

## Schemes of Arrangement in Malaysia: Pre & Post 2010

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**Abstract:** Schemes of arrangement can be used as an easier vehicle in a corporate acquisition. An approved scheme is binding on all including shareholders. The issue is how shareholders particularly minority in target company can be treated under a scheme. The main objective of this paper is to analyze key changes of legal framework of schemes of arrangement after coming new Code in force, and to evaluate the rights of minority shareholders in a scheme of arrangement which results in the transfer of control of a company. It further attempts briefly to acquire basic understanding of schemes as well as to consider certain factors, in the form of pros, which may make a scheme more attractive than an offer, and some disadvantages which may make it more appropriate for a bidder to proceed with a takeover by way of an offer. This writing is mostly analytical in nature, and largely based on secondary materials like books, articles, and several online writings. Primary sources of law including certain foreign judicial decisions have also been used in this paper. The scope of this article is limited as it is going to concentrate on only the use scheme of arrangement for takeover purpose and mainly within Malaysian legal authority. Scheme proposed between company and its creditors is also beyond the ambit of this writing. It does not want to argue that whether treatment of all involved in a scheme is fair rather it seeks to extend the debate in a new direction by stating rights of shareholders including minority are being protected under a scheme of arrangement especially after changes.

**Keywords:** Acquisition of Control, Minority Protection, Scheme of Arrangement, Takeover, Takeover bid.

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### I. Introduction

The most common methods of acquiring the control of a company are the takeover bid and the court approved scheme of arrangement. At a very early stage, a decision should be taken as to whether the acquisition will be effected by means of a takeover bid or a scheme of arrangement. Scheme of arrangement is a statutory court supervised mechanism for the implementation of a wide range of possible corporate transactions which requires the approval of the target shareholders at a meeting in majority basis and the sanction of the court.<sup>1</sup> In other words, the alternative to a take-over bid as a means of acquiring hundred per cent control of a company is a scheme of arrangement.<sup>2</sup> The use of a scheme of arrangement to effect a takeover has gained popularity in Malaysia; it is also seen as an easier route to acquire control as compared to the traditional takeover bid which is regulated by the Malaysian Takeovers Code.<sup>3</sup> The reason for this popularity depends on the fact that a successful scheme assures the bidder of 100 per cent of the target's shares.<sup>4</sup> A scheme can be carried out for takeover by means of a transfer of scheme or by a cancellation of scheme. There is a significant change in the legal framework of schemes of arrangement in Malaysia.

The paper contains broadly three sections: in the first part, it tends to provide briefly the idea of scheme of arrangement with its use, and methods for its implementation. It also focuses certain differences between takeover bid and scheme of arrangement, and pros and cons of schemes; the second part tries to describe scheme of arrangement in Malaysia containing governing laws and process of a scheme; and in the third section of this writing, as the most important one, it attempts to evaluate and analyze changing trends on the amendments of legal regime as well as to find out certain protections of shareholders of target in scheme provided by legal authority compared to shareholders in a bid. And in closing remark, this article tends to address briefly the findings on evaluation on the changes with certain suggestions to make the scheme fruitful in Malaysia.

### II. Schemes Of Arrangement

#### 1. Concept of Scheme of Arrangement

The term 'scheme' literally means a plan or a system for doing or organizing something,<sup>5</sup> and arrangement means an agreement. A scheme of arrangement is essentially a court-approved agreement between the company

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<sup>1</sup>M. A. Khan, *A Guide to Malaysian Takeovers and Mergers Law* (Selangor: Sweet & Maxwell Asia, 2013), at 3.

<sup>2</sup>C. Chandrasegar, *Take-Overs and Mergers* (Singapore: Butterworths Asia, 1995), at 5.

<sup>3</sup>M. A. Khan, Shareholders' Protection under Scheme of Arrangement and Takeovers.<[http://www.maicsa.org.my/article\\_feature/2011/article\\_feature\\_1107.aspx](http://www.maicsa.org.my/article_feature/2011/article_feature_1107.aspx)>(Retrieved May 3, 2013)

<sup>4</sup>J. Payne, Scheme of Arrangement, Takeovers and Minority Protection, *Legal Research Paper Series*, no. 42, University of Oxford, 2010. <<http://ssrn.com/abstract=1600592>>

<sup>5</sup>D. Lea et al. (Ed.), *Oxford Advanced Learner's Dictionary*, New 8<sup>th</sup> edition (Oxford: Oxford University Press, 2010).

and its creditors (e.g. lenders or debenture holders), or its securities holders (e.g. shareholders) which may be used to vary existing rights and obligations.<sup>6</sup> M. A. Khan defines a scheme of arrangement as “a statutory procedure which requires the approval of the target shareholders at a meeting and the sanction of the court, whereby a compromise or arrangement is proposed between a company and its creditors or between the company and its members or any class of them”.<sup>7</sup> The author also mentioned that a scheme allows a company to restructure itself provided that after proposing the scheme by the company to its shareholders if approved by a statutory majority at a special meeting convened by the court, it becomes effective and binding on all shareholders once sanctioned by the court as the arrangement must be approved by a court.<sup>8</sup>

