Principles, Practice and Prospects of Corporate Governance: The Malaysian Legal Framework

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1.0 Definition

Corporate governance means the process and structure used to direct and manage the business and affairs of the Corporation with the objective of enhancing long-term value for shareholders and financial viability of the business. The process and structure define the division of power and accountability among shareholders, the board of directors and management and can have an impact on other stakeholders such as employee, customers, suppliers and communities.

2.0 Scope of Paper

This paper will endeavour to give only an overview of certain topics of corporate law and its practice which relate to corporate governance: the constitution and structure of corporation, the duty of directors and principal officers, shareholders' remedies, the effectiveness of regulatory regimes, the role of the Court. It can plainly be argued that every rule of corporate law, no matter how trivial is related to corporate governance; time does not permit the writer to deal with all such rules and some of the more important are left undiscussed indeed the take-over regime, the audit and accounts function and the disclosure requirements. This paper will also interact with some socio-economic evaluations as to what is conducive to proper corporate governance. It would conclude with some recommendations.

3.0 Concern on Corporate Governance

In the wake of world-wide stock market crashes of 1987 a number of steps were taken in many jurisdictions to improve the system by which companies are controlled.

3.1 The Report of the Committee on Financial of Corporate Governance, the Cadbury Report, published in the United Kingdom in 1992 and recommending the adoption of a Code of

Best Practice (Cadbury 1992) noted that:

- It is, however, the continuing concern about standards of financial reporting and accountability, heightened by the BCCI, Maxwell and the controversy over director's pay which has kept corporate governance in the public eye (preface)

- Had a Code such as ours been in existence in the past, we believe that a number of the recent examples of unexpected company failures and cases of fraud would have received attention earlier (para 1.9)

3.2 In Australia, the Companies and Securities Advisory Committee recommended extensive new laws on related party transactions "following the corporate collapses of the 1980, it has become evident that some corporate controllers abuse their position of trust by arranging for the shifting of assets around and away from companies and corporate groups and into their own hands (CA SAC 1991, p.1), The Explanatory Memorandum to the Australian Corporate Law Report Act 1992 acknowledges that "one cannot prevent dishonesty by legislation" nevertheless states that the new law "is intended to protect the shareholders of public companies against the possibility that the value of their investment will be eroded by a related party arranging for them to enter into a transaction which gives a benefit to the related party" (Explanatory Memorandum, paras 210, 206).

3.3 On June 25, 1993 the Toronto Stock Exchange established the Committee on Corporate Governance in Canada with a mandate to conduct a comprehensive study of corporate governance in Canada and to make recommendations to improve the manner in which Canadian corporations are governed. It is the Committee's belief that there is a direct relationship between corporate governance and investor confidence in capital markets and any recommendations made are to be designed to increase confidence in and improve the efficiency of Canadian capital markets in order to ultimately enhance the competitiveness of the Canadian economy.

3.4 More ambitiously, the American Law Institute (ALI) in 1978 formally instituted the Corporate Governance Project in furtherance of the ALI's mission "to promote the clarification and simplification of the law and its better adaptation to social needs". On March 31, 1992 a proposed Final Draft of the Principles of Corporate Governance: Analysis and Recommendations was released by the ALI which represents a most commendable Restatement of principles accommodating the complexity of American Corporate case law, provisions and practice. This document of 822 pages setting the principles together with comments and related provisions is an impressive product of the ALI and would be a model for

evaluating corporate governance legislation throughout the world.

.0 The common theme of the various committees appear to place some confidence that new rules, code of practice etc. may make a substantial contribution to ameliorate the deficiency of legal structure which accelerated corporate collapse in the past. This paper writer is not so confident. Galbraith recently wrote that the experience of the 1980's have been repeated many times, including the frenzied tulip markets of Holland in the 17th Century, the national South Sea Bubble in th early 18th Century and the booms and busts cycles of the 1890s, 1920s, 1930s and 1960s. Each of the situation in the past appear to have the common elements of : people mesmerized by the idea of easy money, an impression that with money comes intelligence and acumen, an upscaling of greed and the denouement of mass disillusionment following the crash. Despite the cyclical crashes Galbraith's warning on over reliance on the instrumentality of law is apposite:-

> " Those who are involved never wish to attribute stupidity to themselves. Markets also are theologically sacrosanct. Some blame can be placed on the more spectacular or felonious of the previous speculators, but not on the recently enchanted (and now disenchanted) participants. The least important questions are the ones most emphasized: What triggered the crash? Were there some special factors that made it so dramatic or drastic? Who should be punished?
>
> Yet beyond a better perception of the speculative tendency and process itself, there probably is not a great deal that can be done. Regulation outlawing financial incredulity or mass euphoria is not a practical possibility. If applied generally to such human condition, the result would be impressive, perhaps oppressive, and certainly an inefficient body of law. "

.1 **Legislative Framework**

The power to regulate corporate law is vested in the Federal Legislature under the Malaysian Federal Constitution. The centralising of this legislative power in Parliament have the consequence that corporate law in Malaysia is uniform throughout the Federation thereby obviating the problems faced in other jurisdictions which are also federal in nature e.g. Australia where an attempt to have a uniform corporate code was in part struck down as ultra vires the Australian Federal Constitution.

