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The Regulation of Directors' Remuneration: An Overview of the Malaysian Position

Sujata Balan*

Abstract

This article discusses the laws and legal principles that govern the subject of directors' remuneration in Malaysia. It examines the extent to which the Malaysian courts, companies legislation and shareholders of a company have control over directors' remuneration and access to information concerning such remuneration. Importantly, this article will highlight and discuss the significant changes brought about by the Companies Act 2016 on this subject. Chief among these are the introduction of new provisions allowing members of public companies to inspect service contracts of directors and a new mandatory provision that requires the remuneration of directors in public companies to be approved by the members in a general meeting of the company.

Keywords: Company law, Directors, Directors' remuneration

I. INTRODUCTION

This article is an attempt to examine the main legal principles that regulate the subject of directors' remuneration in Malaysia and the extent to which the Malaysian courts, companies legislation and shareholders of a company have control over such remuneration.

At the outset it would be pertinent to mention the origins of company law in Malaysia. A good part of Malaysia's statutory and judge-made law relating to companies has a strong link with English law. Malaysia's post-independence legislation on companies, the Companies Act 1965 (CA 1965) was based on the Uniform Companies Act 1961 of Australia, and both statutes shared a common legislative ancestry in that they are descendants of the Companies Act 1862 of England. It is significant to note that Malaysia's CA 1965 and its English and Australian counterparts were not Codes and that case law plays an important role in the company law of all three countries. A pertinent and remarkable feature of Malaysian law is the application of English case law in its legal system. Under section 3 of Malaysia's Civil Law Act 1956, English common law and equity as they stood on the cut-off dates specified in that Act apply in Malaysia so far as

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the local circumstances of the states of Malaysia and their respective inhabitants permit.[1] As a result of this strong bond with English law, English cases on company law decided before the cut-off dates continue to apply in Malaysia.[2] English cases decided after the cut-off dates are not binding but they are of persuasive authority. It is inevitable that in discussing company law in Malaysia, counsel, judges and academic writers should make constant reference to English company law and to the company law of other jurisdictions to which English company law has travelled.

A recent development that brings a significant change to the corporate landscape in Malaysia is the passing of the Companies Act 2016. This comes as the long-awaited Companies Bill 2015 received Royal Assent on 31 August 2016 and was gazetted on 15 September 2016 as the Companies Act 2016. The Companies Act 2016 (CA 2016) has come into force in Malaysia, starting with phase one which came into effect on 31 Janunary 2017. The Companies Commission of Malaysia has announced that with the enforcement of the first phase, the Companies Act 1965 is repealed.

II. DIRECTORS' FEES AND SALARIES DISTINGUISHED

One may begin this overview of directors' remuneration by referring to the traditional rule at common law (which also applies in Malaysia) that directors are not employees[3] though they render services to their companies. They are fiduciaries and in line with their fiduciary position, they are not entitled to any payment for their services unless payment is expressly provided for in the constitution of the company. Thus with regard to remuneration, a director is akin to a trustee under a trust who is not entitled to any remuneration for his or her services unless there is a provision in the relevant trust instrument stating that he shall be paid.[4] Nevertheless, large companies will have a number of non-executive or part-time directors who may have other occupations or hold similar directorships in other companies.[5] It is unreasonable to expect them to provide

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1 The cut-off dates are (a) 7 April 1956 for West Malaysia, (b) 12 December 1949 for Sarawak, and (c) 1 December 1951 for Sabah. For more details regarding the reception of English Law in Malaysia under the Civil Law Act 1956 see Wan Arfah Hamzah, *A First Look at the Malaysian Legal System*, Oxford Fajar, 2009, pp. 115 - 149; Sharifah Suhanah Syed Ahmad, *Malaysian Legal System*, 2nd ed., Butterworths Asia, 2007, pp. 177 – 196; and Wu Min Aun, *The Malaysian Legal System*, 2nd ed., Longman, 1999, pp. 89 – 144.

2 *PJTV Denson (M) Sdn Bhd* v *Roxy (Malaysia) Sdn Bhd* [1980] 2 MLJ 136 and *Ng Pak Cheong* v *Global Insurance Co Sdn Bhd* [1995] 1 MLJ 64 are two examples of cases where English law on the fiduciary duties of a director was applied.

3 See *Hutton* v *West Cork Railway Co* (1883) 23 Ch D 654; *Newtherapeutics Ltd* v *Katz* [1991] Ch 226. In *Hutton* Bowen LJ said (at pp. 671-2) "A director is not a servant. He is a person who is doing business for the company but not upon ordinary terms. It is not implied from the mere fact that he is a director that he is to have a right to be paid for it."

4 See *Guinness plc* v *Saunders* [1990] 2 AC 663 (HL) where the rule that equity forbids a trustee to make a profit out of his trust was applied with startling consequences to a director of a company.

5 In the last quarter of the twentieth century the importance of independent non-executive directors as free, unbiased and non- partisan voices and monitors on the board on management issues and the role they can and should play in achieving a high level of corporate governance in companies has been emphasised by a number of reports on corporate governance. See Cadbury Committee Report in 1992 and Hampel Committee Report in 1995 in the United Kingdom and in Malaysia the High Level Finance Committee on Corporate Governance in 1999. See also the *Malaysian Code on Corporate Governance* (Code) 2012 at http://www.sc.com.my/eng/html/cg/cg2012.pdf. Site accessed on 29 January 2017.

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gratuitous service to their companies even though they are part-time directors who are not involved in the day to day management of their companies. It is therefore conventional for all directors to be paid a fee and given other allowances for their services and for the constitution of a company to contain some provision on how these are to be determined.

Directors' allowances, and other benefits (such as reimbursement of travelling expense given to all directors in their capacity as directors) must be distinguished from salaries and benefits afforded to some of them as executive directors under a contract of service. The general rule that a director is not an employee of his company was referred to above.[6] However when members of the board enter into contracts of service to occupy salaried positions as executive directors of a company they become its employees. Executive directors devote their full-time energies to their company and are usually paid competitive salaries and attractive benefits. The total amount paid as salaries and benefits to a company's executive directors may amount to a sizeable amount of a company's distributable funds. It is customary practice for the articles of association of a company to bestow upon the board of directors or a committee of the board the power to determine the salaries and benefits of the executive directors.

Malaysian companies legislation does not regulate the amount that may be fixed as directors' remuneration by the articles of association of companies or by the service contracts of directors. Ideally companies should pay its executive directors only affordable salaries from divisible profits and based on market forces. But such a situation is difficult to achieve and at the moment there is hardly any statutory, judicial or extra-legal rules that employ direct control over the level of payments made to CEOs and executive directors of companies. It will be seen that as a general rule, the court will not interfere with the amount fixed by the company as directors' remuneration. This matter is further discussed in part III below.

III. MAY THE COURTS INTERFERE WITH THE QUANTUM OF DIRECTORS' REMUNERATION?

Malaysian company's legislation does not contain any mandatory provision dealing with the mechanism for determining directors' remuneration or its quantum (whether in the form of fees paid to all directors or salaries to executive directors). Further, it is envisaged that Malaysian courts will adopt a general policy of non-interference over the quantum of directors' remuneration save in exceptional circumstances, as was demonstrated in the English case of *Re Halt Garage (1964) Ltd.*[7] It is submitted that such an approach is both practical and sensible as the task of deciding on the adequacy of directors remuneration should be a matter for the members of the company, either by them exercising that power in a general meeting of the company or by delegating it to the board of directors.

Re Halt Garage (1964) Ltd, whilst emphasising the general rule that the court will not question or evaluate the amount of directors' remuneration, also stressed that it may

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6 *Supra* n3.

7 [1982] 3 All ER 1016.

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intervene where blatantly excessive or unwarranted amounts are paid as remuneration, because such payments may be *prima facie*, an indication of fraud or evidence that the payments were in fact camouflaged gifts of the company's capital. In the instant case Mr and Mrs C were the sole shareholders and only directors of a company. They received directors' remuneration in accordance with the express provisions of the company's constitution. In 1967 Mrs C became seriously ill. From December 1967 she stopped taking active participation in the company's operations though she continued to be a director earning remuneration at a lower rate of payment. The company began to suffer losses from the year 1967-1968 and soon after it became insolvent. In March 1971 its winding up commenced. From January 1968 to March 1971 Mr C had received remuneration between £2500 per annum and £3500 per annum whilst Mrs C was paid between £1500 per annum and £500 per annum. During this period the drawings as remuneration were mainly out of capital[8] because the company was experiencing poor trading returns. The liquidator brought a claim for misfeasance and breach of trust under section 333(1)(b) of the Companies Act 1948 of England, alleging that the payments to Mr and Mrs C could not be properly sanctioned by a general meeting. He alleged that Mrs C had no right to receive remuneration from January 1968, that is, after she became ill and ceased to render active service. The liquidator also alleged that her husband had received remuneration which exceeded the market value of his services.

Oliver J held that the real question in that case was whether the sums paid were a true payment of remuneration under the company's articles. In the absence of evidence that the payments were patently excessive or unreasonable a court should not engage on a minute examination of the appropriateness of what shareholders had bona fide voted to be paid as directors' remuneration. His Lordship held that there was no such evidence in the case of the payments made to Mr C and that the liquidators' claim must fail. Oliver J remarked,[9]

> Shareholders are required to be honest but as counsel for the respondent suggests, there is no requirement that they must be wise and it is not for the courts to manage the company.

In the case of Mrs C, Oliver J held that her drawings as remuneration during the time she was absent from the business could not be considered as genuine awards of remuneration. The learned judge observed that a representative of the company's auditors had suggested a payment of £10 per week for Mrs C's presence on the board and that was the sum paid to Mrs C from May 1970. Referring to this weekly sum and the liquidator's claim the learned judge said,[10]

> I cannot regard the payments made to Mrs Charlesworth in excess of this weekly amount, however well-intentioned, as being anything more than disguised gifts out of capital. In my judgment even the sanction of the shareholders in general meeting,

[8] It was held that that the payments were made out of capital and did not, by itself, make them invalid.
[9] *Ibid.* at p. 1039.
[10] *Ibid.* at p. 1044.

> could not, simply by calling the payments remuneration, validate the acts of the directors making them, and to this extent the liquidators summons must succeed...

It is submitted that the decision in *Re Halt Garage (1964) Ltd* is based on sound practical reasoning and there is no reason why the courts in Malaysia should not apply it.[11] It would be unfair and burdensome to the courts if they are asked to determine the appropriateness of a director's remuneration fixed by the company in general meeting or by the board acting under its powers granted by the articles, save in cases where it is manifestly clear that the remuneration fixed is demonstrably excessive or perverse.

A. Quantum Meruit

At common law[12] where A had provided services to B under a contract but a precise amount had not been agreed upon as payment for the services, or, where A had rendered services to B under an unenforceable or a void agreement or an "ineffective"[13] arrangement which A had believed to be binding, the court may order the payment of a reasonable remuneration for his services.[14] The court in such a case is said to award a *quantum meruit* ("as much as he has earned"), a remedy in the realm of quasi-contract.

An issue pertinent to the subject of directors' remuneration is whether a director may claim for the services he had rendered to his company on a *quantum meruit* basis. In *Craven-Ellis* v *Canons Ltd*[15] the plaintiff and the other directors of a company were at the material times disqualified from acting as directors because they had failed to acquire their share qualification within the period prescribed under the articles. The disqualified directors purported to enter into an agreement with the plaintiff by which the plaintiff undertook to render services as the managing director of the company. The plaintiff rendered the services mentioned in the agreement until the company purported to terminate his engagement. He brought an action to recover from the company the remuneration set out in the purported agreement, and as an alternative, payment for his services on a *quantum meruit*. The Court of Appeal held that the disqualification of the directors made the purported agreement and its contents a nullity but the company was bound to pay the plaintiff on a *quantum meruit* basis because it had impliedly accepted his services.

