noted above, according to Rita Bushon of the MSWG,⁷⁷ one of the major concerns of the 2008/2009 financial crisis involves RPTs. The RPTs involving Malaysian companies which she highlighted included Resorts World Bhd's proposed acquisition of a 10% stake in Walker Digital Gaming (WDG) and 100% of Digital Tree (US) Inc (which earns royalties from WDG) for US\$69mil from KH Digital Ltd. Concerns arose as Tan Sri Lim Kok Thay, a major shareholder of Genting Bhd which owns Resorts World, was also a director in WDG. Share prices of Resorts World Bhd tumbled after the RPT, which according to Bushon, was attributable to lack of information on the deal.⁷⁸

On a smaller scale, Bushon gave the example of the RPT in the case of 'The Store Corporation Berhad' which purchased a mall for RM130 million from parties related to the managing director, Datuk Seri Tang Yeam Soon.⁷⁹ A more recent 'mega' deal which she said piqued minority shareholders was the MMC Bhd's proposed acquisition of Senai Airport Terminal Services Sdn Bhd for RM1.7 billion. Both companies are linked to MMC Bhd's major shareholder, Tan Sri Syed Mokhtar Albukhary.⁸⁰

Other examples of recurrent RPTs in Malaysian companies include Genting Malaysia and Tai Kwong Yokohama Berhad. Among the issues raised in the Genting Malaysia (Resorts World) RPT with its parent Genting Berhad were the appointment of a single 'independent' property valuer for both of the transactions and the status of the independent directors when they sat on both boards (Genting Malaysia and Genting Berhad). Although the independent adviser for this transaction concluded that the transaction was immaterial and would not affect the future cash flow of the firms, alternatively it could be seen as a cash extraction by the parent company, Genting Berhad.⁸¹ Shares in Tai Kwong Yokohama Berhad

Emerging Markets Have Synchronous Stock Price Movements?' (2000) 58 *Journal of Financial Economics* 215 -260 and Bebchuk, L., 'The Rent Protection Theory of Corporate Ownership and Control' (1999) Harvard Law School manuscript, <http://www.nber.org/papers/w7203>.

⁷² See generally Gomez, E.T. and Jomo, K.S., *Malaysia's Political Economy: Politics, Patronage and Profits* (1999), New York: Cambridge University Press; Peter Searle, *The Riddle of Malaysian Capitalism: Rent-Seekers or Real Capitalists* (1999), Honolulu: University of Hawaii Press.

⁷³ *Code of Take-overs and Mergers 1987*

⁷⁴ *Country Paper for Malaysia*, Asian Roundtable on Corporate Governance, Hong Kong, 31 May – 2 June 2000, (Nathan Rabindra, Chiew Sow Lin and Soo Wai Fong).

⁷⁵ Ibid and 'Coming Down to Earth', Extracts from Far Eastern Economic Review, reports by Alkman Granitsas, 7 December 2000.

⁷⁶ *Malaysian Business*, 1st August 1994; *Malaysian Industry* July 1995 and *The News Straits Times* newspaper, 13th July, 1995.

⁷⁷ See n6, above.

⁷⁸ Ibid.

⁷⁹ Ibid.

⁸⁰ Ibid.

⁸¹ Genting Malaysia Genting Malaysia (Resorts) had entered into S&P agreements with parent Genting Berhad to acquire: a) 25-storey Wisma Genting office building for RM259.6m (including RM46.9m debt owed to Genting Berhad) ; and b) Segambut land comprising 2 adjoining land parcels with total area of 380,906 sq ft

plunged 38 percent upon the announcement of a recurrent party transaction on 5th March 2009.⁸²

Therefore, in order to overcome problems faced by minority shareholders in Malaysian PLCs and to boost investor confidence, Malaysia has introduced various new legal rules which will hopefully enhance minority shareholder protection. Tighter regulation of RTPs has been affected by reform recommendations, stemming initially from the 1999 Report of the High Level Finance Committee⁸³ and more recently, from recommendations of the CLRC⁸⁴ set up in 2003.

II. THE LEGAL FRAMEWORK

The various common law rules, statutory provisions and self-governing codes which regulate against conflict of interest by related parties in Malaysian PLCs are intended to prevent persons with an actual or potential conflict of interest from dealing with the company's assets at other than arms' length consideration. Originally in Malaysia the rules targeted directors and certain 'connected persons', but recent reforms have extended their coverage to substantial shareholders and to a wider category of 'connected persons' than was previously the case. The rules are intended to enhance the transparency required for RTPs and to minimise the potential for a conflicts of interest by related parties. However it is interesting to note that while Malaysia's new legal rules effectively tighten up the RPT legal framework the problematic issue is enforcement. This seems to be confirmed by recent CG ranking reports. The CLSA CG Watch 2010 shows a small improvement for Malaysia, however it is clear that there is still a weak CG culture and more significantly, Malaysia's improved scores on this ranking exercise appear to be due to enhanced rules and regulatory framework, while enforcement remains problematical.⁸⁵

A. Disclosure Rules

Mandatory disclosure to alert shareholders on RTPs is one of the most important controls affecting PLCs. In Malaysia, fiduciary disclosure obligations

are primarily set out in common law and the *Companies Act 1965* (the Act).⁸⁶ In addition, disclosure rules are also found in securities laws, the LR's and the accounting standards. All PLCs must comply with all these requirements, which increase the costs of management of the company. As will be seen the interplay of these rules is quite complex. The rules overlap, considerably, with the statutory obligations and the LR's intended to overcome limitations or gaps in the common law.

At common law directors owe certain fiduciary obligations to the company. The fiduciary basis of these duties in many cases necessitates a complementary duty to disclose matters which could compromise directors' ability to act *bona fide* in the interests of the company.

Also, at common law, directors are strictly precluded from placing themselves in a position where their duty to the company conflicts with their personal interests. An example of a conflict of interest is where there is a disposal of the company's assets to or the acquisition of assets by a company from its directors or persons connected to such directors.⁸⁷ The application of this no-conflict principle simply means that a director cannot be interested in transactions involving the company or derive any benefit from his or her office. The only exception, in the absence of authorisation in the company's memorandum or articles, is when he/she makes full disclosure of the nature of the interest to the company and has the contract ratified by the general meeting.⁸⁸ If otherwise, the transaction is voidable at the company's option and the company may recover from the interested director all the benefits which might have been derived.⁸⁹ Many companies' articles provide authorisation by the board and thus overcome the need for disclosure to the company as a whole.

The application of the no-conflict rule does not depend upon the extent of the adverse interest of the fiduciary, or whether the transaction entered into is fair or unfair, or whether the company itself could not avail itself of the opportunity or that the directors acted honestly.

The common law fiduciary rules are strict, but have a number of limitations. For example, they do not apply to controlling or substantial

for RM24.6m (including RM8.6m debt owed to Genting Berhad). <http://www.genting.com/press/index.htm>

⁸² The recurrent party transaction was between Tai Kwong Yokohama Berhad and HSG Investments Pte Ltd, a unit of Hup Soon Global Corporation Ltd. However, the nature and extent of transactions are usually not disclosed in the circular to shareholders. The Edge Daily, 2009.