The term ‘arrangement’ is broadly defined to include a reorganization of the share capital of the company by the consolidation of shares of different classes or by the division of shares into different classes or by both these methods.<sup>9</sup> The words “arrangement is proposed...between the company and its members or any class of them...” in section 176 requires that there be not only in existence a scheme of arrangement, but that it has also been proposed.<sup>10</sup>

## 2. Purposes of Scheme of Arrangement

A scheme of arrangement is now included within the definition of a takeover offer under the Code.<sup>11</sup> Hence, scheme is now subject to the 2010 Code as well as the Companies Act 1965. Sections 176 and 177 of the Companies Act 1965 state the procedures of all classes of schemes in details. There are many types of schemes can be arranged under the Companies Act as no specific type of schemes has been mentioned in there. Scheme of arrangement can be used in a wide variety of ways.<sup>12</sup> This mechanism is widely used to facilitate possible corporate exercise or transactions,<sup>13</sup> which may include a reorganization of its share capital, rights and liabilities of members, and transfer the assets of one company to another.<sup>14</sup> It may also include transfers of all or a specified proportion of each shareholder’s securities to a bidder, cancellations of existing securities or issues of new securities to a bidder, and as such can be used as an alternative to a takeover bid to effect a change of control,<sup>15</sup> or merger or amalgamation,<sup>16</sup> of companies. Therefore, a scheme of arrangement can also be utilized to structure a takeover as one of the most common uses of a scheme is as an alternative to a takeover offer.<sup>17</sup>

## 3. Takeover Offer versus Scheme of Arrangement

A takeover is technically defined as a proposal made by bidding company to the target company’s shareholders to purchase the entire shares not owned by the bidder in the target company, whereas a scheme of arrangement refers to a Court approved agreement between a company and its equity or debt holders.<sup>18</sup> In other words, a scheme of arrangement is a court approved agreement between a company and its members whereby all of the shares in the target are transferred from shareholders to the bidder. A takeover offer, on the other hand, involves the bidder making an offer to target shareholders to control through acquiring their shares. There are certain important factors which can differentiate a bid from a scheme. Control can be the first distinguishable key point. In a takeover, the bidder deals with the target shareholders, by contrast where a scheme is used as an alternative to a takeover offer, the bidder deals not with the target shareholders, but with the target company.<sup>19</sup> Therefore, the offer process is led by the bidder whereas as a scheme of arrangement is a corporate action of the target or a scheme is proposed by target the process is controlled by the target rather than the bidder.<sup>20</sup> The second crucial issue is approval matter which distinguishes between offer and scheme. A scheme of arrangement will involve the offeror acquiring 100 percent control of the target as it binds all, once sanctioned by the court.<sup>21</sup> By contrast, in a takeover offer, the bidder’s offer must be conditional on acceptances being secured by the bidder sufficient to give it 50 percent of the voting rights in the target;<sup>22</sup> that is to say, upon 50%

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<sup>6</sup> M. L. Kum, A Robust System for Corporate Restructuring in Malaysia, *Girr-Malaysia*, 2010, 148-152.

<sup>7</sup> M. A. Khan, n. 3.

<sup>8</sup> Ibid.

<sup>9</sup> The Companies Act 1965, s.176(11).

<sup>10</sup> *Perbadanan Kemajuan Negeri Selangor v. Worldwide Holdings Bhd. Shoptra Jaya (M) Sdn. Bhd.*, (Intervener) [2007] 5 MLJ 193, at para 9.

<sup>11</sup> Malaysian Code on Takeovers and Mergers 2010, s. 44.

<sup>12</sup> J. Payne (2010), n. 4.

<sup>13</sup> M. A. Khan (2013), n. 1, at 11.

<sup>14</sup> C. Chandrasegar (1995), n. 2, at 6.

<sup>15</sup> M. A. Khan, n.3.

<sup>16</sup> M. A. Khan (2013: 12) defines amalgamation as a category of compromise or arrangement whereby a company can transfer its undertakings, assets and liabilities to a new company on the terms that shares in the old company will be cancelled and shares in the new company will be allotted to former holders in proportion to their former holdings.

<sup>17</sup> J. Payne (2010), n. 4.

<sup>18</sup> M. A. Khan, n. 3.

<sup>19</sup> J. Payne (2010), n. 4.

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

<sup>22</sup> Ibid.

acceptance offer becomes unconditional. Therefore, a takeover offer can involve the bidder acquiring less than 100 percent of the target. Only when the acceptance level reaches 90 percent of the voting rights, the bidder can exercise a squeeze out right to acquire compulsorily the remaining 10 percent of the remaining dissenting minority voting shares.<sup>23</sup> And third important differentiating factor is the involvement of court. A scheme requires the additional sanction of the court; on the other hand, offer does not require court sanction to make it effective. Due to need for court approval, the scheme is more time consuming, expensive and cumbersome than a takeover offer.

