

Expropriation Through Related Party Transactions: The Position In Malaysia

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Abstract

Johnson et al (2000) explored instances of expropriation of wealth by controlling shareholders of a company from the minority shareholders, among which are the transfers of assets to other companies under the majority shareholders' control and the extractions of cash through dubious transactions. With the amendment to the Companies Act 1965 in 2007, the rules pertaining to related party transactions in Malaysia have become more stringent. However, as shown in some recent reported transactions, the rules are not without weaknesses which may be exploited by the controlling shareholders to the detriment of the minority.

This article provides a critical discourse on first, the law pertaining to related party transactions in Malaysia; and secondly, some recent cases in Malaysia where the controlling shareholders in companies expropriated wealth from the minority. This article will also make some recommendations to further tighten the rules on related party transactions.

Key Words: *Related party transactions, Malaysia,*

1. Introduction

It is trite that a company, upon incorporation, is a separate legal entity from its shareholders and managers. The shareholders appoint the managers to manage the business of the company. When conducting the company's business to generate returns, the managers will inevitably incur debts on behalf of the company. The concept of separate legal entity does not permit the company's creditors to claim repayment of the debts from the managers who contracted the debts on behalf of the company unless fraud is proven. Neither can the creditors claim repayment from the company's shareholders although they are the owners of the business. Instead, the creditors are to claim repayment of the debts owed by the company from the company itself. Thus, looting the company of its assets through corporate payouts to the managers or shareholders is frowned upon (Brockman and Unlu, 2009).

Further, the management of the company is separated from its ownership. The management is in the hands of the board of directors, who are appointed by the shareholders at their general meeting. Thus, the controlling shareholders could appoint their own onto the board. The directors may delegate the day-to-day management to a team of managers. Sometimes the management is part of the board and vice versa. As the directors' interest and those of the managers may not be aligned with that of the shareholders, particularly the minority shareholders, this may lead to the expropriation of the minority (La Porta *et al*, 1999; Djankov *et al*, 2008). Therefore in many jurisdictions, there exists mechanism to prevent expropriation of minority shareholders.

In this paper, the creditors and the minority shareholders of the company who are vulnerable to expropriation by those in control, are collectively referred to as the outside investors. Their protection which is determined by the law of the country, is critical in the country's financial development and growth (La Porta *et al*, 1998). As expropriations of the outside investors may be in various forms (La Porta *et al*, 2000; Johnson *et al*, 2000b), it is of utmost importance that the laws pertaining thereto should be properly worded. Some expropriations are straightforward cases of theft, such as transfer of assets at below market value to other companies under the control of the insiders. There is no or little hindrance particularly where there is inefficient legal protection of

outside investors. But as investor protection increases, those in control will have to be more creative if they want to divert the company's assets for their own benefit (La Porta *et al*, 2000).

Previous researches support the importance and relevance of investor protection in corporate governance (Johnson *et al*, 2000a; Johnson *et al*, 2000b; La Porta *et al*, 2000). In Johnson *et al* (2000a), the researchers studied the impact of the Asian financial crisis in the late 1990's and find that countries with effective minority shareholders protection were less impacted by the crisis. Their study suggests that a country with weakly enforceable minority shareholders rights is vulnerable. If such country suffers a small loss of confidence, the outside investors will reassess their position and withdraw their investment. This may cause an increased expropriation and lead to further outflow. It is a vicious cycle. Thus, protection of outside investors does matter in the promotion of financial and economic development (Johnson *et al*, 2000b). It is one of the reasons why a country undertakes the exercise to reform its corporate governance (La Porta *et al*, 2000).

La Porta *et al* (2000) list the various sources of rules protecting investors, namely, the laws pertaining to company, security, bankruptcy; stock exchange regulations and also accounting standards. For meaningful reformation, these should be reviewed, for the results of La Porta *et al* (2006) "point to the need for legal reform to support financial development". It is important to regulate the conflict between controlling shareholders and outside investors to enhance capital markets. With regard to the reformation of accounting standards, it must be noted that the convergence of many jurisdictions' accounting standards to the International Financial Reporting Standards is a move towards the improvement of corporate governance (Ball, 2006). Malaysia has also announced its road map to converge by 2012.