<http://www.shareinvestor.com.my/tools.pl?action=factsheet&id=9849>.

⁸³ Finance Committee, *Report on Corporate Governance*, February 1999, chapter 6.

⁸⁴ See n 2, above.

⁸⁵ http://www.acga-asia.org/public/files/CG_Watch_2010_Extract_Final.pdf (viewed on 23rd June, 2011.)

⁸⁶ A listed company's articles also impact on its disclosure obligations.

⁸⁷ This is illustrated in the English case of *Transvaal Lands Co v New Belgium (Transvaal) Land & Development Co* [1914] 2 Ch 488.

⁸⁸ See the Canadian case of *North-West Transportation Co Ltd v Beatty* (1887) 12 App. Cas. 589. In the Australian case of *Furs v Tomkies* (1936) 54 CLR 583, 592, a company could ratify the transaction even with the votes of the director in question in his/her capacity as shareholder.

⁸⁹ Hahlo H.R. and Farrar, J.H., *Hahlo's Cases and Materials on Company Law* (1987), 3rd ed, 392, 396.

shareholders.⁹⁰ In addition, under the common law there is no prohibition on the company entering into the transaction in the first place. There is also generally no prohibition on a director who is a shareholder from voting on the transaction in which the director has an interest and this may enable the director or related persons to use their voting power to expropriate the company's assets at the expense of the minority shareholders.⁹¹ Further, in a concentrated shareholding company (common in Malaysia), if the director owns substantial shares, this defeats the purpose underlying shareholder protection as his/her vote can also be taken into account since he/she will have a right to vote to ratify the transaction. This may be overcome by the provision of a voting exclusion rule in the articles of association that prevents directors and related parties from voting to approve their own self-interested transactions.

The common law position regarding disclosure by directors who contract with their companies or who place themselves in a conflict of interest situation is supplemented by the Act.⁹² The Act recognizes that directors may be interested in contracts but imposes a statutory duty on the part of interested directors to disclose their interests.⁹³ The effect of this is to take away and limit the freedom of companies in drafting articles which abrogate the common law principle that there must be disclosure of interests in contracts.

Every direct (or indirect interest) on the part of directors, other than those excluded by the Act,⁹⁴ needs to be disclosed. For example, where the interest of the director consists only of being a member or creditor of a corporation, the interest can be disregarded unless the interest is regarded as being a material interest.⁹⁵ No guidelines are given as to the circumstances under which the interest of a director as shareholder or creditor of a corporation may be regarded as being material. The requirement that the interest must be 'material' endorses the test

applied under the common law⁹⁶ that for the no-conflict rule to apply, a reasonable person must consider that the interest held by the director was one which would give rise to a real sensible possibility of conflict between duty and interest. A further exception releases a director from the necessity to make a formal declaration of the interest at a board meeting where the nature and extent of interests is well-known to all the other directors.⁹⁷

Where a director is interested in a contract (or proposed contract), the interest⁹⁸ has to be declared as soon as practicable after the relevant facts have come to his/her knowledge. The Act explicitly requires interested directors to declare their interests to the board.⁹⁹ In addition, a director who holds any office or possesses any property which might create a conflict between his/her duties and interests must declare at a meeting of the board of directors the fact and the nature, character and extent of the conflict.¹⁰⁰ This takes the disclosure requirements to a much wider category of situations than merely disclosure of interests in contracts.

The Act provides that an interested director has to declare the 'nature' of his/her interest. It also requires judgment on whether an interest is material or not. The disclosure has to be not only of the nature but also the extent of the interest. It is clear that a disclosure is not sufficient unless there is full and detailed disclosure of the interest.¹⁰¹ Disclosure is enhanced by the requirement under the Act,¹⁰² that the company must also keep a register disclosing the particulars of its directors' interests and the nature and extent of the interest in shares in the company or in a related corporation, in debentures or participatory interests of the company or related corporations and the nature and extent of the interest, rights or options held individually by the director or with other persons.

However these disclosure provisions in the Act are not as strict as the common law as they only require directors to disclose to the board of directors. In such circumstances, the shareholders, especially the minority shareholders, will not be aware of the transaction nor can they do anything about it. Moreover, until recently there was no provision in the Act which restricted directors of PLCs from being present at the meeting where a contract where he/she has a direct or indirect

⁹⁰ Section 69D of the Act and section 7 of the *Securities Industries (Reporting of Substantial Shareholding) Regulations* 1998 define a 'substantial shareholder' as a person who has an interest in one or more voting shares in the company and the nominal amount of that share or the aggregate of the nominal amounts of those shares is not less than two% the aggregate amount of all voting shares in the company. (The *Companies (Amendment) (No.2) Act 1998* reduced it from 5% to 2%).

⁹¹ This has been altered by the LRs, discussed later in the article.

⁹² Section 131(1) Act.

⁹³ *Companies (Amendment) Act 2007*, inserted the following clause (7A) "..... [a]n interest of the spouse of a director of a company ... and an interest of a child ... of a director of the company ... in the shares or debentures of the company, shall be treated as an interest in the contract and proposed contract."

⁹⁴ Section 131(2) and (3) Act.

⁹⁵ Section 131 (2) Act.

⁹⁶ *Tneu Beh v Tanjong Kelapa Sawit Sdn Bhd* [1995] 1 CLJ 741.

⁹⁷ Ibid.

⁹⁸ The *Companies (Amendment) Act 2007* ⁹⁸ inserted section 131(7A) into the Act to include the interest of the spouse and of a child of a director of the company in the shares or debentures of the company as an interest in the contract and proposed contract.

⁹⁹ Section 131(1) Act.

¹⁰⁰ Section 131(5) Act.

¹⁰¹ Under s 131(4) Act.

¹⁰² Section 134(1) Act.

interest is being considered or voted. The law in Malaysia has now been brought in to line with the law of other jurisdictions.¹⁰³ Section 131A, inserted by the *Companies (Amendment) Act 2007*, now provides that a director of a company who is in any way, whether directly or indirectly, interested in a contract shall not participate in any discussion while the contract is being considered at the board meeting and shall not vote on the contract.