#### **4. Mechanisms for Implementation of Scheme of Arrangement**

As it is stated earlier, in order to acquire control a scheme may be implemented through different ways i.e. by way of a transfer scheme or by way of cancellation scheme.<sup>24</sup> A transfer scheme may simply require that the existing target company's shareholders transfer their shares to the offeror company in consideration of a cash payment or the issue of securities.<sup>25</sup> A transfer scheme requires a third party to execute, on behalf of the target shareholders, the transfers necessary to transfer all the shares in the target company to the bidder.<sup>26</sup> Transfer scheme is adopted to avoid triggering any rights related to reduction of capital.<sup>27</sup> Alternatively, under a cancellation scheme the shareholders of the target company agree to the cancel of all their existing issued shares in the target company, and to issue of new share to the offeror company, in consideration of the offeror company making a payment or issuing securities to the former shareholders of the target company.<sup>28</sup> The cancellation of the shares creates a reserve in the target which is capitalized and used by the target to issue new target shares to the bidder and the end result is to give the entire ownership of the company to the bidder.<sup>29</sup> This is also known as a reduction scheme as it combines a scheme with a reduction of capital.<sup>30</sup> The detailed procedures for reduction of share capital are found in section 64 of the Companies Act. The complexity and the length of time involved is one of the disadvantages of reduction schemes.<sup>31</sup> There is no difference in substance between these two types of scheme mentioned above.<sup>32</sup> The only reason for choosing the later is that they avoid the payment of stamp duty on the value of shares transferred.<sup>33</sup>

#### **5. Pros & Cons of Scheme of Arrangement**

Scheme of arrangement has certain advantages and disadvantages as every coin has two sides. There are some advantages which may make a scheme more attractive than an offer, as well as some disadvantages which may make it more appropriate for a bidder to proceed with a takeover by way of an offer.

To begin with, a scheme provides a high degree of certainty as to outcome as courts order is binding on all. In other words, a scheme gives assurance of certainty of acquiring of 100% of target company. Where a bidder is seeking to acquire 100 percent of the target's shares, it will need to consider the most effective way of achieving this goal.<sup>34</sup> A scheme to effect a takeover has an 'all or nothing' outcome, and a bidder will have the certainty of knowing that it will either acquire 100% of the securities to which the scheme relates, or nothing if it is not successful. Here, the bidder acquires the entirety of the shares in the target company unlike bid where the bidder may only obtain all the shares in the target company if more than 90% of shareholders accept the offer. Apart from this, there is no quorum requirement at the meeting. Provided this majority is obtained and the scheme is sanctioned by the court, it then becomes binding on all members of the class and on the company.<sup>35</sup> Moreover, once voting is done (assuming the scheme is sanctioned by the court), no further action is required on the part of the shareholders to ensure that the scheme becomes effective.<sup>36</sup> A scheme of arrangement may have a further advantage in relation to shareholders outside Malaysia. As mentioned earlier, a scheme of arrangement is a compromise between a company and its members or class of members, as such, circulation of documents relating to a scheme are, generally speaking, less likely to be subject to regulation than a take-over offer document.<sup>37</sup> Another merit of a cancellation scheme is no stamp duty payable by the bidder.<sup>38</sup> If a scheme is

<sup>23</sup>Capital Market and Services Act 2007, s. 222.

<sup>24</sup> M. A. Khan, n. 3.

<sup>25</sup> C. Chandrasegar (1995), n. 2, at 6.

<sup>26</sup> M. A. Khan, n. 3.

<sup>27</sup> M. A. Khan (2013), n. 1, at 13.

<sup>28</sup> C. Chandrasegar (1995), n. 2.

<sup>29</sup> M. A. Khan, n. 3.

<sup>30</sup> Ibid.

<sup>31</sup> C. Chandrasegar (1995), n. 2, at 6.

<sup>32</sup> Ibid.

<sup>33</sup> Ibid.

<sup>34</sup> M. Thompson, n. 49.

<sup>35</sup> C. Chandrasegar (1995), n. 2 at 9.

<sup>36</sup>Ibid., at 10.

<sup>37</sup>Ibid., at 11.

<sup>38</sup> M. Thompson, Scheme of Arrangement in Takeovers.<<http://www.stephoe.com/publications-6643.html>> (accessed on April 2, 2013).

structured as a cancellation scheme, no stamp duty would be payable on a takeover since no transfer of shares or agreement to transfer shares would have occurred.<sup>39</sup> By using a reduction scheme if the target company is acquired, stamp duty on the value of the target company can be saved. In addition, bidder is also not concentrated with third party.<sup>40</sup>

On the other hand, there is a lack of control of bidder in a scheme. Unlike a takeover offer where the process is controlled by the buyer, scheme is proposed by a target, as such, procedures driven mostly by it. Target may withdraw scheme before sanction. From bidder perspective, it is a con of a scheme. Additionally, Schemes of arrangement are essentially inflexible.<sup>41</sup> They are ‘all or nothing’ in nature and, whilst the acquisition of 33% of the target company will be sufficient to obtain control by means of take-over bid, it will not be sufficient for a scheme of arrangement.<sup>42</sup> Moreover, court involvement may be treated as key disadvantage in a scheme. A successful scheme must be sanctioned by court. Therefore a key risk in a scheme is that a court may refuse to sanction a scheme of arrangement (or convene the appropriate scheme meeting) if it considers it appropriate to do so in the context of the scheme as a whole and any potential prejudice to security holders, creditors or other parties, even if the requisite levels of security holder approval have been obtained at the scheme meeting. Besides this, the need to involve the court may mean that the prospective offeror company will take a long time to obtain control by means of a scheme of arrangement.<sup>43</sup> Further, the legal costs of implementing a takeover by way of a scheme will usually be higher than those of an offer as it involves court process.<sup>44</sup> Furthermore, schemes of arrangement which are designed to give effect to an acquisition involve a reduction of capital, any creditor of the target company is entitled to attend the hearing of the petition and object to the reduction, though it is difficult to see grounds on which such an objection would succeed.<sup>45</sup> Last but not least, demerit of scheme from target shareholder’s perspective, there is less possibility of competition in scheme as binding all unlike takeover offer is required to be competitive.<sup>46</sup>

