

WHAT CONSTITUTES FRUSTRATING AN OFFER UNDER THE MALAYSIAN CODE OF TAKEOVER AND MERGERS?

Introduction of Take-Overs and Mergers Code and its Application

The revised law which governs takeovers and mergers in Malaysia came into force on 15th August 2016 ("**Code**"), replacing the Take-Overs and Mergers Code 2010. The Securities Commission of Malaysia ("**SC**") also introduced a rule book, *Rules on Take-Overs and Mergers and Compulsory Acquisitions (The Rules)* ("**the Rules**") serving as guidelines under the Capital Market and Services Act 2007 ("**CMSA**").

The Rules set out the operative provisions applicable for various aspects of takeovers and mergers. The Code prescribes 12 broad-based principles consisting of standards of corporate practices to be observed in takeover transactions. Whereas the Rules provide for the details and technicalities cascading from the general principles embedded in the Code.

The Code and the Rules apply to takeovers and mergers of any listed corporation and any company or entity specified in the Rules[1]. Although the CMSA defines "company", to mean a public company whether or not it is listed on any stock exchange[2], the Rules define a "company" to which the Code applies to include only an unlisted public company having more than 50 shareholders and net assets of RM15 million or more.

Frustrating Action

A takeover is exercised by way of a takeover bid or takeover initiated by a bidder or acquirer to acquire control over a target company from existing shareholders of the target company to acquire their shares for a consideration in cash or securities, or for a consideration involving a combination of both. Frustration of offer occurs where the board of the target makes it difficult for the bid to succeed.

The Code has laid down clearly the various actions of the board of the target which will

lead to frustration of an offer. A frustrating action occurs when an action by the board of the target results in the takeover bid to be withdrawn or lapsed.

Fiduciary Duties of Directors Owed to the Company and Director Duties Imposed Under the Code

The duties of directors which flow from the Code mirrors the objectives of the law as specified in the CMSA[3]. These include the duty to act in good faith to observe the objects specified by the Act and that minority shareholders are not subject to oppression or disadvantaged by the treatment and conduct of the directors of the target company or the bidder.[4] In order to ensure that the board of the directors of the target observes their duties to the shareholders of the target, the Rules make it clear that no directors should resign until the first closing date of the take-over or the date when the take-over offer becomes or is declared wholly unconditional[5].

The same rule applies to the board of the directors once a bona fide offer has been communicated to the board of the target or they have reason to believe that a bona fide offer is imminent[6]. The law restricts the actions which target directors can take in response to a takeover bid. As mentioned above, directors owe fiduciary duties to the company.

In Malaysia, in addition to their fiduciary duties imposed upon them by the Companies Act 2016, directors involved in a takeover are subject to duties imposed by the Code. The Code restricts the ability of the target directors to take measures which may frustrate an offer once a bona fide offer has been received or becomes imminent. Paragraph 16.01 of the Code reflects the view that in Malaysia, the outcome of a takeover offer should be left to the shareholders of the offeree to decide upon during the general meeting as the board of the offeree cannot undertake any action or make any decision without first obtaining the approval of shareholders.

Frustrating Actions under the Code

One of the few actions of frustration with similar outcome are the issuance of authorised but unissued shares[7], grant of options in respect of unissued shares[8], also creation of securities creating rights of conversion or subscription of shares of the offeree[9] and also the selling of treasury shares into the market[10] as these proposed actions may amount to dilution of the shareholding of the bidder, effectively making it difficult and more costly for the bidder to obtain control of the target company. The board of the target company is also refrained from disposing any assets of a material amount[11] of the target and from acquiring any assets of a material amount[12] as this will obviously deter the bidder from its pursuit to takeover.

It would naturally have been impossible to enumerate all frustrating actions- thus the Code sets out the general prohibition of the target company from entering into contracts[13], which includes service contracts, other than in the ordinary course of business of the target company. This includes director's service contract or terms of employment which leads to a significant improvement in his terms of service as entering into a contract "*other than in the ordinary course of business*".

Further to the above, any action which causes the offeree or subsidiary/ associated company of the offeree to purchase or redeem shares in the offeree also consists as a frustration event[14].

Finally, the declaration of dividends other than in the normal course and usual quantum would be deemed as an action for frustration[15]. This is unless the scheduled payment of dividends has been declared prior to the board of the offeree company has reason to believe that a bona fide offer is imminent[16].

The Code also introduces additional proposed actions for takeover of business trust or a REIT, such as altering the terms of engagement between the offeree entities and its related manager as well as from entering into or alteration of the terms of the service contracts with its related manager or any of the entity's Directors[17].

The board however, is allowed to engage in any action which is required to be carried out by an agreement that was entered into prior to the bid[18] and which is not designed to frustrate the takeover offer or change the activity of the target. Where the action of the board of the target falls under some other obligation or special circumstances, the SC must be consulted at the earliest opportunity[19].

Waiver of Frustrating Action

Should the action fall within Paragraph 16.02 of the Rule, it is important to note that the application of this rule can be waived by the SC if such proposed action by the board of the offeree is acceptable to the offeror[20]. When considering whether any proposed action by the board of the target amounts to frustration of a bid, SC will consider whether such action is acceptable to the bidder.

Concluding Remarks

The Malaysian law identifies the above as transactions that cannot be carried out without the shareholders' approval once the takeover bid becomes imminent or during the bid period. It allows a balance between the ability of directors to pursue transactions to maximise the interests of the company and the right of the shareholders to be able to consider the takeover bid.

Since Malaysia applies a restrictive approach, i.e. by laying down the list of actions which the board of the target should refrain from doing, it is worth noting that any action by the board of the target which goes beyond the list may amount to frustration and circumstances unacceptable to the bidder where the spirit of the law is violated. It is also worthwhile to mention that in Malaysia, the SC has the power to enquire into any matter relating to takeover offer, merger or compulsory acquisition and may issue public statements as the SC thinks fit[21] and enforcing the principal rules contained in the Code and the spirit of the takeover law.

-
1. Paragraph 1.06, the Rules.
 2. Section 217(1)(b) of the CMSA.
 3. Section 217(5)(d) of the CMSA.
 4. General Principle 2 & 8 of the Code.
 5. Paragraph 15.02, the Rules.
 6. Ibid.
 7. Paragraph 16.01(2)(a), the Rules.
 8. Paragraph 16.01(2)(b), the Rules.
 9. Paragraph 16.01(2)(c), the Rules.
 10. Paragraph 16.01(2)(a), the Rules.
 11. SC has set out several factors in determining the material amount in Item 6 of Notes to Paragraph 16.01, the Rules.
 12. Paragraph 16.01(2)(d), the Rules.
 13. Paragraph 16.01(2)(e), the Rules.
 14. Paragraph 16.01(2)(f), the Rules.
 15. Paragraph 16.01(2)(g), the Rules.
 16. Item 8 of Notes to Paragraph 16.01, the Rules.
 17. Paragraph 16.05(a) and (b), the Rules.
 18. Paragraph 16.01(3), the Rules.
 19. Ibid.
 20. Item 1 of Notes to Paragraph 16.01, the Rules.
 21. Section s217(4)(b) of the CMSA.

Written by:



Serina Abdul Samad
Partner
serina@azmilaw.com



Heu Wen Yen
Associate
heuwenyen@azmilaw.com

Corporate Communications
Azmi & Associates
8 May 2024

The contents of this publication are for reference purposes only and do not constitute legal advice.