The position of substantial shareholders has been contentious, as they also have the ability to influence the uptake of related party transactions. There are also provisions in the Act which require disclosure of directors' substantial shareholdings in a PLC. These provisions are pertinent as they facilitate the enforcement of the disclosure provisions on substantial shareholders. Substantial shareholders,¹⁰⁴ as well as being required to notify the company of their interest in the company,¹⁰⁵ must also notify the company of a change in their interest.¹⁰⁶ A change in interest or interests is deemed to have occurred when substantial shareholders acquire or dispose of their voting shares. They must also notify the company within seven days that they have ceased to be substantial shareholders.¹⁰⁷

The common law, as we noted above, only requires directors and not substantial shareholders to make disclosure of RPTs. Besides the statutory requirements of disclosure, the LRs now require all RPTs to be disclosed, including those involving substantial shareholders.¹⁰⁸ Following the Renong/UEM case and other¹⁰⁹ scandals involving RPTs, the disclosure obligations in the listing rules now cover transactions involving the interests,

direct or indirect, of persons connected with directors or substantial shareholders. In 1995, the Securities Commission (SC) set out its special requirements for RPTs but these were only guidelines and not regulations. Under the SC guidelines and the LRs, a listed company was required to make a public announcement, send a circular and seek the approval of shareholders on all material RPTs. A transaction is deemed to be material if its value exceeds five% of any one of a select set of variables such as profits, equity market capitalization and assets.

In November 2005 *Bursa Malaysia Securities Bhd* amended¹¹⁰ the LRs in relation to RPTs, tightening the disclosure requirements for transactions involving related parties. The LRs have also expanded the role of the 'independent adviser'. Under the LRs an independent adviser is appointed to advise the shareholders before the terms of the transactions involving related parties are agreed upon. Since the 2005 amendments an independent adviser is now required to advise minority shareholders in relation to voting on the RPT in question. The independent adviser must advise the minority shareholders whether the transaction involving related parties is fair and reasonable so far as the minority shareholders are concerned and whether the transaction is to the detriment of minority shareholders. The independent advisor must also advise minority shareholders on whether they should vote in favour of the transaction.

The changes have also widened the range of RPTs. The definition of RPT under the LRs¹¹¹ covers the acquisition and disposal of assets, the provision and receipt of services and the provision of financial assistance. It also now extends to the establishment of joint ventures and any business transaction or arrangement entered into by a listed issuer or its subsidiaries.

Under the LRs, if the RPT is one where the percentage ratio¹¹² of the assets which are the subject of the transaction is equal to or exceeds five%, the company must ensure that a circular is sent to the shareholders giving them details of the transaction. The shareholders' approval of the transaction is then sought in a general meeting following the report of the independent adviser who is to act as appointed to advise the shareholders.¹¹³ As noted above, by virtue of the recent enactment of s 131A of the Act, only disinterested parties may vote at the meeting to

¹⁰³ For example, under s 195 of the Australian *Companies Act 2001* (Cth), public company directors with a material personal interest in a matter being considered by the board are prohibited from being present and voting on the matter unless allowed to by disinterested directors under s 195(2) or approval by the Australian Securities and Investments Commission under s 195(3) or by a general meeting.

¹⁰⁴ Section 69D of the Act and s 7 of the Securities Industries (Reporting of Substantial Shareholding) Regulations 1998 define a substantial shareholder. See Above n 48.

¹⁰⁵ Section 69E (1) Act.

¹⁰⁶ Section 69F Act.

¹⁰⁷ Section 69G (2) Act.

¹⁰⁸ Rules 111 to 120, Part 4 of the LRs.

¹⁰⁹ Other examples include Malaysian Airlines highlighted in Gomez, E.T., Jomo, K. S., (1999), "Malaysia's political economy: politics, patronage and profits", Cambridge University Press: Cambridge., MMC Bhd and Resorts World Bhd highlighted by Bushon, R.B. in 'More Scrutiny on RPTs in Times of Crisis', *The Star*, Starbizweek, Saturday 21 February, 2009 and the recent Port Klang Free Zone reported in the Malay Mail - Anti-Corruption Commission being called in to investigate PKFZ, Bernama, Thursday, May 28th, 2009, The Malay Mail. <http://www.mmail.com.my/>

¹¹⁰ Paragraphs. 10.08, 10.09 and 2.06, 2.08 and 2.19 of the LRs

¹¹¹ The LRs, Paragraph 10.2.

¹¹² Percentage ratios mean the figures, expressed as a percentage, resulting from various calculations including, the value of the assets which are the subject matter of the transaction, compared with the net assets of the listed issuer – Chapter 10 of the LRs.

¹¹³ As discussed above.

approve the transaction. The requirement for shareholder approval means that the LRs now align with the strict common law rules for disclosure of material interests to the general meeting.

With regard to RPTs involving recurrent transactions of a revenue or trading nature which are necessary for the company's day-to-day operations such as supply of materials, the company does not have to seek shareholders' approval in respect of transactions that are in the ordinary course of business and are on terms not more favourable to the related party than those generally available to the public.

As well as changes to the LRs, disclosure rules have also been enhanced under the Accounting Standards. Since the late 1970s Malaysia has been adopting the accounting standards consistent with those issued by the International Accounting Standards (IAS) Committee. The International Accounting Standard 24¹¹⁴ on related party disclosures has been adopted as an accounting standard in Malaysia as Financial Reporting Standard (FRS) 124.

The objective of this standard is to ensure that a company's financial statements contains the necessary disclosures that highlight the existence of related parties, transactions and outstanding balances with such parties which affect the financial position and profit and loss of the company. Under FRS 124, which came into effect in 2006, the following disclosures have to be made: the relationships between parent company or the ultimate controlling party and subsidiaries irrespective of whether there have been transactions between those related parties, key management personnel compensation including termination benefits and share-based payments and also if there have been transactions made between related parties. The company shall disclose the nature of the related party relationships as well as information about the transactions and outstanding balances which are necessary for an understanding of the effect of the relationship on the financial statements.

In theory, the various disclosure requirements we have discussed above are intended to achieve the objective of ensuring that the shareholders and other users of the financial statements have timely access to material and relevant information. However, the effectiveness of the requirement of disclosure of RPTs has a number of problems in Malaysia. Firstly, minority shareholders in a concentrated shareholding PLC, even with the material information, may decide not to vote against the majority shareholders who normally are the founder families of the company, as in the case of the late Lim Goh Tong and family of Genting

Bhd or have political linkages as in the case of Tajuddin Ramli, the former CEO and shareholder of Malaysian Airlines had connections with the former Prime Minister, Tun Dr. Mahathir Mohammed.

Members of the 2007 Asian Roundtable on Corporate Governance¹¹⁵ found various other problems with the disclosure of RPTs. The members said that detecting a RPT is problematic. The members highlighted that the complex ownership structure of PLCs in Asia, including Malaysia, creates particular challenges for detecting RPTs. They said that groups of companies with major shareholders who have access to insider information often expropriate minority shareholders. According to them, some of the most difficult transactions to identify include those that occur between a listed company and another company in a group that can lead to transfer pricing and expropriation. Therefore if the company decides not to disclose a RPT, it may go undetected.

In countries, like Malaysia, with fairly large state-owned companies, determining the nature of RPTs is particularly difficult and costly. Even in the case of large RPTs, it may be difficult to identify whether the transactions are abusive, especially if there is no market price. Abusive RPTs according to the Roundtable members are a global challenge, as the lack of transparency when insiders deliberately fail to disclose such deals to shareholders is widespread.