This paper does not intend to discuss the pros and cons of the convergence to IFRS, but to undertake a study on the reformation of the other sources of rules pertaining to investor protection, namely the law and regulation reformation particularly on related party transactions. The arrangement of this paper is as follows. Following this introduction, this paper discusses the march towards the improvement of corporate governance in Malaysia. Part 3 discusses the laws pertaining to related party transactions in Malaysia. Part 4 examines three companies in Malaysia which effected related party transactions within the ambit of the law but which are detrimental to the outside investors. Part 5 concludes.

2. Corporate Governance Reform in Malaysia

In Malaysia, the principal legislation governing corporate governance is the Companies Act 1965, an Act which has been amended 35 times since its enactment. The years 1986 and 1987 witnessed the introduction of provisions in the Act to restrain the conduct of controlling insiders. Restrictions on transactions involving them were added onto the Act, thus rendering expropriation more complicated. The new provisions were found in sections 132C, 132E and 133A.

The next wave of reform came a decade later when Malaysia was hit by the Asian financial crisis. Malaysia, recognizing the need to shore up its corporate governance, set up a High Level Finance Committee on Corporate Governance in the midst of the crisis to study her existing corporate governance framework. The Committee's findings were published a year later on 9 March 1999. In its Report, it acknowledged that "the economic turmoil had, within less than a year, taught corporate Malaysia that corporate governance or rather the lack thereof, can exact a heavy toll for the markets" (Para 1, Chapter 1). It also admitted that the massive loss of confidence by investors in Malaysia's capital market was due to cases of corporate abuses including related party transactions, asset shifting and conflict of interests. These abuses were made possible by ineffective enforcement and the ability of some shareholders to influence and control the company (Para 1.6, Chapter 3). Thus, the importance of good corporate governance which the Committee defined as:

the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the ultimate objective of realising long term shareholder value, whilst taking into account the interests of other stakeholders (Para 1, Chapter 2).

The Committee also recognized that the board of directors plays a crucial role in the governance of a company. They are to oversee the conduct of the company's business to ensure it is properly managed (Para 2.9 and 2.10, Chapter 2) for the benefit of all, including the shareholders. Hence, the Committee recommended that, among others, there should be a codification of the fiduciary duty to avoid conflict of interests and the duty to act for a proper purpose (Para 3.1.5, Chapter 2); that controlling shareholders and members of the senior management are deemed to be directors in certain transactions involving the company (Para 3.1.9, Chapter 2); and that a controlling shareholder is prohibited from exercising his right to vote in a transaction which he has an interest in (Para 3.1.8, Chapter 2).

In March 2000, the Finance Committee on Corporate Governance issued its Code on Corporate Governance. One of the best practices prescribed was that the board of directors should establish an audit committee, a majority of whom should be independent. One of the prescribed duties of the audit committee is to consider any related party transactions that may arise within the company or group (Para 4.62 Part 4). Further, the Finance Committee emphasized that the ultimate responsibility of the board is to create value for shareholders, not for any single shareholder or shareholder group (Para 4.73 Part 4). There was no change in the emphasis by the Finance Committee on the ultimate responsibility by the directors when the Code was revised in October 2007.

However, as the Code of Corporate Governance does not have force of law, it is also important to review and revise the relevant company law legislation to improve investor protection. On 17 December 2007, Malaysia established a Corporate Law Reform Committee (the "CLRC") to reform the company legislation to make it current and in line with the best practices elsewhere. The CLRC issued 12 consultative documents to, among others, review the provisions in the Companies Act 1965 regulating a company's substantial property transactions with its directors and loans to directors, directors' role and duties and members' rights and remedies. The CLRC's Final Report was issued in early 2009. Thus, there is a continuing process to enhance corporate governance principles and practices in Malaysia.