.2 **Sources of Malaysian Corporate Law**

Corporate law in Malaysia is primarily governed by the provisions of the Companies Act 1965 (No.125) which was based on the U.K. Companies Act 1948 and the Australian Uniform Companies Act 1961. Two major subsidiary legislation (in area of corporate governance) has been passed under the Companies Act that is:

- Companies Regulation 1966
- Malaysian Code on Takeovers and Mergers, 1987

These are supplemented by the following legislation and also regulatory directives:-

- The Securities Industries Act
- The Securities Commission Act
- The Guidelines on the Regulation of Acquisition of Assets, Mergers and Takeovers (commonly referred to as the FIC Guidelines).

The legislative provision co-exists with rules of common law and equity emanating from judicial decisions from our own Malaysian Courts and also Singapore, Australia, Canada, New Zealand and the United Kingdom.

The main bodies which are involved in the regulatory framework may be set out in diagrammatic form:(see Appendix)

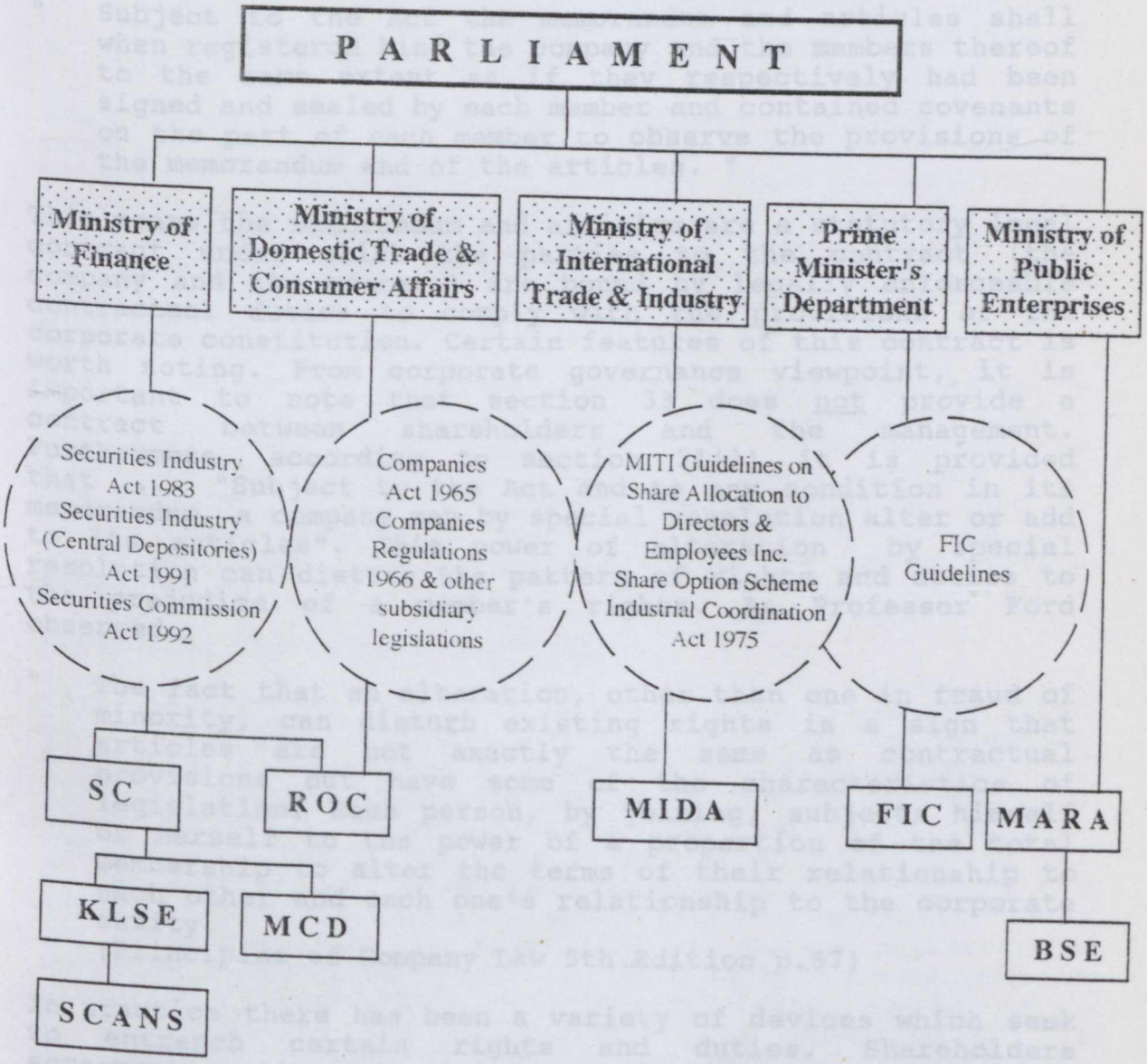
.0 **Regulating Corporate Governance**

.1 Historically, promoters of a corporation petitioned in the English Parliament to obtain incorporation on an individual basis. The terms of incorporation were negotiated and jointly settled by the promoters and Parliament. Promoters in avoiding rigidities and formalities associated with incorporation formed "deed of settlement" and "unincorporated joint stock companies". By the 19th Century promoters of a corporation had considerable freedom drawing up their constitution subject to them meeting minimal statutory requirements. The Malaysian Companies Act 1965 similarly impose minimum requirements on the way in corporations are incorporated in Malaysia.