However in *Re Richmond Gate Property Co Ltd*[16] Plowman J held that *quantum meruit* will not be ordered in favour of a director where the constitution of a company prescribed the manner by which the payment for his services is to be determined. In that

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[11] The case is not binding under the Civil Law Act 1956 as it was decided in 1982, that is, after the cut-off dates in the Act. However it is of strong persuasive authority.

[12] It may be noted that in Malaysia there are provisions in the Contracts Act 1950 that deal with quasi- contractual claims. See Andrew Phang Boon Leong, *Cheshire, Fifoot and Furmston, Law of Contract, Singapore and Malaysian Edition,* 1998, pp. 971-5.

[13] See Andrew Phang Boon Leong, *Ibid* at p. 968.

[14] *Ibid.* pp. 966-8 and pp. 971-5.

[15] [1936] 2 KB 403 (CA).

[16] [1965] 1 WLR 335.

case, article 9 of the company's articles of association provided that W, a subscriber to the memorandum, shall be one of the two managing directors of the company. In addition, article 108 provided that a managing director was entitled to receive such remuneration as "the directors may determine". W served as the managing director of the company but his remuneration was never determined by the board. He served for about seven months before the company was wound up. Plowman J held that W was not entitled to a *quantum meruit*. His Lordship said[17]

> The effect of art. 9 of the articles, coupled with art. 108...,coupled with the fact that the applicant was a member of the company, in my judgment is that a contract exists between himself and the company for payment to him of remuneration as managing director, and that remuneration depends on art.108...,and is to be such amount "as the directors may determine"; in other words the managing director is at the mercy of the board, he gets what they determine to pay him, and, if they do not determine to pay him anything, he does not get anything. That is his contract with the company, and those are the terms on which he accepts office. Since there is an express contract with the company in regard to the payment of remuneration, it seems to me that any question of *quantum meruit* is automatically excluded.

Plowman J. distinguished *Craven-Ellis* v *Canons Ltd* saying that in that case "there was no contract and the only contract that could have been prayed in aid was held to be void". Two observations may be made on the decision in *Re Richmond Gate Property Co Ltd.* First of this relates to the learned judge's finding that the provisions relating to a director's remuneration in the articles was a contract. This finding goes against the traditional English rule that the articles do not bind the company to its members except where it confers rights on its members qua members. Secondly, even if there was a contract it is unfair to assume that the managing director took office on the implied understanding that if the board did not determine his remuneration he would not be able to claim on a *quantum meruit*.[18]

In *Guinness plc* v *Saunders*[19] a director, Mr Ward, was paid special remuneration of £5.2 million which was determined by a committee of the board. The director alleged that the payment was made by virtue of an oral agreement between him and the committee by which the committee had agreed to pay him for his services in respect of the take-over by Guinness or another company. The payment was based on the value of the takeover, if the take-over was a success. The House of Lords held that the payment was unauthorised because on a proper construction of the articles of the company such a payment could only be determined by the board and not by a committee of the board. One of the issues before the House of Lords was whether the director was entitled to a

[17] *Ibid.* at p. 337.

[18] Plowman J's decision has been criticised for a number of reasons by Paul L. Davies, *Gower and Davies' Principles of Modern Company Law*, 8th ed., Sweet & Maxwell Asia, 2008 at p. 382.

[19] [1990] 2 AC 663 (HL).

payment on a *quantum meruit* basis. Both Lord Templeman and Lord Goff in the House of Lords were against the payment of a *quantum meruit* to Mr Ward.

Lord Templeman held that Mr Ward was not entitled to claim by way of *quantum meruit* for the services that he had rendered because "… the law will not imply a contract between Guinness and Mr Ward for remuneration on a *quantum meruit* basis awarded by the court when the articles of association of Guinness stipulate that special remuneration for a director can only be awarded by the board"[20]. At a later part of his judgment his Lordship distinguished *Craven-Ellis* v *Canons Ltd* saying that in *Craven-Ellis*'s case the plaintiff was not a director at the time he was appointed managing director, that is, he was appointed after he had failed to acquire his qualification shares within the stipulated period. Further in *Craven-Ellis* there was no conflict between his claim for remuneration and the rule in equity which forbids a director from making a profit from his fiduciary position.

Lord Goff in his judgment referred to the age-old principle that a trustee is not entitled to any payment for their services unless expressly permitted by the trust deed and its derivative that director of a company is not entitled to any remuneration unless authorised by the articles. His Lordship said,[21]

> Plainly, it would be inconsistent with this long-established principle to award remuneration in such circumstances as of right on the basis of a *quantum meruit* claim.

It may be concluded that after *Guinness* directors may find that it is seldom possible to obtain an award on a *quantum meruit* basis from the court. This is in line with the general rule that the courts would not usurp the function of the board or the company in general meeting in determining directors' remuneration where articles do confer that function on those organs. Nevertheless the impact of this aspect of *Guinness* on Malaysian courts remains to be seen.

B. Equitable Allowance

In *Phipps* v *Boardman*[22] the House of Lords recognised an exception to the fundamental rule that a trustee is not entitled to any remuneration for the services rendered by him to the trust except as provided in the trust instrument. It was held that in an exceptional case the court may award an equitable allowance to a trustee where the trustee had rendered service which had brought benefit to the trust. However, the exception will not be applied where its effect is to encourage a trustee to put himself in a position where his personal interests conflicts with his duties as a trustee. In *Guinness plc* v *Saunders,*[23] the facts of which were stated above, the House of Lords refused to award an equitable allowance to Mr Ward. Lord Templeman in his judgment doubted if a court of equity would invoke its

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20 *Ibid.* at p. 692.
21 *Ibid.* at p. 700.
22 [1964] 2 All ER 187.
23 *Supra* n19.

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power to grant remuneration to a director when the articles of his company vested that power on the company's board of directors. In addition both Lords Templeman and Goff laid emphasis on the fact that the nature of the agreement that Mr Ward had made with Guinness put him in a position where his personal interests conflicted with his fiduciary duties. In refusing to award an equitable allowance to Mr. Ward, Lord Goff said[24].

> I proceed, of course, on the basis that Mr Ward acted throughout in complete good faith. But the simple fact remains that, by agreeing to provide his services in return for a substantial fee the size of which was dependent on the amount of a successful bid by Guinness, Mr. Ward was most plainly putting himself in a position in which his interests were in stark conflict with his duty as a director.

Lord Templeman's judgment in *Guinness* indicates that one of the reasons why the House of Lords was reluctant to grant an equitable allowance to Mr Ward was because there was a specific provision in the company's articles giving the power to determine directors' remuneration to a specific organ. Thus it would appear that *Guinness* has made it difficult for directors to obtain an equitable allowance similar to that recognised in *Phipps* v *Boardman,* as it is customary for the articles or company legislation to assign the function of fixing directors' remuneration to either the board or the general meeting.

This aspect of *Guinness* on the granting of an equitable allowance will certainly have a strong bearing in Malaysia because of the link between Malaysian law and English equity. However, as there is no Malaysian authority on the subject, the approach Malaysian courts would take on the subject cannot be stated with certainty.

IV. PROVISIONS IN MALAYSIAN COMPANIES LEGISLATION REGARDING DIRECTORS' REMUNERATION

This article now turns its spotlight on the statutory provisions in Malaysia relating to directors' remuneration. As mentioned earlier in this article, Malaysia stands at the threshold of a new era in the regulation of its companies and its corporate framework. This comes with the passing of a new legislation on companies, namely the Companies Act 2016 (CA 2016). The CA 2016 will be implemented over several stages, starting with phase one which came into effect on 31 January 2017. With the implementation of the first phase, the CA 1965 is now repealed. In this article, mainly for purposes of discussion and for comparison of the old and the new, the provisions relating to remuneration of directors under both the CA 1965 and CA 2016 will be examined.

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[24] *Ibid.* at pp. 701, 702.

A. Companies Act 1965

(i) The Regulation of Directors' Remuneration under CA 1965

It is important to note that the CA 1965 did not contain a specific provision on directors' remuneration and left this subject to be regulated by the articles of association of a company.[25] In this context reference may be made to article 70 of Table A of the Fourth Schedule of the Act, the model set of articles of association provided by the Act and which, under the CA 1965, may be adopted in whole or part[26] by Malaysian companies. Article 70 provides that "the remuneration of directors shall from time to time be determined by the company in general meeting". It also empowered the company to pay all travelling, hotel and other expenses properly incurred in attending and returning from meetings or in relation to the business of the company. Article 70 must be read together with article 91. Article 91 permitted the board to appoint one or more of its members to the office of managing director and determine the duration and the terms of the appointment. Significantly article 92 empowered the board to determine the remuneration of the appointee. Thus where Table A applied the salary and allowances paid to a managing director, unlike the general remuneration paid to that person in the form of directors' fees, need not be approved by members in a general meeting.

It may be noted that under the CA 1965 a company was not bound to adopt the provisions of Table A referred to above and its articles may contain one or more provisions that indicate that directors' fees as well as the remuneration of the chief executive officer and its executive officers are to be determined by a body other than the general meeting, such as the board of directors or a remuneration committee of the board in large public companies.[27] Under the CA 1965, provisions in the articles could not be amended except by way of a special resolution. Members of a large company unhappy with provisions

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[25] In rare cases hardship to directors could arise because of the absence of specific provisions regarding directors' remuneration in the CA 1965. One such rare case will be where a company's articles did not contain any provision on the subject. In such a case a Malaysian court is likely to follow the traditional English rule that as directors are fiduciaries they are not entitled to any remuneration unless the articles so provide. Secondly, where the articles contain a procedure or mode by which directors' remuneration is to be determined that procedure or mode must be carried out or implemented by the company before directors may claim any remuneration. Thus where articles require a director's remuneration to be approved by members, a director may not be able to claim any remuneration if no meeting had been held by the company to determine his or her remuneration (see *Re Richmond Gate Property Co Ltd* [1936] 2 KB 403 and *Guinness plc* v *Saunders* [1990] 2 AC 403 (CA) discussed in part III A. of this article) or if a meeting had been held to determine the remuneration but no resolution determining the remuneration had been passed. It was seen in part III A. of this article that the courts will not order payment on a *quantum meruit* basis where there is express provision in the articles as to the mode by which directors' remuneration is to be determined.

[26] By virtue of section 30(2) of Malaysia's CA 1965, Table A applied automatically to a company limited by shares if the company has no registered articles. Secondly, section 30(2) also stated that where a company limited by shares has registered articles "then so far as the articles do not exclude or modify the regulations in Table A those regulations shall so far as applicable be the articles of the company in the same manner and to the same extent as if they were contained in registered articles".

[27] See *Guinness plc* v *Saunders* [1990] 2 AC 663 (HL) where the articles of a large public company expressly permitted the board to "fix the annual remuneration" of the company subject to the limits stated therein.

in the articles may have often found they are powerless to amend them because of their inability to garner the three-quarter majority vote required to pass a special resolution.

(ii) Members approval of directors' fees and executive directors' service contracts

Another issue which is allied to the regulation of directors' remuneration is whether directors' fees and executive directors' service contracts should be approved by members of a company. The CA 1965 did not contain any mandatory provision that requires directors' remuneration to be approved by the members in a general meeting of the company. By this omission, the Act impliedly allowed the articles of a company to empower the board or a committee of the board to determine directors' fees and other allowances. Further, in relation to directors' contracts of service or services, there was no requirement in the CA 1965 that disclosure to members is necessary of its terms, or that members' approval is mandatory before a service contract is offered to a director. In addition, the CA 1965 did not control the terms or the duration of directors' service contracts or put any limit on the salaries or the benefits that directors may be offered in their service contracts.

It was noted above that under CA 1965, where Table A applied, articles 91-93 empowered the board to appoint one or more of its members as managing director and to determine the remuneration of the appointee. Plainly, it would be permissible for a company's articles to go further and prescribe wider terms and confer broader powers on the board regarding the appointment, salaries and benefits of executive directors. A negative effect of this is that it would allow an indulgent board to offer to a director, or for a go-getting director to obtain by negotiation, a long-term service with an attractive salary and generous compensation when he retires or loses his office. Further, where the task of setting the terms of an executive director's service contract was assigned to the board the total impartiality of the board in determining the terms cannot always be obtained or assured and the possibility that they may favour a colleague cannot be completely ruled out.[28] In recent years the need for good corporate governance and the necessity for compliance with best practices regarding directors' remuneration have led many large companies to establish special remuneration committees composed entirely of independent directors. This is a helpful move to minimise conflicts of interests. Even in such a case, there is a risk that in relation to this matter, independent directors may not take a truly independent view because they are also members of the board and the service contract before them is that of another member of the board.

