DEALINGS BY A COMPANY IN ITS OWN SHARES – A MALAYSIAN PERSPECTIVE

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I. Introduction

The prohibition against a company acquiring its own shares was originally enunciated by the House of Lords in *Trevor* v *Whitworth*.[1] In this case, the House of Lords held that a company could not purchase its own shares even if there was an express power to do so in its memorandum. The underlying basis of this prohibition is that if such transactions are allowed, it would lead to the depletion and reduction of the company's capital. This in turn will prejudice the interests of the company's creditors who may only look to the capital of the company as a source of funds to obtain payments. The company's creditors take the legitimate risk of the company losing its capital in trading but they have a right to rely on the company not diminishing its capital by returning any part of it to its shareholders.[2] The prohibition also aims to safeguard the interests of the company itself and its shareholders as they are entitled to be protected against the abuse or misapplication of the company's capital by its directors or controlling shareholders.

Subsequent to the landmark decision of *Trevor* v *Whitworth*, the prohibition against a company purchasing its own shares remained as an established feature of English company law. The prohibition ultimately found statutory form in the United Kingdom as a result of recommendations made by the Greene Committee[3] in 1926 and the Jenkins Committee[4] in 1962. Furthermore, having prohibited a company from purchasing its own shares it became apparent that an equally undesirable practice was that of a company giving financial assistance to enable persons to purchase the company's shares. In this regard, both the Greene Committee and the Jenkins Committee recommended an extension to the prohibition of a company purchasing its own shares to the giving of financial assistance to purchase the company's shares.[5]

Many countries that have based their company law on the English model have enacted legislation which embodies the prohibition against companies purchasing its own shares and giving financial assistance on the purchase of its shares. However, in the last five decades, there has been a re-examination of the prohibitions followed by a clear move to relax these prohibitions. Several jurisdictions, including the United Kingdom, Australia, Singapore and Malaysia, have taken steps to modify the law pertaining to dealings by a company in its own shares. The modifications were aimed at a relaxation of the prohibitions. This was achieved by either by adding exceptions to the prohibitions or by clarifying the parameters of the prohibitions.

This aim of this paper is to examine the Malaysian perspective on the law relating to this subject. This paper will discuss the development of the law in Malaysia and will, whenever possible, highlight the challenges that have been faced by the courts when giving effect to and interpreting the law. This paper will also attempt to discuss whether the law in Malaysia on this area provides adequate protection for the company, its creditors and shareholders.

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[1] (1887) 12 App. Cas. 407.

[2] *Ibid.*, at 415, per Lord Herschell.

[3] The Greene Committee Report (Cmnd. 2657, 1926).

[4] The Jenkins Committee Report (Cmnd. 1749, 1962).

[5] The Jenkins Committee in 1962 recommended that the provisions in the Companies Act which made it unlawful for a company to give financial assistance for the acquisition of its own shares, be retained and strengthened. The report, at para 173, stated as follows:-

> *If people who cannot provide the funds necessary to acquire control of a company from their own resources, or by borrowing on their own credit, gain control of a company with large assets on the understanding that they will use the funds of the company to pay for their shares it seems to us all too likely that in many cases the company will be made to part with its funds either on inadequate security or for an illusory consideration. If the speculation succeeds the company and therefore its creditors and minority shareholders may suffer no loss, although their interests will have been subjected to an illegitimate risk; if it fails, it may be little consolation for creditors and minority shareholders to know that the directors are liable for misfeasance.*

II. Dealings By A Company In Its Own Shares – The Prohibition In Malaysia

The law in Malaysia relating to the subject of companies dealing in its own shares is found in section 67 of the Malaysian Companies Act, 1965.[6] The general prohibition which is contained in section 67(1) of the Companies Act 1965 (the Act), states as follows:

> *Except as is otherwise expressly provided by this Act no company shall give, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company or where the company is a subsidiary, in its holding company or in any way purchase deal in or lend money on its shares.*

Section 67(1) contains a widely worded prohibition. According to the section, a company cannot, in any way, purchase, deal in or lend money on its shares. Further, any financial assistance given by the company, directly or indirectly, with the object of dealing in the shares of the company or its holding company is prohibited.

However, it is to be noted that the prohibitions contained in section 67(1) are not absolute. Section 67(2) of the Act identifies three specific situations where the prohibitions contained in section 67(1) do not apply. First, pursuant to section 67(2)(a), financial assistance by way of a loan is permissible if the lending of money is part of the ordinary course of business of the company and the loan itself is within the ordinary course of business. Secondly, section 67(2)(b) permits the provision of money by a company for the purchase of or subscription for fully paid shares in the company by trustees for shares to be held by or for benefit of employees of the company, including full-time salaried directors. Thirdly, section 67(2)(c) allows the giving of financial assistance by a company to persons other than directors, who are bona fide in the employment of the company, for the purchase of fully paid shares in the company to be held by themselves by way of beneficial ownership.