### III. Legal Process Of Schemes In Malaysia

#### 1. Process of Scheme of Arrangement

In Malaysia, the relevant legal provisions for a scheme of arrangement are found in the Part VII of the Companies Act 1965 as well as it is subject to the Malaysian Code on Takeovers and Mergers 2010.<sup>47</sup> As it is mentioned earlier that sections 176 and 177 of the Companies Act 1965 deal with the procedures all types of schemes. Jennifer Payne (2010) asserted that “there are three main steps involved in effecting a takeover by way of a scheme. First, a compromise or arrangement is proposed between the company and its members. An application must then be made to court....for an order that a meeting or meetings be summoned. Second, meetings of the members (or creditors as the case may be) will be held to seek approval of the scheme by the appropriate majorities. Third, the scheme must be sanctioned by the court.”<sup>48</sup> The English judge Chadwick LJ stated the purposes of these steps in *Re Hawk Insurance Co Ltd.* in the following terms:

“It can be seen that each of those stages serves a distinct purpose. At the first stage the court directs how the meeting or meetings are to be summoned. It is concerned, at that stage, to ensure that those who are to be affected by the compromise or arrangement proposed have a proper opportunity of being present (in person or by proxy) at the meeting or meetings at which the proposals are to be considered and voted upon. The second stage ensures that the proposals are acceptable to at least a majority in number, representing three-fourths in value, of those who take the opportunity of being present (in person or by proxy) at the meeting or meetings. At the third stage the court is concerned (i) to ensure that the meeting or meetings have been summoned and held in accordance with its previous order, (ii) to ensure that the proposals have been approved by the requisite majority of those present at the meeting or meetings and (iii) to ensure that the views and interests of those who have not approved the proposals at the meeting or meetings (either because they were not present or, being present, did not vote in favour of the proposals) receive impartial consideration.”<sup>49</sup>

Apart from these, an announcement of the key terms of the scheme including the consideration to be paid by the bidder and the key features of the agreement is also required. The Practice Notes says any agreement in

<sup>39</sup> M. A. Khan (2013), n. 1, at 13.

<sup>40</sup> G. Stedman, *Takeovers* (Sweet & Maxwell, 1993), pp 35-37, in M. A. Khan, *A Guide to Malaysian Takeovers and Mergers Law* (Selangor: Sweet & Maxwell Asia, 2013), at 15.

<sup>41</sup> C. Chandrasegar (1995), n. 2 at 11.

<sup>42</sup> Ibid.

<sup>43</sup> Ibid.

<sup>44</sup> Ibid., at 12.

<sup>45</sup> Ibid.

<sup>46</sup> Section 217(5) of CMSA 2007 says offer should be competitive.

<sup>47</sup> In Malaysia, the Code on Takeovers and Mergers 2010 replaced the 1998 Code.

<sup>48</sup> J. Payne (2010), n. 4. ; M. A. Khan, n. 3.

<sup>49</sup> [2001] 2 BCLC 480.

relation to a scheme of compromise, arrangement, amalgamation or selective capital reduction, which will cause the acquirer to trigger a mandatory offer obligation upon the implementation of the scheme require an announcement.<sup>50</sup>

### **1.1. Statutory application to court to convene a meeting**

Whichever form of scheme is used, the target company will apply to the Court to convene a meeting of its shareholders or, if it has more than one class of shares, meeting of each class of its shareholders for the purpose of considering the proposed scheme. Where an arrangement or a compromise is proposed between a company and its members, an application must be made to Court for an order that a meeting be summoned, and the court has powers to order a meeting of members in such manner as the Court directs.<sup>51</sup> This application is normally granted as a matter of course and the target company then sends a circular to its shareholders containing notice of the relevant meeting or meetings, and a detailed explanation of what is proposed.<sup>52</sup> Before it exercises its discretion to order a court convened meeting under section 176(1) of the Companies Act, the court will consider whether:

- a. the scheme proposed to undertaken is fair and reasonable,<sup>53</sup>
- b. the scheme was cast in the terms such that it is likely to be approved at the shareholders' meeting and whether the court was likely to sanction it at the subsequent application.<sup>54</sup>

Where the court satisfied that on proper reading of the proposed scheme, it was not viable, feasible, workable or intelligible, and that if a meeting were called it would certainly result in the proposed scheme being rejected, no meeting should be ordered.<sup>55</sup> The court directs meeting to be held of all the classes concerned.<sup>56</sup> If there are conflicting interests within a class, meeting of sub-classes must be held.<sup>57</sup> In the UK, at the first court hearing, the court has a wide discretion to order the meetings of members on such terms as it thinks fit, but the court is not concerned with the merits or fairness of the scheme at this stage.<sup>58</sup>