B. Companies Act 2016

(i) The Regulation of Directors' Remuneration under CA 2016

As a prelude to examining the position under the new CA 2016, it would be pertinent to first discuss certain recommendations made by the Malaysian Corporate Law Reform

[28] See Gower and Davies, *supra* n18, at p. 382.

Committee[29] (the CLRC) on this subject. In August 2006, the CLRC issued a Consultative Document 5 bearing the title "Clarifying and Reformulating the Directors' Role and Duties" (CD 5). CD 5 posed the question whether companies legislation in Malaysia should incorporate a provision that required directors' remuneration to be approved by members at a general meeting of the company. CD 5 contained the CLRC's own recommendation that members' approval of directors' remuneration should be mandatory so as to ensure transparency and accountability. CD 5 also contained another recommendation, namely, "to define the term 'remuneration' in relation to a director to include fees, any sum paid by way of expenses allowances in so far as those sums are charged to income tax in Malaysia, any contribution paid in respect of a director under any pension scheme and any benefit received by him otherwise in cash in respect of his services as a director".[30] This definition seems to indicate that the CLRC's recommendations were in relation to directors' fees and other benefits provided by a company for all directors and were not meant to cover salaries payable under a contract of service. The majority of the individuals and organisations that responded[31] to the CLRC's CD 5 supported its proposals. In its Final Report issued in 2008 the CLRC recommended that a statutory provision be enacted to require the remuneration of directors to be specifically approved by members in general meeting but restricted the recommendation to public companies.[32]

This recommendation of the CLRC is now enacted in the new Companies Act 2016 (CA 2016). Section 230(1) of CA 2016 provides that the fees of directors and any benefits payable to the directors, including any compensation for loss of employment, shall be approved by members at a general meeting. Section 230(1) applies to directors of public companies and listed companies and its subsidiaries.

Two significant matters may be noted from section 230(1). First, unlike the position under the CA 1965, the CA 2016 now contains a mandatory provision that requires the remuneration of directors in public companies to be approved by the members in a general meeting of the company. Secondly, it follows that with the enactment of this provision, a public company's constitution can no longer give its board the power to fix the "remuneration" of its directors. The remuneration of directors of public companies must now be approved by members in a general meeting.

An important question which arises from section 230 is whether this provision removes the board's power to determine both directors' fees *and* the salaries of managing /executive directors and gives that power to members in a general meeting. The answer to this would depend on how the term "remuneration" is defined in the legislation which

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29 The Corporate Law Reform Committee was established in 2003 by the Malaysian Government to review Malaysia's corporate laws. The Committee's Final Report bearing the title *Review of the Companies Act 1965-Final Report* was issued in 2008 (see http://www.ssm.com.my/en/docs/CRLC Final Report). Site accessed on 29 January 2017.

30 Paras 1.28-1.40 at pp. 30-36.

31 CLRC, *Responses and Comments Received on Consultative Document "Clarifying and Reformulating the Directors Role and Duties" https://www.ssm.com.my/en/clrc/consultation-document/cd5* Site accessed on 29 January 2017.

32 See Final Report, recommendation 2.29 at p. 104.

enacts the provision. Does the term "remuneration" include both fees/benefits payable to directors *and* salaries under directors' service contracts? It is unfortunate that in this regard, the CA 2016 does not contain a definition of the term "remuneration". It was earlier seen that the Final Report of the CLRC seemed to propose a restrictive definition for the term "remuneration" that does not include salaries of directors under service contracts or contracts for services. If this restrictive definition of "remuneration" is adopted, section 230(1) will not give any direct control to members of public companies over salaries stipulated in directors' service contracts or contracts for services. The section will only give members of public companies direct control over directors' fees and other benefits paid to directors. It will then remain permissible for the public company's constitution to prescribe that the terms of directors' service contracts and salaries/benefits to be paid under such contracts shall be decided by a company's board of directors or a committee of the board.

On this issue, this article supports the restrictive approach because it may not be a practical move to give total control to members in general meeting over the salaries and benefits of executive directors. Indeed, doing so may even be detrimental to the company. Members may not fully understand the market forces that regulate the type of remuneration package that must be provided by companies to attract and retain able and talented individuals. If shareholder approval is required it is possible for an uninformed and rebellious majority to frustrate a board's proposals to hire executive directors of ability by voting against a remuneration package, even though the proposal is based on market forces and is not overly generous.

Moving on, this discussion would not be complete without an examination of the position relating to private companies. Section 230(2) of the CA 2016 makes provision for remuneration of directors of private companies. Section 230(2) states that in the case of private companies, the *board* may, subject to the constitution, approve the fees of the directors and benefits payable to them including any compensation for loss of employment. Further, section 230(3) stipulates that an approval by the board made under section 230(2) shall be recorded in the minutes of the directors' meeting and the board shall notify the shareholders of the approval of the fees within fourteen days from the date of the approval.

Thus for private companies, the board of directors retains the power, subject to company's constitution, to fix the remuneration of its directors. Members of private companies do not have any direct control over directors' fees and other benefits paid to directors. However, the board is issued with a mandate to record the approval of the fees in minutes of the meeting and to notify the shareholders of such approvals. Further and significantly, section 230(4) creates a mechanism for members of private companies who consider that the payment of the fees under subsection (3) is "not fair to the company". Pursuant to subsection (4), members holding at least 10% of the total voting rights and who consider the payment to be unfair to the company may, within 30 days after they have knowledge of the payments, require the company to pass a resolution to approve the payment. The resolution may be a written resolution or by way of general meeting. Unless an approval by a resolution is obtained, the payment shall be a debt due by the director to the company.

It is indeed praiseworthy that the CA 2016 makes specific provision for this subject to cater for private companies. The requirement of the recording of board approvals on directors' fees in minutes and notification to shareholders of such approvals is commendable. It ensures greater transparency and accountability on the part of the board. The creation of a mechanism in section 230(4) for members unhappy with the payment of the fees is also laudable as it ensures a check and balance for boards which are overly indulgent in fixing the remuneration schemes for directors.

In the final analysis, this article submits that the new provisions in the CA 2016 discussed above are steps taken in the right direction. Without doubt, the provisions provide greater clarity on the subject of the regulation of directors' remuneration and are a tremendous improvement from the position under the CA 1965 where the subject was left to be regulated by the company's articles.

V. INSPECTION OF DIRECTORS' SERVICE CONTRACTS BY MEMBERS

Another matter of concern in recent times has been with service contracts which provide directors with substantial or generous sums as salaries, lucrative compensation packages which operate in the event of removal, loss of office or retirement, and entrenching clauses which make lawful dismissal a protracted and expensive exercise.[33] One of the consequences of this is that the company and its members may find that they cannot rid themselves of an inept director without paying a substantial sum as compensation or as damages for breach of contract. Admittedly, the services of skilled and able executive directors cannot be acquired without providing them with the benefits they deserve but there should be some restraint on over indulgence on the part of the board when it deals with a director's remuneration package.

This raises the question whether directors' service contracts should be scrutinised and approved by members in a general meeting before the contracts are offered to them. It was argued above that the new provisions in the CA 2016 may not give members any direct control over the salaries and benefits of executive directors. This article has submitted that the salaries and perks of executive directors should remain the domain of the board or a competent committee of the board. A company will naturally be anxious to recruit able and experienced men and women as its executive directors, the salaries of whom are decided by market forces. The board or a remuneration committee of the board is better placed to understand the appropriate remuneration that must be offered to attract such persons. Members may not be equipped with the knowledge, experience or the information which is required to evaluate the appropriateness of the salaries and benefits that must be offered to attract the attention of talented individuals. A requirement that the salaries of executive directors must be approved by shareholders may have negative effects. The company may not be able to act with speed and efficiency. Further, the lucrative salaries

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[33] For instance the service contract may be a fixed term agreement with a "rolling" fixed-term. The fixed term would be drafted to state that the duration of the contract is renewed from day to day. The duration of the contract always remains a period which has not commenced its run.

and attractive benefits that must necessarily be offered by companies in competitive times to obtain the services of individuals of high calibre may alarm some shareholders, who may control sufficient votes to defeat the board's proposals in a general meeting.

As compensation for this freedom the board must promote transparency and accountability regarding the service contracts and the salaries and benefits of its executive directors. It must ensure that adequate information on these matters are given or made available to members. One way to ensure that adequate information is available to members regarding the companies' remuneration schemes is to allow the inspection of directors' service contracts and their salaries and benefits. Further, there must also be a clear forum or avenue, additional to the general meeting, where members who are dissatisfied with the company's remuneration schemes and policies may express their views. These matters are now dealt with in this part of article. We begin by first examining the position under the CA 1965, then the position in other jurisdictions and finally, the CA 2016.

A. Companies Act 1965

It was seen that under the CA 1965, Malaysian companies enjoyed considerable freedom in respect of directors' service contracts as the CA 1965 neither regulated the terms of directors' service contracts nor required such contracts to be approved by members. As mentioned above, one way the damaging consequences of this omission may be lessened is to ensure that adequate information is available to members regarding the terms of such contracts, as an example, by allowing inspection of such contracts. As stated earlier one of the benefits of allowing inspection is that it results in greater transparency as to how shareholder funds are utilised. Further, the awareness of the board that they may be questioned and made accountable for the salaries, benefits and the terms of the contracts may make them exercise greater care and vigilance when they are involved in settling service contracts. Allowing inspection of service contracts would also benefit members of a public company who intend to exercise the right to remove a director from office. Inspection would allow members to determine whether there is any compensation to be paid to the director if he or she is to be removed and the extent of the compensation. The CA 1965 contained no statutory requirement that directors' service contracts must be deposited with a company's registered office or elsewhere for inspection by members. Neither was there any provision which enabled members, even if they formed a substantial majority, to compel their company to disclose the contents of the service contracts of the directors of the company.

B. Some Examples from Other Jurisdictions

It may be pertinent, at this juncture, to examine how some other jurisdictions have dealt with the subject of inspection of directors' service contracts.

In the United Kingdom under section 228 of the UK Companies Act 2006, a company must keep available for inspection a copy of every director's service contract with the company or with a subsidiary of the company. If the contract is not in writing, a written memorandum setting out the terms of the contract must be kept and made available for

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inspection. They must be retained by the company for at least one year from the date of termination or expiry of the contract and must be made available for inspection during that period. They must be kept available for inspection at the company's registered office or a place specified in regulations made under section 1136 of the Act. The company must give notice to the Registrar of the place at which the copies and memoranda are kept for inspection and of any change in that place unless they have at all times been kept at the company's registered office. The aforesaid requirements apply to a variation of a director's service contract as they apply to the original contract. By virtue of section 229 every member has a right to inspect and to request a copy of every agreement or memorandum kept under section 228. Inspection of the document is without charge but a fee as prescribed may be imposed if a copy is requested. Failure to comply with the requirements of section 228 and section 229 is a criminal offence.

A helpful provision in the UK which enables members of a quoted company to obtain information about directors' service contracts is section 420(1) of the Companies Act 2006 (UK). The section imposes a duty on the directors of a quoted company to prepare a Directors' Remuneration Report for each financial year of the company. Breach of this duty is a criminal offence. Among the matters the Report is required to disclose is the company's policy on the duration of service contracts, notice periods and termination benefits. In addition, the salaries and bonuses which were paid to directors and other specified payments or benefits in cash or kind received by directors during the financial year must be disclosed. The Report must be approved by the board of directors and signed on behalf of the board by a director or the secretary of the company. Further, by virtue of section 439, a quoted company must, prior to the general meeting in which the companies annual accounts are to be laid, give to the members of the company entitled to be sent notice of that meeting, notice of the intention to move at that meeting, an ordinary resolution approving the directors' remuneration report for the relevant financial year. The existing directors must ensure that the resolution is put to the vote of the meeting. It is to be noted that the vote is only advisory and section 439(5) provides expressly that no entitlement of a person to remuneration is to be made conditional on the resolution being passed under section 439(4). Nevertheless, the Report allows members to obtain valuable information on the remuneration paid to directors. Significantly, the advisory vote provides an avenue for unhappy members to display their dissatisfaction. Needless to say, a negative vote may prompt a board to re-examine its remuneration strategy for its directors.