In Malaysia, the courts have shown no hesitation in striking down transactions which fall foul of section 67(1) of the Act. Since its enactment in 1965, section 67 has been raised in the courts on numerous occasions. One such occasion was in the case of *Mookapillai & Anor* v *Liquidator, Sri Saringgit Sdn Bhd.*[7] This case concerned an application by the appellants, the effect of which was to substitute a winding up order granted against the company with the terms of an agreement that had been reached between minority shareholders and majority shareholders of the company. The agreement provided, *inter alia*, that in consideration of the minority shareholders supporting the application, the company would purchase the shares of the minority shareholders and then reduce the paid up share capital of the company. The Federal Court dismissed the appellant's appeal on the basis, *inter alia*, that the scheme proposed by the appellants amounted to the company purchasing its own shares and this was contrary to section 67(1) of the Act.

III. The Prohibition Against A Company's Purchase Of Its Own Shares –A Change In Approach

In 1997 and 1998, significant changes were made to this area of the law in Malaysia. The change came in the form of a new section inserted into the Companies Act 1965, namely, section 67A. Section 67A, which came into force on 1 September 1997, allows public companies to purchase its own shares under certain circumstances. This change in the law was a direct response to the infamous Asian financial crisis which hit Asian financial markets in 1997 and 1998. The crisis uncovered the inadequacies of the capital market in Malaysia and was the catalyst for the passing of legislation to improve the regulatory framework of the capital market and companies in Malaysia. Notably, in the explanatory statement to the Companies (Amendment) Bill 1997 (which introduced section 67A), it was stated that section 67A was to enable

> *... a company to purchase its own shares and give financial assistance to a person to purchase shares in the company if it is made in good faith and in the interest of the company. It is intended to stabilise the supply and demand as well as the prices of the shares of the company on the Stock Exchange and ultimately to create a healthy environment for the capital market in this country.*

The decision by the Malaysian legislature at that time to relax the prohibition against a company's purchase of its own shares was also consistent with the position taken by other jurisdictions such as United Kingdom and Australia. It is to be noted that company law in Malaysia is closely modelled on that of United Kingdom and Australia and it is therefore axiomatic that company law reforms considered in these jurisdictions would have substantial impact in Malaysia.

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[6] Section 67 of the Malaysian Companies Act 1965 is derived from section 67 of the Australian Uniform Companies Act 1961 and section 54 of the English Companies Act 1948.

[7] [1981] 2 MLJ 114.

In the United Kingdom, the initial step to modify the prohibition against a company purchasing its own shares was taken in 1981. Until 1981, the purchase by a company of its own shares and the giving of financial assistance for the purchase of its shares were strictly prohibited under English company law. At this juncture, it would be pertinent to note that a distinction must be made between the purchase of own shares by a company and redemption of shares by a company. Redemption of shares involves the redemption by the company of its shares which were issued on the basis that they are redeemable at the option of the company or the shareholder. The power to issue preference shares as redeemable shares was available to companies in the United Kingdom since the Companies Act 1929.[8] The purchase of shares, on the other hand, involves the purchase back by the company of its own shares and it can apply to any shares whether or not they were issued as redeemable shares. As mentioned above, the purchase by a company of its own shares was forbidden in the United Kingdom until a change in approach took place in 1981.

What prompted the change in 1981? It has been suggested that the change was attributable to a few factors – one of them being the United Kingdom's membership in the European Economic Community (the EEC).[9] The EEC's Second Directive on Company Law contained provisions which forbade the purchase of a company's own shares but made provisions allowing such purchases subject to certain conditions. Thus, the EEC's Second Directive presented an opportunity for the UK Parliament to re-examine the prohibition and to consider the feasibility of its relaxation. Another factor which prompted the re-examination of the prohibition was the need to encourage equity investment in small businesses.[10] Small businesses faced difficulties in trying to raise capital because many of them were family companies and would therefore be reluctant to raise funds through an issue of shares for fear of losing control of the company to an outsider. Thus, there were calls to consider measures to allow small companies to raise capital without having to part with family control. A share buyback scheme may facilitate the achievement of this objective.

These factors led to a consultative paper entitled "Purchase of Company of its Own Shares"[11] (the Green Paper) being presented to Parliament in June 1980 by the Secretary of State. The Green Paper made a series of recommendations to give both public and private companies the power to purchase back its own shares under certain conditions. These recommendations received an enthusiastic response and were implemented in the Companies Act 1981, namely in sections 45 to 62. Subsequent to these changes in 1981, company legislation pertaining to this area in the United Kingdom has undergone further modifications. Currently, the English position on this area can be found in Part 18 of the Companies Act 2006 which came into force on 8 November 2006.