### **1.2. Statutory scheme meeting for shareholder's approval**

A restructuring plan or scheme is devised and will be put up for shareholders' approval through a voting process. To succeed, a scheme needs approval 75% in value, and at least 50% in number of each class of shareholders, either in person or by proxy, at a duly convened shareholders' meeting.<sup>59</sup> Additionally, Practice Notes (PNs)<sup>60</sup> imposes another requirement that where take-over offer is effected by way of a scheme of arrangement, the value of votes cast against the resolution to approve the scheme at such meeting is not more than 10% of the votes attaching to all disinterested shares of the total voting shares of the offeree.<sup>61</sup>

### **1.3. Application to court for sanction of the scheme**

Once the statutory requisite approval is obtained i.e. the necessary resolutions are passed, an application will be made to the Court to sanction the proposed scheme. The court has discretion whether or not to approve a scheme.<sup>62</sup> Before approving or sanctioning the scheme and in exercising discretion, court will generally consider the following factors that-

- a. Whether the statutory provisions have been complied with e.g. resolution is passed by statutory majority.
- b. Whether the scheme is fair and reasonable. The classes of members have been fairly represented by those who attended and that the statutory majority approving the scheme is acting in good faith in the interest of the class it profess to represent. Where a scheme is proposed, the issue of fair dealing with respect to minority shareholders also becomes a great concern.
- c. Whether the scheme has been proposed for the purpose of avoiding the takeover provisions of the relevant law.<sup>63</sup>

<sup>50</sup>Practice Notes on the Code 11, para 1.8(c).

<sup>51</sup> The Companies Act 1965, s. 176(1).

<sup>52</sup> C. Chandrasegar (1995), n. 2 at 6.

<sup>53</sup>*Sri Hartamas Development Sdn. Bhd. v MBF Finance Bhd.* [1990] 2 MLJ 31 at 33.

<sup>54</sup>*Sri Hartamas Development Sdn. Bhd. v MBF Finance Bhd.* [1990] 2 MLJ 31 at 35; *Twenty First Century Oils Sdn. Bhd. v. Bank of Commerce (M) Bhd. &Ors.* [1993] 2 MLJ 353 at 358.

<sup>55</sup>*Twenty First Century Oils Sdn. Bhd. v Bank of Commerce (M) Bhd. &Ors.* [1993] 2 MLJ 353.

<sup>56</sup>J. Dine, *palgrave macmillan law masters: Company Law*, 5<sup>th</sup> edition (Hampshire: PALGRAVE MACMILLAN, 2005), at 315.

<sup>57</sup>*Re Hellenic and General Trust Ltd.* [1976] 1 WLR 123.

<sup>58</sup>*Re Telewest Communications plc.* [2004] BCC 342

<sup>59</sup> Companies Act 1965, s. 176(2); PNs 44, para.1.3(a).

<sup>60</sup>PNs on the 2010 Code, the explanation of the Code, issued by Security Commission pursuant to Section 217(4) and 377 of the Capital Markets and Services Act 2007, which replaced the practice notes under the previous code.

<sup>61</sup>PNs 44, para.1.3(b).

<sup>62</sup> C. Chandrasegar (1995), n. 2 at 7.

<sup>63</sup> M. A. Khan (2013: 3) states that schemes of arrangement have been brought under ambit of the Code due to tendency of people as to avoidance of the law. If court observes that the scheme has been proposed for the purpose of avoiding the takeover provisions of the Act, it may not grant application.

The Supreme Court of Victoria had held that in sanctioning a proposed scheme of arrangement, the court must be satisfied not only that the support of the statutory majorities in value and number of company shareholders and debenture holders at meetings duly convened and held have been obtained but also that the arrangement can reasonably be supposed by sensible business people to be for the financial benefit of both shareholders and debenture holders as such.<sup>64</sup> The English court will, in considering whether a scheme ought to be approved, disregard a majority vote in favour of it if it appears that the majority did not consider the matter with a view to the interests of the class to which they belongs only.<sup>65</sup>

#### 1.4. Effective scheme

If the court sanctions the scheme, it will become effective upon an office copy of the court order being delivered to the Registrar of Companies for registration.<sup>66</sup> Once a scheme is approved by the statutory requisite, and sanctioned by the court, it becomes binding on all shareholders or any relevant class of its(including any dissenters) of the target company under the scheme,<sup>67</sup> thereby ensuring that if the scheme relates to the entire issued share capital of the target, a bidder acquires 100 percent of the shares of the target.<sup>68</sup> The scheme also binds any dissentients.<sup>69</sup> Upon approval by the court, the scheme assumes the characteristics of the statutory contract imposed by law on all parties who are affected by it.<sup>70</sup> The court can set aside the scheme subsequently only on very limited grounds, for example, if the consent has been obtained by fraud or any unlawful means, the sanction of scheme may be refused by the court.<sup>71</sup>

### IV. Changing Trends

#### 1. Key Changes in Scheme of Arrangement

The takeover Code of the United Kingdom, Singapore, and Malaysia all start with the same objectives, that is to say, all shareholders should be treated fairly and equally.<sup>72</sup> The concept of all would appear the same.<sup>73</sup> The differences are not material and raised because of the need to take account of local conditions.<sup>74</sup>