The Australian position is set out in section 202B of the Corporations Act 2001 (Cth) which states that a company must disclose the remuneration paid to each of its directors or its subsidiary or by an entity controlled by the company if it is directed to disclose that information by members entitled to at least 5% of the votes at its general meeting or by at least 100 members who are entitled to vote at its general meeting. The company's duty of disclosure extends to all remuneration paid to the director, regardless of whether the payment is made in relation to that person's capacity as a director or in another capacity. The company must comply with the members' direction as soon as practicable by taking three steps. First, it must prepare a statement of the remuneration mentioned above for the last financial year before the direction was given. Secondly, it

must have the statement audited; and finally, it must send a copy of the audited statement to each person entitled to receive notice of its general meetings.

In Singapore, section 164A of the Companies Act (Cap 50) (Singapore) provides a procedure by which a member may obtain information about the remuneration of the directors of its company. Under the section, if a notice is sent by or on behalf of at least 10% of the total number of members[34]or a member or members with at least 5% of the total number of issued shares of the company[35]requiring the emoluments and other benefits received by the directors of the company or of a subsidiary to be disclosed, the company is under a duty within 14 days[36]to prepare or cause to be prepared and cause to be audited a statement showing the total amount of emoluments and other benefits paid to or received by each of the directors of the company and each director of a subsidiary, *including any amount paid by way of salary* for the financial year immediately preceding the service of the notice. When the statement referred to above has been audited, the company is required within 14 days to send a copy of the statement to all persons entitled to notice of the general meetings of the company. In addition the company must lay the statement before the next general meeting of the company held after the statement is audited. Every director who is in default of the above provision commits a criminal offence.

C. Companies Act 2016

Before examining the position under the CA 2016, it may be of interest to consider recommendations of the CLRC pertaining to this issue. The CLRC in its CO5 had recommended that Malaysia enact a provision which will give members of a company statutory right to inspect service contracts of directors. Interestingly, this proposal was opposed by the majority of the individuals who submitted responses to the Consultative Document.[37] The main reason given for the objection to allow inspection was that contracts of service were confidential and private documents that may contain information, which when made available for inspection, may injure the company. In its Final Report the CLRC reported that there were also views that a right of inspection given to members in general may lead to abuse as it would enable any shareholder to exercise that right.[38] The Committee also noted that some of the respondents had suggested that the right to inspect be limited to members who hold 5% of the shares of the company. The upshot of the views of the respondents was the Committee's recommendation that members should be given the right to inspect directors' service contracts only "if requested by (a) members with not less than 5% shareholding or (b) at least 100 members who are entitled to vote at a general meeting".[39]

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34 Excluding the company itself, if it is registered as a member.

35 Excluding treasury shares.

36 Or such longer period as the Registrar may allow.

37 CLRC, *Responses and Comments Received on Consultative Document "Clarifying and Reformulating the Directors Role and Duties", https://www.ssm.com.my/en/clrc/consultation-document/cd5*. Site accessed on 29 January 2017.

38 Final Report Chapter 2, para 7.16.

39 Recommendation 2.29 in Chapter 2, p. 104.

In this regard, the relevant provisions now enacted in the new CA 2016 are subsections 231, 232 and 233. The starting point is section 231, which gives a definition to the term "service contract" of a director.[40] Section 232(1) then states that a public company shall keep and maintain a copy of every director's service contract with the company available for inspection. All copies are to be kept available for inspection at the registered office of the company.[41] The copies are to be available for inspection for at least one year from the termination or expiry of the contract.[42] Notice must be given to the Registrar of the place at which the copies are available for inspection and if there is any change of the place.[43] Contravention of these provisions is an offence and the company and/or officers shall on conviction be liable to a fine not exceeding RM1million.[44]

Next, section 233 is a key section as it states a qualification requirement for members who intend to exercise the right to inspect a service contract. It also prescribes how the right of inspection is to be exercised and the company's duties when a request for inspection is made. The section states as follows –

> 233(1) Every copy of the contract required to be kept under section 232 shall be made available for inspection by –
> (a) in the case of a public company having share capital, by members holding at least five percentum of the total paid up capital; or
> (b) in the case of a public company not having share capital, by at least ten percentum of members.
> (2) Subject to subsection (1), the members so entitled to inspect on request and on payment of such fee as may be prescribed shall be entitled to be provided with a copy of any such contract.
> (3) The copy shall be provided within seven days from the date the request is received by the company.
> (4) Every officer who refuses a request for inspection under subsection (1) or contravenes subsection (2) commits an offence and shall on conviction, be liable to a fine not exceeding two hundred and fifty thousand ringgit.
> (5) In the case of any such refusal or default, the Court may, by order, compel an immediate inspection or, as the case may be, direct that the copy required be sent to the person requiring it.

This article submits that these new sections are certainly a welcome development in the Malaysian corporate law. They provide an enhanced measure of transparency and

40 Section 231(1) states, "For purposes of this Division, a director's "service contract" in relation to a public company means a contract under which – (a) a director of the company undertakes personally to perform services, as a director or otherwise for the public company or for a subsidiary of the public company; or (b) services that a director of the public company undertakes personally to perform as director or otherwise are made available by a third party to the public company, or to a subsidiary of the public company".

41 Section 232(2) CA 2016.

42 Section 232(3) CA 2016.

43 Section 232(4) CA 2016

44 Section 232(5) CA 2016

accountability on the part of the board as to how shareholder funds are utilised. The sections call a number of matters for comment. First, the sections are restricted to public companies only. Secondly and commendably, the provision is succinct in spelling out how the right to inspection is to be exercised and also in stating the nature and extent of the company's duties when a valid request is made. Notably, section 233 allows only those members of a company who qualify to make a request to inspect the actual contract of service, to examine its terms and its benefits.

However, a somewhat dismal feature of the provisions may be noted. It is, admittedly, difficult to strike a balance between the competing interests of the members and the company, but the qualification imposed in the section may not be completely fair to minority members particularly in large public companies. This is because they may seldom satisfy the 5% threshold or garner enough support from other members to attain the requirement of 10% of members.

D. Disclosure in the Company's Annual Reports

A final and pertinent matter to be examined is the extent to which Malaysian companies are required to make disclosure of directors' remuneration in the company's yearly reports. In this regard, Malaysia's Code of Corporate Governance 2012 (MCCG 2012) prescribes that a company's annual report should contain details of the remuneration of each director. However it is to be noted that the Code does not define the term "remuneration" and whether it includes remuneration and/or salaries paid under directors' service contracts. Also, it must be pointed out that observances of the MCCG 2012 by companies are voluntary. Listed companies are however required to report on their compliance with the MCCG 2012 in their annual reports. In addition to the above, public listed companies are required by the Bursa Malaysia Listing Requirements to disclose the remuneration of its directors by giving the aggregate remuneration of directors with categorisation of relevant components such as directors' fees, salaries, percentages, bonuses, and benefits in kind.[45] This disclosure must distinguish between executive and non-executive directors. Notably however, there is no requirement for the disclosure to be on a named basis.

Turning now to the statutory requirements under CA 2016, companies must disclose details of directors' remuneration in a director's report which forms part of the company's yearly financial statements under section 248. The relevant provision in the CA 2016 is section 252 which prescribes that directors of a company must prepare a directors' report that satisfies the requirement of the Act. Section 252 read with section 248 of the CA 2016 requires a copy of the directors' report to be sent to every member of the company (under section 257) and in the case of a public company, to be sent to every member of the company <u>and</u> laid before the company's annual general meeting. In relation to directors' remuneration, this directors' report is required by the Fifth Schedule to show "the fees and other benefits distinguished separately paid to or receivable by [directors]

[45] See Appendix 9C, Bursa Malaysia Listing Requirements, pursuant to para 9.25 and 9.41.

from the company or its subsidiary companies as remuneration for their services …"[46] It is submitted that the use of the words "and other benefits" in the Fifth Schedule is misleading. They appear to refer to benefits other than the fees paid to non-executive directors only. The words do not appear to include the remuneration of executive directors as the salaries and benefits paid to executive directors are given to them in their capacity as employees under a contract of service. Also it is to be noted that the directors' reports need only show aggregate amounts and there is no requirement for the disclosure to be on a named basis.

It is submitted that the statutory requirements regarding disclosure in the directors' reports do not ensure that members will have sufficient knowledge of the remuneration paid to directors. Few members may know the directors' report contains some limited information on directors' remuneration. Secondly although "fees and other benefits" must be shown separately, it is only necessary to show aggregate amounts and there is no requirement that the payments to each director must be identified by name or designation. Thirdly, whilst it is commendable that the CA 2016 has made it mandatory for companies to prepare a directors' report and to send this to all members under section 257, there is no requirement that it must be <u>approved</u> by the members.[47] There is also no requirement of an advisory vote by members similar to that required in the case of the director's remuneration report under section 439(4) of the Companies Act 2006 (UK). Greater transparency and responsibility will be achieved if shareholders are given more information regarding directors' remuneration. In this context a model worth considering is the directors' remuneration report under the Companies Act 2006 (UK).

VI. CONCLUDING REMARKS

The shareholders of a company provide the capital for its commercial enterprise but in most cases they have to rely on the company's board of directors to manage its activities and to make the company's enterprise a successful venture. The board is the pulse of a company and the success of a company's business enterprise depends on the ability and the calibre of the individuals who manage its operations, particularly its chief executive officer and its executive directors. It is axiomatic that a company's remuneration scheme for directors will have a direct bearing on its capability to obtain the services of experienced and skilled individuals for its board.

In the past, Malaysia's CA 1965 left the subject of directors' remuneration to be regulated by the articles of association of a company. Whilst this delegation was a pragmatic move, a possibly undesirable consequence was the fact that articles may be drafted to give too much freedom to the board in determining their own remuneration. It was seen that it was possible for articles to provide that directors' fees as well as the salaries of executive directors shall be determined by the board or committee of the board. This, as pointed out by a leading work on company law, raises the risk of "mutual back scratching"[48] - directors may bestow some favour on a compatriot in the expectation

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[46] See s. 253(1)(c) of CA 2016 and the Fifth Schedule, para 2.

[47] See the observation of the Corporate Law Reform Committee in CD No 5, para 1.33.

[48] Gower and Davies, *supra* n18, at p. 382.

they will receive a similar treatment when it comes to their own remuneration. Neither is total impartiality or objectivity achieved by leaving the subject to a remuneration committee made up entirely of independent directors as the fact remains that they are dealing with the salaries of their colleagues on the board. It was also seen that whilst the courts have been vigilant to ensure that directors do not abuse their fiduciary duties, they have stopped short of questioning the quantum of directors' remuneration save in exceptional circumstances.

For the future, the CA 2016 contains a provision that will require the remuneration of directors of public companies to be specifically approved by members in a general meeting. It was argued in this article that this does not include remuneration under an executive director's service contract. This article supports this position because as was argued earlier, it may not be a practical move to give control to members in general meeting over the salaries of executive directors. This is because members of a company may not fully understand the market forces that regulate the type of salary and remuneration packages that companies must provide to attract and retain competent and skilled individuals.