The enactment in the United Kingdom in 1981 was the turning point with regard to the relaxation of the prohibition against the purchase by a company of its shares, not just for the United Kingdom but also for other jurisdictions. The enactment eventually led other Commonwealth jurisdictions to reconsider their laws on this subject. Among others, Australia, Singapore and Malaysia had adopted the path taken by the British and made substantive changes to this area of the law. The Malaysian position will be discussed below.

IV. The Power Of A Company To Purchase Its Own Shares – The Malaysian Position

In Malaysia, the legal framework regulating the power of a company to purchase its own shares can be found in the Companies Act 1965, the Companies Regulations 1966 and the Listing Rules of the Bursa Malaysia. Each of these laws will be considered in turn below.

(i) Section 67A of the Companies Act 1965

As mentioned above, the relevant piece of legislation in Malaysia which allows a public company to purchase its own shares is section 67A of the Companies Act. The section stipulates several conditions which must first be met by a company before it can purchase back its shares. First, the power of the company to purchase its shares must be sanctioned by its articles of association.[12] Secondly, the company must be solvent at the date of purchase and must show that it would not become insolvent by incurring debts involved in the obligation to pay for the shares intending to be purchased.[13] Thirdly, the purchase of the shares must be made

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[8] In the United Kingdom, prior to the Companies Act 1981 only preference shares could be issued as redeemable shares. Subsequently, by virtue of section 159 of the Companies Act 1985, a company may, if authorized by its articles, issue shares of any class which are to be redeemed at the option of the company or shareholders. In Malaysia, section 61 of the Companies Act 1965 permits a company to issue preference shares which are redeemable at the option of the company and the redemption can only be effected on such terms as provided for in the company's articles of association and in accordance with the provisions of the Companies Act.

[9] E. Magner, "The Power of a Company to Purchase its own Shares: A Comparative Approach" (1984) 2 Companies & Securities Law Journal 79 at p. 88

[10] *Id.*

[11] Department of Trade, "The Purchase by a Company of its Own Shares, A Consultative Document", H.M.S.O, Cmnd 7944.

[12] Section 67A(1).

[13] Section 67A(2)(a).

through the Stock Exchange and in accordance with the rules of the Stock Exchange.[14] Fourthly, the company must show that the purchase of the shares is made in good faith and in the interests of the company.[15] It is to be noted that the terms "good faith" and "interests of the company" are not defined in the Act and would therefore be subject to judicial interpretation.

The Act further provides in section 67A(3) that the company may apply its share premium account to pay for the shares which it has purchased. The shares purchased by the company may either be cancelled or retained as treasury shares or a combination of both.[16] If the company decides to retain the purchased shares as treasury shares, the treasury shares may be distributed as dividends to its shareholders (in which case the dividends are to be called "share dividends") or be resold on the Stock Exchange.[17] Section 67A(3D) provides that if the treasury shares are distributed to shareholders as share dividends, the cost of the shares on original purchase shall be applied in the reduction of the share premium account or other funds available for distribution as dividends or both.

Notably, section 67A(3C) states that when the purchased shares are retained as treasury shares, the rights attached to them as to voting, dividends, participation in other distribution or otherwise will be suspended. This means that the treasury shares will not be taken into account when calculating the number or percentage of shares or of a class of shares in the company for any purposes including notices, the requisitioning of meetings, the quorum for a meeting, results of a vote on a resolution at a meeting, substantial shareholding and takeovers. This section allays the concern that if a company had the power to purchase its shares, the power may be abused by the company's controllers to keep or maintain control of the company. For example, in a takeover, the controllers of a target company may seek to marshal the resources of the target company itself to purchase its own shares in order to thwart a takeover by a bidder.

Where the company decides to cancel the purchased shares, the issued and paid up capital of the company shall be diminished by the shares so cancelled and the amount by which the company's issued and paid up capital is diminished shall be transferred to a capital redemption reserve.[18] In this regard, the Act emphasises that the cancellation of shares made under section 67A shall not be deemed as a reduction of capital within the meaning of the Act.[19] This is because the capital redemption reserve will be treated as if it is part of the shareholders funds.

Finally, if a default is made in complying with section 67A, the company, every officer of the company and any other person who is in default shall be guilty of an offence against the Act which is punishable with imprisonment for five years or a fine of RM100,000 or both.