Another problem identified by the 2007 Asian Roundtable on Corporate Governance is the capacity of regulators to sanction non-compliance with disclosure and/or approval rules. Leading international corporate law scholars have identified this as the most serious problem of all in controlling agency costs associated with RPTs.¹¹⁶ Where information, such as that concerning RPTs, is outside of the categories of information typically required for periodic disclosure then 'vigorous enforcement alone seems to be able to ensure compliance'. We discuss enforcement issues in Part F of this paper below.

It is evident, that disclosure is an important aspect in the regulation of RTPs, but clearly not in itself a sufficient tool.

¹¹⁴ The International Accounting Standards are drawn up by the International Accounting Standards Board based in London, UK.

¹¹⁵ 2007 Asian Roundtable on Corporate Governance Singapore: 27 and 28 June 2007 DRAFT Conclusions and Key Findings Note, Corporate Affairs Division, Directorate for Financial and Enterprise Affairs, Organisation for Economic Co-operation and Development 2 rue André-Pascal, Paris 75116, France <http://www.oecd.org/>

¹¹⁶ Armour, A., Hansmann, H. and Kraakman, R., 'Agency Problems, Legal Strategies and Enforcement' Law and Economics Working Paper, Oxford University faculty of Law, Yale Law School and Harvard Law School: <http://ssrn.com/abstract=1436555>

B. Independent Directors

The function of the board of directors is two-fold. The board must lead the company by determining future strategy, while monitoring and controlling its current performance.¹¹⁷ It has been said that non-executive/independent¹¹⁸ directors should contribute to both the functions.¹¹⁹ Their 'independence' means that they have an important role to play in monitoring RTPs. When considering a RPT, the responsibility of the independent director is to comment whether the transaction is fair and reasonable so far as the shareholders are concerned and whether the transaction is to the detriment of minority shareholders. The opinion must set out the reasons for, the key assumptions made and the factors taken into consideration in forming that opinion and to advise minority shareholders on whether they should vote in favour of the transaction.¹²⁰

In Malaysia, requirements for appointing independent directors to monitor transactions between companies and their directors and/or controlling shareholders are found in the LRs. Paragraph 15.02 of the LRs require at least two directors or one-third of the board (whichever is higher) to be independent.¹²¹ The definition of an independent director under the LRs is a person independent of management and free from any business or other relationship which could interfere with the exercise of independent judgment or the ability to act in the best interests of the company.¹²² An independent director does not get involved in the day-to-day running of the company. Further, there is no contract of service between the director and company. The concern for minority shareholders is whether the independent director will give an honest opinion to the minority shareholders bearing in mind that the majority are the ones who appointed him/her.

The Malaysian Code on Corporate Governance 2000¹²³ introduced a form of proportional representation by requiring that one-third of the board should comprise of independent directors.¹²⁴ The Code was revised in 2007. The key amendments to the Code were aimed at strengthening the board of directors and audit committees, and ensuring that the board of directors and audit committees discharge their roles and

responsibilities effectively. The new Code states that independent directors should continue to make up at least one-third of the members of the Board and that there should be a more meaningful and independent oversight function. However, it is worth noting that in the Asian context, the OECD has cautioned against complacency on the issue of director 'independence'. The Paper stated that:

While the theory on independent non-executive approval may hold some appeal, real-life experience in Asia reveals shortcomings not unlike those in other regions. High ownership concentration among Asian listed companies means that controlling shareholders usually select the entire board of directors. In these and similar cases, non-executive directors can fail to demonstrate in practice the independent judgment required to make their consent an effective safeguard against abuse. In other cases, non-executive directors assume their duties with an independent mindset but cease to maintain it over time as their sympathies, or their interests become too closely aligned with insiders. Finally, passive or acknowledgeable directors can fail to scrutinise transactions closely enough to apply informed, independent judgment, even if their level of activity may be sufficient to shield them from liability from negligence.¹²⁵

It is also worth noting that there are some contradictions in the conventional approach to board effectiveness and compassion, including the emphasis on 'independent' directors. It may well be that the emphasis on independent directors has been overplayed. As Carter and Lorsch¹²⁶ point out:

Assumptions about board effectiveness have considerable impact on composition of boards and how directors approach their duties...But assumptions are flawed and unintended consequences can cause problems for boards that diminish their effectiveness.

In fact, independent directors with no relationship to the company are not likely to know very much about its business and will have to learn, and will be dependent on management for this.¹²⁷ This underscores the fact that independence of judgment, as emphasized by the OECD, will be more important as a safeguard against improper actions by directors and related parties, than strict or technical definitions of independence.

Another unintended consequence of the push for 'independent' boards may have arisen as a result of recent changes to the Code 2007. The revised Code states that in circumstances where a company

¹¹⁷ 'Corporate Governance in Malaysia: Reforms in Light of Post-1998 Crisis', Phillip Koh Tong Ngee, chapter in *Reforming Corporate Governance in South-East Asia, Economics, Politics and Regulations*, (2005) edited by Ho Khai Leong, ISEAS, 129.

¹¹⁸ Paragraph 1.01, LRs.

¹¹⁹ Ibid.

¹²⁰ Paragraph 15.2, LRs.

¹²¹ See n 75, above

¹²² Practice Note 13/2002.

¹²³ See n 4, above.

¹²⁴ Paragraph 15.26, LRs.

¹²⁵ 2003 OECD White Paper on Corporate Governance in Asia, para [124] 27.

¹²⁶ Carter, C. and Lorsch, J. 'Back to the Drawing Board: Designing Corporate Boards for a Complex World (2004) Harvard Business School Press, 42-3.

¹²⁷ Ibid.

has a “significant shareholder”, in addition to the requirement that one-third of the board should comprise independent non-executive directors, the board should include a number of directors which fairly reflects the investment in the company by shareholders other than the significant shareholder. For this purpose, a “significant shareholder” is defined as a shareholder with the ability to exercise a majority of votes for the election of directors. Further, the Code states that in circumstances where a shareholder holds less than the majority but is still the largest shareholder, the board will have to exercise judgement in determining the appropriate number of directors which will fairly reflect the interest of the remaining shareholders.

The exclusion of substantial shareholders from independent participation on boards can have the effect of disenfranchising a significant group of persons with a strong incentive (as a result of their large shareholding) to ensure that their rights are not aggrieved by the conduct of the controlling shareholders. At times, the collective action problems preclude effective monitoring by small shareholders. However, large shareholders, in defending their own self-interests will often defend the interests of the small shareholders as well. Therefore, to exclude these persons or their nominees from the definition of ‘independent’ and thereby from the various board committees that mandate the presence of an independent majority may seriously erode the ability of large outside shareholders to make it harder for the insiders of a company to ignore or deceive a minority shareholder.