Pending the outcome of the CLRC's review, the legislature deemed it necessary to implement some of the recommendations of the High Level Finance Committee made in 1999. In 2007, before the revision of the Malaysian Code of Corporate Governance and whilst the exercise to review the Companies Act 1965 was still ongoing, the Companies Act 1965 was amended to, among others, improve some of the investor protection rules. The Companies (Amendment) Act 2007 which came into effect on 15 August 2007, has to an extent adopted the recommendations of the High Level Finance Committee made in 1999. Some of the rules pertaining to related party transactions in Malaysia were tightened, but there is still room for improvement. These will be discussed below.

3. Related Party Transaction Rules in the Companies Act 1965

The provisions in the Companies Act 1965 which pertain to related party transactions are found in sections 131, 132E, 133 and 133A. The 2007 Act saw more checks and balances being put in place to protect the rights of outside investors, and sections 131 and 132E were amended. These provisions will be examined below.

3.1 Transaction involving director or person connected with him

Prior to the 15 August 2007, a director of a company who is in any way, whether directly or indirectly, interested in a contract or proposed contract with the company, shall declare the nature of his interest at the board of directors' meeting. The Act did not prohibit him from participating in the deliberation of or the voting on the transaction at the board meeting or even at the shareholders' meeting if the transaction requires the shareholders' approval. Similarly, the director is not required to declare the interest of a person connected with him as defined in section 122A.

The 2007 amendment altered the position. A new section 131A was added to disallow the interested director from participating in any board discussion on the contract or proposed contract when it is being considered. It follows too that he cannot vote. However, the law does not restrain him from being present during the deliberation and it is submitted that this may give rise to governance issues, for his mere attendance may shape the direction of

the discussion and have an effect on the board's decision. The position of an interested director of a listed company is similar. Para 10.08(6) of the Bursa Malaysia Listing Requirements provides that the interested director "must abstain from board deliberation and voting on the relevant resolution in respect of the related party transaction". Para 7.25 further emphasized it by requiring a listed company to incorporate in its Articles of Association a provision to the effect that "a director shall not vote in regard to any contract or proposed contract or arrangement in which he has, directly or indirectly, an interest". However, the Listing Requirements do not curb the attendance of the interested director at the meeting.

With regard to shareholders' meeting, section 132E provides that where a proposed related party transaction breaches a threshold, prior shareholders' approval is required. This provision will be discussed in detail below. But for the purpose here, the writer wishes to highlight that section 132E does not prohibit the interested director from attending the meeting nor participate in the deliberation. It merely provides that the interested director shall not vote on the resolution. Again, this leads to governance issues and will be further discussed below.

The 2007 amendment has also attempted to expend the coverage of section 131, but due to bad drafting, much is to be desired. First, in the Explanatory Statement of the Bill for the amendment, it was stated that with the amendment to section 131, the interests of a spouse and a child including adopted child and step-child shall also be included in the interests that a director must disclose pursuant to this section. Thus, it follows that upon the amendment to section 131, a director shall be required to disclose the interest of his spouse or child in a contract where the company is a contracting party. However, the new section 131(7A) does not reflect the intention of the legislature, for it reads,

For the purpose of this section, an interest of the spouse of a director of a company (not being herself or himself a director of the company) and an interest of a child, including adopted child or stepchild, of a director of the company (not being himself or herself a director of the company) in the shares or debenture of the company, shall be treated as an interest in the contract and proposed contract.

A literal interpretation would require the director to disclose his spouse's or child's interest in the shares or debenture issued by the company, as opposed to the interest of the spouse or child in the contract or proposed contract which the company is deliberating.

Secondly, assuming that the court would give a purposive interpretation to sub-section (7A), the director is then required to disclose his interest, his spouse's interest and that of his child in the contract or purported contract. It is unfortunate that the net was not casted wide enough to include the interest of any other person connected with him as defined in section 122A of the Companies Act 1965. Section 122A is found in Division 2 of the Act. Section 131 is also part of this Division. According to section 122A, for the purpose of Division 2, a person shall be deemed to be connected with a director if he is a member of the director's family, a body corporate which is associated with that director, a trustee of a trust under which that director or a member of his family is a beneficiary, or a partner of that director or person connected with that director. Members of the director's family include his spouse, child (including adopted and step child), parent, sibling and the spouse of his child and sibling. It is suggested that for good governance, a director should be required to declare the interest of any person connected with him in the contract or proposed contract with the company.