(ii) Part IIIA of the Companies Regulations 1966

The amendments made to the Companies Act in 1997 and 1998 resulted in amendments also being made to subsidiary legislation relating to a company's purchase of its own shares. In this regard, the main piece of subsidiary legislation in respect of the operation of the Companies Act 1965 is the Companies Regulations 1966 (hereinafter referred to as "the Regulations"). In September 1997, the Companies (Amendment) Regulations 1997[20] inserted Part IIIA into the Regulations. Part IIIA, entitled "Shares Buy Back by a Company", contains eight regulations, namely, Regulations 18A to 18G.

Regulations 18A to 18C deal with a declaration that must be made by the directors of a company before a share buyback scheme is carried out. Regulation 18A(1) states that the directors of the company must make a declaration that they have conducted an inquiry into the affairs of the company and at a meeting of directors, have formed an opinion *inter alia*, that (1) it is "necessary" for the company to buy back its own shares and (2) the company is solvent at the date of the declaration and the buyback will not result in the company being insolvent or its capital being impaired. Additionally, the declaration must also state that the company will be able to remain solvent after each buyback during the period of six months after the date of the declaration and that the buyback is made in good faith and in the interests of the company. It has been suggested that the use of the word "necessary" in Regulation 18A(1) is nebulous as it raises the question as to whether the directors have to consider that there is a commercial necessity to undertake a share buyback before

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[14] Section 67A(2)(b).

[15] Section 67A(2)(c).

[16] Section 67A(3A).

[17] Section 67A(3B).

[18] Section 67A(3E).

[19] Section 67A(5). It may be noted that under the section 64 of the Act, a company must comply with special procedures before a reduction of capital can take place.

[20] PU(A) 337.

proceeding with the scheme.[21] This ambiguity may cause difficulties for a company proposing to undertake a share buyback scheme. If, for example, a company with excess funds wishes to distribute these funds to its shareholders by way of share buyback scheme followed by an issue of bonus shares to its shareholders – this company may be unable to show that the share buyback is "necessary" for the company. Thus far, the issue as to the proper construction to be given to the word "necessary" in Regulation 18A(1) has not been raised or litigated upon in the Malaysian courts.

Regulation 18B states three requirements that must be met in order for the declaration made under Regulation 18A(1) to be effective. First, the declaration must be made at a meeting of directors. Secondly, it must be made within seven days immediately preceding the first share buyback after making the declaration. Thirdly, the declaration must be lodged with the Registrar of Companies and the Stock Exchange with a copy extended to the Securities Commission within seven days after it is made. Regulation 18BA provides for the period of validity of the declaration, namely, it shall be valid for a period of six months after the date it is made unless earlier revoked.

Notably, Regulation 18C makes it clear that directors must take utmost care before making the declaration required under Regulation 18A(1). This is because a director who makes this declaration without having reasonable grounds for his decision shall be guilty of an offence under the Regulations.

Regulations 18D to 18F deal with adjustments to made to the register of substantial shareholders in the event that a person becomes a substantial shareholder as a result of a share buyback scheme. These Regulations are necessary provisions to ensure the company's compliance with Division 3A of the Companies Act 1965 which provides that certain notices must be made by substantial shareholders of a company. Finally, Regulation 18G(1) provides that where a company has either sold or cancelled any of its treasury shares, it must, within fourteen days, lodge a notice of such sale or cancellation to the Registrar of Companies, Stock Exchange and Securities Commission. Failure to comply with this Regulation will result in the company and every officer of the company who is in default to be guilty of an offence.

(iii) Chapter 12 of the Listing Rules of the Bursa Malaysia

Apart from the Companies Act 1965 and the Companies Regulation 1966, the Listing Rules of the Bursa Malaysia Securities Sdn Bhd (the Stock Exchange in Malaysia) also contains provisions relating to the purchase by a company of its own shares. Chapter 12 of the Listing Rules sets out certain requirements which must be complied with by a company listed on the Exchange in respect of the purchase of its own shares. These requirements relate to *inter alia*, the obtaining of authorisation from the shareholders to carry out a share buyback scheme,[22] the source of funds to be used for the share buyback,[23] a declaration of solvency to be made preceding the share buyback[24] and other additional requirements regulating matters such as the purchase price and resell price of the shares.[25]

As can be seen from the discussion above, Malaysia has a comprehensive legal framework regulating a company's power to purchase its own shares. It is clear that there are stringent, rigorous and mandatory requirements that must be fulfilled by a company before it can exercise its power to buy back its shares. These requirements help to ensure that a company will undertake share buyback schemes only when it is beneficial to the company itself and its shareholders. At the same time, these requirements eliminate or reduce possible abuse of a company's power to purchase its shares. The power is also subject to strict scrutiny by three regulatory bodies namely, the Registrar of Companies, the Bursa Malaysia and the Securities Commission. Furthermore, the imposition of criminal penalties for default of the provisions of the Companies Act and Regulations will help to deter abuse and also ensure compliance of these laws.