On 15 December 2010, the Malaysian Securities Commission introduced a new Malaysian Code on Take-Overs and Mergers 2010 (the Code) which replaced the previous the Malaysian Code on Take-Overs and Mergers 1998. The new Code is broadly similar to the 1998 Code. It does not introduce major changes to the takeovers and mergers law,<sup>75</sup> rather brings improved protection for investors through codifying the conduct of all parties, enhances transparency of information through greater disclosure and also puts a heavier onus on independent directors of the target company. Actually, the amendment seeks to provide adequate and appropriate protection for minority shareholders.<sup>76</sup>

The key change involving acquisition of control of company arising from the implementation of the new Code includes extension of scope of application of the Code to scheme of arrangement. Unlike the 1998 Code the current code covers wider corporate exercises that involve acquisition of control in a company.<sup>77</sup> The inclusion of a wider corporate exercise aims to provide protection to the shareholders of the company undertaking the corporate exercise.<sup>78</sup> The 2010 Code states that

“it shall apply to any person who carries out a take-over offer, howsoever effected, including by way of a scheme of arrangement, compromise, amalgamation or selective capital reduction.”<sup>79</sup>

The Code now makes very clear that a scheme of arrangement, compromise, amalgamation or selective capital reduction (schemes), will be treated as take-over offers and fall within the purview of the Securities

<sup>64</sup> *The Matter of Chevron (Sydney) Ltd. cases.*

<sup>65</sup> *Carruth v. Imperial comical Industries Ltd.* [1937] AC 707.

<sup>66</sup> The Companies Act, s. 176(5).

<sup>67</sup> *Ibid.*, s. 176(3).

<sup>68</sup> M. Thompson, n. 38.

<sup>69</sup> J. Payne (2010), n. 4.

<sup>70</sup> Lord Wrenbury, *Buckley on the Companies Acts* 14<sup>th</sup> edition, in G. B. Parker and M. Buckley (Ed.) (London: Butterworths, 1981).

<sup>71</sup> *Fletcher v. RAC* [2000] 1 BCLC 331; J. Payne(2010) says that there is some doubt whether the court can withdraw its sanction if it subsequently emerges that there has been a defect or irregularity in the proceedings leading up to the order. The decision in *Sovereign Life Assurance Co v. Dodd* [1892] 2 QB 573 suggests this might be possible, but this seems questionable. There is no subsequent English authority on this point but the Australian courts have rejected the *Dodd* approach (see eg *Chief Commissioner of Payroll Tax v. Group Four Industries Pty Ltd* [1984] 1 NSW LR 689) and this latter approach seems preferable.

<sup>72</sup> R. Paterson, Comparative Analysis between the Malaysian Code, the UK Code and the Singapore Code with emphasis on problem areas, at 16, in Association of Merchant Banks in Malaysia, *Malaysian Code on Take-Overs and Mergers 1987: Key Issues and Practical Implications*, Kuala Lumpur.

<sup>73</sup> *Ibid.*

<sup>74</sup> *Ibid.*

<sup>75</sup> M. A. Khan, An Insight Into the the latest Development on Takeovers and Mergers law in Malaysia, *C&SLJ*, 29(2), 2011,125-129, in Say Goo (Ed.),Overseas Notes-Hong Kong, Singapore, and Malaysia.

<sup>76</sup> *Ibid.*

<sup>77</sup> *Ibid.*

<sup>78</sup> M. A. Khan, n. 3

<sup>79</sup> The 2010 Code, s. 44.

Commission.<sup>80</sup> That is to say, scheme of arrangement in Malaysia is now subject to the Companies Act as well as the 2010 Code. Thus, these schemes all require compliance with the Code and approval from the Securities Commission.<sup>81</sup> It also makes clear that a mandatory general offer is now triggered where control or acquisition of the target company is obtained through a Scheme.<sup>82</sup> But why did scheme of arrangement come within the definition of takeover offer. The English Takeover Panel include a scheme of arrangement under the purview of the City Code (UK) in early 2008 when there was a significant increase in the use of schemes of arrangement and the use of the scheme was seen as a route to avoid the City Code.<sup>83</sup> A similar approach was taken by Singapore.<sup>84</sup> Therefore, preventing avoidance of the Code may be the one reason of inserting scheme as takeover offer. Moreover, the protections afforded to shareholders under the 1998 Code were not available to shareholders of a company involved in a scheme of arrangement. With the inclusion of these schemes under the Code, shareholders affected by these schemes are now afforded by the same protections.<sup>85</sup>

In addition, where a takeover offer is effected by way of a scheme of arrangement, Practice Note 44 requires not only the approval of at least a majority in number and three-quarters in value of the shareholders, but also that the number of votes cast against the resolution to approve for the scheme at such meeting is not more than 10%. The latter requirement has raised some concerns about ‘greenmailing’ by majority shareholders.<sup>86</sup> Despite this, the inclusion of the requirement is seen as a move to safeguard minority shareholders in the company affected by such an exercise.<sup>87</sup> The offeror and advisors are also required under the new Code to consult with the Securities Commission before undertaking a scheme.<sup>88</sup>