Thirdly, the threshold of interest of the director, spouse or child in the contract or proposed contract is not prescribed. Subsection (2) refers to disclosure of interest which may be regarded as material. But what is material is subjective and opened to interpretation. It is submitted that lessons may be drawn from another provision on related party transaction, *i.e.*, section 132E. The threshold is clearly stipulated and easily computed. Section 132E will be further examined below.

Another governance issue which may arise is found in section 131(4) wherein it is stated that it is sufficient for the director to give a general notice to the board to the effect that he is an officer or a member of a specified company or firm and thus is to be regarded as interested in any contract which may be made with the company or firm. There is no necessity for the interested director to give any specific notice when the contract is being

deliberated unless there is a change in the nature or extent of his interest, for sub section (6) provides that such declaration “shall be made at the first meeting of the directors held after he becomes a director, or if already a director, after he commenced to hold office or to possess the property”.

Is it then the duty of the company secretary to highlight the interest of the director? If not, the other members of the board may not be alerted. Even if they were at the board meeting when the notice was first given, they may not remember it when the contract is being deliberated which may be months or years later. The current directors might not be the directors at the time of declaration. It is thus submitted that the interested director should be required to re-declare his interest when the resolution on the contract is on the agenda of the board meeting. Indeed he should also excuse himself from the meeting at that juncture.

It is also observed that the consequence for failing to make the necessary disclosure by the interested director renders the contract voidable at the option of the company unless the contract is for valuable consideration and the other party has no actual notice of the contravention. Thus, it follows that the contract is binding and enforceable against the company if the other contracting party proves that first, it has given valuable consideration for the contract; and secondly, it did not have actual notice of the failure by the interested director to declare his interest in the contract. This gives rise to the following issues.

First, though the consideration for the transaction is valuable and at the market price, it may not be an arm’s length transaction due to the other terms of the contract. Secondly, the company is bound if the other contracting party did not have actual notice of the infringement by the director *i.e.* it did not know at the time of the contract that the interested director did not declare his interest. Unless the director himself was the contracting party or had informed the contracting party, the latter would not know whether the declaration was ever made. A better choice of words was suggested by Balan and Lingam (2008) *i.e.* the contract is binding against the company if the other contracting party acted “in good faith and without notice” of the contravention.

3.2 Substantial value transaction involving director or substantial shareholder or person connected with him

Section 132E on substantial value property transaction involving directors, first came into force in 1987. It is a safeguard against tunneling by directors, for the original section 132E required such transaction to be first approved by the shareholders in a general meeting. If there was no prior approval, the contract would be voidable at the option of the company unless the transaction was ratified within a reasonable time by the company in a general meeting. However, this provision against tunneling was found to be wanting by the High Level of Finance Committee on Corporate Governance and steps were taken to plug the loopholes under the Companies (Amendment) Act 2007.

First, the coverage was extended to include transactions involving not only a director of the company or holding company or a person connected with the director, but also the following persons:

- (1) A substantial shareholder, or a person connected with him
- (2) A person primarily responsible for the operations or financial management of the company such as the chief executive officer, the chief operating officer or the chief financial controller, or a person connected with him

For ease of reference, they are referred to as “interested person”.

However, as in section 131 discussed above, the amendment to section 132E is also not free from bad drafting. Who is a substantial shareholder is not defined in the section and is subject to interpretation. Though the phrase is defined in section 69D, it is unfortunate that the definition therein does not apply, for it clearly stipulates that its application is restricted to Division 3A. Section 132E does not belong to this Division. The legislature might have overlooked the definition for substantial shareholder for the purpose of related party transaction.

Under the Bursa Malaysia Listing Requirements, a related party transaction is defined as a transaction entered into by a listed company or its subsidiary which involves the interest, direct or indirect, of a director, major shareholder or person connected with the director or major shareholder. A major shareholder is a person who has interest in at least 10% of the voting shares in the listed company or its holding company or subsidiary. The threshold is reduced to only 5% where he is or was the largest shareholder of the said company. A past director or major shareholder is also caught if the transaction is made within six months after he ceased to hold that position.