In formulating these laws it is submitted that the legislature in Malaysia has taken into account the interests of the company's creditors as well as that of its shareholders. The law as it stands provides adequate safeguards to protect the interests of creditors against the dissipation or depletion of the company's capital. The law also preserves the welfare of shareholders in that there is little chance for the misapplication of the company's capital by controlling shareholders or directors via a share buyback scheme.

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[21] Aishah Bidin, "The Position of Share Buybacks in Malaysia and Recent Amendments to the Malaysian Companies Act" (1999) 20(10) Company Lawyer 339-344.

[22] According to clause 12.04, a listed company must not purchase its own shares unless the shareholders of the listed company have given an authorization to the directors of the company to make such purchase(s) by way of an ordinary resolution which has been passed at a general meeting. In this regard, clause 12.07 and Appendix 12B of the Listing Rules sets out the matters that must be included in the ordinary resolution for the share buyback.

[23] Clause 12.10 of the Listing Rules provides that a company must ensure that the proposed purchase of its own shares is made wholly out of retained profits and/or the share premium account of the company.

[24] See clauses 12.12 and 12.13 of the Listing Rules.

[25] See clauses 12.14 to 12.25 of the Listing Rules.

V. The Giving Of Financial Assistance By A Company For The Purchase Of Its Own Shares

Another form of prohibited practice in connection with a company's dealings in its own shares is the giving of financial assistance for the purchase of the company's shares. As has been mentioned above, section 67(1) of the Malaysian Companies Act expressly prohibits any financial assistance given by the company, directly or indirectly, with the object of dealing in the shares of the company or its holding company. It would be pertinent to take note again of the relevant part of section 67(1), which states as follows:-

> *... no company shall give, whether directly or indirectly and whether by means of a loan guarantee or the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for any shares in the company...*

In this regard, it is to be noted that unlike the position in the United Kingdom, the words "financial assistance" is not defined in the Malaysian Companies Act.[26] Be that as it may, it will be noticed that section 67(1) does provide that the prohibited financial assistance may take the form of a loan, guarantee or the provision of security from the company whose shares are being purchased. Further, the use of the words "or otherwise" in the section necessarily means that the financial assistance can take forms other than those mentioned above. In the case of *Datuk Tan Leng Teck* v *Sarjana Sdn Bhd*,[27] Justice Augustine Paul, had this to say in relation to the words "or otherwise" in section 67(1):-

> *The words 'or otherwise' are very wide and mean 'in any other way'. In this regard, I refer to EH Dey Pty Ltd (In Liquidation) v Dey [1966] VR 464 ... The essence of the question whether a company has contravened s 67(1) is whether it has diminished its financial resources, including future resources, in connection with the sale and purchase of its shares and the matter is not to be determined by considering only what is done by the parties to the transaction ... the giving of financial assistance means making a provision in money or money's worth to which a shareholder was not already entitled in his capacity as a shareholder...*

The Malaysian courts have demonstrated a liberal approach in construing the term 'financial assistance' and have cast a wide net with regard to transactions which fall foul of the prohibition in section 67(1). The courts have struck down transactions where the giving of the financial assistance was clear and direct and also transactions which were ostensibly legitimate on its face but in substance were devised to circumvent the prohibition.[28]

Has Malaysia taken steps to relax the prohibition on the giving of financial assistance by a company to purchase its own shares? It will be remembered that significant changes were made to this area of the law in 1997-1998 and that the change came in the form of the introduction of section 67A into the Companies Act. It would be pertinent to note that when section 67A of the Companies Act was initially introduced in September 1997, the section permitted a company to grant financial assistance for the purchase of its shares, subject to the conditions stated in the section. In this regard, the original section 67A, which came into force on 1 September 1997, read as follows:-

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[26] In the United Kingdom, the term "financial assistance" is defined in section 677 of the Companies Act 2006 as follows:-

In this Chapter "financial assistance" means -

a) financial assistance given by way of gift,
b) financial assistance given -
   i. by way of guarantee, security or indemnity (other than an indemnity in respect of the indemnifier's own neglect or default), or
   ii. by way of release or waiver,
c) financial assistance given -
   i. by way of a loan or any other agreement under which any of the obligations of the person giving the assistance are to be fulfilled at a time when in accordance with the agreement any obligation of another party to the agreement remains unfulfilled, or
   ii. by way of the novation of, or the assignment (in Scotland, assignation) of rights arising under, a loan or such other agreement, or
d) any other financial assistance given by a company where -
   i. the net assets of the company are reduced to a material extent by the giving of the assistance, or
   ii. the company has no net assets.

[27] [1997] 4 MLJ 329.