Whilst this article does not support any move to give total control over directors' remuneration to the members of a company, it wishes to stress, however, that it is imperative to impose a duty on the board to provide members with adequate information about the terms of director's service contracts. Also, members should be provided with an avenue to express their dissatisfaction over the salaries and benefits paid to executive directors under such contracts. In this respect, the CA 2016 has taken great strides forward by enacting statutory provisions that members of public companies are bestowed with a right to inspect the service contracts of their company if requested by members holding not less than 5% of the company's shares or by at least 10% of the company's members who are entitled to vote at a general meeting. This article has submitted that whilst these qualifications are no doubt aimed at shutting out frivolous and vexatious requests, but at the same time they may prove to be an obstacle to a small group of minority shareholders in a large company who are genuinely pursuing information regarding the terms of their directors' contracts. In this context, it may be useful if public companies in Malaysia are required by statute to table at each annual general meeting a director's remuneration report similar to the UK model discussed in Part V of this article.

The Companies Act 2016: Key Changes and Challenges

Lee Shih*

I. INTRODUCTION

The Companies Act 2016 (2016 Act) has been brought into force in stages starting from 31 January 2017.[1] To date all the provisions of the 2016 Act have come into force except for section 241 contained in Division 8 Part III of the 2016 Act on the registration of company secretaries and the corporate rescue mechanisms. The 2016 Act is a culmination of more than 10 years of Malaysia's corporate law reform process. While there have been piecemeal amendments to the old Companies Act 1965 (1965 Act), the 2016 Act represents a fresh start and a modernisation of Malaysia's corporate law framework.

Before delving into the key changes contained in the 2016 Act, it is useful to look back at the corporate law reform process which led to the enactment of the 2016 Act.

II. CORPORATE LAW REFORM PROCESS

In December 2003, the Companies Commission of Malaysia (CCM) established the Corporate Law Reform Committee (CLRC) to undertake a review of existing corporate laws and to propose amendments to the 1965 Act in order to align it with international standards of good corporate governance.[2]

In 2004, the CLRC issued 12 Consultation Documents to receive feedback from all stakeholders. From this consultation process, the CLRC released its Final Report in 2008 consisting of 188 recommendations, addressed to the Minister of Domestic Trade and Consumer Affairs.[3]

In July 2013, CCM issued its Consultation Document on the proposed Companies Bill.[4] This consultation document explained the underlying 19 policy statements and the proposed Companies Bill. The proposed provisions to be included in the Companies Bill were based on the CLRC's Final Report and recommendations made by the Accounting

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1 P.U.(B) 50/2017.

2 See https://www.ssm.com.my/en/clrc/history . Site accessed on 20 April 2017.

3 See http://www.maicsa.org.my/download/technical/technical_clr_final_report.pdf . Site accessed on 20 April 2017.

4 See https://www.ssm.com.my/sites/default/files/announcement/PC%20Companies%20Bill.pdf. Site accessed on 20 April 2017.

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Issues Consultative Committee. In addition, the-then proposed Companies Bill also reflected recommendations made by regulatory authorities, professional bodies, the World Bank's 2012 Malaysia Report of the Observance of Standards and Codes on Accounting and Audit Oversight, the World Bank's Ease of Doing Business Report and the report issued by the Organisation for Economic Co-operation and Development (OECD) Peer Review Group of the Global Forum on Transparency and Exchange of Information for Tax Purposes on Malaysia.

After this round of public consultations, the Companies Bill 2015 was tabled in Parliament and passed in 2016.

III. KEY CHANGES UNDER THE COMPANIES ACT 2016

The 2016 Act spans 620 sections containing 13 Schedules. This note sets out ten of the key changes contained in the 2016 Act.

A. Constitution Replaces the Memorandum and Articles of Association

Firstly, the memorandum and the articles of association will now be replaced by a single document called the constitution. Under section 34(c) of the 2016 Act, the memorandum and articles of association of an existing company incorporated under the 1965 Act will be deemed to be the constitution.[5]

Secondly, section 31(1) of the 2016 Act makes it optional for a company to have a constitution. A company limited by guarantee however, must have a constitution.[6]

Thirdly, the new 2016 Act provides a comprehensive list of the rights, power, duties and obligations of the company, for each director and each member of the company. The constitution will allow for a variation from the default provisions under the 2016 Act but only to the extent that the 2016 Act permits such variation.[7] The constitution would have no effect if its provisions contravenes or is inconsistent with the provisions of the 2016 Act.[8] Where a company does not have a constitution, the default provisions under the 2016 Act will govern such rights, power, duties and obligations.[9]

In short, a company incorporated under the 1965 Act could have its memorandum and articles of association deemed to be the constitution. Such a company should ensure that the provisions in its constitution do not contravene the 2016 Act and note that the constitution can adequately vary or opt out of the default provisions of the 2016 Act.

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5 Section 34(c) will be read together with section 619(3) of the 2016 Act: "*The memorandum of association and articles of association of an existing company in force and operative at the commencement of this Act, and the provisions of Table A under the Fourth Schedule of the Companies Act 1965 if adopted as all or part of the articles of association of a company at the commencement of this Act, shall have effect as if made or adopted under this Act, unless otherwise resolved by the company*."

6 Section 38(1) of the 2016 Act.

7 Section 31(2) of the 2016 Act.

8 Section 32(2) of the 2016 Act.

9 Section 31(3) of the 2016 Act.

B. Incorporation of a Single-Member Single-Director Company

A company may now be incorporated with only a single member. This is evident from section 9 of the 2016 Act which provides that a company shall have "*one or more members*". In addition, a private company will only require a minimum of one director.[10] While a public company can have a single member, it will still require a minimum of two directors.[11]

This change would make it more attractive for individuals to incorporate a private limited company. Instead of operating a business through a sole proprietorship, the incorporation of a company would allow the individual to be the sole member and the sole director of the company. This theme of making the company vehicle more business-friendly continues in the next change in relation to the abolition of the annual general meeting requirement for private companies.

C. No Annual General Meeting for Private Companies

In helping to reduce the compliance costs of running a company, private companies are no longer required to hold annual general meetings. The requirement to hold an annual general meeting has only been maintained for a public company.[12] With the absence of an annual general meeting for a private company, there are certain consequential changes that flow from this. Firstly, all companies shall now lodge its annual return for each calendar year within 30 days from the anniversary of its incorporation date.[13] Therefore, the lodgement of the annual return is no longer pegged to the holding of any annual general meeting of the company.

Secondly, a private company shall now circulate its financial statements and reports to its members within six months from its financial year end.[14] Within 30 days of circulation, the private company shall lodge the financial statements and reports with the Registrar of Companies.[15] These provisions introduce an easier process of circulating such financial statements instead of having to present such statements before the members in an annual general meeting. Thirdly, auditors of a private company would essentially be deemed re-appointed every year unless certain exceptions occur.[16] For instance, one exception is where the members exercise their right under section 270 of the 2016 Act to prevent the re-appointment of the auditor. Finally, it is up to a company to determine the retirement of its directors.[17]

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[10] Section 196(1)(a) of the 2016 Act.

[11] Section 196(1)(b) of the 2016 Act.

[12] Section 340 of the 2016 Act.

[13] Section 68(1) of the 2016 Act.

[14] Section 258(1)(a) of the 2016 Act.

[15] Section 259(1)(a) of the 2016 Act.

[16] Section 269(3) of the 2016 Act.

[17] Section 205 of the 2016 Act.

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D. *Written Resolutions for Private Companies*

For private companies, the resolutions of its members can be passed by way of the written resolution mechanism under the 2016 Act.[18] Such written resolutions cannot be utilised to remove a director before the expiration of his term of office[19] or to remove an auditor before the expiration of his term of office.[20] There is no longer a requirement to pass a unanimous written resolution of the members,[21] as the written resolution shall be passed when the required majority of eligible members have signified their agreement to the written resolution.[22]

E. *Corporate Documents*

We will see changes to corporate-related documents. Firstly, it is optional for a company to have a common seal.[23] Secondly, upon incorporation under the 2016 Act, the Registrar of Companies will issue a notice of registration.[24] Under the 1965 Act, a certificate of incorporation would have been issued instead.[25] Nonetheless, a company can still apply to the Registrar of Companies for the issuance of a certificate of incorporation.[26]

Thirdly, it is not compulsory for a company to issue a share certificate. A shareholder would have to apply for a certificate relating to the shareholder's shares in the company or the constitution may provide for the requirement to issue a share certificate.[27] The new company forms will now have to be lodged with the Registrar of Companies. The old form numbers under the 1965 Act are no longer applicable and with the lodging of forms eventually moving into a completely electronic filing process.

F. *Dividends and Solvency*

The term 'dividend' is now used interchangeably with the term 'distribution'. Section 101(2) of the 2016 Act refers to the registered shareholder having the right to receive a distribution in respect of the share. A company may now only make a distribution to the shareholders out of the profits of the company available if the company is solvent.[28] This is a welcomed move in terms of ensuring that the creditors of the company are protected. Shareholders should not gain the benefit of receiving distribution if there is the risk that the creditors' debts are not paid.

There is now a requirement on the directors to ensure that the company will be solvent immediately after the distribution is made.[29] The test for solvency for the purposes

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[18] Sections 297 to 308 of the 2016 Act.
[19] Section 297(2)(a) of the 2016 Act.
[20] Section 297(2)(b) of the 2016 Act.
[21] Section 152A of the 1965 Act.
[22] Section 306(4) of the 2016 Act.
[23] Section 61(1) of the 2016 Act.
[24] Section 15(c) of the 2016 Act.
[25] Section 16(4) of the 1965 Act.
[26] Section 17 of the 2016 Act.
[27] Section 97 of the 2016 Act.
[28] Section 131 of the 2016 Act.
[29] Section 132 of the 2016 Act.

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of distribution is whether the company is able to pay its debts as and when the debts become due within 12 months immediately after the distribution is made.[30] Where the distribution has exceeded the level where the distribution could have been properly made, the company can recover the distribution from the shareholder[31] or hold the director or manager of the company liable.[32]

There is also potential criminal liability. Every director or officer who wilfully pays or permits to be paid or authorises the payment of any improper or unlawful distribution may now face a maximum of five years' imprisonment and RM3 million fine or both.[33]

G. Solvency Statement

In line with this emphasis on solvency, there is a new requirement for a solvency statement when a company undertakes certain activities that may impact on the capital of the company. These requirements for solvency are to ensure that creditors' interests are also safeguarded. The directors are required to sign a solvency statement when a company carries out the following transactions:

(i) redemption of preference shares out of capital;
(ii) capital reduction by way of a solvency statement;
(iii) financial assistance; and
(iv) share buyback.

A solvency statement in relation to a transaction is a statement that each director making the statement has formed the opinion that the company has satisfied the solvency test in relation to the transaction.[34] In forming such an opinion, a director must inquire into the company's state of affairs and prospects and take into account all the liabilities of the company.[35] The directors should note that there are different solvency tests for different transactions.[36]

H. No Par Value Regime

The 2016 Act has ushered in the no par value regime. All shares issued before or upon the commencement of the 2016 Act shall have no par or nominal value.[37] This brings Malaysia in line with other countries like Australia, Singapore and Hong Kong that have also adopted the no par value regime.

The rationale for this change is that the concept of par value for shares is archaic. Par value does not necessarily indicate the real value of the shares and can be misleading.

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30 Section 132(3) of the 2016 Act.
31 Section 133(1) of the 2016 Act.
32 Section 133(3) of the 2016 Act.
33 Section 132(5) of the 2016 Act.
34 Section 113(3) of the 2016 Act.
35 Section 113(4) of the 2016 Act.
36 Section 112 of the 2016 Act.
37 Section 74 of the 2016 Act.

With a move to the no par value regime, a company will have more flexibility in the raising of capital and in determining the pricing of the shares.

There are a number of effects the move to no par value will engender, one of which is that there will no longer be restriction on the discount to the par value of shares.[38] Next, the concept of authorised share capital would also be abolished. Finally, the share premium account and capital redemption reserve would be abolished and the amounts standing in credit in the share premium account and capital redemption reserve shall become part of the share capital.[39]

I. Greater Directors' Accountability to the Members

There is an increase in accountability by ensuring directors are made more accountable and transparent to members of the company.

Firstly, the 2016 Act stipulates that all payment of fees and benefits payable to the directors, including any compensation for the loss of employment of a director or former director require approval by the members in a general meeting. This applies to public companies and listed companies and its subsidiaries.[40] This ensures that the shareholders have a greater say in the general remuneration of the directors.