Thus, the scope of major shareholder is wider than that of substantial shareholder as defined in section 69D of the Companies Act 1965. The threshold for the latter is 5% and it does not include a person who was but is no longer a substantial shareholder. It is not clear whether the legislature intended to capture too, a transaction effected by a substantial shareholder as defined in section 69D or a major shareholder as defined in the Listing Requirements for the purpose of a related party transaction.

Secondly, the new section 132E clearly states that shareholders' prior approval is required before a company enters into a transaction of substantial value which involves an interested person. Failing which, the contract is void. Ratification after the transaction has been entered into is no longer permissible.

However, it is unfortunate that where the other contracting party is a director or substantial shareholder or senior management of not the contracting company itself, but its holding company, or a person connected with any of them, then the resolution of the shareholders of the contracting company itself can be dispensed with. Due to the drafting of subsection (2), it is sufficient to obtain the approval from the shareholders of the holding company. It is submitted that the concepts of corporate personality and good governance require approval of the company which is the contracting party. A company is a separate legal entity from its holding company. Unless it is a wholly owned subsidiary, the contracting company has other shareholders apart from the holding company. Thus, where a company is proposing to enter into a transaction which is of substantial value, its shareholders particularly the minority shareholders should be given the opportunity to approve or reject it.

The law as it stands does not prevent tunneling by a holding company nor give the minority shareholders a say in the proposed transaction of substantial value with a director, substantial shareholder or senior manager of the holding company or a person connected with either one of them. The one exception is where the contracting company is public listed, for the Bursa Malaysia Listing Requirements require the listed company's shareholders to approve a related party transaction which has breached a certain threshold. The threshold of transactions which require shareholders approval will be discussed below.

Thirdly, section 132E(3) provides that the "director, substantial shareholder or person connected with such director or substantial shareholder, as the case may be," shall abstain from voting on the resolution. Again, there is no prohibition to attend and deliberate on the matter before the resolution is put to vote. His presence may compel some shareholders to vote for it. Further, the abstinence found in subsection (3) should be extended to include not only the interested person, but also persons connected with him. Following the strict interpretation of subsection (3), it appears that the persons connected with the interested person may vote on the resolution.

The position under the Bursa Malaysia Listing Requirements is slightly better. Though it does not prohibit the attendance of the interested person or persons connected with him, or his participation in the deliberation of the resolution, para 10.08(7) clearly prohibits the interested person and persons connected with him from voting on the resolution.

Fourthly, the value prescribed in section 132E is not accumulative. For a non listed company, it is provided that a transaction is of substantial value if it exceeds 10% of the company's assets or RM250,000, whichever is lower. Transaction below RM10,000 is excluded. For a public listed company, a threshold of 5% subject to a minimum of RM250,000, is set. To avoid shareholders' scrutiny, the company management may break up a substantial value transaction into smaller parcels. There is no contravention of section 132E in letter but in spirit. Though there must be compliance with section 131, this section may not prove to be a hindrance as discussed above. It is submitted that the legislature should review the threshold found in section 132E of the Companies Act 1965 and

the Bursa Malaysia Listing Requirements. To avoid abuses and expropriation of outside investors, the cumulative value within a specific timeframe should be adopted.

3.3 Loan to director or person connected with him

Expropriation of assets from minority shareholders may take the forms of assets shifting and transferring, both are subject to constraints by the procedures put in place by sections 131 and 132E of the Companies Act 1965. Expropriation can also come in the form of a loan guarantee effected by a company for the benefit of the insider which is in control. In Malaysia, sections 133 and 133A are two sections in the Companies Act 1965 against loan guarantees to related parties.

Section 133 prohibits a company from giving a loan or providing a security for a loan granted to its director and the director of its related company, *i.e.* its holding company, its subsidiary or the subsidiary of its holding company. Section 133A prohibits the company from giving a loan or providing a security for a loan granted to a person connected with its director or the director of its holding company. However, the prohibitions found in sections 133 and 133A are not absolute. One of the exceptions is they do not apply to an exempt private company, which is defined in section 4 as a private company with not more than 20 shareholders, all of whom are individuals.