[28] For examples of Malaysian cases where the courts have struck down transactions as falling foul of the prohibition against financial assistance see the following:- *Wai Hin Tin Mining Co.* v *Lee Chow Beng* [1968] 2 MLJ 251, *Cheah Theam Swee & Anor* v *Overseas Union Bank Ltd & Ors* [1989] 1 MLJ 426., *Kidurong Land Sdn Bhd* v *Lim Gaik Hua* [1990] 1 MLJ 485 and *Chung Khiaw Bank Ltd v Hotel Rasa Sayang Sdn Bhd* [1990] 1 MLJ 356.

67A.(1) Notwithstanding the provisions of section 67, a public company with a share capital may, if so authorised by its articles, purchase its own shares or give financial assistance to any person for the purpose of purchasing its shares.

(2) A company shall not purchase its own shares, or give financial assistance to a person for purchasing its shares under this section, unless

(a). it is solvent at the date of the purchase or the giving of financial assistance;

(b). the purchase is made through the Stock Exchange on which the shares of the company are quoted; and

(c). the purchase or the giving of financial assistance is made in good faith and in the interests of the company. (emphasis added)

However, within a short period of time, section 67A was amended by the Companies (Amendment) (No.2) Act 1998,[29] which deleted the words "or give financial assistance to any person for the purpose of purchasing its shares" from the subsection (1) quoted above. Further, all references to the words "the giving of financial assistance" in subsection (2) were also deleted. Thus, the amendment referred to above clearly removed the provision allowing the giving of financial assistance to a person for the purpose of acquiring a public company's shares. The amended section 67A now reads as follows:-

67A. (1) Notwithstanding the provisions of section 67, a public company with a share capital may, if so authorised by its articles, purchase its own shares.

(2) A company shall not purchase its own shares unless –

(a). it is solvent at the date of the purchase and will not become insolvent by incurring the debts involved in the obligation to pay for the shares so purchased;

(b). the purchase is made through the Stock Exchange on which the shares of the company are quoted and in accordance with the relevant rules of the Stock Exchange; and

(c). the purchase is made in good faith and in the interests of the company.

Proceeding from the above, it is clear that in Malaysia, the giving of financial assistance by a company to purchase its shares is expressly prohibited save for the exceptions contained in section 67(2).

VI. Dealings By A Company In Its Own Shares – The Effect Of Contravention Of Section 67(1) Of The Companies Act

(i) General principles – Criminal and Civil Consequences

It would be pertinent to consider the legal consequences which will ensue if the prohibitions against the company's purchase of its own shares and the giving of financial assistance were violated by the company or its officers. In this regard, the relevant parts of section 67 state as follows:-

67(3) If there is any contravention of this section, the company is, notwithstanding section 369, not guilty of an offence but each officer who is in default shall be guilty of an offence against this Act.

Penalty: Imprisonment for five years or one hundred thousand ringgit or both.

67(4) Where a person is convicted of an offence under subsection (3) and the Court, by which he is convicted is satisfied that the company or another person has suffered loss or damage as a result of the contravention that constituted the offence, the Court may, in addition to imposing a penalty under that subsection, order the convicted person to pay compensation to the company or the person, as the case may be, of such amount as the Court specifies, and any such order may be enforced as if it were a judgment of the Court.

67(6) Nothing in this section shall operate to prevent the company or any person from recovering the amount of any loan made in contravention of this section or any amount for which it becomes liable, either on account of any financial assistance given, or under any guarantee entered into or in respect of any security provided, in contravention of this section.

It can be seen that the criminal consequences of breaching section 67 is spelt out in subsection (3). This subsection makes it clear that if section 67 is violated, only the officers of the company, and not the company, are guilty of an offence. Significantly, the company is not viewed as an offender but as a victim of the prohibited transaction. This is reinforced by the fact that section 67(6) provides remedies for the company where there is a contravention of section 67(1). Clearly, the object of section 67(6) is to preserve the rights of

[29] Act A1043.

the company in the event of any contravention of the prohibitions in section 67(1). It is submitted that the exclusion from the imposition of a penalty on the company is premised on the need to protect the interests of the company's creditors and shareholders. Undoubtedly, penalising the company would lead to the ultimate detriment of its creditors and shareholders. In this regard, it is to be noted whilst the law in Australia and Singapore adopts a position similar to Malaysia,[30] the law in the United Kingdom is different. In the United Kingdom, contravention of the statutory prohibitions would render the company itself and every officer who is in default to be guilty of an offence.[31]

Whilst the criminal consequences of violating the prohibitions in section 67 are clearly spelt out, the Act is silent as to civil consequences. The Act does not expressly provide for the legal effect of contracts and transactions that have contravened the prohibitions under section 67. Are these contracts and transactions valid despite the contravention or are they void or merely voidable? This matter has been the subject of extensive litigation and there are numerous Malaysian decisions that have attempted to shed light on this issue.

