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Power of the Court to Alter the Company Constitution According to Shareholders' Agreement

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Abstract

Members of a company can vote in general meetings to alter the company's constitution. The courts can also alter the company's constitution under section 37(1) of the Companies Act 2016. The problem is that of statutory construction. A literal interpretation means altering the contents of the constitution without voting. A purposive construction entails an alteration of the quorum or procedures to facilitate proper voting. The objective of this paper is to ascertain how the Malaysian courts exercise that power. A comparative research methodology involving a legal doctrinal analysis is employed. Primary and secondary sources of law throughout the commonwealth countries are ascertained as to the effect of the law on the research objectives. The findings reveal that alteration by the court entails a direct alteration of the constitution and not the procedures therein to facilitate proper voting. In the absence of oppression, an alteration is possible to satisfy the legitimate business or management expectations of members, according to a shareholders' agreement. This is true in private companies where shares cannot be transferred to outsiders and quasi-partnership companies. Retrospective alteration and alteration that affects third-party rights cannot be made in the event proper voting can be executed under the existing constitution.

Keywords: business, company law, company constitution, statutory interpretation.

I. INTRODUCTION

Under section 211 of the Malaysian Companies Act 2016 (hereinafter called MCA16), the business and management of a company shall be managed by the Board of Directors subject to any exception contained in the company's constitution or Companies Act 2016. Under section 214(1) MCA16, directors are subject to the business judgment rule and are required to act in good faith for the best interest of the company and avoid any conflict of personal interest. A member of a company is defined as a person (shareholder) who is registered in the register of members of the company (section 2 MCA16). Under section 214(2) MCA16, business judgment is defined as any decision in respect of a matter relevant to the business of the company. Under section 195 MCA16, the shareholders may pass a special resolution on matters affecting the management of

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the company which is binding on the directors if it is a matter provided for in the company's constitution. Morse (2005) maintains that the shareholders of a company can vote for a resolution at general meetings which is binding on all the other members. Thus, the decisions of members are embodied in statements known as resolutions. Whether an ordinary resolution (simple majority voting) or special resolution is required, the general meeting of members and voting can only be taken if the proper procedures stated in the company's constitution are satisfied. The thrust of this research is the statutory interpretation of the power of the Malaysian court to alter the company's constitution. Section 37(1) MCA16 provides that the Court may alter the company's constitution on terms as it thinks fit on the application of a member or director when it is satisfied that it is not practicable to alter the same using the procedures set out in the constitution or the Companies Act 2016.

The problem this research seeks to address is that section 37(1) MCA16 is open to several statutory constructions. Firstly, Salleh's (2018) strict literal interpretation means that the court has the inherent power to directly alter the contents of the constitution when it is not practical to alter the same using the procedures of the Companies Act 2016 or those stated in the constitution. She states that the restrictive procedures in the constitution could prevent its alteration, like the need for consent from the board of directors or a particular person, or the fulfillment of a condition precedent. The perceived problem with Salleh's (2018) approach lies with companies with a large number of shareholders who are against the application for alteration. If the courts deem it necessary to grant the application to alter based on the application of one or a few minority shareholders, then the requirement of special resolution majority under section 36(1) MCA16 would have been waived. Thus, if the court exercises its discretion to alter the constitution without the need for a special majority, it will seem to usurp the need for such voting by the members in general meetings. However, in the alteration of the constitution, section 36(1) MCA16 provides that a special resolution is required at a general meeting of shareholders, but this is subject to the requisite quorum and procedures of meeting stated in the company's constitution. To obtain a special resolution, a majority vote of at least 75% of shareholders present must be attained under section 292 MCA16. Secondly, a purposive interpretation of section 37(1) MCA16, is subject to section 17A Interpretation Act 1948 and 1967 which provides that an interpretation that would promote the purpose or object underlying the Act is preferred. It is held in Sakuragawa Pump (S) Pte Ltd v Perkapalan Mesra Sdn Bhd (2007) 7 MLJ 555 submitted that statutes cannot be read in isolation. Such an approach suggests that the court only has the power to alter the procedures stated in the constitution to make it possible for proper voting to be undertaken under section 36(1) MCA16. In this way, the court will avoid interfering with the internal affairs of the company as to how a company should satisfy its business expectations of shareholders. Thirdly, the construction of section 37(1) MCA16 could mean that it is not practical to alter the constitution because the majority of members refuse to alter the same even under the proper procedures of voting. Thus, the first objective is to ascertain whether the power of the court to alter the constitution under section 37(1) MCA16 entails a direct change of the contents of the constitution or the procedural requirements of voting that is preventing proper voting from taking place under section 36(1) MCA16. The second objective is to ascertain what are the circumstances which will enable the courts to alter the constitution concerning a shareholders' agreement. The final objective is to ascertain whether the courts have the power to alter the constitution under section 37(1) MCA16 in the event it is possible to properly vote for a special resolution under the procedures set out in the constitution,