The High Level Finance Committee on Corporate Governance found the coverage and scope of sections 133 and 133A are lacking and recommended their review. The Committee reported that the prohibited transactions are in respect of loans only, and should “be amended to cover quasi-loans or other financial benefits, arrangements, gifts or quasi-gifts” (Para 3.16 Chapter 6).

The Corporate Law Reform Committee (“the CLRC”) also undertook a review of sections 133 and 133A. It carried out a cross jurisdictional study and noted that Australia allows a company to give financial benefits to its director or a person connected with him provided shareholders’ approval is obtained and the interested person abstains from voting. New Zealand too permits it but requires the benefit to be disclosed (not approved) to the shareholders. The United Kingdom allows it too and requires both shareholders’ approval and disclosure to shareholders. In all three jurisdictions, the restriction on the benefits applies to a director and persons connected with him. It was not extended to a substantial shareholder or persons connected with him.

In addition, the CLRC also note that the types of transactions which are prohibited under Bursa Malaysia Listing Requirements are wider than what is prescribed in sections 133 and 133A of the Companies Act 1965. They include giving an indemnity, forgiving a debt, releasing or neglecting to enforce a financial obligation or assuming the financial obligation of another. Moreover, the Listing Requirements provide that a listed company may give a loan or provide a guarantee or security to its director or employees only if permitted under the Companies Act 1965. It may also do so for its subsidiaries or associated companies. To others, the listed company may do so only if it is necessary to facilitate the company’s ordinary course of business.

In view thereof, the CLRC recommended no change be made to the ambit and scope of sections 133 or 133A. There is no need to extend them to cover financial benefits other than loans, as well as include transactions involving a substantial shareholder and persons connected with him. The CLRC recommendation found support among the majority of the respondents. Thus, in their Final Report which was published early 2009, the CLRC recommended no modification to either section 133 or 133A (Para 23 of Chapter 2).

Possibly due to the study undertaken by the CLRC and its recommendation, the suggestion by the High Level Finance Committee in 1999 was not followed through. This is unfortunate for the following reasons. First, the Bursa Malaysia Listing Requirements apply to only listed companies. Secondly, other forms of financial benefits such as quasi-loans and gifts are even more prejudicial to the outside investors. If the director or person connected with him is granted a loan, at least he has an obligation to repay it. A gift need not be returned.

Thirdly, studies have shown that expropriation of the company’s assets can be done through loan guarantees committed by directors as well as controlling shareholders. Johnson *et al* (2000b) discussed a case in

Belgian where the controlling shareholder tried to pledge the company as a security to guarantee the repayment of the shareholder's debts. Berkman *et al* (2009) identified 88 public listed companies in China which guaranteed repayment of loans granted to related parties. The loans were for purposes that were unrelated to the businesses of the guarantors. In Malaysia, the case of how the Goh family lost control of Goh Ban Huat Bhd through loan guarantees makes an interesting case study. This will be discussed in Part 4 below.

4. Three Cases on Expropriation

Part 3 above examined the laws pertaining to related party transactions and their weaknesses, giving room to inside investors to exploit and expropriate wealth to the detriment of the outside investors. This Part will study three companies which have entered into such transactions without contravening the black letter law, but which have an impact on the outside investors. The facts of the three cases which are the subject of discussion in this Part, namely, Ho Hup Construction Company Bhd, Tradewinds (M) Bhd and Ceramtec Sdn Bhd, are based on documents made available to the public.

4.1 The case of Ho Hup Construction Company Bhd

In the middle of 2009, Ho Hup Construction Company Bhd ("Ho Hup") proposed to sell two pieces of land to Permata Juang (M) Bhd ("Permata") and Santari Sdn Bhd ("Santari") respectively. An Extraordinary General Meeting was called on 8 July 2009 to deliberate and vote on the two transactions.

There was a disclosure that the proposed sale to Permata was a related party transaction for both Ho Hup and the holding company of Permata, Magna Prima Bhd ("Magna") had common directors. Lye Ek Seng ("Lye") was a common director of both Ho Hup and Magna. Further, the managing director of Ho Hup, Lim Ching Choy ("Lim"), was a former executive director of Magna. Following the Bursa Malaysia Listing Requirements, Lim was deemed to be a director of Magna too for the transaction took place within six months of his resignation. Ho Hup's shareholders rejected the proposed transaction.