In the case of *Wai Hin Tin Mining Co. v Lee Chow Beng*,[32] it was held that a loan made from the company's funds to allow a person to purchase the company's shares would be illegal and unenforceable. In arriving at this decision, the court relied on the principle of *ex turpi causa non oritur actio* (no action could arise out of an illegal or immoral consideration). Similarly, in *Kidurong Land Sdn Bhd v Lim Gaik Hua*,[33] the Malaysian Supreme Court (the precursor of the Federal Court in Malaysia) dealt with a transaction where a company gave financial assistance to a developer to enable the purchase of the company's shares. The Supreme Court held that this transaction was unenforceable and void. In *Che Wan Development Sdn Bhd v Co-operatif Central Bank Bhd*,[34] it was held, *obiter*, held that a prohibited transaction under section 67(1) would be void on the ground that the transaction was made illegal by the Act as it subjects the company's officers to criminal penalties.

In *Chung Khiaw Bank Ltd v Hotel Rasa Sayang Sdn Bhd*,[35] a loan was given by a financial institution to a company to fund the company's purchase of shares in a hotel. The security provided for the loan was property belonging to the hotel itself. The Supreme Court held that the loan agreement in this case was a transaction which violated the prohibition against the giving of financial assistance. The court further held that transactions prohibited under section 67(1) would be void and illegal on the ground that the courts were bound to give effect to section 24 of the Malaysian Contracts Act 1950 which provided that an agreement which was forbidden by law would be void. Proceeding on this basis, the Supreme Court in *Chung Khiaw Bank* struck down the loan agreement and all related transactions (including the securities and guarantees given by the company to the financier).

A different stance from that discussed in the cases above was taken in *Datuk Tan Leng Teck v Sarjana Sdn Bhd*.[36] In this case, the court held that the effect of a transaction which violated section 67(1) was not void but was valid and enforceable. It was reasoned that a contract which was prohibited by statute did not become void and unenforceable if the statute itself saved the contract or that there were contrary intentions which could reasonably be read from the language of the statute itself. In arriving at this conclusion, the court relied, *inter alia*, on the dicta of Gibbs ACJ in *Yango Pastoral Co Pty Ltd v First Chicago Australia Ltd*[37] where His Lordship stated,

> *It is often said that a contract expressly or impliedly prohibited by statute is void and unenforceable. That statement is true as a general rule, but for complete accuracy it needs qualification, because it is possible for a statute in terms to prohibit a contract and yet to provide, expressly or impliedly, that the contract will be valid and enforceable. However, cases are likely to be rare in which a statute prohibits a contract but nevertheless reveals an intention that it shall be valid and enforceable, and in most cases it is sufficient to say, as has been said in many cases of authority, that the test is whether the contract is prohibited by the statute. Where a statute imposes a penalty upon the making or performance of a contract, it is a question of construction whether the statute intends to prohibit the*

[30] For the position in Australia see section 260D of the Corporations Act 2001. For the position in Singapore, see section 76(5) of the Companies Act (Chap 50).

[31] See sections 658(3) and 680(2) of the UK Companies Act 2006.

[32] [1968] 2 MLJ 251.

[33] [1990] 1 MLJ 485.

[34] [1990] 2 MLJ 365.

[35] [1990] 1 MLJ 356.

[36] *Supra* n 27.

[37] (1978) 139 CLR 410.

contract in this sense, that is, to render it void and unenforceable, or whether it intends only that the penalty for which it provides shall be inflicted if the contract is made or performed.

Having referred to the dicta quoted above, the court in *Datuk Tan Leng Teck* opined that section 67 of the Act was an example of the rare legislative power mentioned by Gibbs ACJ. The court held that this was because whilst section 67(3) prescribed criminal penalties for a breach of section 67(1), section 67(6) provided remedies for the breach thus saving the prohibited contract or transaction. In these circumstances, the court ruled that the prohibited transaction did not become void and unenforceable but was valid. It may be noted that the views expressed in *Datuk Tan Leng Teck* were subsequently affirmed by the Federal Court in the case of *Lori Malaysia Bhd (Interim Receiver)* v *Arab Malaysian Finance Bhd.*[38]

(ii) The effect of Contravention on Securities Provided by the Company

Another issue that has invoked much discourse and litigation relates to the legal position of a security provided by a company in a prohibited transaction. The question here is as follows – what is the legal effect of a security given by a company to a financier for a loan which contravenes section 67(1)? Specifically, the issue which arises is whether or not the company's liability on the loan and security is unaffected by the contravention of section 67(1). This issue was dealt with in the *Chung Khiaw Bank* case.[39] The Supreme Court ruled in this case that a charge granted as a security by a company for a loan transaction prohibited under section 67(1) would be void and unenforceable. The court reached this conclusion on the basis that under section 67, in particular subsection (6) thereof, the only person entitled to recover a loan prohibited under the section was the company itself and no one else. It should be noted that at the time this case was decided, section 67(6) was differently worded. Section 67(6), at the time read as follows:-

Nothing in this section shall operate to prevent the company from recovering the amount of any loan made in contravention of this section...