C. Shareholder Approval

The right to vote is one of a member’s fundamental rights.¹²⁸ It is recognised in Malaysia as a proprietary right and every member has an unfettered right to exercise his/her votes as attached to the shares.¹²⁹

We have already referred briefly, above, to the need for shareholder approval of RTPs under the common law, and more recently the LRs. At common law, a director must not place himself/herself in a situation where personal interest may actually or possibly conflict with his/her duty to act in the interest of the company. The common law states that directors may be held liable for a breach of fiduciary duty unless shareholders’ approval or ratification at the general

meeting has been obtained in respect of transactions that involve a conflict of interest.¹³⁰

Although the common law provides that a director has a duty to avoid conflict of interest situations, which include self-dealing transactions, the common law fiduciary duty may be inadequate because such a duty would not be applicable where the director did not have a direct pecuniary interest in the transaction, or did not intend to cause any detriment to the company. In addition, under the common law there is no prohibition on the company entering into the transaction. More significantly, there is also generally no prohibition on a director who is a shareholder also voting on the transaction in which he or she has an interest¹³¹ and this may enable the director or related persons to use their voting power to expropriate the company’s assets at the expense of the minority shareholders, although in some cases the vote of the majority shareholders at a general meeting may constitute a fraud on the minority.¹³² Whilst a director may be held liable to account for the profits he or she accumulated as a result of the breach of duty under the common law, there is however no criminal liability.

There are provisions in the Act governing specific conflict of interest situations which require shareholder approval for the disposal or acquisition of a company’s main undertaking or assets;¹³³ for the issue of shares by directors,¹³⁴ and for the acquisition and disposal of substantial non-cash assets. The specific provisions on substantial asset transfers, contained in s 132E, apply to both directors and persons connected with directors. These transactions require disclosure to and approval of shareholders. Since the introduction of the *Companies (Amendment) Act 2007*, substantial shareholders are also caught under this provision.¹³⁵ Section 132E now provides that no director, substantial shareholder or connected person can acquire shares or non-cash assets of requisite value from the company or dispose of such shares or non-cash assets of unless they have had prior approval of the transaction by a resolution of the company at a general meeting. Without such approval the transaction is voidable at the instance of the company unless the arrangement and transaction

¹²⁸ It is uncommon in Malaysian PLCs to have non-voting shareholdings.

¹²⁹ Section 148 of the Act provides that every member shall have the right to vote on any resolution notwithstanding anything to the contrary in the company’s memorandum and articles of association .

¹³⁰ *Cooks v Deeks* [1916] 1 AC 554; *Avel Consultants Sdn Bhd v Mohamad Zain Yusof* [1985] 2 MLJ 209; *Yukilon Manufacturing Sdn Bhd v Dato’ Wong Gek Meng* [1998] 7 MLJ 551.

¹³¹ *North-West Transportation Co v Beatty* (1886)12 SCR 598.

¹³² *Cook v Deeks* (1916) 1 AC 554.

¹³³ Section 132C Act. The *Companies (Amendment) Act 2007* amended s 132C by inserting the definition of ‘substantive value’.

¹³⁴ Section 132D Act.

¹³⁵ Another disclosure requirement of companies in Malaysia is the composition of the firm’s equity ownership.

are ratified within a reasonable period by the company in general meeting. The term 'any arrangement or transaction' includes a number of transactions which have a common purpose.¹³⁶

Section 132E covering substantial asset transfers is in some respects quite narrow. For example, it only applies to non-cash transfers. It is also subject to a minimum threshold requirement and a number of broad exceptions.¹³⁷ A decade ago the Finance Committee¹³⁸ expressed concern about this provision in the Act which allows for ratification of a substantial property transaction, observing that in practice shareholders may be unwilling to vote against a transaction that has already been entered into. The Finance Committee recommended that the provision should be removed and the Act should be reformulated to adopt a simplified method of defining a substantial property transaction. Unfortunately, these recommendations were not adopted by the *Companies (Amendment) Act 2007*. However, some safeguards have now been introduced to mitigate the influence of the controlling or substantial shareholders.

There is no doubt that these are needed. Loh¹³⁹ highlighted that the purpose of the Act as a source of law to safe-guard minority shareholders from unfair RPTs is not served if the wrong-doers themselves are allowed to vote in a ratification exercise. He went on to say that in Malaysia, with concentrated shareholding companies, it can safely be assumed that directors acting in contravention of the Act command or are able to command, a sufficient number of votes, either directly or indirectly, to enable effective ratification would be effective. He suggested that for better governance of management, errant directors and persons connected to them holding shares in the company should not be allowed to vote at a general meeting to ratify the contravention. A prohibition on voting by interested parties has now been incorporated in the new section 132E (3), inserted by the *Companies (Amendment) Act 2007*. This reinforces the general provision, also introduced by the *Amendment Act*, s 131A, discussed above, restricting participation and voting by interested parties.

To complement its review of the substantial property transaction provisions, the CLRC was of the view that the definition of persons connected to directors under the Act should be tightened and clarified, to provide a more precise definition of the

phrase 'person connected to directors'.¹⁴⁰ The amendment to s 122A (2) of the Act is based on the view that familial connections and relationships often give rise to the ability to influence. The CLRC also stated that in cases where the director or substantial shareholder may not be aware that the transaction is entered into with persons connected to them, the proposal that parties who are 'innocent' of the contravention should not be made liable provides adequate protection for the director or substantial shareholder. The recent amendment to the *Companies Act*¹⁴¹ reflects this recommendation placing liability only on directors who 'knowingly authorize the company to carry into effect such transactions'.

In addition to the substantial asset provisions, discussed above, the Act also contains several other specific related party prohibitions which reinforce general provisions against conflicts of interests¹⁴² and act in addition to the common law fiduciary principles set out in established cases.¹⁴³ For example, under s 130 loans to directors or persons connected to directors are prohibited except in the case of exempt private companies.¹⁴⁴ Unlike the substantial asset provisions, shareholder cannot vote to approve loans to directors. However, as presently formulated, the Act narrowly only prohibits loans and guarantees. Other financial benefits to directors and related parties such as gifts, quasi loans and generous extension of credit facilities are not covered. There are also a number of exceptions to the loan prohibition, which are subject to the approval of the shareholders in general meeting.

The Finance Committee¹⁴⁵ recommended amendments to close off the apparent loopholes allowing other types of financial benefits which have the potential to adversely affect the company to be provided to directors and others.

D. Listing Requirement amendment affecting RTPs

A wide range of transactions are now regulated by the LR. They include such transactions as the acquisition, disposal or leasing of assets, the establishment of joint ventures, the provision of financial assistance, the provision or receipt of

¹³⁶ In *MUI Plaza Sdn Bhd v Hong Leong Bank* [1998] 6 MLJ 203, entering into six tenancies constituted an 'arrangement or transaction'.

¹³⁷ Section 132F Act.

¹³⁸ Finance Committee, "Report on Corporate Governance" (February 1999), online: <http://www.sc.com.my/visited> 10 January, 2007).

¹³⁹ Loh Siew Cheang, *Corporate Powers, Remedies and Decision-making*, (1996) LexisNexis Butterworth, 281.

¹⁴⁰ See n 14, above.

¹⁴¹ Section 132E (6) *Companies (Amendment) Act 2007*.