but the majority members refuse to vote for the benefit of the company as a whole. The significance of this research is that parties to a litigation should know their rights before even going to court, otherwise, there will always be uncertainty surrounding a lawsuit. Members and directors of a company should know how the court exercises its power to alter the constitution before an application is made under section 37(1) MCA16, as this will ensure that any application under the said provision would not be met with uncertainty which would be a waste of the courts' time and costs of the companies making the application.

II. LITERATURE REVIEW

At the point of writing, there are no secondary sources of law (journals and textbooks) written on section 34(1) of the New Zealand Companies Act 1993 (hereinafter called NZCA93) or section 37(1) MCA16. What is discussed here is the literature on the statutory interpretation and shareholders' agreement. Salleh (2018) states that a company with two shareholders who hold an equal number of shares may have difficulty altering the constitution and thus the court can exercise its power under section 37(1) MCA16 to directly alter the same on the application of a director or member of the company (Salleh, 2018). It could also be the voting requires a higher majority to obtain a special resolution compared to the usual 75% as provided under section 292(1) MCA16 (Salleh, 2018). Ali (2008) concurs with the principle in the case of Kesultanan Pahang v Sathask Realty Sdn Bhd [1998] 2 MLJ 513 that a judge is not required to examine a statute in isolation but to view the entire range of law by reading a statute in relation to other statutes and judicial precedents. This is to comprehend the law in the background of the principles, doctrines, and standards that function in a democratic society. Arjunan (1999) maintains that the court in Pembinaan KSY Sdn Bhd v Lian Seng Properties Sdn Bhd (1991) 1 MSCLC 90, had erred in considering section 219 and section 224 Companies Act 1965 in isolation and employing a purely literal construction. On the contrary, they should be read in their proper context in which the sections appear in the legislation and the relationship the sections bear to other relevant provisions in the Companies Act 1965. When it comes to shareholders' agreement, Lim (2015) postulates that any shareholders' agreement made by the directors and the majority shareholders may be tantamount to a special resolution that alters the articles. However, any provision in the shareholders' agreement in contravention to the provisions of the Companies Act 2016 is void (Aiman & Effendy, 2018). However, matters are not so clear when it comes to shareholders' agreement that affects the legitimate expectation management decisions of the company. An illustration is when the issuance of new shares by the directors results in the dilution of minority shareholding in the company (Aiman, 2001). Nosworthy (2016) provides that the management of the company is normally vested in the board of directors. Svehla (2006) argues that the law imposes common law, statutory, and equitable duties on directors because the powers of managing and controlling the company's affairs and its properties are vested in its directors. In addition, to the business judgment rule, the limitations imposed on directors by statutory law and the equitable doctrines of fiduciary law seek to minimize the potential for them to act in abuse of the immense managerial powers conferred on them, to secure the utmost protection of the interests of the company (Mayanja, 2014). It was pointed out by Lim (2015) that the duty to act in good faith for the benefit of the company must be distinguished between non-fiduciaries and fiduciaries. He maintains that the duty of good faith only applies to majority shareholders (non-fiduciaries) not to injure the interest of the minority shareholders intentionally. In contrast, fiduciaries like directors, are subject to the said duty (Lim, 2015). Mayanja (2014)

states that directors should promote the long-term interests of the shareholders and thus to give precedence to other interests would constitute a breach of duty despite their honest intentions.