Therefore, in *Chung Khiaw Bank*, the financial institution which had advanced a loan to a company, which was to be used for the purchase of shares in a hotel, was not allowed to enforce the guarantees and securities provided for by the company.

The decision in *Chung Khiaw Bank* much caused disquiet and anxiety among banks and financial institutions. It was argued that section 67 did not afford adequate protection to innocent financiers and creditors of the company namely, those who have advanced apparently legitimate loans without any knowledge of the illegal or prohibited purpose of the loan. Subsequent to the decision of *Chung Khiaw Bank*, an amendment was made to section 67(6) of the Act to insert the words "or any person" into the subsection. After this amendment, the relevant part of section 67(6) as it stands today, reads as follows:-

Nothing in this section shall operate to prevent the company or any person from recovering the amount of any loan made in contravention of this section... (emphasis added)

Clearly, the amendment to section 67(6) was made to overcome the decision of *Chung Khiaw Bank*. The effect of the amendment is to enable the company and any person to recover a loan or other amounts given on account of the financial assistance or in respect of any security or guarantee which was provided in contravention of section 67(1).

Further, notwithstanding the protection given by the amended section 67(6), it may be noted that the *Chung Khiaw Bank* decision was subsequently overruled by the Federal Court in *Lori Malaysia Bhd (Interim Receiver)* v *Arab Malaysian Finance Bhd.*[40] In *Lori Malaysia*, the Federal Court, after conducting a comprehensive review of both local and foreign cases on this issue, decided, *inter alia*, as follows:-

a. The Federal Court in Lori Malaysia disagreed with the decision in Chung Khiaw Bank that the scope of section 67(6) was confined to the protection of the company and no one else. After making reference to the second limb of section 67(6), the Federal Court considered that the section was enacted for the protection of the company's funds and the interests of shareholders as well as creditors and the general public. The Federal Court therefore opined that there was no valid reason why its operation should be limited only to enabling a company to recover loans granted by it.
b. The Federal Court was of the view that the decision in Chung Khiaw Bank was unduly swayed by certain English authorities which were of little assistance since the relevant legislation on which they were decided did not contain a saving provision equivalent to section 67(6). Yet another difference was that the prohibition under the relevant English legislation considered in

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38 [1999] 3 MLJ 81.

39 *Supra* n 35.

40 *Supra* n 38.

Chung Khiaw Bank imposed criminal liability not only on officers of the company but also on the company itself, whereas under the Malaysian section 67, criminal liability is imposed not on the company but only on officers of the company.

c. The Federal Court also took the view that section 67(6) created an important exception to section 24 of the Contracts Act 1950 by allowing recovery under an illegal contract, thereby excluding the operation of section 24. Therefore, the court ruled that in a situation where a company obtains a loan from a financial institution on the security of a charge for the purpose of enabling an intending purchaser to purchase shares of the company, the company's liability to the financial institution both in respect of the loan and the security remains unaffected, having regard to the saving provision in the second limb of subsection (6) of section 67.

It is submitted that the legal reasoning adopted in *Lori Malaysia* is justifiable on the following premise. The Federal Court in this case recognised that there is a need to achieve a balance between the conflicting interests of innocent financiers or creditors, shareholders and that of the company. This conflict arises because on the one hand, there is a need to protect the assets of the company by striking down prohibited transactions under section 67(1). On the other hand, the interest of innocent financiers cannot be disregarded and they should be allowed to recover loans granted for ostensibly legitimate purposes and to enforce securities given for such loans.

VII. Concluding Remarks

The age-old principle of *Trevor v Whitworth*, although expounded more than a century ago, continues to have relevance and applicability today. However, if the principle is applied without exceptions it would hinder the progress and development of business and commerce. As such, legislature in many jurisdictions, whilst recognising the value of this principle, have created exceptions and have set parameters to determine the ambit and scope of the principle.

In this paper, a brief attempt was made to explain and comment on the Malaysian position pertaining to this area of the law. In this writer's opinion, the Malaysian legislature has demonstrated a good balance in protecting the interests of the company, its creditors and its shareholders. The Malaysian courts have also been proactive as illustrated in the case of *Lori Malaysia*.