For private companies, the directors may, subject to the constitution, approve the fees and benefits payable to the directors.[41] However, there are disclosure requirements. This approval must be recorded in the minutes of the directors' meeting and shall be notified to the members within 14 days from the date of the approval.[42] Members holding at least 10% of the voting rights, who consider that the fee or benefit was not fair to the company, may require the company to pass a resolution to approve the said fees and benefits before it is payable.[43] Hence, members of a private company have the final say in the approval of such fees and benefits payable to the directors.

Secondly, the directors' service contracts with a public company and its subsidiaries shall be made available for inspection to the members.[44] A copy of such contracts shall be made available for inspection for at least one year from the date of termination or expiry of the contract.[45] Also, the 2016 Act allows for more flexibility for directors to enjoy the benefit of an indemnity from the company and for the company to effect insurance for the directors.[46] But this is coupled with the requirement for the directors to disclose the particulars of the indemnity and insurance in the directors' report of the company's financial statements.[47] This ensures greater transparency when the financial statements are provided to the members.

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38 Section 59 of the 1965 Act had set out the restrictions on the issuance of shares at a discount.
39 Section 618(2) of the 2016 Act.
40 Section 230(1) of the 2016 Act.
41 Section 230(2) of the 2016 Act.
42 Section 230(3) of the 2016 Act.
43 Section 230(4) of the 2016 Act.
44 Section 232(1) of the 2016 Act.
45 Section 232(3) of the 2016 Act.
46 Section 289 of the 2016 Act.
47 Section 289(7) of the 2016 Act.

Finally, the 2016 Act introduces a new concept: the member's right to review the management decisions of directors.[48] The chairperson of a meeting of the shareholders shall allow a reasonable opportunity for members at the meeting to question, discuss, comment or make recommendations on the management of the company.[49] Next, a meeting of members may pass a resolution which makes recommendations to the board of directors on matters affecting the management of the company.[50] These steps allow the members to voice their views and to express their concerns to the directors, and where the directors can take into account these views and recommendations made to them. Further, the recommendation by the members could be binding on the board of directors. This occurs when the recommendation is in the best interest of the company and where the right to make recommendations is in the constitution or where the recommendation is passed as a special resolution.[51]

J. Strengthening Insolvency Laws

The final area of change to be discussed is the strengthening of insolvency-related laws, through improvements added to the laws of receivership, schemes of arrangement and winding up.

On receivership, the 2016 Act has codified many of the rights and procedures making it easier to carry out a receivership process. Examples would include the clear provisions on the appointment of a receiver or receiver and manager,[52] added clarity to the powers of a receiver or receiver and manager if the company is to be wound up,[53] and added obligations on the company and its directors to provide information to the receiver or receiver and manager.[54]

The provisions on schemes of arrangement have set a limit on the maximum duration of a restraining order[55] and the court now has the power to appoint an approved liquidator to assess the viability of the proposed scheme.[56] These changes aim to ensure that the creditors' interests are safeguarded.

Finally, the winding up framework has been improved. For example, there is a new minimum threshold of RM10 000[57] for the issuance of the statutory demand leading to the filing of the winding up petition.[58] The powers of the liquidator have also been further clarified and expanded on[59] and there is now a new provision allowing the court to order the termination of a winding up.[60]

48 Section 195 of the 2016 Act.
49 Section 195(1) of the 2016 Act.
50 Section 195(2) of the 2016 Act.
51 Section 195(3) of the 2016 Act.
52 Sections 374 to 376 of the 2016 Act.
53 Section 386 of the 2016 Act.
54 Section 389 of the 2016 Act.
55 Section 368(2) of the 2016 Act.
56 Section 367 of the 2016 Act.
57 P.U. (B) 58/2017.
58 Section 466(1)(a) of the 2016 Act.
59 Section 486 and the Twelfth Schedule of the 2016 Act.
60 Section 493 of the 2016 Act.

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So while there are changes making it easier to incorporate and to continue the operation of companies, the new winding up laws are also aimed at streamlining the processes that bring an end to a company.

IV. SOME AREAS OF UNCERTAINTY

While the 2016 Act has ushered in sweeping changes, some of the provisions may present a number of challenges as well. There may be some uncertainties in the interpretation of certain sections. Part IV lists three examples of the challenges and uncertainties facing any interpretation of the 2016 Act.

A. Invalid Execution of Documents

There are concerns on the wording contained in section 66(2) of the 2016 Act. This section states that a document is validly executed by a company if it is signed on behalf of the company "*by at least two authorised officers, one of whom shall be a director … or … in the case of a sole director, by that director in the presence of a witness who attests the signature*."

The question arises whether section 66(2) of the 2016 Act is the *only* way for a company to validly execute a document or whether it is meant to be merely *one* way for the valid execution of documents. The term 'document' has the meaning assigned to it in the Evidence Act 1950[61] which covers a very wide category of written and electronic material.[62]

This uncertainty is also seen in section 66(1) of the 2016 Act which may be interpreted to mean that a document may only be executed by a company through the affixing of its common seal[63] or by signature in accordance with section 66 of the 2016 Act.[64]

On the other hand, section 64 of the 2016 Act preserves the general principle of law that a contract may be made on behalf of a company by a person acting under an express or implied authority.[65] This suggests that a single authorised person can still validly execute a contract on behalf of a company. There is uncertainty how section 64 will be interpreted with the wider provision set out in section 66(2) of the 2016 Act on the valid execution of a document.

It would be extremely cumbersome, if not almost impossible, to have a director sign on every document in order to ensure that it is validly executed by the company.

A partial solution may be found through an application of section 67(3) of the 2016 Act which states: *"… a company may, by instrument executed as a deed, empower a person … to execute deeds or other documents on its behalf*." The deed executed by the

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61 Section 2 of the 2016 Act.
62 Section 3 of the Evidence Act 1950.
63 Section 66(1)(a) of the 2016 Act.
64 Section 66(1)(b) of the 2016 Act.
65 Section 64(1)(b) of the 2016 Act.

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company[66] would likely have to comply with the requirements of a common seal or a signature in accordance with section 66 of the 2016 Act. This deed will then empower the authorised person to execute documents on behalf of the company.

This would still be a convoluted mechanism. The company would be forced to execute a deed to empower a set list of persons to execute documents, and having to constantly execute fresh deeds to update the list of persons authorised to execute documents. Documents could extend to email communications, purchase orders, receipts, and invoices.

The added uncertainty is that it is not entirely clear how to draft such a deed and what requirements should be contained in such a deed. For example, the question arises whether such a deed would require consideration. As a result, section 66 of the 2016 may have a very wide impact on all commercial transactions and documentation. There will undoubtedly be uncertainty whether a document is validly executed or not.

B. Winding up

There are certain areas of uncertainty in the winding up provisions of the 2016 Act.

Firstly, the Companies (Winding-Up) Rules 1972 ("Winding Up Rules") enacted under the 1965 Act have not yet been amended to be consistent with the 2016 Act. The Winding Up Rules still refer to the section numbers of the 1965 Act. However, it is likely that section 35(2) of the Interpretation Act 1948 and 1967 can be applied. This particular provision provides that where any written law is repealed and re-enacted, references in any other written law to the law so repealed shall be construed as references to the re-enacted law.

Nonetheless, the existing Winding Up Rules may not be comprehensive enough to cater for all the winding up provisions of the 2016 Act. For example, section 454 of the 2016 Act states that for every voluntary winding up, a liquidator shall be entitled to receive salary or remuneration as prescribed in the rules.

This is a change from the position under the 1965 Act. In the case of a member's voluntary winding up under the 1965 Act, the company in a general meeting may fix the remuneration of the liquidator.[67] In a creditor's voluntary winding up under the 1965 Act, the committee of inspection (or, if there is no such committee, the creditors) may fix the remuneration of the liquidator.[68] The Winding Up Rules do not presently contain provisions for the remuneration of a liquidator in a voluntary winding up. This leaves such a liquidator uncertain on how to receive remuneration.

Secondly, there may be uncertainty whether a liquidator appointed under the 1965 Act would then be subject to the provisions of the 1965 Act or the 2016 Act. For instance, a liquidator appointed under the 1965 Act may wish to utilise some of the wider powers of a liquidator under the 2016 Act.[69] The transitional provision in section 619 of the 2016 Act

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[66] Section 67(1) of the 2016 Act.

[67] Section 258 of the 1965 Act.

[68] Section 261(3) of the 1965 Act.

[69] For example, the powers of a liquidator in a winding up by the court in the Twelfth Schedule of the 2016 Act.

may provide different possible interpretations. The liquidator appointed under the 1965 Act may be deemed as continuing in office as if he had been appointed under the 2016 Act.[70] That may suggest that the liquidator may now exercise powers under the 2016 Act.

However, all winding up proceedings commenced before the commencement of the 2016 Act shall be deemed to have commenced and may be continued under the 1965 Act.[71] Similarly, a company which is in the course of winding up immediately before the commencement of the 2016 Act shall continue to be wound up under the 1965 Act.[72] That may suggest that all the winding up proceedings, including the powers of the liquidator, continue to be governed by the 1965 Act.

Similarly, if a company had been wound up under the 1965 Act, it is not clear whether the winding up can be terminated under the new provisions of the 2016 Act.[73] This is a new right that only exists under the 2016 Act.

C. Capital Reduction Through the Solvency Statement

The 2016 Act has introduced an additional method for capital reduction through the solvency statement route. Under the 1965 Act, a capital reduction could only be effected by way of a court order[74] and where the capital could be reduced "*in any way*". The phrase "*in any way*" is extremely wide and general[75] and has allowed a court order to approve a capital reduction in different ways. For instance, there can be the court order for a selective capital reduction,[76] a reduction of capital to nil and with a simultaneous issuance of shares,[77] and a capital reduction with a distribution of assets in specie.[78]

However, the 2016 Act has omitted the words "*in any way*" for a capital reduction through the solvency statement route. Sections 115 and 117 of the 2016 Act do not make clear whether the solvency statement would allow for all the different methods of capital reduction. The words "*in any way*" have only been retained in section 116 of the 2016 for a reduction in capital by the court. This is compared with other jurisdictions that have allowed a solvency statement route for capital reduction. Hong Kong[79] and Singapore[80] make it clear that the solvency statement would allow for a capital reduction "*in any way*".

Secondly, the Companies (Reduction of Capital) Rules 1972 ("Reduction of Capital Rules") were enacted under the 1965 Act. The Reduction of Capital Rules have not been amended to be consistent with the provisions of the 2016 Act. Similar to the Winding Up Rules, during the interim period, it is possible to apply section 35(2) of the Interpretation Act 1948 and 1967 to read the Reduction of Capital Rules consistently with the 2016 Act.

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70 Section 619(1) of the 2016 Act.
71 Section 619(4) of the 2016 Act.
72 Section 619(6) of the 2016 Act.
73 Section 493 of the 2016 Act.
74 Section 64 of the 2016 Act.
75 *Poole v National Bank of China* [1907] AC 229, HL.
76 *Re Ann Joo Steel Berhad* [2009] 1 CLJ 935, HC.
77 *Primus (Malaysia) Sdn Bhd v Rin Kei Mei & Ors* [2012] 1 CLJ 176, FC.
78 *Ex Parte Westburn Sugar Refineries* [1951] AC 625, HL.
79 Section 210 of the Hong Kong Companies Ordinance.
80 Sections 78A and 78B of the Singapore Companies Act.

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However, it may still be necessary to amend the Reduction of Capital Rules in order to cater for the new solvency statement route for capital reduction.

V. CONCLUSION

The 2016 Act brought about long-awaited changes and improvements to the law. Regardless, certain issues may arise during the transition phase. Nonetheless, the 2016 Act will undoubtedly serve as a harbinger to a more modern corporate landscape.