The Corporation's constitution must provide for a "memorandum of association" and "articles of association" which had their precursor in the "deed of settlement".

The memorandum contains basic details setting out the name of the corporation, the promoters, the amount of share

REGULATORY STRUCTURE GOVERNING PUBLIC LISTED COMPANIES AND THE SECURITIES INDUSTRY IN MALAYSIA



SC	–	Securities Commission
ROC	–	Registrar of Companies
KLSE	–	The Kuala Lumpur Stock Exchange (self–regulatory)
MCD	–	Malaysian Central Depository Sdn Bhd
SCANS	–	Securities Clearing Automated Network Services Sdn Bhd
FIC	–	Foreign Investment Committee
MARA	–	Majlis Amanah Rakyat (Council For The Advancement of Indigenous Races)
BSE	–	Bumiputera Stock Exchange
MIDA	–	Malaysian Industrial Development Authority

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capital, a statement of objects etc.

2 Section 33 of the Companies Act provides:-

" Subject to the Act the memorandum and articles shall when registered bind the company and the members thereof to the same extent as if they respectively had been signed and sealed by each member and contained covenants on the part of each member to observe the provisions of the memorandum and of the articles. "

This means the memorandum and articles are a statutory legal contract under which the parties to the contract (the company and the members) are bound by legally enforceable contractual duties to comply with the provisions of the corporate constitution. Certain features of this contract is worth noting. From corporate governance viewpoint, it is important to note that section 33 does <u>not</u> provide a contract between shareholders and the management. Furthermore, according to section 31(1) it is provided that ... "Subject to the Act and to any condition in its memorandum, a company may by special resolution alter or add to its articles". This power of alteration by special resolution can disturb the pattern of rights and duties to the prejudice of a member's rights. As Professor Ford observed:

" The fact that an alteration, other than one in fraud of minority, can disturb existing rights is a sign that articles are not exactly the same as contractual provisions but have some of the characteristics of legislation. Each person, by joining, subjects himself or herself to the power of a proportion of the total membership to alter the terms of their relationship to each other and each one's relationship to the corporate entity. "
(Principles of Company Law 5th Edition p.57)

3 In practice there has been a variety of devices which seek to entrench certain rights and duties. Shareholders agreement, voting arrangement can be entered into providing for various procedual and substantive arrangements which delineates the lines of power and entitlements. Insertion of these provisions in the memorandum may also have an entrenchment consequence. The common form of Articles of Association e.g. Table A (which is entitled Regulations for management of a company limited by shares) provides for wide ranging powers e.g.:-

· The business of the company shall be managed by the directors ... and may exercise all such powers of the company as are not, by the Act or by these regulations

required to be exercised by the company in general meeting (Article 73).

- The directors may exercise all other powers of the company to borrow money and to mortgage or charge its undertaking, property and uncalled capital .... and to issue debentures and other securities whether outright or as security for any debt, liability, or obligation of the company or any third party (Article 74).

.4 Subject to any overarching statutory provision it is possible to draw a constitution to provide for greater powers to shareholders. For example, there is nothing to prevent insertion of articles that provide for directors being subject to a more objective standard of care and diligence than those set out by the common law. Additionally directors can be made subject to specific contractual arrangements with the body of shareholders.

.5 Provisions in the corporate constitution may also affect a variety of non-shareholders such as employees, creditors, suppliers and these are normally referred to as "stakeholders". Again, such stakeholders may contract with the corporation and in a perfect market model be able to adjust their contractual terms to take into account any risks suffered from non-standard terms in the corporate constitution.

.6 **Regulating the initial Constitution.**

There is a strict regulatory regime at the pre-incorporation stage. The main rationale for this is based on imperfect bargaining between promoters and the initial subcribers. If this is a perfect information world the governance structure will reflect a consensus as to the terms that maximise wealth. For public companies, the price of the initial shares will reflect market perception of the efficacy of the terms. Promoters have the motivation to maximise share prices by supplying the terms that the market believe will maximise shareholders' wealth. Government intervention in promotion of corporation by strict legislative provisions or listing criteria for public listing is justified by the belief that information supplied may not be congruent with the facts.

.7. The Malaysian regulatory regime in this area is based on a paternalistic attitude towards ignorant investors who are assumed to be susceptible towards being cheated and that share prices may not adequately reflect fair terms.

.8 The basic types of provisions are:-

- The requirement for prospectus, its standard contents and control of advertisements and strict civil and

criminal liabilities for mis-statements (see sections 37-47, 5th Schedule).

- Compliance with Detailed requirements for listing of securities set out in the KLSE Listing Requirements (the Yellow Book).

- Compliance with Guidelines For the New Issues of Securities and the Valuation of Public Companies.

The rationale for the strict regulatory regime is based principally on assumption of (i) information inefficiency (ii) possible ethical misconduct of promoters/controllers (iii) ignorant investors (iv) promotion of a sound and healthy capital market.