As statutory duty imposed by the section 15 of the Code, the board of directors of target must appoint an independent adviser to advise and make recommendations on the takeover offer to the shareholders to make their decision as to whether to accept or reject the takeover bid. For the purpose of this, independent advisor as expert evaluates whether offer is reasonable and fair and make comment on it.<sup>89</sup> According to PNs, “where a take-over offer is effected by way of a scheme of arrangement, compromise, amalgamation or selective capital reduction, the analysis or evaluation should be conducted in the same manner as for a take-over offer”.<sup>90</sup> As schemes of arrangement can result in substantially the same outcome as an offer, the analysis or evaluation of such proposals should be the same as for an offer. The independent adviser should evaluate whether the scheme of arrangement is ‘fair and reasonable’ as it would for an offer. The independent adviser should also highlight the advantages and disadvantages of the scheme to the affected shareholders when it considers the ‘reasonableness’ of the scheme. If the independent adviser is of the view that the scheme is ‘not fair but reasonable’, the independent adviser should also comment on the consequences on the shareholders when they approve and reject the scheme.

Where acquisition of control is done through a scheme, the process is driven by the board of directors on behalf of the target company.<sup>91</sup> It starts with a meeting as required under the Companies Act 1965 and is subsequently approved by the Court. Under general duties under Company law, Board’s duties owes to company as a whole. It must exercise the powers vested on it for the proper purpose, in good faith and promote the best interests of the company. The law imposes upon director the duty to act in the best interests of the company as it is an agent of company, and their relationship is fiduciary in nature.<sup>92</sup>

## **2. Protections of Shareholders under a Scheme**

The purpose of amendment is to afford protection to investors. More specifically, object of inclusion of scheme of arrangement in the new Code as takeover offer is to ensure the rights of shareholders, especially minority shareholders in a scheme. In case of a scheme, if it is approved by the court, it is binding on all whether or not they supported the proposal. Consequently, minority shareholders cannot seriously disrupt the implementation of the scheme. Although aim of the Code is to protect all shareholders especially minority, they

<sup>80</sup>B. Chia and M. A. Aziz, Public Mergers and Acquisitions in Malaysia: Overview. <<http://www.practicallaw.com/0-502-1894?source=relatedcontent#a449636>> (Retrieved May 3, 2013)

<sup>81</sup>M. A. Khan (2011), n. 75.

<sup>82</sup>B. Chia and M. A. Aziz, n. 80.

<sup>83</sup>M. A. Khan (2011), n. 75.

<sup>84</sup>Ibid.

<sup>85</sup>Ibid.

<sup>86</sup>Ibid.

<sup>87</sup>Ibid.

<sup>88</sup>B. Chia and M. A. Aziz, n. 80.

<sup>89</sup>The new Code highlights the Securities Commission's continuous efforts to enhance investor protection and transparency and to establish higher standards of governance in takeover and merger activities in Malaysia. SC inserted the tests of fairness and reasonableness in 2012 by amendment of PNs 15

<sup>90</sup>PNs 15, para. 3.7.

<sup>91</sup>M. A. Khan, n. 3.

<sup>92</sup>*Mills v. Mills* (1938)

will have to transfer their shares to the bidder for the price agreed in the meeting. Now, the question is how minority shareholders can be protected under a scheme, if majority did not see their interest to make decisions.

The principle of majority rule means that *prima facie* minority shareholders will always be bound by the decisions taken by the majority, but they must do so *bona fide* in the best interests of the company. In ‘squeeze outs’,<sup>93</sup> the minority can apply to court for an order that there should be no acquisition or that the offer price be amended. It is for the petitioner to establish that the squeeze out is unfair. In a case dealing with unfair prejudice petitions, Lord Hoffmann made it clear that if the majority make an offer to buy out the minority at a fair price then any exclusion of the minority shareholder is not unfair.<sup>94</sup> Apart from these rights, J. Payne(2010), in two different writings, rightly pointed out largely two protections of minority shareholders in a scheme:<sup>95</sup>

The first protection is found during the voting process involving the shareholders of the different ‘classes’<sup>96</sup> of shares.<sup>97</sup> The law requires the company to obtain approval of all classes of members who will be affected by the scheme.<sup>98</sup> In consequence, the success of the scheme depends upon the approval of each class meeting. Hence, the courts can protect minorities by ensuring that they have all of the information they need to determine whether to attend and how to vote at the meetings, and by ensuring that the correct class meetings are held.<sup>99</sup> In *Re Anglo American Insurance Ltd.*, it was held by the Court that where the scheme itself proposes to treat different group of members within a particular class differently, then separate meetings of the group are needed.<sup>100</sup>

The second protection is driven during court process when scheme comes for sanction.<sup>101</sup> The scheme will not bind the company and its members until the court approves it. The court has wide discretion at this stage to refuse to sanction a scheme if minority oppression is present.<sup>102</sup> The role the court performs before sanctioning the scheme can operate as an important protection for shareholders. Before sanctioning, court will consider three matters.

First, the court must ensure that the statutory provisions have been complied with and that the resolutions are passed by the requisite statutory majority of each class. If this is not, the court cannot approve the scheme, even if the court considers it to be fair and the scheme would, otherwise, have been approved.<sup>103</sup> Second, the court must also determine that the scheme is fair and reasonable.<sup>104</sup> The majority has to represent the class fairly,<sup>105</sup> i.e. they will act in good faith. Courts are prepared to refuse to sanction a scheme if they believe that the majority has not voted in the interests of the class as a whole and so this hurdle can operate as a real protection for minorities.<sup>106</sup> If the court finds the absence of *bona fide* in resolution, it may decline the sanction. The third issue for the court is whether the scheme is one which a reasonable person would approve.<sup>107</sup> Therefore, the court will exercise due diligence.<sup>108</sup> By exercising due diligence, court may deny to approve the proposed scheme.