III. RESEARCH METHODOLOGY

Yaqin (2007) provides that legal research as employed by the researchers of this paper can be briefly categorized into pure legal research and socio-legal research. The latter entails a social element in which the application of the law and its effectiveness is put into scrutiny. Thus research on the effect of legislation on the public requires the opinions of the members of the public affected by the same to ascertain its effectiveness and thus field work is required to ascertain what they feel about the legislation. On the other end of the spectrum is pure legal research which is commonly called doctrinal legal research. Here there is no social element involved as what is studied is the issue that involves a question of law only, as in how the courts construe a provision in a statute. Hence, public opinion is not relevant as it is a question for judges to decide in the court of law. What lawyers and academicians think should be published and by doing so their writings become known as secondary sources of law. Judges can revert to secondary sources of law to assist them in their decision-making. What is even more relevant are the primary sources of law that consist of legislation and decided cases. Judges must interpret statutes and apply decided cases under the doctrine of judicial precedent. It is futile to seek the opinions of lawyers or academicians as judges do not decide cases based on these opinions but based on primary and secondary sources of law. It follows that fieldwork like interviews or surveys, is hardly relevant as every legal expert is entitled to his personal views of the law. Since the objective of this paper is to ascertain how the Malaysian court would construe section 37(1) MCA16, it falls under pure legal research. No field work is undertaken as this is a pure legal research and not a socio-legal research. In this research, the legal comparative methodology will be used together with the doctrinal approach in construing legislation and cases. The comparative approach has the aim to bring about improvement in law, so that it may work more efficaciously and effectively (Yaqin, 2007). For Mehren (1991-1992), in comparative legal research, the rules, principles, and theories that serve similar purposes can be meaningfully compared. Darpo & Nilsson (2010) state that it entails identifying a common character of the objects compared to the different legal systems. The researcher seeks to compare legislation and its ensuing cases (common law) with the same functional purposes throughout the commonwealth countries which is similar to section 37(1) MCA16 as far as function is concerned. According to Yaqin (2007), doctrinal research essentially entails a library-based study, whereby the materials required by the researcher may be available in libraries and online databases. The essential aim of such research is to examine, ascertain, and then present the law in a systematic form of concepts and theories suitable for litigation. Litigation entails two opposing parties seeking redress from the courts in enforcing their legal rights. The interpretation of such cases or published writings would serve as an effective indication of how the Malaysian courts would interpret section 37(1) MCA16. This is because commonwealth law is largely premised on English law. There are no secondary sources of law on section 37(1) MCA16 whilst writing.

IV. RESULTS AND DISCUSSIONS

On the first research objective, the parliamentary papers on section 37(1) MCA16 and section 34(1) NZCA93 do not shed light on addressing the objectives of the research. The search across the commonwealth countries to find statutes that serve the same

functional effect as section 37(1) MCA16 and its ensuing cases decided on the same reveals that only section 34(1) NZCA93 namely fits that requirement. The said section provides that,

> The court may, on the application of a director or shareholder of a company, if it is satisfied that it is not practicable to alter the constitution of the company using the procedure set out in this Act or in the constitution itself, make an order altering the constitution of a company on such terms and conditions that it thinks fit.

A direct comparison between the two sections shows that the only difference is the additional words in section 37(1) MCA16 namely 'to amend' the constitution which is not found in section 34(1) NZCA93. Section 34(1) NZCA93 uses the word shareholders as opposed to 'members' under section 37(1) MCA16. It is submitted that these semantic differences hardly matter as there is no perceivable difference between them as far as the effect of the law is concerned. Regarding the first objective of the research, Chew Meu Jong v Lysaght (Malaysia) Sdn Bhd (Liew Swee Mio @ Liew Hoi Foo & Ors) (hereinafter called Lysaght's case) [2019] MLJU 2168) decided that the court's decision for alteration is not to change the procedures of voting or requirement of quorum stated in the company's constitution to facilitate obtaining a special resolution under section 36(1) MCA16. It was a direct alteration of the constitution's provision to facilitate the legitimate business expectations of the members in management decisions of the company according to the sale and purchase agreement of shares amongst its members. Here the alteration did not affect the rights of any third-party outsiders. The criticism of the finding here is that from the perspective of public policy, in Northern Milk Vendors Association Inc v Northern Milk Ltd [1988] 1 NZLR 530 (CA), Cooke P stated that the court must not usurp the policy-making role of Parliament, as it can fill in gaps only to make the statute work as Parliament has intended. It seems that due to section 36(1) MCA16 and section 292(1) MCA16, it was never the intention of Parliament for the courts to usurp the function of majority members in voting for a special resolution to alter the constitution. When a sole shareholder or director applies for the court to alter the constitution, and the application is granted, it means that the alteration need not require a special resolution. Such a manner of statutory interpretation has support from Cooke P in Northern Milk Vendors Association Inc v Northern Milk Ltd who opined that the courts can in a sense fill in gaps but only to make the Act work as Parliament must have intended.