.0 **Regulating Change to the Corporate Constitution.**

The Act permits a company by way of special resolution to alter its memorandum and its articles (section 28, section 31). It now appears that this statutory power has overriding effect against inconsistent shareholders arrangements so that a shareholder having not less than 75% can always alter the articles and cannot be enjoined by the Court from so asserting this statutory right. This however does not mean that the party who effects such amendments does not breach its contractual obligations so that it can be subject to a claim in damages.

The Courts have also further fashioned rules governing the exercise of discretionary powers under the rubric of "fraud on power" so that it can strike down an exercise of power (albeit expressly provided) upon which does not meet the criteria of fair dealing. In Howard Smith Ltd v. Ampol Petroleum, the Privy Counsel struck down an exercise of power to issue shares which although "not motivated by any purpose of personal gain or advantage, or by any desire to retain their position on the board" on grounds that "it must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with the element of the company's constitution which is separate from and set against their powers. "

.0 **Corporate Governance in Practice**

.1 The corporation being a separate entity upon its incorporation (section 16(5) of the Act) have the consequence that shareholders cannot in law control the directors directly but instead operate indirectly through two major organs i.e. the shareholder's meeting and the board of directors.

The relative power of each organ would depend on legislation, the corporate constitutions and for a listed corporation the listing rules of the KLSE.

2 The Articles invariably delegate to directors all powers of management (see para 5.3 above) and the effect of Article 73 is that "directors and no one else, are responsible for the management of the company except in the matters specifically allotted to the company in general meeting" (Alexander Ward & Co Ltd v. Samyang Navigation Co Ltd (1975) 1 WLR 673). Historically the Board was regarded merely as a delegate and agent of shareholder's general meeting. By the 20th Century judicial decisions however established that the board is not only an agent but one of the primary organs of the corporation (See Automatic Self-Cleansing Filter Syndicate Co Ltd v. Cunninghame [1906] 2 Ch 34; Quin & Axtens Ltd v. Salmon [1909] AC 442). In practicable terms the directors, once in office may make management decisions against the wishes of the majority of the shareholders, and indeed the majority cannot control the exercise of management powers while the directors remain in office. Ultimate power of control by shareholders is retained only in two instances:

(i) the power to remove the directors; but this power is a drastic one and if wielded may prove to be too late to unravel a transaction (see however section 20 where a member may take proceedings to prevent an ultra vires transaction);

(ii) the power to alter the corporate constitution.

3 In comparison to the range of management powers vested in the board of directors (by legislation and by the Courts) there are only limited matters which are commonly reserved to the general meeting.

- altering the memorandum and articles
- altering the authorised share capital
- consolidating or subdividing the shares
- altering rights to shares
- altering company's status
- residual power to act when the board is unable to

In Malaysia there has been legislative measures to increase matters which require the general meeting's approval:

- the approval for disposal by directors of company's undertaking or property (sectioin 132C)
- the approval for issue of shares by directors (section 132D)
- substantial property transaction involving connected

persons (section 132E read with section 132F and section 122A).

There has also been promulgated the notorious section 132G (which prohibited certain transactions involving shareholders and directors) which brought in its wake widespread repercussions in the corporate community leading to its amendment introduced as subsection (6) to Section 132G.

From one perspective the plethora of statutory provisions are designed to strengthen corporate governance by empowering shareholders with negative veto rights against transactions which come within their purview. It may be going against the grain of opinion to question this trend; however, in some instances the statutory provisions appear to go too far so as to increase the costs of transactions and to curb entrepreneurial flair and efficiency.

.5 For example:

- Section 132C has given rise to uncertainty as to the scope of meaning of "undertaking" "property" and "substantial value" leading to doubts as to whether in any one transaction approval of general meeting is needful. Furthermore, it is arguable that only acquisition/disposal which materially <u>and</u> adversely affects the performance or financial position of the company would require the approval of the general meeting. It can be debated in anyone case whether the transaction is adverse to the company performance or financial position.

- Section 132E is also ambiguous as to whether it precludes the board from executing a conditional agreement given the wide language of the provision. This has given rise to various devices e.g. execute a Memorandum of Understanding, Letter of Intent or initialling a penultimate draft.

- Section 132G is riddled with difficulties of interpretation which (although there is no empirical study made on it) has a definite effect of thwarting some deals. The scope to be attributed to "the shares" "assets of another company" and the notoriously difficult phrase "first held the shares" has caused much debate amongst both corporate players, practitioners and the regulatory authorities. The costs of transaction has certainly been raised; and whether there are gains to be made by this provision has yet to be demonstrated from a macro-perspective. The section may result in more parties executing transactions through more layers of nominees.

6 Shareholders Meetings

Other than the matters introduced by recent amendments, traditionally shareholders are entitled to vote on a number of matters such as the election of the board of directors, alteration to the corporate constitution and major structural changes in the company's constitution. There is also the power to ratify certain improper acts by directors. Apart from the substantive matters above, the procedural rules upon which the collective will of the company is determined are also important. It may be said in the formal sense the shareholders in general meeting is the "sovereign" power in the corporate entity. However, in reality and practice shareholders control can face a number of problems.

In close-held corporations (private companies), the shareholders and directors are essentially the same individuals or belong to a family grouping so that there is no hindrance to shareholder's exercising their voting rights in control of management.

