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Legal Updates

NAVIGATING TAKEOVER OFFERS IN MALAYSIA: MANAGING THE CONFLICT OF INTEREST OF DIRECTORS

Introduction

"Takeover(s)" is a transaction or a series of transactions whereby a person (individual, group of individuals, or company) acquires control over the assets of a company either directly by becoming the owner of those assets, or indirectly by obtaining control of the management of the company.[1]

A "takeover offer" is generally a technique for effecting a takeover through an offer to acquire shares of a company.[2] It is an offer made to acquire all or part of the voting shares or voting rights, or any class or classes of voting shares or voting rights, in a company.[3]

Takeovers in Malaysia are governed by the Capital Markets and Services Act 2007 ("**CMSA**"), the Malaysian Code on Take-Overs and Mergers ("**Code**") and the Rules on Take-Overs, Mergers and Compulsory Acquisitions ("**Rules**"), both issued by the Securities Commission of Malaysia ("**SC**").

Director's Duty

Directors owe a fiduciary duty to exercise their powers for a proper purpose and in good faith in the best interest of the company.[4] In addition to their duties under the Companies Act 2016, the board of directors are also bound by the specific duties laid down under the CMSA, the Code and the Rules.

The directors' duties outlined in the Code align with the objectives set forth in the CMSA. Specifically, the CMSA requires directors to act in good faith when making recommendations regarding any takeover offer, merger or compulsory acquisition, ensuring that minority shareholders are not subject to oppression or disadvantaged by the treatment and conduct of the directors either the target or bidding company.[5]

The Code also imposes a prohibition on actions that could frustrate the takeover offer.

The Code restricts the board of the offeree company from engaging in any action or making any decision (other than in the ordinary course of business) which may frustrate a takeover offer once a bona fide takeover offer has been received or becomes imminent.[6] The board must not do any of the following without the approval of the target's shareholders[7]:

(a) the issuance of any authorised but unissued shares of the offeree and the selling of treasury shares into the market;

(b) the issuance or granting options in respect of any unissued shares of the offeree;

(c) the creation or issuance or permitting the creation or issuance of any securities carrying rights of conversion into or subscription for shares of the offeree;

(d) the sale, disposal of or acquisition or agreement to sell, dispose of or acquire assets of the offeree of a material amount;

(e) the entering into of contracts, including service contracts, otherwise than in the ordinary course of business of the offeree;

(f) any action which may cause the offeree or any subsidiary or associated company of the offeree to purchase or redeem shares in the offeree or provide any financial assistance for any such purchase or redemption; or

(g) the declaration of dividends, other than in the normal course and the usual quantum.

The board of the offeree company is permitted to take actions required by agreements made prior to the takeover, provided they are genuine and not intended to frustrate a takeover offer or change the activity of the target. If the board feels that other obligations or other special circumstances exists, the board may consult the SC who may approve in writing such actions without the need for the board to obtain approval from its shareholders.[8]

In short, actions taken in accordance with a bona fide contract entered into before the offer, or when an offer is imminent, do not constitute frustration.

Conflict of Interests

When a company receives a takeover offer, a director may face a problem of conflict of interest. This can occur when a director serves on the boards of both the bidding company and the target company, potentially facing conflicting duties. A conflict of interest may also arise when directors could benefit financially from the takeover offer, as the director might prioritize personal financial gain over their duty to act in the best interest of the shareholders.

There is no general rule that a director must resign from one of the boards as a result of conflict of interest and duties in a takeover context.[9] It is important to understand the extent to which the director, who sits on the boards of both companies and how this may impact their ability to act in the best interests of each company.

Managing Conflict of Interests

The Rules are also silent on whether an interested director (i.e. directors of an offeree company who have or potentially may have a conflict of interest) should abstain from deliberating and making decisions in relation to the takeover offer. However, we take the approach, and it has been common practice that the director of the offeror must refrain from becoming involved in matters related to the takeover offer, otherwise a conflict of interest may arise and it may affect the conduct and outcome of the takeover offer.

If a due diligence working group (DDWG) has been formed in relation to the takeover offer, the interested director shall not be part of the DDWG to ensure that the non-interested directors and other DDWG members can provide their views on the takeover offer without influence or direction from the offeror. However, in the event the interested director is appointed as a member of the DDWG, when it comes to delivering the offeree board's obligation to issue its comments, opinion and views[10] on the takeover offer, he must recuse himself from meetings, participation and deliberations on the takeover offer.

In addition to the above, several measures could be adopted by the offeree company to manage the conflict of interest of the directors and to ensure independence of work relating to the takeover offer:

(a) Abstention from the takeover offer, including any involvement and/or during the process of decision making

(i) To adopt / establish a "Clean Team"

In general, the best practice is to establish guardrails around the due diligence, valuation, works and preparation in relation to the takeover offer all required for the compliance by the offeree and its director's obligations in respect of and/or necessary for the takeover offer ("**Works relating to takeover offer**") by delegating the responsibility to a special / designated group in which the interested director(s) shall not be part of it.

A Clean Team's purpose is to filter and remove information on Works relating to takeover offer from the interested director(s).

(ii) To establish a "Clean Room"

In anticipation of large amount of documents which may involve in relation to the Works relating to takeover offer, best practice is to set up a separate virtual data room in which all documents related thereto can be uploaded and reviewed by the Clean Team ("**Clean Room**"). The interested director(s) should not have access to the Clean Room.

(iii) Recuse from meeting, participation and deliberations on the takeover offer

The interested director(s) should not be appointed as a member of DDWG to ensure that non-interested directors and DDWG members are free to provide their views on the takeover offer.

(b) No access to information by the interested director

The offeree company shall take every possible step to ensure that the interested director(s) has no access to any information in relation to the takeover offer. The offeree company may consider measures via passwords or IT security measures for documents related to the Works relating to the takeover offer, also to inform Clean Team and third-party advisers to communicate with each other via emails only.

Conclusion

It is crucial to address conflicts of interest of directors when managing takeover offers in Malaysia, as they play a crucial role in maintaining the integrity of the takeover process. The duties imposed by the Companies Act 2016, CMSA, Code and Rules serve to protect the shareholders and ensure decisions are made in the best interests of the company. By adhering to their fiduciary duties, directors can ensure that takeover decisions are made objectively and transparently.

By fostering a culture of accountability, transparency and ethical conduct, companies can uphold investor confidence in the Malaysian capital markets. This, in turn, creates a more attractive environment for investment and supports the country's overall economic growth.

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1. Chandrasegar Chidambaram, "Take-overs and Mergers" (Second Edition, Lexis Nexis) Page 1.
2. Mushera Ambaras Khan, "A Guide to Malaysian Takeovers and Mergers Law" (Sweet & Maxwell Asia) Page 9.
3. Capital Markets and Services Act 2007, section 216(1).
4. Section 213 (1) of the Companies Act 2016.
5. Section 217 (5)(d) of the Companies Act 2016.
6. Paragraph 16.01(1) of the Rules.
7. Paragraph 16.01(2) of the Rules.
8. Paragraph 16.01(3) and (4) of the Rules.
9. Mushera Ambaras Khan, "A Guide to Malaysian Takeovers and Mergers Law" (Sweet & Maxwell Asia) Page 74.
10. Paragraph 11.03(1) of the Rules.

Written by:

Gabriel Yee Full Yek
Senior Associate
gabrielyee@azmilaw.com

Low Jun Yen
Trainee Solicitor
lowjunyen@azmilaw.com

Corporate Communications
Azmi & Associates

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