The second objective delineates the circumstances on how the court is likely to exercise its power to alter the company's constitution. What is clear is that the court cannot alter the constitution under section 37(1) MCA16 if it is practical for a special resolution to be obtained under section 36(1) MCA16 voting for a special resolution. In Lysaght's case, it was held that the meaning of impracticable to conduct a meeting under section 115(2) of the English Companies Act 1929 is because a quorum is not practical but not impossible. The judge followed Venning J in Karen Davy and John Dewar Marsh v. Grace Natalie Scarrott & Ors [2016] NZHC 179 (hereinafter called Davy's case) namely, impracticability refers to the procedure or process to alter the constitution under the normal process like where directors refuse to call a meeting or are unable to do so or where it is impossible to obtain a quorum for a shareholders meeting (Lysaght's case). In Shell (Petroleum Mining) Co Ltd v. Todd Petroleum Mining Co Ltd [2006] 3 NZCCLR 538 (hereinafter called Shell's case), the reasons for impracticality to alter the constitution rests on factors like impossibility to reach quorum or directors refusing or unable to call meetings.

The court further held that the principle of Pang Ten Fatt & Anor v. Tawau Transport Co. Sdn Bhd [1986] 1 MLJ 179 cannot apply in the court's consideration of section 37(1) MCA16. In that case, the court refused amendment even after a special resolution was obtained as it infringed the rights and privileges of some members conferred on the formation of the company (Lysaght's case). Under common law, the requirement that the members in voting for an alteration must do so for the benefit of the company as a whole, and if they fail to do so the proposed alteration can be challenged is not a factor (Lysaght's case). The said requirement is also not relevant for the court in exercising its power under section 37(1) MCA16 (Lysaght's case). It is also submitted that the court may be prepared to exercise its power under section 37(1) MCA16 to satisfy the legitimate management or business expectations of the members.

Firstly, the exclusion of a member from management who is in breach of an express or implied agreement to allow him to do so could justify relief under oppression (Tan Kian Hua v Color Image Scan Sdn Bhd [2004] MLJU 178). In the event of oppression, the remedy provided under section 346(2) MCA16 enables the court to inter alia regulate the conduct of the company affairs in the future, which includes the alteration of the constitution. Pursuant to that, an application under section 37(1) MCA16 becomes redundant. However, in Dato' Low Mong Hua v Banting Hock Hin Estate Hock Hin Estate Co Sdn Bhd & 8 Ors [2003] 6 AMR 245, it was held that minority shareholders should accept majority members' rule and any dissatisfaction with the wishes of the majority did not tantamount to oppression.

Secondly, in the absence of oppression, when the principle of estoppel can apply to a shareholders' agreement. The concept of unfair prejudice means that the courts will take into account the rights of the members under the company's constitution and the legitimate expectations of shareholders that arise from the shareholders' agreement (Hoffman J in Re Posgate & Denby (Agencies) Ltd v [1987] BCLC 8). In Jet-Tech Materials Sdn Bhd v Yushiro Chemical Industry Co Ltd (2013) 2 MLJ 297 (hereinafter called Jet-Tech's case), Chen (managing director) had participated in a meeting of the directors and had agreed to the investment plan put forth, and this was a management investment decision which Chen was estopped from reneging upon. The court held that the principle of estoppel operated on the parties of the resolution who cannot later renege the same. The said agreement embodied private matters of management investment decision which are enforceable by the parties to the shareholders agreement. It follows that the court would in the absence of oppression, arguably exercise its power to alter the constitution of the company to incorporate the shareholders' agreement voted by all the members as in Jet-Tech's case, as the said agreement estopped all members from reneging the same. The rationale is, that if the shareholders agreement had been agreed by all the members, then in the event it is practical to vote under section 36(1) MCA16 for a special resolution, the outcome would have been the same. However, not every shareholder's agreement gives rise to legitimate expectation to partake in management which would enable the courts to alter the constitution. In Tuan Haji Ishak bin Ismail v Leong Hup [1996] 1 MLJ 661, a private agreement between Leong Hup and a few of the directors of KFC Holdings (Malaysia) Berhad to have the Lau brothers always on the board of the company was not incorporated in the company's articles. There was no such provision in the company's management agreement. The appointment of the Lau brothers to the company's board was by a majority voting at its AGM with all the shareholders present. Leong Hup sought to prevent the removal of its nominees from the board of directors of the company based on legitimate expectations, as it held 30% of the share capital of the company and based on the said private agreement. The court rejected the argument