However, the shareholders approved the sale of another tract of land to Santari, a dormant company whose shareholders were Hiew Yoke Ching ("Hiew") and Lee Siong Hai. This proposed transaction was not disclosed as a related party transaction, for it wasn't one. However, subsequent events revealed that Hiew was actually the sister-in-law of Lee Kian Seng ("Lee"), who resigned as an independent director of Magna in June 2009. It must be stressed here that Lee was not a director of Ho Hup and thus, on record, Santari was then not a person connected with a director or substantial shareholder of Ho Hup.

On 10 August 2009, a major shareholder of Ho Hup, Low Chee & Sons Sdn Bhd instituted legal action against Ho Hup. It claimed that Magna was the "shadow" and ultimate purchaser of the land that Santari acquired from Ho Hup. There is circumstantial evidence leading to this. First, Magna had earlier entered into a transaction with Lai Meng Girls' School Association ("Lai Meng"), whereby Magna would transfer a plot of land to Lai Meng. It was the same land which Santari was acquiring from Ho Hup. Secondly, one of the two shareholders in Santari was the sister-in-law of a former director of Magna.

If Magna was the ultimate buyer of the land, it would tantamount to a related party transaction, for some of directors of Ho Hup were on the board of Magna less than six months earlier. Thus, some existing shareholders of Ho Hup should not have voted on the proposed land sale to Santari. It is unfortunate that for reasons not revealed, Low Chee & Sons Sdn Bhd subsequently withdrew their suit against Ho Hup.

4.2 The case of Tradewinds (M) Bhd

According to its website, Tradewinds (M) Bhd ("Tradewinds") is an investment holding company with core businesses in oil palm and sugar. Its authorized capital is RM500 million, and paid-up capital is RM296.5 million. According to its 2008 Annual Report, its trade receivables as at 31 December 2008 was RM323.2 million, and 65% thereof (RM209.9 million) were due from its related parties. A big portion of it (RM193.9 million or 60%) arose

from its transactions with Bukhary Sdn Bhd (“Bukhary”). This was an increase from the previous year where its total trade receivables was RM315.1 million, of which RM176.7 million (56%) were due from its related parties. Bukhary’s debts then amounted to RM167.8 million (53%). The increase was notwithstanding the increase in the normal credit term from 60 days to 90 days. Further, the interest for late payment was reduced from 18% in 2007 to 6.5% in 2008.

It is observed that the trade receivables from Bukhary arose from the sale of refined sugar from Gula Padang Terap Sdn Bhd (“GPT”) which is a subsidiary of Tradewinds. For the financial year 2008, the aggregate value of the sale was RM165 million. It would be interesting to find out what is the total sale of GPT and the credit terms given to other purchasers, for Para 10.09(2) of the Bursa Malaysia Listing Requirements demand that the recurrent related party transactions must be “in the ordinary course of business and are on terms not more favourable to the related party than those generally available to the public”.

The 2008 Annual Report also revealed that among the interested directors or shareholders in this recurrent related party transaction was Syed Azmin Syed Nor (“Syed Azmin”), who was also a member of the Audit Committee (“AC”). Syed Azmin was said to be a non independent non executive director because he is the brother of Syed Mokhtar who held an indirect major shareholding in Tradewinds. As discussed in Part 2 above, one of the functions of the AC is to review the related party transactions and conflict of interests’ situation. The issue is how independent is the AC where one of its members has already declared his interest in Bukhary which is a substantial debtor of the group? Further, the following observations which also raise questions on the independence of the AC are made.

The members of the AC were somewhat ‘connected’. The Chairman of the Committee, Ooi Teik Huat (“Ooi”), was also a director of MMC Corporation, DRB-Hicom Bhd, EON Bhd, Tradewinds Plantations Bhd and Johor Port Bhd. These companies share a common substantial shareholder in Syed Mokhtar who is the brother of Syed Azmin. The other member of the AC was Khalid bin Sufat (“Khalid”), an independent non executive director, who was also appointed a director of a company known as Amtek Holdings Bhd. Syed Azmin was also a director of this company. It is also observed that Ooi and Khalid were appointed on 1 April 2009, upon the resignation of two directors who were also members of the AC. The reasons for their resignation from the board and AC were not revealed.