¹⁴² The provisions in the Act governing specific conflict of interest situations are ss 133 and 133A prohibiting loans and guarantees provided to directors and connected persons and s 132G prohibiting the acquisition of shares or assets in a company in which a director, substantial shareholder or related party has a direct or indirect interest.

¹⁴³ See, for example, *Regal (Hastings) v. Gulliver* [1942] 1 All ER 378 and *Cook v Deeks* [1916] 1 AC 554.

¹⁴⁴ Section 4 Act.

¹⁴⁵ See n 96, above.

services or any business transaction or arrangement entered into. This is in contrast to the specific provisions in the Act, which are confined only to the acquisition and disposal of assets.¹⁴⁶

Recent amendments to the LRs,¹⁴⁷ as we have indicated, strengthened the provisions on RPTs, which are now generally tighter than the rules under the Act, given that the RPTs now require the approval of the shareholders after the independent advisor has explained to them the nature of the RPT. Additionally, there is a wider range of transactions which are prohibited under the LRs than under the Act. The prohibitions under the LRs include providing an indemnity¹⁴⁸ and forgiving a debt, not enforcing or assuming financial obligations of another.¹⁴⁹ There are also standard strategies like the imposition of certain duties on directors of a listed company for example a duty of disclosure and the expansion of the role of the independent adviser to include advising minority shareholders in relation to voting on the related party transaction in question.¹⁵⁰ For recurrent RPTs, the LRs have introduced a threshold for the requirement to disclose in the annual report, the aggregate value of recurrent transactions made during the financial year for which a mandate has been obtained, amongst others for the protection of minority shareholders in the event of RPTs when the controlling shareholders divert value unfairly from the company and the minority shareholders to themselves.¹⁵¹

In addition, under the LRs, a listed company may only:

- i. lend or advance any money; or
- ii. guarantee, indemnify or provide collateral for a debt,¹⁵² to or in favour of directors or employees of the listed issuer or its subsidiaries or persons to whom the provision of financial assistance is necessary to facilitate the ordinary course of business of the listed issuer or its subsidiaries or associated companies.¹⁵³ The transaction may only proceed if it 'fair and reasonable to the listed issuer and not to the detriment of the listed issuer and its shareholders'.

¹⁴⁶ Sections 132E, 132F and 132G Act.

¹⁴⁷ Bursa Malaysia, Practice Note No. 12/2001, issued in relation to paras. 10.08, 10.09, 2.06, 2.08 and 2.19 of the LRs.

¹⁴⁸ Ibid.

¹⁴⁹ Para 10.02, LR. In this respect, Australia does not have a total prohibition. They have arm's length or disinterested shareholder approval.

¹⁵⁰ See n 105, above.

¹⁵¹ Ibid.

¹⁵² These transactions are termed in the LRs as 'giving financial assistance'.

¹⁵³ Para 8.23, LR.

E. Directors' Duties Provisions

Besides steps taken by the Code, LRs and legislation to require disclosure and prohibition of RPTs, there are also statutory duties imposed on directors under s 132 of the Act. The *Companies (Amendment) 2007* inserted a number of provisions into the Act clarifying and extending the duties directors owe to their companies. Some of these changes build on reform recommendations of the Finance Committee and the CLRC. The amendments relating to directors' duties to act honestly and avoid conflict of interest reinforce the specific rules in regulating RPTs. The Act expressly states that the statutory duties operate in addition to any general law duties.¹⁵⁴

The Act formerly imposed a broad duty on directors at all times to act honestly and exercise reasonable diligence in the exercise of their powers and the discharge of the duties of their office.¹⁵⁵ However, the meaning of 'honesty' under the Act was not entirely clear. It was question of fact, based on the circumstances of the particular case, as to what 'honestly and reasonably' means. The test for dishonesty seemingly placed an emphasis on subjective, rather than objective factors. The Finance Committee and the CLRC therefore both recommended that the statutory duty to act honestly be reformulated to require directors to exercise their powers for a proper purpose and in good faith in the best interests of the company.¹⁵⁶ The replacement of the duty to act 'honestly' with the requirement that directors act 'bona fide in the best interests of the company' was recommended to avoid the confusion concerning the meaning of 'honesty' in the context of directors' duties. This reformulation places a higher objective standard on directors involved in related party transactions and brings greater certainty to the law, as there is a body of case law in other jurisdictions which on which has clarified the meaning of the good faith test.

Directors are also under a duty to avoid conflicts of interest. This means that they must not allow a situation to develop where their duties to the person for whose benefit they act and their personal interests are in, or may be in conflict. This is a crucial aspect of the fiduciary duties owed by directors to their company. The fiduciary duty to avoid conflict of interests has been applied in various circumstances. The common feature in all cases in which a breach of the duty has been established is that the directors placed themselves in a position where they put or may have put their own interests ahead of the interests of the company,

¹⁵⁴ Section 132(5) Act.

¹⁵⁵ This has now been amended by the *Companies (Amendment) Act 2007*.

¹⁵⁶ Chapter 2, Para 10.03, 108, Committee's Final Report, released in November 2008. See n 2, above.

as in the case of a related party transaction.¹⁵⁷ Again, both the Finance Committee and CLRC recommended that the common law fiduciary duty to avoid conflicts of interest should be codified. This required that a clear set of rules be inserted into the Act. While the fiduciary rules have evolved in some detail in case law over many years, the reform bodies argued that it was inappropriate for the matter to be left purely to case law. Case law principles have frequently developed in the context of the legal frameworks of different jurisdictions and the rules obviously operate by reference to the particular facts of the case in question. The course of law reform in Malaysia required a more settled set of rules than that provided by case law.

Amendments to s 132 inserted by the *Companies (Amendment) 2007*¹⁵⁸ impose the duty that directors or officers of a company shall not use the property of the company, any information acquired by virtue of their position as a director or officer of the company, their position as a director or officer, any opportunity belonging to the company; or engage in business is in competition with the company, to gain directly or indirectly, a benefit for him/herself or any other person, or cause detriment to the company. There will be no breach if the consent or ratification of a general meeting was obtained.

The codification of these specific common law rules sends a strong signal to directors of all companies, not just those in the listed sector, that conflicts of interest causing detriment to the company and its stakeholders will not be tolerated. They rules are now backed up the remedies and sanctions in the amended Act, including s 132E and s 368A.

F. Enforcement

Introducing legal rules and principles to regulate RTPs is not enough. Ensuring compliance is an essential component of shareholder protection. Compliance with these rules is monitored by the Securities Commission, *Bursa Malaysia*, the Companies Commission of Malaysia (CCM) and company auditors.¹⁵⁹ Enforcement of laws by the regulators¹⁶⁰ is an important issue for the protection of minority shareholders in Malaysian PLCs from the actions of controlling shareholders and directors who are engaged in RPTs and other conflict of interest situations. Unfortunately, despite increasingly stringent corporate laws and

regulations, regulatory enforcement in Malaysia has generally been considered poor. This is illustrated by the Credit Lyonnais Securities Asia last survey.¹⁶¹

The Securities Commission has investigated a significant number of cases ranging from submission of false and misleading information, the use of schemes to defraud as well as the engagement in acts to defraud and short-selling¹⁶² however, the prosecution of blatant breaches of law by politically well connected persons in PLCs has been extremely slow.¹⁶³ Table 1 illustrate the number and type of enforcement action taken by Securities Commission from 2005 up until December, 2008.¹⁶⁴

¹⁵⁷ A case example is *Aberdeen Railway Co v Blaikie Bros* (1854) 1 Macq 461.