of legitimate expectation as there is the possibility of Leong Hup disposing of its shares on the open market. Here the company is a public listed company and not a small private company as in Lysaght's case.

Thirdly, the conflict of opinions on commercial decisions on the business of the company cannot constitute oppression as the judge is not equipped to make a judgment call on these matters (Re Elgindate Ltd (1991) BCLC 959). The findings reveal that if the shareholders have entered into a shareholders' agreement that reflects the legitimate business expectations of the members, then the courts can alter the constitution when proper voting procedures are not possible. In Lysaght's case, the application by one of the directors (plaintiff), for an order of the court to alter the constitution under section 37(1) MCA16 was made after the sale of all the Class A shares by a shareholder (United Engineers Limited) to another shareholder (Chew Brothers). As a result, the quorum required to transact business at general meetings under the original company's constitution cannot be satisfied as the presence of a United Engineers Limited member is not possible. The application for alteration to the existing constitution is to enable general meetings and appointments of directors to be made to reflect the sole current constitution of class A shareholders. The court held that the application under section 37(1) MCA16 was justified, as it is not practicable for the company to obtain a quorum for the shareholders' meeting or directors' transaction of business under the existing constitution after the sale of the Class A shares (Lysaght's case). The alteration made is not to change to procedures of voting or the requirement of quorum stated in the constitution, but to facilitate obtaining a special resolution under section 36(1) MCA16. It was a direct alteration of the constitution's provision to facilitate the legitimate business expectations of the members in management decisions of the company after the sale of shares. Here the said alteration did not affect the rights of any third party outside the company. It seems that the courts are more likely to exercise their powers to alter the constitution according to a shareholders' agreement which creates legitimate expectations when it comes to small private companies as in Lysaght's case, where the composition of members remains the same as opposed to public companies, where members can sell their shares to the public. Under section 43(1) MCA16, a private company limited by shares in Malaysia shall not offer and allot its shares to the public. It is also restricted from transferring its shares under section 42(2) MCA16. Aiman & Effendy (2018) maintain that the shareholders' agreement is more effective in a private company where there are only a small number of shareholders who are parties to the agreement, as opposed to a public company. The contents of such agreements may include voting on issues like changing the company's business, additional rights conferred to a member, rights to appoint or remove directors, and settlements of disputes. Any agreement in contravention to the provisions of the Companies Act 2016 is void (Aiman & Effendy, 2018).

Aiman & Effendy (2018) argue that the court will not interfere with the business decision of the company made in general meeting so long as it does not contravene the Companies Act 2016 or common law. A quasi-partnership company is also known as an "Ebrahimi" type of company. In Eng Man Hin & Anor v King's Confectionery Sdn Bhd [2005] 8 CLJ 77, a quasi-partnership company is defined as an association formed based on a personal relationship involving mutual confidence and an agreement that all or some of the shareholders shall participate in the conduct of the business. Further, a restriction is imposed upon the transfer of the members' interests so that if confidence is lost or one member is removed from management, he cannot take out his stake and go elsewhere. Thus, in a quasi-partnership company, the researcher argues that an order under section

37(1) MCA16 is more likely to be granted for the shareholders' agreement to be incorporated into the constitution. In ISM Sendirian Berhad v Queensway Nominees (Asing) Sdn Bhd & Ors and other suits [2020] MLJU 388 it was stated that when the company was a quasi-partnership company, the relationship between the shareholders was governed by the terms of the articles of association, and the joint venture agreement, and by equitable principles. It follows that since the legitimate expectation of the members is determined by the shareholders' agreement, and thus incorporating the same into the constitution arguably tantamount to a mere formality.