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A Comparative Analysis on the Enforceability of Knock-for-Knock Indemnities in Thailand and the United Kingdom

Wan M. Zulhafiz*

I. INTRODUCTION

The standard form of oilfield service contracts, such as the Leading Oil and Gas Competitiveness (LOGIC) model, is widely used in Southeast Asia including Thailand. Under the LOGIC model form, the allocation of risk is set out by way of knock-for-knock indemnities where each party will indemnify the other for bodily injury or death of his employees and loss or damage to his property, regardless of negligence. However, under the Thai Unfair Contract Terms Act B.E. 2540 (A.D. 1997) (TUCTA), a contracting party is not allowed to restrict or exclude liabilities pertaining to bodily injury and death arising from his negligence. This restriction appears to be an attempt to hamper risk allocation in oilfield service contracts. On the other hand, the UK Unfair Contract Terms Act 1977 (UCTA) has a similar restriction. However, by virtue of the Supreme Court decision in *Farstad Supply A/S v Enviroco Ltd* [2011] UKSC 16, the knock-for-knock indemnities could be enforceable despite the restriction. Nevertheless, the knock-for-knock indemnities will be subject to the reasonableness test under UCTA. Thus, it could be argued that in spite of the restriction under TUCTA, the knock-for-knock indemnities in standard form oilfield service contracts e.g. LOGIC could still be enforceable in Thailand, subject to certain limitations. This note addresses the issue of enforceability of knock-for-knock indemnities pertaining to bodily injury and death in oilfield service contracts in Thailand. The methodology employed in this research will be a comparative analysis which will be carried out in a descriptive, analytic and prescriptive manner.

II. OIL FIELD SERVICE CONTRACTS

The term 'service contract' or 'service agreement' is used in two different contexts within the petroleum industry.[1] The definition of service contract that is used for the purpose

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* *This paper is a revised and expanded version of a paper entitled 'Enforceability of Knock-For-Knock Indemnities in Oilfield Service Contracts in Thailand' presented at the '5th International Conference on Advancement of Development Administration (ICADA) 2016 - Social Sciences and Interdisciplinary Studies (SSIS) at National Institute of Development Administration (NIDA), Bangkok Campus Thailand, on May 26-28, 2016.*

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[1] Timothy Martin, "Model Contracts: A Survey of the Global Petroleum Industry", *J.Energy & Nat.Resources L.*, 2004, Vol. 22, p. 281.

of the discussion in this article is thus: an agreement entered into between petroleum project parties and various contractors to provide specialised services throughout the lifecycle of a project development. This includes contracts for the activities of seismic survey, maintenance, drilling, well-resting, design, from-end engineering, construction, installation of major facilities, removal, decommissioning, and standby vessels.[2] Smith elaborates on this further and writes that -

> [t]he typical service contract is simply an agreement in which a company agrees to perform certain service for a monetary payment … For example, an oil company that has an oil and gas lease on a tract of land may contract with a seismic company to do geophysical exploration on the land. After analysing the results of the seismic survey, the oil company may enter into an agreement with a drilling contractor who agrees to drill a well at a specified location to a specified depth. If the drilling is successful, still another company may be hired to operate the well.[3]

The main parties to oilfield service contracts are typically an operating oil company (the operator), and a service company (the oilfield service contractor). Sometimes sub-contractors are involved. The following chart illustrates the relationship between the parties:

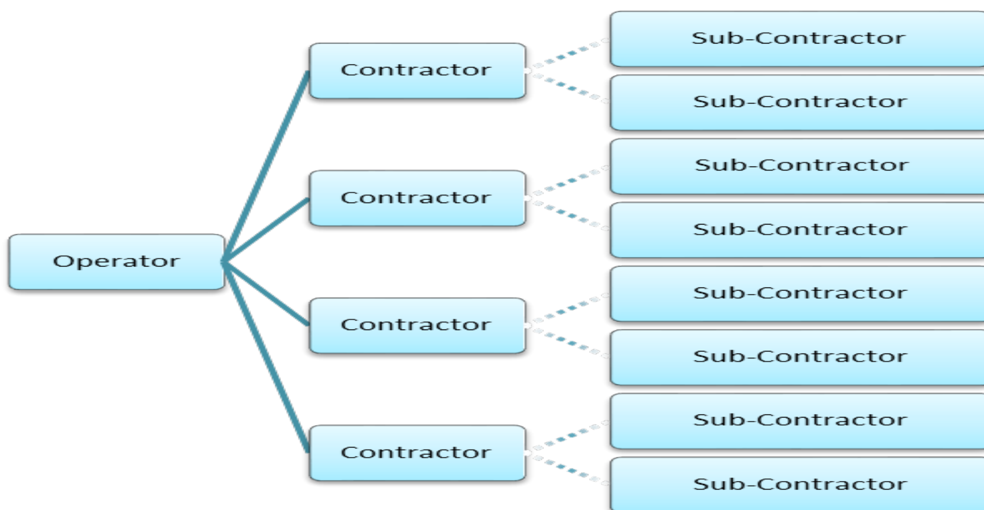

Figure A[4] - Relationship between parties in Oilfield Service Contracts

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2 Joseph E Aigboduwa and Michael D Oisamoje, "Promoting Small and Medium Enterprises in The Nigerian Oil and Gas Industry", *E.Sci.J.*, 2012, Vol. 9 at 244, p. 45; KW Putt, "Secondary Industries and Value Added Activities Study", *Mackenzie Valley Secondary Industry Report*, 2008, p. 45 <http://www.iti.gov.nt.ca/sites/default/files/Mac_Valley_Secondary_Industry_2008.pdf> Site accessed 6 August 2015; Norman J Smith, *The Sea of Lost Opportunity: North Sea Oil and Gas, British Industry and the Offshore Supplies Office*, Vol. 7, Elsevier, 2011, p. 40.

3 Ernest E Smith, "Service Contracts, Technology Transfers and Related Issues", *Int'l Petro. Trans.*, 2000, Vol. 2, p. 480.

4 Greg Gordon, "Risk Allocation in Oil and Gas Contracts", Greg Gordon, John Paterson and Emre Usenmez (eds.), *Oil and Gas Law: Current Practice & Emerging Trends*, Vol. 2, Dundee University Press, 2011, p. 481.

The oil and gas industry has developed model forms of contracts which address the allocation of risk among the common participants of offshore projects.[5] The principal major hazard risks in the oil and gas industry have caused the death of many offshore workers. These are often triggered by fire and explosion associated with hydrocarbon releases and the loss of structural integrity and stability; especially so when dealing with construction works.[6] Therefore, the model form offers certain options of standard provisions that regulate the project parties' liabilities in a way that achieves fair and (more importantly) efficient practical results.

III. LOGIC STANDARD FORMS

LOGIC is a non-profit subsidiary of Oil & Gas United Kingdom that aims to oversee projects across the sector and to enhance the working practice efficacy in the United Kingdom Continental Shelf (UKCS).[7] LOGIC publishes several standard forms of contracts to be used in marine construction contracts within the petroleum industry.[8] For construction contracts, LOGIC has produced a set of General Conditions for Marine Construction (the Model Construction Contract), 2004 Edition.

The Model Construction Contract is intended for use in an offshore context and specifically for pipe laying, offshore installation, subsea construction and inspection, repair and maintenance operations. It is similar in overall form and content to Engineering, Procurement, Construction and Installation (EPCI) contracts, which are frequently used by operators in South/Southeast Asia to deliver 'turnkey' solutions for offshore infrastructure projects and could be used as a basis for these with appropriate amendments.[9]

In the LOGIC standard forms of contract for the oil and gas industry, reciprocal indemnity is simply referred to as "indemnities".[10] In this arrangement, each party will agree to bear the liability respectively with regards to the death or personal injury of its own personnel and the damages to the party's property, regardless of the tortious act which has been committed or the breach of contractual duty by the other party, except in the event of wilful misconduct or sole negligence of the indemnitee.[11] Such arrangement is called reciprocal indemnities and mutual hold harmless. It is also well known in the oil and gas industry as the knock-for-knock regime.

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5 Maria Manuela Andrade, "Knock for Knock Indemnities: Contract Practices and Enforceability Issues", *Oil, Gas & Energy Law Journal (OGEL)*, 2001, Vol.9, p. 1.

6 'Offshore Oil & Gas Sector Strategy 2014 to 2017' (2014) 1 <http://www.hse.gov.uk/offshore/offshore-oil-and-gas.pdf> Site accessed 1 March 2016.

7 LOGIC, 'LOGIC' (*Oil & Gas UK*, 2017) <http://www.logic-oil.com/> Site accessed 7 May 2017. LOGIC

8 Martin, *Supra* n1, at p. 281.

9 Toby Hewitt, "An Asian Perspective on Model Oil and Gas Services Contracts", *Journal of Energy & Natural Resources Law*, 2010, Vol. 28, p. 331.

10 CRINE Network, *Guidance Notes for General Conditions of Contract for Construction*, Vol. 1 (1st Ed), Leading Oil & Gas Industry Competitiveness (LOGIC) 1997 [2.12].

11 Richard W. Williams, "Knock-for-Knock Clauses in Offshore Contracts: The Fundamental Principles", Baris Soyer and Andrew Tettenborn (eds.), *Offshore Contracts and Liabilities,* Informa Law, Routledge, 2014.

A. Knock-for-Knock Indemnities

Knock-for-knock indemnities are believed to represent the best and most efficient model of risk allocation and liability distribution for construction contracts and oilfield services contracts.[12] Provisions of this kind have also been incorporated into most model forms developed by independent associations and major players in both industries in recent years. The adoption of this common approach to risk allocation is highly desirable as it simplifies contract negotiation, facilitates the administration of contracts and ultimately contributes to cost savings.[13] It is not an unusual practice under this contractual arrangement that both parties take out insurance in order to compensate the risks which have been assumed by each party as well as to diminish and eliminate the prospect of any claims resulting from negligence.[14] According to Professor Hewitt -

> The knock-for-knock regime has also been widely adopted in South/ South East Asia. Each party to the contract agrees to take responsibility for, and to indemnify the other against, injury and loss to its own personnel and property and its own consequential losses. These cross-indemnities are usually intended to be effective even if the losses arose because of the negligence, breach of statutory duty or breach of contract of the party receiving the benefit of the indemnity. It is also common in standard contracts for each party to indemnify the other not only against its own losses but also against those of members of its 'group', which is usually defined to include, in the case of the contractor group, the contractor's employees, affiliates, agents and subcontractors and, in the case of the company, the company's employees, affiliates, co-venturers and other contractors engaged by the company to provide services in relation to the relevant area of operations.[15]

Since the LOGIC standard form is widely used in Southeast Asia, such as Indonesia, Malaysia, Thailand and Vietnam, it is therefore necessary to look into how the national law of these countries react to the knock-for-knock regime. However, this note focuses only on Thai law. It is also important to consider the English law in the discussion since LOGIC standard form was established and widely used in the UK. In this respect, the experience of English law in dealing with the knock-for-knock regime will be considered as a reference to hypothetical events.

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12 James A Ligon and Paul D Thistle, "The Formation of Mutual Insurers in Markets with Adverse Selection", *Journal of Business*, 2005, Vol. 78, p. 529.

13 Helen Franklin, "Irretrievable Breakdown? A Review of Operator/Contractor Relationships in the Offshore Oil and Gas Industry", *Journal of Energy & Natural Resources Law,* 2005, Vol. 23, p. 1.

14 *Ibid.*

15 Hewitt, *Supra* n 9, at p. 333.

IV. THE KNOCK-FOR-KNOCK INDEMNITIES IN THAILAND AND THE UK

A. Enforceability of Knock-For-Knock Indemnities in Thailand

Section 4 of the Thai Unfair Contract Terms Act B.E. 2540 (A.D. 1997) ("TUCTA") provides that the terms of a standard form contract which render the party prescribing the standard form contract an unreasonable advantage over the other party shall be regarded as unfair contract terms, and shall only be enforceable to the extent that they are fair and reasonable according to the circumstances. There have been a number of cases where the Thai courts held that section 4 of TUCTA also applies to a business-to-business contract such as oilfield service contracts.[16] This note addresses the issue of enforceability of knock-for-knock regime of the LOGIC model forms under Thai law.