¹⁵⁸ Section 132 (2).

¹⁵⁹ The Police and the Anti-corruption Agency (ACA) are also vested with the authority to investigate corporate crimes.

¹⁶⁰ This includes the Securities Commission, Bursa Malaysia and the Companies Commission of Malaysia.

¹⁶¹ CLSA, 2001. See n 11, above.

¹⁶² The World Bank Group, Reports on the Observance and Standards of Codes – Malaysia', <http://www.worldbank.org/>.

¹⁶³ Raphael, P. (1997) "Confidence erodes in Malaysia's ability to carry out corporate damage control" AWSJ 21-22 September at 1.

¹⁶⁴ <http://www.sc.com.my> (viewed 5th January, 2009).

Table 1. The number and type of enforcement action taken by Securities Commission from 2005 up until December, 2008

Year	Number of Cases		
	Administrative Actions	Criminal Actions	Cases Compounded
2005	2	12	9
2006	1	9	6
2007	2	11	3
2008	8	12	4

Source: <http://www.sc.com.my>

With over 1000 PLCs in Malaysia, clearly the number of cases of administrative action taken, criminal cases commenced and cases compounded by the Securities Commission is extremely low.

The quality of public governance is an important point to consider in the context of enforcement. The political interference in the law enforcement process which has generally undermined public confidence in public governance also impacts upon the corporate sector in Malaysia¹⁶⁵ affecting governance over institutions such as the Securities Commission, the Companies Commission and Bursa Malaysia. The independence and transparency of these bodies have been questioned in the past where there were blatant breaches of the law and the regulatory bodies were slow to prosecute.¹⁶⁶ It is well known that corporate misdeeds involving companies controlled by preferred political cronies have gone unremedied and sometimes followed by government bailouts. Weaknesses in public governance have been uncovered by the extensive economic literature on corporate wrongdoing and political cronyism.¹⁶⁷ PLCs in Malaysia are highly concentrated and ownership involves people with strong political connections. It therefore places the regulators, who are government appointees and answerable to the Minister of Finance, in a very difficult position if they have to sanction these

companies for having breaches of laws, regulations or best practices.

Bursa Malaysia has in recent times been more proactive in terms of enforcement. It has many powers to ensure compliance with the LRs and to penalise offenders.¹⁶⁸ These include powers to impose fines and to issue a public reprimand.¹⁶⁹ Its powers are not confined to sanctioning the listed company itself, but in some instances, extend to the directors and officers of the company.¹⁷⁰ It has taken action, more often through public reprimands.¹⁷¹ One of the powers of the *Bursa Malaysia* which has been under some criticism is the power to delist companies from the exchange. This effectively means that the company no longer enjoys a listing status and its shares are not tradable on the stock exchange. It has been argued that delisting may not necessarily be in the best interests of the minority shareholders. The company no longer comes under the purview of the *Bursa Malaysia* and the shareholders therefore lose the protection afforded to them under the relevant rules of the *Bursa Malaysia*. An example of this is in the case of access to information. Information is critical and valuable. The shareholders would find it more difficult to gain access to information about the company upon the delisting of the company since the strict requirements to furnish information under the *Bursa Malaysia* framework may no longer be applicable. A study by the Credit Lyonnais Securities Asia 2010¹⁷² last survey in Table 2

¹⁶⁵ See, speech by Lee Chong San, Deputy President, Transparency International, "Corporate Governance and Transparency" Malaysia, Kuala Lumpur, August 2005. Available at: <http://www.transparency.org.my/>

¹⁶⁶ Raphael, P. (1997) "Confidence erodes in Malaysia's ability to carry out corporate damage control", *Asian Wall Street Journal*, 21-22 September at 1, (for example, the cases of Renong and Promet Bhd); Gomez, E.T., and Janine Pascoe, 'Corporate Law Reform and some "Rule of Law" issues in Malaysia' (2008) 38 (3) *Hong Kong Law Journal* 769.

¹⁶⁷ See, Gomez, E.T., and Jomo, K.S, *Malaysia's Political Economy: Politics, Patronage and Profits*, New York: Cambridge University Press, 1999; William Case, "Malaysia: New Reforms, Old Continuities, Tense Ambiguities" (2005) (4) *Journal of Development Studies* 284.

¹⁶⁸ Paragraph 16.16, LRs.

¹⁶⁹ Paragraph 16.17(1) (a), LRs.

¹⁷⁰ Paragraph 16.16, LRs. The actions or penalties imposed on such parties are the same as that imposed on the listed company, Paragraph 16.17(1)(b) and (c)).

¹⁷¹ The most recent being against Datuk Keramat Holdings Berhad for breach of paragraphs 9.03(1), 9.04(f) and 9.04(l) of the LRs and paragraphs 2.1(d) and 3.2 of Practice Note No. 1/2001.

¹⁷² The Credit Lyonnais Securities Asia (CLSA) 2010 survey showed that Malaysia's enforcement of laws is generally poor. They gave Malaysia a score of 38% for enforcement. This was far below Singapore, Hong Kong, Japan, Taiwan and Thailand. http://www.acga-asia.org/public/files/CG_Watch_2010_Extract_Final.pdf (viewed on 23rd June, 2011.)

illustrates that Malaysia has fairly tough corporate laws and regulations but the enforcement and CG

culture is generally poor compared to Singapore.

Table 2. Market category scores on compliance of CG regulations and enforcement in Southeast Asia

(%)	Singapore	Hong Kong	Japan	Taiwan	Thailand	Malaysia
CG Rules and Practices (%)	65	59	57	50	56	49
Enforcement (%)	60	63	53	47	42	38
Political & Regulatory (%)	69	67	62	56	54	60
IGAAP (%)	88	80	75	78	73	80
CG Culture (%)	53	54	53	46	49	32
Total (%)	67	65	57	55	55	52

Source: Asian Corporate Governance Association

The table below shows the percentage scores that each market gained in the five categories in the survey: “CG Rules and Practices”, “Enforcement”, “Political and Regulatory Environment”, “IGAAP” (ie, accounting and auditing) and “CG culture”.

To add to the problem of enforcement (and maybe it is another cause and effect of poor enforcement) is the existence of corruption. The Transparency International 2009 report¹⁷³ and the World Business Environment Survey¹⁷⁴ show remarkably high figures in comparison, for example, to Singapore. In Malaysia, 20% of public officials take bribes frequently whereas an additional 25% take them sporadically, compared to Singapore where, according to the reports, there is almost no corruption.¹⁷⁵ The establishment of the Malaysian Anti Corruption Commission which commenced operations on 1 January 2009 is a necessary and important initiative, given evidence of entrenched corruption in Malaysian society.