In a larger corporation the board of directors usually calls the meeting, sets the agenda and controls the proxy machinery. The Companies Act sets out only minimum procedural rules:-

- All companies are required to hold an annual general meeting (Section 143)
- At the AGM a profit and loss account, balance sheet, auditors and directors reports must be presented.
- The AGM may appoint and remove directors and deal with any matter permitted by the constitution.

In respect to convening of the Extraordinary General Meeting:

- by the directors upon the requisition of members holding (at the date of the deposit of the requisition) not less than one-tenth of the paid-up capital of the company; or
- by two or more members holding not less than one-tenth of the issued share capital.

7 In certain public companies owing to the dispersed nature of share ownership the nature of shareholder controls is believed to be a myth. JK Galbraith's oft-quoted words are apt:

" With even greater unction although with less plausibility, corporate ceremony seek also to give the

shareholders an impression of power. When stockbrokers are (or were) in control of a company, stockholders' meetings are an occasion of scant ceremony. The majority is voted in and the minority is voted out, with such concession as may seem strategic, and all understand the process involved. As stockholders cease to have influence, however, efforts are made to disguise this nullity. Their convenience is considered in selecting the place of meeting. They are presented with handsome printed reports, the preparation of which is now a specialised business. During the proceedings, as in the report, there are repetitive references to your company. Officers listen, with every evidence of attention, to highly irrelevant suggestions of wholly uninformed participants and assure others that these will be considered with the greatest care. Votes of thanks from women stockholders in print dresses owning ten shares "for the excellent skill with which you run our company are received by the management with well-simulated gratitude. All present show stern disapproval of critics and especially those who use the occasion to attack the social, political or military activities of the firm. No important stockholders are present. No decisions are taken. The annual meeting of the large [American] corporation is perhaps, one most elaborate exercise in popular illusion. "
(The New Industrial State (1971) p.72-85)

Although slightly caricatured in its description Galbraith's words resonates in large public companies in Malaysia. We may add that the meeting may often end with Malaysian buffet tea and a gift of the company's products to the devoted shareholder who attended.

.8 Recent studies have confirmed that the results of a study in the 70's [Lim Mah Hui, Ownership and Control of the one hundred largest corporations in Malaysia (1981) (Oxford)] which revealed that share ownership has been highly concentrated in the hands of a few institutions is accurate and that there is in fact a growth of such concentration in the 90's.

Lim Mah Hui's study which was based on a survey of 62 large corporations in the years 1974-76 is significant in pointing out that the Berle Means thesis of management control rather than ownership control cannot be applied to Malaysia without strong corrective and empirical analysis. Dr Mansur Md Isa points out that:

" Over the years, it seems that the ownership concentration has increased. This is evident from the findings of a KLSE Survey ..... which shows about 5% of

the shareholders in Malaysia as at the end of 1987 were institutions, owning above 80% of the shares. The remaining 95% were individuals, holding about 20% of the shares." (from Investors Digest, KLSE August 1993).

9 The implication from the above findings are many. For most investors in public companies the easiest route to express dissatisfaction with management is by divestment of their holdings. The individual shareholder is a hapless figure (in Denning MR's words "a little David against the Goliath"; see Wallesteiner v Moir (No.2) [1975] QB 373 and it would be impossible for him to challenge a united majority if the cost of doing so outweighs the simple costs of exiting the company.

10 The cost of seeking remedial action against mismanagement or even positive misconduct is high and even institutional shareholders who hold minority equity may find it easier to cut loss through sale rather than regain loss by court action. The example of an English case vividly illustrates this point. In the Prudential Assurance Co Ltd vs Newman Industries Ltd & Ors (1980) 2 All ER 841;; (1982) 1 All ER 345 litigation, institutional shareholders seeking a variety of remedies against what they contend were breaches of fiduciary duty incurred substantial amounts in costs which finally resulted in a rebuff by the Courts. The question nevertheless worth posing is whether considering their power and sophistication, institutional investors owe an obligation to their fellow shareholders to oversee corporate managers and to effect changes when necessary. The relative passivity of institutional shareholders and its'pro-management stance are often reflective of the convention of the corporate/financial community, a desire to be able to obtain free flow of information and also to obtain other businesses in their non-investor capacities. There has been however, in the U.S. a healthy tendency for institutional investors to exercise their independent judgment on the corporate governance issue; a trend which so long as conflicts of issue are addressed, seems the only alteration which at least gives rise to some hope of providing a check to the dominance of ownership dominated management.

11 Proxy Contests

Challenges to directors can be by way of Court action or by way of proxy contests. Shareholders do not have to attend in person to vote at meetings. Proxy contests however suffer from a number of defects, especially imperfect information. Small shareholders are often woefully ignorant of the merits or demerits of the issues or candidates. The cost of obtaining information about issues or about candidates are higher than the anticipated gains (if any). For larger

shareholders to engage in proxy contests the potential (private) gains in terms of increased value of their shareholding must be greater than the transaction costs involved in obtaining proxies. Experience confirms that directors have advantages in a proxy fight as the proxy machinery favours the incumbent e.g. the proxy forms are sent out with notice of shareholders meeting. In two of the proxy contests of which the paper writer was involved (The Petaling Tin's contest and the Hong Leong's bid for Ban Hin Lee Bank Berhad) the incumbent board of directors emerged victorious after verbal skirmishes between lawyers acting for proxies for the contesting factions (The Petaling Tin contest and the Hong Leong's bid for Ban Hin Lee Bank Berhad).

