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Federal Court Clarifies Division of Powers between Shareholders and Directors

Tengku Dato' Ibrahim Petra bin Tengku Indra Petra v Petra Perdana Berhad

The Federal Court recently delivered a significant decision pertaining to a conflict between shareholders and the board of directors on the management of a listed company.

This conflict emanated from the board of directors' decision to divest the company's shareholding in a subsidiary company in order to meet severe cash flow requirements.

The shareholders had earlier passed an ordinary resolution (by a simple majority) conferring mandate to the board of directors to divest up to 10% of the said shareholding — but the actual divestment made by the board of directors exceeded this mandate. Hence, the shareholders contended that this divestment was made in breach of the board of directors' duties as it did not conform to the wishes of the shareholders.

Findings of the Federal Court

The Federal Court rejected the shareholders' arguments, and held, *inter alia*, as follows:

Division of Powers between Shareholders and Directors

- (a) Section 131B of the Companies Act 1965 [*similar to s 211 of the Companies Act 2016*] expressly provides that the business and affairs of a company must be managed by the board of directors.
- (b) The Court of Appeal had erred in finding that the board of directors' broad powers of management were subject to shareholders' supervision.
- (c) In this instance, the board of directors' powers of management, including that of carrying out the said divestment, were conferred by the Companies Act 1965 and Article 115 of the company's articles of association. These powers so conferred cannot be overridden by an ordinary resolution passed by the shareholders.

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- (d) Hence, shareholders are unable to control the board of directors' powers of management unless and until they remove those powers by altering the company's articles of association. Alternatively, they may also refuse to re-elect the directors whose actions they disapprove of.

Test for Acting in Good Faith in the Best Interest of the Company

- (e) Sections 132(1) & (1A) of the Companies Act 1965 [*similar to s 213 of the Companies Act 2016*] provides that directors shall exercise their powers for a proper purpose and in good faith in the best interest of the company.
- (f) The correct test to determine whether there is a breach under these sections is a combination of both subjective and objective tests:
- (i) Subjective test — the breach of duty is determined on an assessment of the state of mind of the director.
 - (ii) Objective test — the director's assessment of the company's best interest is subject to an objective review or examination by the Courts.
- (g) Therefore, the Court of Appeal had erred in concluding that it is for the majority shareholders to decide what amounts to the best interest of the company.

Business Judgment Rule

- (h) Section 132(1B) of the Companies Act 1965 [*similar to s 214 of the Companies Act 2016*] provides for a presumption of a director acting with due care and skill if the requisite pre-conditions are fulfilled.
- (i) In the absence of fraud, breach of fiduciary duty and conspiracy, the courts will not assess the merits of a commercial or business judgment made by directors. In other words, the courts will be slow to interfere with *bona fide* commercial decisions made by directors.

Conclusion

This decision has provided the much-needed clarification on this area of the law. Although it concerns the Companies Act 1965, these principles apply equally to the Companies Act 2016 since the relevant provisions are substantially similar.

The Federal Court's grounds of judgment may be viewed [here](#).

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