Professor Hewitt maintains that TUCTA makes the exemption of liability clauses void insofar as they restrict or exclude liability for personal injury or death caused deliberately or negligently, and are otherwise valid only insofar as it is fair and reasonable in all the circumstances.[17] In this regard, section 8 of TUCTA limits the use of exclusion clauses. The section provides that any contractual term which exclude or restricts liability for tort or breach of contract in respect of the loss of life, body or health of another person as a result of an action deliberately or negligently committed by the person making the term, shall not be raised as an exclusion or restriction of the liability.

Additionally, section 8 of TUCTA also states that any exclusion clause shall only be enforceable to the extent that they are fair and reasonable according to the circumstances. Such enforceability is based on the principles of 'autonomy of will' and 'freedom of contract'. In this regards –

> The Unfair Contract Terms Act 1997 has been enacted to uphold legal principles in relation to juristic acts and those contracts which are based on principle of sacredness of declaration of intention. It consists of 15 sections with its main justification to combat unfairness in their society. Since the law of contract in Thailand is based on the principle of 'autonomy of will' and 'freedom of contract', the objective of this Act is to protect the contracting parties from any deviation from these two principles.[18]

Therefore, where a contract term is enforceable because it falls outside the scope of section 8 of the TUCTA, such a term is enforceable as a result of section 151 of the

[16] Tjakie Naude, "The Use of Black and Grey Lists in Unfair Contract Terms Legislation: A Comparative Perspective" *South African Law Journal,* 2007, Vol. 124, p. 128.

[17] Hewitt, *Supra* n 9.

[18] Azimon Abdul Aziz and others, "Standard Form Contracts in Consumer Transactions: A Comparative Study of Selected Asian Countries", *Malaysian Journal of Consumer and Family Economics*, 2012, Vol. 15, p. 21, <https://www.researchgate.net/publication/287524704_Standard_form_contracts_in_consumer_transactions_A_comparative_study_of_selected_Asian_countries> Site accessed 10 May 2017 at p. 15.

Thai Civil and Commercial Code. The said section provides that 'an act is not void on account of its differing from a provision of any law if such law does not relate to public order or good moral.'[19]

B. Enforceability of Knock-for-Knock Indemnities in the United Kingdom

In the UK, there is a similar statute which is akin to TUCTA, the UCTA. Section 2 of UCTA provides that:

(1) A person cannot by reference to any contract term or to a notice given to persons generally or to particular persons exclude or restrict his liability for death or personal injury resulting from negligence.

(2) In the case of other loss or damage, a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness.

Meanwhile, section 3 of UCTA provides that such conditions are applicable to any contract made under standard terms of business. Since LOGIC is a contract under standard terms of business, the terms will be governed by UCTA.[20] The scope and restriction of UCTA and TUCTA, which relate to indemnity and hold harmless clauses, are set out in the table below:

	UCTA	**TUCTA**
Scope of the Act	*Section 3* *Liability arising in contract.* *(1) This section applies as between contracting parties where one of them deals as consumer or on the other's written standard terms of business.*	*Section 4* *The terms in a contract between the consumer and the business, trading or professional operator or in a standard form contract or in a contract of sale with right of redemption which render the business, trading or professional operator or the party prescribing the standard form contract or the buyer an unreasonable advantage over the other party shall be regarded as unfair contract terms, and shall only be enforceable to the extent that they are fair and reasonable according to the circumstances.*

[19] Section 151 of the Thai Civil and Commercial Code.

[20] Wan Zulhafiz, "Unfair Contract Terms Act 1977: Does It Provide a Good Model in Regulating Risk Allocation Provisions in Oilfield Contracts in Malaysia?", *International Journal of Trade & Global Market,* 2015, Vol. 8, p. 3.

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	UCTA	TUCTA
Restriction on Exclusion of Liability	*Section 1* *(3) In the case of both contract and tort, sections 2 to 7 apply (except where the contrary is stated in section 6(4)) only to business liability, that is liability for breach of obligations or duties arising—* *(a) from things done or to be done by a person in the course of a business (whether his own business or another's) ...*	*Section 8* *The terms, announcement or notice made in advance to exclude or restrict liability for tort or breach of contract respecting loss of life, body or health of another person as a result of an action deliberately or negligently committed by the person making the terms, announcement or notice or by other person for which the person making the terms, announcement or notice shall also be liable, shall not be raised as an exclusion or restriction of the liability.* *The terms, announcement or notice made in advance to exclude or restrict the liability in any case other than that mentioned in paragraph one which is not void shall only be enforceable to the extent that they are fair and reasonable according to the circumstances.*
	Section 2 *Negligence liability.* *(1) A person cannot by reference to any contract term or to a notice given to persons generally or to particular persons exclude or restrict his liability for death or personal injury resulting from negligence.* *(2) In the case of other loss or damage, a person cannot so exclude or restrict his liability for negligence except in so far as the term or notice satisfies the requirement of reasonableness.*	

V. ANALYSIS AND DISCUSSION

In the English case of *Farstad Supply A/S v Enviroco Ltd*,[21] it has been argued that the Supreme Court's decision in that case has implications for the application of indemnity clauses in oil and gas contracts.[22] The reason is that, according to Lord Mance in *Farstad* –

> [t]he language therefore operates as a series of indemnities against third party exposure combined with exclusions of direct exposure to the other contracting party. This is both what the heading of clause 33 and what common commercial

[21] [2011] UKSC 16.

> sense would lead one to expect under a scheme clearly intended to divide risk between the contracting parties.

On this point, Greg Gordon explains that -

> The most obvious potential consequence would appear to be that the UCTA will now become engaged. UCTA had hitherto been largely overlooked by the oil and gas industry as the restrictions imposed upon the use of indemnity clauses apply only when the indemnifying party deals as a consumer. However, as indemnity and hold harmless clauses would now appear to function as exclusion clauses when they operate in the context of 'direct exposure to the other contracting party', the various restrictions imposed by UCTA now need to be considered. Thus, if a party wishes to rely upon an indemnity and hold harmless clause to regulate losses which, in Lord Mance's formulation, fall into the category of direct exposure to the other contracting party, it will have to demonstrate that the provision satisfies UCTA's requirements.[23]

Based on the above discussion, it is important to note that, indemnity and hold harmless clauses pertaining to bodily injury and death could be enforceable in the UK despite the restriction under section 2 of UCTA. This is because the clauses pertaining to bodily injury and death are to be operated in its original function as indemnities against third party exposure. Hence, UCTA is not applicable.

In contrast, any part of the clauses which deals with the operator's property or the property of the contractor, for instance, damage to property owned by that party or consequential loss suffered by it, would be considered as exclusion clauses in the context of direct exposure to the other contracting party.[24] Therefore, the parties must ensure that such clause should have fulfilled the reasonableness test under section 3 of UCTA.

Applying the above scenario into the context of Thai law, it could be argued that indemnity and hold harmless clauses pertaining to bodily injury and death could be enforceable in Thailand despite the restriction under section 8 of TUCTA. It is worth noting that, even though section 8 of TUCTA provides that 'any contractual terms which exclude or restrict liability for tort or breach of contract respecting loss of life, body or health of another person as a result of an action deliberately or negligently committed by the person making the terms shall not be raised as an exclusion or restriction of the liability', according to *Farstad*, the clauses should be treated as indemnity clauses and not exclusion clauses. In this case, TUCTA will not be applicable. Thus, knock-for-knock indemnities pertaining to bodily injury and death could be enforceable in Thailand.

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22 Greg Gordon, "Contribution, Indemnification and Exclusion: Farstad in the Supreme Court", *Edinburgh Law Review,* 2011, Vol. 15, p. 259.

23 *Ibid,* at p. 264.

24 Zulhafiz, *Supra* n 20.

On the other hand, it could be argued that indemnity and hold harmless clauses which deal with the operator's property or the property of the contractor will only be enforceable subject to certain limitations. The reason is that, under section 8 of TUCTA, it also provides any terms which exclude or restrict the liability in any case other than loss of life, body or health of another person as a result of an action deliberately or negligently committed by the person making the terms, which are not void shall only be enforceable to the extent that they are fair and reasonable according to the circumstances. In other words, it could be said that in order for indemnity and hold harmless clauses pertaining to loss and damage to property to be enforceable in Thailand, these clauses have to pass the requirements of 'fair and reasonable' under section 8 of TUCTA.

That said, it could also be argued that the knock-for-knock indemnity clauses could be regarded as 'fair'. This is because, the clauses provide mutual indemnities to contracting parties. Additionally, it can also be seen as 'reasonable' since the knock-for-knock indemnities reflect the practice of the oil and gas industry.[25] For example, in the UK, the House of Lords in the English case of *Caledonia North Sea Ltd v London Bridge Engineering Ltd*[26] acknowledged the popularity and enforceability of the offshore industry practice of the knock-for-knock regime. Therefore, it could be argued that the knock-for-knock indemnity is 'fair and reasonable' under section 8 of TUCTA. Besides, it may also be argued that since LOGIC is the standard form of contract, where the terms provide reciprocal indemnities, it could be said that these clauses do not have an element of 'unreasonable advantage over the other party' under section 4 of TUCTA.

Despite the above arguments, it is important to note that, unlike the English legal system which is based on the common law, the Thai legal system is based on the civil law. Under the civil law, judges make decisions in a particular case based on the relevant statutes as such case laws are persuasive and not binding. That said, the Supreme Court's decision in *Farstad* is noteworthy since it affects the practice of knock-for-knock indemnity in the oil and gas industry. In this regard, the Thai Court may learn from the result of that case.

Indemnity and hold harmless clauses should not be treated as exclusion clauses. It could be argued that it is inappropriate for the court to go beyond that and treat indemnity and hold harmless clauses in the same way as exclusion clauses. The reason for this is that, indemnity clauses are used by the parties in oilfield service contracts to allocate risk. This is true for knock-for-knock indemnities, in which parties do not use the mutual indemnity and hold harmless clauses to entirely exclude risk. Instead, the parties may use the clauses to partly eliminate the risk. Therefore, the difference between an exclusion clause and an indemnity clause is that the exclusion clause may entirely remove liability for the party who seeks for such exclusion. Moreover, the effectiveness of exclusion clause does not depend on the financial position of the other party.[27]

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25 Peter Cameron, "Liability for Catastrophic Risk in the Oil and Gas Industry", *International Energy Law Review*, 2012, p. 207.

26 [2002] 1 Lloyd's Rep 553.

27 Laurence Koffman and Elizabeth Macdonald, *The Law of Contract,* Oxford University Press, 2010.

VI. CONCLUSION

In a nutshell, according to *Farstad*, the knock-for-knock indemnity would be enforceable in Thailand. The enforceability, however, is subject to certain limitations. Any part of indemnity and hold harmless clauses pertaining to bodily injury and death would be enforceable since the clause was regarded to operate in its own original function. On the other hand, any part of the clause that pertain to loss and damage to property was considered to serve as an exclusion clause. Therefore, for the clause to be enforceable, it will be subject to the requirement of 'fair and reasonable' under TUCTA. The provisions will be caught by general statutes, such as UCTA and TUCTA.

Even though *Farstad* is not directly relevant to Thai laws the case can be said to represent a hypothetical situation where indemnity and hold harmless clauses in oil and gas contracts can be operated as exclusion clauses. This is because, Thailand is not a common law country and case law is not binding. It is not like some other common law countries in Southeast Asia (such as Singapore or Malaysia) where the courts may make reference to English cases. However, the English decision may still be applied in Thailand, as a "general principle of law", or as a source of law, provided under section 4 of the Thai Civil and Commercial Code. Despite Thailand being a civil law country, as a matter of reference, the Thai courts may look into other jurisdiction such as the UK, when interpreting or when giving meaning to TUCTA, particularly on matters pertaining to the knock-for-knock indemnities in oilfield service contracts and may have recourse to the application of *Farstad*. That said, it is important to note that an actual outcome of whether the knock-for-knock indemnities are enforceable in Thailand can only be seen after a real case has been tested in the Thai courts.