Without clear statutory intervention, the proxy machinery could even be more unfairly weighted against the shareholders.

Regulating the Directors

The efficacy of governance mechanism depends on whether shareholders can actually monitor directors. In a perfect world any breaches of duties are instantly detected and enforcement of penalties vis-a-vis shareholder's meetings, regulatory authorities and the courts are meted out forthwith. But this is not "a zero transaction cost world" and therefore care must be exercised in setting the standards of behaviour so as not to blunt the competitiveness of the Corporation (cf. Michael E. Porter's "Capital Disadvantage: America's Failing Capital Investment System" Harvard Business Review September-October 1992 p.65). The Companies Act regulate directors by:

- Prohibiting certain persons from managing (Section 130)

- Disqualifying person from being a director if he has been a company who has gone into insolvency (Section 130A)

- Providing for disclosure of interests, whether directly or or indirectly in a contract or proposed contract or holds any office or possesses any property which might be in conflict with his duties as director. (Section 131).

And in respect of a director's basic duty expressly provides that -

" A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office" (Section 132).

The statutory provisions are based on the consideration that directors are fiduciaries which is well-described by Cardozo CJ in Meinhard v Salmon (1928) 249 NY 458, 16E NE.

" Many forms of conduct permissible in a workday would be for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the moral of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behaviour. "

The two principal components of duties are -

(a) to exercise good faith in the discharge of duty and exercise of power;

(b) to exercise reasonable standard of care, diligence and skill.

N.P. The statement of principles are well known enough and statutory provision in the Companies Act 1965 appropriates these principles by:

- Prohibition of dealing by officer in securities (Section 132A)
- Prohibition of abuse of information, more commonly referred to as "insider trading" (Section 132B; see also Section 89 of Securities Industry Act) and the Section 132C, 132D, 132E, 132F and 132G already referred to above (see para 7.5 above).

The litany of provisions is quite austere and coupled with both severe stipulations of penalties and potential civil liabilities it would seem to deter all but the stout hearted to accept an office of directorship. Yet many may still accept directorship without much aforethought for the prestige it bears and also the perceived compensation.

One cynical commentator observed -

"In England, where they have a "profession" known as "company director:, the boardroom life is popularly regarded as a cushy sinecure. Said Lord Boothby, a life peer, in a reflective moment: "If you have five directorships it is heaven, like having a permanent hot bath .... No effort of any kind is called for. You go to a meeting once a month in a car supplied by the company, you look grave and sage, on two occasions say "I agree", say "I don't think so once, and if all goes well yet get 500 pounds just a year. " (from Chamberlain, Why It's harder and harder to get a good Board, Fortune Nov 1962 p.109).

It would be unfair to generalise the characteristics of directors but one cannot but feel that there are a hosts of Lord Boothbys', even in Malaysia; particularly those serving as pure nominees who do not discharge their non-executive

directorship with any particular rigour.

In the American Law Institute Principles of Corporate Governance is found an admirable statement (see Para 3.4 above) concerning the functions and powers of principal senior executives and directors.

Section 3.02(a) provides:-

"Except as otherwise provided by statute:-

(a) The board of directors of a publicly held corporation should perform the following functions:-

(1) Select, regularly evaluate, fix the compensation of, and, where appropriate, replace the principal senior executive.

(2) Oversee the conduct of the corporation's business to evaluate whether the business is properly managed.

(3) Review and, where appropriate, approve the corporation's financial objectives and major corporate plans and actions.

(4) Review and, where appropriate, approve major changes in, and determination of other major questions of choice respecting the appropriate auditing and accounting principles and practices to be used in the preparation of the corporation's financial statements.

(5) Perform such other functions as prescribed by law, or assigned to the board such a standard of the corporation.

This is an admirable statement of directorial's functions and powers but given following realities:-

- Constraints of Time: (boards seldom meet more than once a month (at most) and often only bi-monthly.
- Constraints of Information: opportunity to evaluate and consider data to make meaningful decisions is severely restrictive.
- Constraints of composition, selection and tenure (see M.A. Eisenberg (1976) The Structure of the Corporation, Chapter 11) - it is to be doubted in actual practice whether without a rigorous re-examination and reform of the Board that the goals as exemplified in the re-statement can ever be achieved.

Enforcing Good Directors Liability in Principle and Practice.

The remedies available to check directors' malfeasance are formally impressive. If a corporation is not controlled by a concentrated shareholding it is theoretically possible to resolve a dispute by requisitioning an extraordinary general meeting. A dissatisfied shareholder in a public listed corporation ordinarily withdraws his investment by selling his shares. If take-over bidders are active and are given leeway then indolent directors will have to be watchful. Clearly as Professor Ford points out, "If.... market is efficient there would be less need for remedies in the Courts".

The four main causes of legal action "available to" a member are:-

(i) member's personal action whether based on express shareholder's contract in the form of incorporated joint venture forms or where a company is listed on a stock exchange, on the basis of an implied term in the contract between the shareholder and the company that the company will comply with the listing rules of the Stock Exchange (see Zytan Nominees Pte Ltd v Laverton Gold NL (1988) 14 ACLR 524.