However, despite the mounting debts and the issue whether the deal with Bukhary was an arm’s length transaction, the shareholders of Tradewinds had in the company’s annual general meeting on 17 June 2009, renewed its mandate for recurrent related party transactions with Bukhary for an estimated value of RM300 million from 17 June 2009 to 16 June 2010.

4.3 The case of Ceramtec Sdn Bhd

Goh Ban Huat Berhad (“GBH”) was founded by Goh Leng Soon in 1897 and the company was listed in the Kuala Lumpur Stock Exchange in 1989. Up to 2007, the descendants of the founder (“the Goh family”) controlled about 37% of the shares in GBH. However, a hostile takeover from Robert Tan saw the Goh family lost control of the company and on 2 October 2009, it was reported that the family had sold its entire stake in the company. How the family lost control of GBH is heartbreaking, for the humiliation arose from guarantees given for loans granted to an inside investor of GBH, who is not even a member of the Goh family, as well as to a related company.

In 2000, the Goh family’s stake in GBH was held by a private company controlled by the family, Ceramtec Sdn Bhd (“Ceramtec”). In January that year, Ceramtec amended its Memorandum and Articles of Association to allow the company to charge its assets as security for loans granted to third parties. Soon thereafter, Ceramtec charged some of its shares in GBH to secure a loan granted to Wan Shalihudin, who was then the third largest shareholder of GBH. A year later, Ceramtec charged another block of shares in GBH to secure a loan granted to Asas Ketara Sdn Bhd, a subsidiary of Ceramtec.

As both loans were not repaid, the lender sold the shares in September 2006. Two months later, Robert Tan emerged as a substantial shareholder, holding 10.8% stake in GBH. In January 2008, Robert Tan raised his stake in the company to 30% and in June 2009, announced a voluntary general offer. The 33% level was breached when the offer lapsed in June 2009, and Robert Tan announced a mandatory general offer for GBH. Despite a fight put up by the Goh family, the offer was too good to be rejected by the other shareholders and thus, many sold out to Robert Tan who managed to raise his stake in GBH to 82.5% when the takeover offer closed. The Goh family, having lost the battle, sold out all shares held by them.

The loan guarantees given by Ceramtec are not prohibited by any provision in the Companies Act 1965. This is because Ceramtec being an exempt private company is exempted from section 133 or 133A of the Companies Act 1965. The Listing Requirements also do not apply to it because it is not a listed company. Even assuming Ceramtec was not an exempt private company, the loan guarantee to Asas Ketara contravened neither section 133 nor 133A, for it is a subsidiary of Ceramtec. Section 133A(2)(a) expresses that a company may grant a loan to its related company without contravening the section. Section 133 pertains to a loan to its director. Thus, the loan guarantee to Wan Shalihudin is also not caught by section 133, for Wan was then not a director of GBH. He was appointed subsequent to Ceramtec issuing the loan guarantee.

The Ceramtec case is an example of how section 133 or 133A may be circumvented. As the prohibitions do not cover a substantial shareholder, he may cause the company to give him a loan or provide a security for a loan granted by a third party prior to his appointment as a director. This is because the provisions are not extended to loans granted to substantial shareholders. In this case, the loan guarantees proved to be costly acts made by Ceramtec.

5. Conclusion

The year 2007 marked a momentous high point in corporate governance reformation in Malaysia, for the Companies Act 1965 were amended to, among others, check the abuses of those in control of companies. However, as discussed in Part 3 above, the benefits of the amendments were marred by bad drafting. Further, there appeared to be some reluctance to extend the coverage of prohibited transaction, possibly due to fear that it might have an impact on genuine transactions for the benefit of the company as a whole. It is submitted that if Malaysia wishes to advance its capital market, reformation to the corporate governance should be done whole heartedly.

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