III. CONCLUSION

There is cautious optimism that genuine changes are occurring in Malaysia, albeit slowly, in terms of higher standards of corporate governance for listed companies and a greater willingness to accept accountability and to protect minority shareholders against conflict of interest by related parties in Malaysian PLCs. While there is little debate that the various compliance requirements put in place to protect minority shareholders impose a heavier load

on companies, particularly smaller listed companies, compliance costs have to be seen in the context of companies’ commitment to enhancing their ethical and governance frameworks. Having higher standards of integrity and ethics, particularly by improving the ‘tone at the top’ in signalling that RTPs need strict controls, is good for companies, investors and shareholders. Much has been achieved, on paper at least, in terms of the formulation of higher standards designed to ensure sound systems and practices in place to protect minority shareholders. While this is commendable, evidence of ongoing RPTs and mismanagement is still being uncovered¹⁷⁶ and the challenge is to enhance regulatory capacity and address issues of weak enforcement.

An important aspect of shareholder protection is the Malaysian culture. It is not the Malaysian culture to be confrontational.¹⁷⁷ These aspects of the culture have resulted in minimal shareholder activism in Malaysia. Minority shareholders would rather accept their fate than to confront the majority in power especially if the majorities have political power or are the founders. A small number of minority shareholders know of their rights but do not exercise them, whereas the bulk of the minority shareholders do not even know of their rights. As a writer stated,¹⁷⁸ the mindset of Malaysian minority shareholders is such that they view themselves as shareholders rather than share owners and as owners, they have a stake in how the company is

¹⁷³ Transparency International - Global Corruption Report 2009.

Available at <http://www.transparency.org/publications/2009> (viewed 30 October, 2009).

¹⁷⁴ World Business Environment Survey, World Bank, 1999

¹⁷⁵ Ibid.

¹⁷⁶ Above n 6.

¹⁷⁷ Hartog, D.N.D., ‘Assertiveness’ in House, R.J., Hanges, P.J., Javidan, M., Dorfman, P.W. and Gupta, V. (eds), *Culture, Leadership and Organizations: The GLOBE Study of 62 Societies*, (Sage Publications, (Thousand Oaks, California, 2004) 410–411.

¹⁷⁸ Jalalullal Othman, ‘Corporate Governance after the Enron Experience’, (2003), paper presented at Commonwealth Law Conference, Melbourne, Australia.

being managed. As holders of shares, they accept the manner in which the company is being run. The reluctance to confront and antagonize means they would rather be spectators to the event instead of drivers and catalysts for change.¹⁷⁹ The paternalistic approach to conducting matters is also an aspect of Malaysian culture. The shareholders would usually rely on the majority shareholders of the company to manage the company in whatever manner and believe that they would look out for the best interests of the minority shareholders. However, the establishment of a Minority Shareholder Watchdog Group in Malaysia¹⁸⁰ shows that these cultural patterns can be changed with time.

Finally, in more recent times there have been concerns about whether Malaysia's legislative agenda to enhance corporate governance standards and protect minority shareholders represents a genuine reform initiative or a knee-jerk reaction to the financial crises and the need to shore up foreign investment.¹⁸¹ The 2007 survey¹⁸² undertaken by brokerage house CLSA and the Asian Corporate Governance Association ('ACGA') revealed that a number of common problems still exist across the region, including poor quality of quarterly reporting, the independence of audit committees and political influence on regulatory action. Commenting on the 2007 findings, the ACGA noted that after initial improvements following the Asian Financial crisis, Malaysia's corporate governance scorecard has slipped in recent times. It concluded¹⁸³ that Malaysia's corporate governance practices are unimpressive and lack commitment to genuine governance. Although regulators are well-staffed, the ACGA pointed to political and other obstacles to sound enforcement, with limited private enforcement.

Another related concern is that the government's genuine commitment to corporate law reform may have been undermined by the drafting and release of the *Companies (Amendment) Act 2007* prior to the handing down of the Committee's Final Report. Although generally adopting some of the CLRC's recommendations for strengthening the duties of directors and officers

and for the regulation of substantial property transactions, there was no consultation or transparency in the implementation of the legislation, which pre-empted the Committee's final views. It is not clear why the Act was amended before the CLRC had completed its Final Report, although a possible explanation is that the government wished to strengthen key provisions relating to directors' and officers' duties in the light of impending problems which might arise as a result of possible fall-out from the United States 'sub-prime' financial sector crisis.¹⁸⁴ In other words, the government needed to be seen to be doing something. The Explanatory Memorandum accompanying the amendments is very brief and provides no background information or analysis of the new provisions. While the amendments are a positive step in addressing the inadequacy of previous provisions in terms of the modern day standards expected of directors and in protecting minority shareholders the fact that they clearly pre-empted the recommendations of the Government's corporate law reform body, while not incorporating all of the fine details of its other recommendations, is of concern.

As we have shown in this paper, while there have been some worthwhile reforms concerning RPTs in Malaysia in recent times the problem seems to be with implementation and enforcement. This could be due to a number of factors. It could be a funding and resource issue. Cultural factors come into play. Also relevant is that fact there is no tradition in Malaysia of standing reform committees which put into effect ongoing plans and structures and review the outcomes of previous initiatives to ensure proper compliance and enforcement. It is submitted that corporate law reform should be undertaken on a deliberative and systemic basis, with both the reform process and the implementation stages being fully transparent. A permanent reform body would ensure that matters of best corporate governance practice are regularly addressed and updated and that reforms to critical areas, such as RTPs, do not continue to be undertaken on a piecemeal basis.

An unknown, but undoubtedly significant factor is the ultimate effect that the fallout from the Global Financial Crisis will have on the will and ability of governments everywhere to implement deep and lasting reforms in the corporate and financial sectors.

¹⁷⁹ Ibid.

¹⁸⁰ www.mswg.org.my/

¹⁸¹ Case, W. *Malaysia: New reforms, old continuities, tense ambiguities*, (2005), *Journal of Development Studies* 41(2), 284-309, 288, observes that there has been disillusionment within Malaysian government circles about the ability of the various market reforms and good governance measures to deliver desired economic outcomes, in particular a return to the pre crisis high levels of foreign investment.

¹⁸² CLSA/ACGA: 'CG Watch 2007-ON AQA Wing and a Prayer', Available at <https://www.clsa.com/>

Of 10 countries surveyed in 2007, Malaysia was in 6th place, having slipped from 4th place in 2006.

¹⁸³ 'CG Watch 2007: Market rankings, trends and issues'. Available at: <http://www.acga-asia.org>.

¹⁸⁴ Interview with senior official at the Malaysian Integrity Institute, April 10, 2008. (Transcript on record with the author).