(ii) Members' Derivative actions, being an action brought by a member or members basing a cause of action vested in the company alone rather than a cause of action based on plaintiff-shareholder personally.

(iii) Member's application for an order of winding-up (Section 218).

(iv) Member's statutory remedy for oppressive or unfair conduct of company's affairs (Section 218 (f) (i) and Section 181)

The issue of enforcement of shareholder's rights arises only in the context of the minority shareholders; the majority shareholders can call a general meeting to dismiss directors but with concentration of share-ownership many corporations have majority shareholders who are also directors. The infamous common law authority of Foss v Harbottle laid down two major principles viz the non-interference of courts of acts of directors which are capable of being ratified in general meeting and that the corporation is the proper plaintiff for wrongs done to the corporation. The right to sue for wrongs done by directors are generally vested in directors as the power to manage is vested in directors (e.g. Regulation 73 of Table A) has been judicially determined to mean the right to litigate also resides in the board.

The Foss v Harbottle rule is definitely inhibitive of shareholders' ability to utilise legal remedies in the effecting of good governance on directors. The recognised exceptions are, if acts of directors are found to be:-

* ultre vires, illegal or criminal
* fraud on minority
* invasion of personal right

In practice the legal costs of funding a minority action (cf see Wallersteiner V.Moir (No.2) (1975) 1 All ER 849, Sherborne Park Residents Co. Ltd (1986) 2 BCC 99, 528 and the complexity of both substantive and procedural requirements have proved to be almost insurmountable for the minority. In Smith & Ors v Croft & Ors (No.2) (1987) 3 BCC 207, (No. 3) (1987) 3 BCC 218 Knox J. had to decide on various significant legal and procedural issues as to minority action where three minority shareholders in a company brought an action claiming that various payments out of the company was improper and therefore ought to be recouped for the company's benefit. The Court held that there must first be (a) a prima facie case made out that the company is entitled to the relief (b) the action fell within an exception of the Foss v Harbottle rule. Knox J. further held that an appropriate independent organ should determine whether the action should continue and in answer to that question it would be proper to have regard to the views of the majority of independent shareholders i.e. those whose votes would be cast that secure benefit to the company rather than to support any sectorial interests. He further held that whilst a minority shareholder was permitted to assert a company's right of substantive recovery as a result of procedure the minority could not have any larger right to relief from the company itself and could be prevented from suing if the will of the company was so expressed through an appropriate independent organ. In the case the majority was entitled to abandon the company's right of action in the company's interest and the minority shareholder's action was struck off.

Oppression of the minority: The avenue more often relied upon would be the statutory remedy of the oppresion of minority and the winding up on the "just and equitable" ground.

In the Kong Thai Sawmill (Miri) Sdn Bhd (1978) 2 MLJ 227 the Plaintiff Counsel pointed out that the Malaysian provision of Section 181 is wider than that of the English equivalent and therefore local courts are not bound to follow English decisions although they would be persuasive in authority. Section 181 is superior to common law remedies in that it is unhampered by procedural difficulties and the court has unlimited discretion to order any form of relief. Lord

Wilberforce in the Kong Thai Sawmill (Miri) Sdn Bhd said that for the remedy to apply:

"..... there must be a visible departure from the standards of fair dealing and a violation of the conditions of fair play which a shareholder is entitled to expect... disregard involves something more than a failure to take account of the minority's interest: there must be awareness of that interest in an evident decision to override it or brush it aside or act it ..... the proper company procedure... what is attacked by the [remedy] is not particular acts but the manner in which the affairs of the company are being conducted or the power of the directors exercised."

To be successful in a minority oppression action the shareholder must have sufferred harm in his capacity as a shareholder. Relief is not available for a member of the company's creditor or shareholder of a creditor (see Verghese Mathai v Telok Plantations Sdn Bhd (1988) 1 MSC LC 90, 122) Acquiesence in conduct complained of is also a bar to relief: Re; Senson Auto Supplies Sdn Bhd (1988) 1 MSCLC 90, 067.

Instances in Malaysia and Singapore where mismanagement was held to be oppressive are:

. Neglect and indifference shown by directors towards the assets of the company where the assets were allowed to deteriorate to such an extent that it was almost forfeited by the Government (see Ng Chee Keong v Ng Teong Kiat Highlands Plantations Ltd (1980) 1 MLJ 45.

. A director paying himself huge director's fees and makes loans unconnected with company's business so that he was held to have disregarded the shareholder's interests (see the Coliseum Stand Car Services Ltd (1972) 1 MLJ. 45.

. Where benefits which majority shareholders obtained were out of proportion to benefit to minority shareholders, evidence of non-payment of dividends and refusal to allow proportionate representations on the board (see Re. Gee Hoe Chan Trading Co. Ltd. (1991) 1 MSCLC 95, S.76

. However, where there were merely disagreements on whether certain corporate decisions ought to have been made albeit management had taken such decisions honestly and in good faith, disgruntled shareholders were not entitled to obtain relief (see In result of Tri-Circle Investment Pte Ltd (1993) 3 in MSCLC 95, 922.