## V. Concluding Remarks

It is laid down earlier that the acquisition of control of a company can be obtained through a scheme of arrangement under the Companies Act 1965 as alternatives to the acquisition of shares of the target. The present

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<sup>93</sup>Under section 222 of Capital Market and Services Act 2007, if bidder acquires 90% shares of target, it can compel 10% shareholders to exit company by selling their shares i.e. minority shareholders have to leave, This right of bidder is commonly known as ‘squeeze out’ right. However, by section 223 of same Act, the dissenting shareholders are given a statutory corresponding right, which is known as the ‘bought out’ right, to sell their shares to the bidder on the terms of the offer.

<sup>94</sup>*O'Neill v. Phillips* [1999] 1 WLR 1092.

<sup>95</sup> M. A. Khan, n.3 ; J. Payne(2010), n.4.

<sup>96</sup>G. McEwen (2009) asserted that the ‘class’ test is directed to ‘rights’, not ‘interest’, in determining class. In *Sovereign Life Assurance Co v. Dodd* [1892] 2 QB 573 at 583 explained the term class in this way that “the word ‘class’ used in the statute is vague, and to find out what it means we must look at the general scope of the section ... it seems to me that we must give such a meaning to the term ‘class’ as will prevent the section being so worked as to produce confiscation and injustice, and that we must confine its meaning to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with the view to their common interest.”; See also *Re Chevron (Sydney) Ltd.* [1963] VR 249; *Nordic Bank plc. v. International Harvester Australia Ltd.*[1982] 2 VR 298 at 303; See also G. McEwen, Friendly Takeovers by Scheme of Arrangement: The Question of Class, Francis Burt Chamber, 2009.

<sup>97</sup> M. A. Khan, n.3 ; J. Payne(2010), n. 4.

<sup>98</sup> Ibid.

<sup>99</sup> Ibid.

<sup>100</sup>[2001] 1 BCLC 755.

<sup>101</sup> J. Payne(2010), n.4.

<sup>102</sup> Ibid.

<sup>103</sup>*Re Neath and Brecon Railway* [1892] 1 Ch 349.

<sup>104</sup> M. A. Khan, n.3.

<sup>105</sup> J. Payne (2010), n.4.

<sup>106</sup>*Re NFU Development Trust Ltd* [1972] 1 WLR 1548.

<sup>107</sup> J. Payne (2010), n. 4.

<sup>108</sup> Due diligence is the process of systematically researching and verifying the accuracy of a statement. In law, due diligence is considered as a synonym of reasonable care. When a person acts as a prudent or reasonable man, it can be deemed that due diligence was exercised by such person. In Malaysia, a ‘Guidelines on due diligence conduct for corporate proposals’ is issued in 2008, by Securities Commission under section 377 of the CMSA 2007.

Act does not prescribe the subject matter of a scheme and in theory it can be a compromise or arrangement about anything which the creditors or members may properly agree amongst themselves. Hence, scheme of arrangement can be utilized for takeovers. The new Code does not introduce drastically new principles of scheme of arrangement rather it does develop further detail on existing provisions, and establishes new parameters for greater investor protection. Though a scheme of arrangement is processed in accordance with the Companies Act, the shareholders of a target company are afforded better protection at different levels by virtue section 44 of the 2010 Code. If a company prefers to use a scheme of arrangement to acquire another, the shareholders' rights including the minority shareholders rights should be protected from any oppression.

Since a scheme approved by court is binding on all, how minority can be protected under scheme if majority did not see their interest to make decisions. The 'majority rule' is not denied, but the rule of majority comes with its exception, not to abuse the minority. It may be expected that the level of protection available to minority shareholders in a bid and in scheme would be equivalent. To some extent, in practice, the level of protection available to minority shareholders may be lower than in relation to takeovers. However, to a large extent the minority in a scheme is being protected by court through refusing sanction on the ground of non-compliance with statutory provisions, unfairness and unreasonableness instead of direct protections. Hence, the rights of minority shareholders afforded by law through the court against oppression, compared to minority in takeover offer, cannot be denied. It can be stated that now that there are different modes and processes followed in a takeover bid and a scheme, the shareholders are provided protection at different stages. The current law aims to afford similar protection to shareholders in a target according to their class, during acquisition of control of such target either through a takeover bid or a scheme of arrangement.

Scheme of arrangement, as a tool to acquire control of a company, has come within the ambit of definition of takeover offer by virtue of the 2010 Code. The new Code may have some implied constraints regarding entire protections of all types of shareholders at all stages in takeover through a scheme, but it is encouraging the investors through triggering to reach better protection. In fact, the provisions of the new Code were inserted by applying functional approach in order to make uniform the law. Hence, the success of legal amendment made in 2010 depends on how it is being implemented and how the people accepted it. To make effective and efficient, there must be a willingness to accept the spirit of the new Code as well as its black letter.

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