Concerning the third research objective, the findings reveal that an alteration of the constitution by the court is not possible under section 37(1) MCA16 if the majority shareholders will not agree to a special resolution when proper voting procedures are in place under the existing constitution (Lysaght's case) In Davy (directors of Dorchester Apartments Ltd) v Scarrott BC201661792, Venning J held that failure to obtain the requisite majority to alter the constitution did not fall under the definition of impractical to alter the constitution under section 34(1) NZCA93. The directors earlier at an AGM wanted to amend the constitution to recover the cost of the replacement as the current constitution did not facilitate the same. The majority required for the special resolution was defeated. Thus, the application under section 34(1) NZCA93 was made by the directors to alter the license entrenched in the constitution which could not be made via the normal voting process. It was held that under section 34(1) NZCA93 the phrase "not practicable to alter the constitution" is directed to process or procedural impracticality, whereby the court's intervention to alter is then justified. If the voting is taken again and there is unlikely to be a change in the constitution, section 34(1) NZCA93 cannot be invoked as something more than how the shareholders exercise their rights to vote is necessary. The reasoning of the decision hinged upon the bargain between the shareholders contained in the constitution and their balance of powers. Thus, any changes in the constitution must be via a special resolution (Davy (directors of Dorchester Apartments Ltd) v Scarrott BC201661792). In Tung Ah Leek & Anor v Perundmg DJA Sdn Bhd (2005) 3 MLJ 667 court opined that alteration of constitution is an internal affair of the company and the court should be slow to intervene. Whether an alteration is for the benefit of the company, is an internal matter for the shareholders to decide and the court should not impose their ideas (Shuttleworth v Cox Bros & Co (Maidenhead) Ltd [1927] 2 KB 9).

Lastly, in Shell's case, it was held section 34(1) NZCA93 cannot be invoked including retrospectively validating the appointment of current directors in the event such an appointment could be, later voted invalid. Thus, if a special resolution is already obtainable from the members, it means that the precondition to invoke section 34(1) NZCA93 no longer exists, and this includes any application for alteration of the company's constitution retrospectively. The proper procedure of voting should be employed to validate the appointment of the said directors. Shell's case argument that retrospectively changing the dates of appointment via resolution is problematic to third parties was also rejected as the court added that an order under section 34(1) NZCA93 is not possible without hearing from all the 3rd parties affected.

V. CONCLUSION

To conclude, any alteration of the company's constitution by the courts under section 37(1) MCA16 can be made only if the proper procedures of voting for a special resolution are not practicable, and the alteration is the actual contents as opposed to facilitating proper voting. Such alteration is more likely to happen in small private

companies and quasi-partnership companies when there is a need to satisfy the legitimate business expectation of the company according to a shareholders' agreement. Failure to attain a special resolution when proper voting can be made is not a reason for alteration, even if it means that the rights of the minority shareholders are affected by the said alteration. However, the question remains open whether the court will alter the constitution retrospectively as in Shell's case stated above, if the special resolution can no longer be obtained under the proper procedures stated in the company's constitution. The criticism of the conclusion is that it entails the court usurping the voting rights of the members of the company. Under section 36(1) MCA16, any alteration of the company's constitution can only be made if the voting of the members in the general meeting achieves a special majority of 75% votes. Thus, the power of the court to alter the constitution if it thinks fit, on the application of a director does not seem to involve the members in voting. It is suggested that the alteration by the court should be an alteration of the procedures of voting in the company's constitution to enable proper voting to take place under section 36(1) MCA16 when the current provisions in the constitution do not permit such proper voting. Thus, any alteration should not entail a direct alteration of the provisions of the company's constitution without the involvement of the members of the company.

Further, Lysaght's case was decided at the High Court and is subject to appeal to the appellate courts. If the current decision is overruled, then further research is necessary to ascertain its implications. There is also the possibility that section 37(1) should be purposefully interpreted to facilitate the alteration to enable proper voting to take place as opposed to one that bypasses that requirement since voting is required under section 36(1) MCA 16 and the right of every member.

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