Remedy of Just & Equitable Winding Up

This remedy provided for under S.218(1)(i) gives a wide discretion to the Court and may be exercisable in favour of

petitioner - shareholder where :

* the substratum of the company is destroyed.
* when the company is fraudulent from its' time of incorporation.
* when the company is no longer profitable.
* when there is a deadlock.
* where the company is a quasi-partnership and the members are unable to cooperate.
* where there is fraud, misconduct or oppression in management.

Mere differences between directors does not suffice to justify winding up under this rubric (see Re; Xing Ji Food Products (M) Sdn Bhd (1988) 1 MSCLC 90, 100; also Ng Eng Hian v Ng Kee Wai & Ors (1950 - 1985) MSCLC 7.

However the ouster of one director without due cause and interest of the company from being appointed director and chairman was held in the circumstance to justify intervention of the Court : Tay Bok Choon v Tahansen Sdn Bhd (1989) 1 MSCLC 90, 063. The threat of winding up by an aggrieved shareholder, if backed by justifiable factual circumstances, constitutes a singularly potent remedy to bring to heel overweening behaviour of dominant shareholders. In such instances many cases never reach the Court and may be settled by means of mediation or arbitration where the cost of losing the case (leading to liquidation of corporation) outweighs the cost of settlement.

0 Who should regulate corporate governance and director liability?

We have seen that shareholder control through common law and statutory remedies are not entirely adequate as a result of the viscissitudes of litigation. The Courts too face problems setting standards for directors. Judges who are not entirely conversant with the factual matrix within which corporate activities are implemented may either set unrealistically high standards or alternatively may abdicate in evaluating and adjudicating a dispute. The traditional basis of the Court's determination is by analogy with a fiduciary which essentially is on a moral basis. Whilst such a basis is not entirely inappropriate as a reflection of the wider community's expectation of fair dealing and proper behaviour of directors statutory intervention appears to be gaining in impetus based on an unexamined assumption

of the efficacy of law as a mode of social control.

The other major development is the setting up of governmental regulatory agencies (e.g. The Securities Commission).

One commentator cautioned (citing various studies) as follows:-

"Classical regulatory theory argues that policy makers are motivated by public interest concerns and contends that they should be concerned with the public good. Disputing the public interest theory is the "economy" theory of regulation that argue government regulation reflects the influence of special - interest groups. As well, regulators, it is argued have self-interested goals (job retention, power et cetera). Thus people both determining regulations and laws and those administering them behave selfishly to further their own ends". (from Dr R. Ian McEwin, Public vs Shareholder Control of Directors, the Company & Securities Law Journal Vol. 10 (1992) P.182, 201)

Whilst it may be inappropriate or premature to apply the above critique to Malaysian regulators its' cautionary note is nonetheless of value. It is not an easy task to steer between the Scylla of unregulated corporate and capital behaviour and the Charybdis of over-regulation leading to inefficiency and non-competitiveness for the Malaysian corporation.

0 **The Malaysian Corporation as an Institution in Transition.**

1 In the 17th Century, the great common law judge, Sir Edward Coke wrote "Corporations cannot commit treason, nor be outlawed nor excommunicated for they have no souls". As the Malaysian corporation moved into the 21st Century, the question arises whether the management and shareholder of the Corporation can move the corporation towards its' proper ends. At the heart of the debate over good governance are questions as to what a corporation is for.

At the commencement of this paper we have included in the definition of corporate governance reference to other stakeholders i.e. the employee, customers, suppliers and communities. In Malaysia, as elsewhere there is tension arising as the forces are played out within the tenets of efficiency, morality and managerial effectiveness (see James M. Gustafson and Elmer W Johnson in The U.S. Business Corporation (1988) a publication of American Academy of Arts and Sciences, Ballinger Publishing Company).

2 The identifiable tensions are:

Firstly, within a large corporation the interplay between structures of authority and accountability and the conditions to encourage entrepreneurship and adaptability.

Secondly the long term responsibilities of management and the more restrictive immediate self-interests.

Thirdly, is the more complex interplay of the often conflicting interests between shareholders and the work force, and the community's interest as a result of the drive towards a more caring and socially responsible corporation.

Any recommendations towards good corporate governance must take into consideration the dialectical tensions as stated above.

Concluding Observations and a Recommendation.

The corporation is one of the great inventions of the industrial and capitalist revolution. Good corporate governance is not an option but is a necessary feature for the growth of a healthy corporate society. We therefore recommend that :

- A permanent institute be set up by the Government to provide a proper forum for consultation, debate and dialogue in respect of proper corporate governance including in its agenda not only laws and regulations but evaluation of managerial models and public policies relating to the corporation.

- This Institute should have representatives from all major governmental, regulatory, professional academic consumer bodies and should be properly furnished to reflect its importance.

- Consultants serving in its various committees should review all laws and regulations in light of Malaysia's corporate experience and developments overseas to keep abreast with the environment in which good corporate governance flourishes.

- No legislation or regulatory directive should be passed without an endeavour to seek a consensual understanding of both its' principles and practices by all stakeholders.

The setting up of such an Institute would not be a panacea for all the issues relating to the corporation but would certainly be in step with the democratic impulse which in the final analysis be the justification

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of the existence of the corporation i.e. the common good.