

AN OVERVIEW OF COMPANY SHARES AND PROCEDURE FOR CLASS RIGHTS VARIATION

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ABSTRACT

This article explores the complex world of corporate shares and briefly outlines the classes of shares and the corresponding class rights. Class rights could be varied or abrogated as businesses grow, but legal complexities frequently obscure the procedure. This article aims to provide some insights to legal professionals, corporate entities, and shareholders.

INTRODUCTION OF SHARES

Shares represent the shareholder's ownership in a corporation or company. The shares signify the "interest" as well as the "liability" of the shareholders in the company. In larger corporations, shares serve as a form of capital.

A share is:

- (1) a "*chose in action*", which means you can legally enforce your rights. Additionally, the shares can be bought, sold, transferable and charged (s. 70 read together with s. 105 of the Companies Act 2016 ('CA 2016'));
- (2) a *contract* with the company as a shareholder (with reference to the effect of the Constitution – s. 33 CA 2016.)^[1]

Borland's Trustee v. Steel Bros & Co Ltd, Farwell J famously defined shares as:

A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders inter se in accordance with section 16 of the Companies Act, 1862.^[2]

This legal precedent determined that a share is more than just a tangible or monetary asset. Instead, it represents a stake in the company that entails both privileges (such as receiving dividends or participating in general meetings) and responsibilities (such as potentially being required to contribute additional funds towards the company's debts and liabilities).^[3]

It's important to note that shareholders and companies are distinct legal entities, as exemplified in the landmark case of *Salomon v. A Salomon & Co Ltd*. A shareholder, therefore, holds rights within the company, unlike debenture holders with rights against the company.^[4]

The aforementioned legal definition is fundamental and commonly used when discussing the nature of shares in a legal setting.

CLASSES OF SHARES AND CLASS RIGHTS

A company with a share capital may issue different classes of shares, each of which may have different rights, privileges, and restrictions. If the rights associated with a particular type of share differ from those of others, it will typically constitute a separate class. However, it is important to note that courts will determine the existence of classes of shares on a case-by-case basis.

In Malaysia, there are two main recognisable classes of shares, namely:

- (1) Ordinary shares; and
- (2) Preferences shares.

Ordinary Shares

Ordinary shares, which are the “default shares” and are also known as equity shares, represent the risk capital of a company. They give shareholders ownership rights, such as the ability to share in profits, vote in general meetings, and elect/dismiss directors. These characteristics are codified in s. 71(1) of the CA 2016.^{[5], [6]}

However, they also come with ownership obligations and can lead to financial loss if the company fails. Ordinary shares typically comprise most of a company’s capital and hold no special privileges over other shares. In the event of liquidation, ordinary shares are ranked last among all the company’s liabilities.

Preference Shares

Preference shares are a type of shares that entitle the holder to a fixed dividend payment, which takes priority over dividends paid to ordinary shareholders. It is important to note that preference shares may also be given priority in the distribution of assets during the dissolution of the company.

Unless otherwise provided in the company’s Constitution, it should be noted that preference shares do not usually come with voting rights. Only in the event that dividends on the shares are not paid for a specific period of time can the holder be granted voting rights.^[7]

Sections 2 and 72 of the CA 2016 provide that “preference share” means a share by whatever name called, which does not entitle the holder to the right to vote on a resolution or to any right to participate beyond a specified amount in any distribution whether by way of dividend, or on redemption, in a winding up, or otherwise.^[8]

There are several subcategories of preference shares, i.e.:

- (1) *Cumulative dividend*: A share grants the holder the right to “carry forward” a dividend. In the event that there are no profits, the dividend will accrue until there are sufficient profits to pay it out, up to one year.
- (2) *Non-cumulative dividend*: If a company does not declare a dividend in a specific year, the shareholder will not receive any dividends for that year; there is no right to carry forward.
- (3) *Redeemable*: A share issued with terms allowing it to be redeemed at a future date or upon certain events.^[9]
- (4) *Irredeemable*: Not redeemable share.
- (5) *Participating*: Provide their holders with specific rights beyond the typical features found in standard preference shares, i.e., dividend rights or liquidation rights.
- (6) *Non-participating*: For example, the non-participating preference shareholders, after receiving their liquidation preference, are no longer eligible to participate alongside regular shareholders.
- (7) *Convertible*: Shares may be converted into ordinary shares or other specified classes of shares based on agreeable terms, e.g., 1:1 or 2:1 ratio. This conversion event can happen during the Initial Public Offering (IPO) if the company fails to meet financial performance, if redemption does not occur on the agreed date, or if the majority of convertible shareholders decide to convert their shares.^[10]
- (8) *Non-convertible*: The preference shares could not be converted into ordinary or other company shares.

The source of authority of the company to issue different classes of shares is derived from s. 69 of the CA 2016. The directors of the company have the authority to issue shares subject to prior approval by way of resolution

pursuant to s. 75 of the CA 2016. It is presumed that shares are in the same class if the rights attached to the shares are identical in all aspects unless otherwise rebutted by the Constitution of the company according to s. 89 of the CA 2016.^[11]

PURPOSES OF SHARES ISSUED WITH DIFFERENT RIGHTS

Shares are issued with different rights to differentiate control and distribution rights and to accommodate different investment strategies and risk profiles of investors. These factors are in line with the proviso of s. 90(4) of the CA 2016, amongst others, regarding voting rights, eligibility for dividends payouts, nominal share value, participation rights in surplus assets and profits, and the rights of shareholders during liquidation or winding up. Another critical point is that certain companies’ Constitutions may grant “pre-emptive rights” to existing shareholders. This gives them the privilege to subscribe to newly issued shares to prevent the dilution of their shareholdings in the company, per s. 85 of the CA 2016.^[12]

Examples:

Class A Shares	Voting rights on all resolutions of the company. No dividends’ rights.
Class B Shares	Voting rights on the issue of appointment of directors of the company. Voting rights on all resolutions of the company upon the death of Class A shareholder. No dividends’ rights.
Class C Shares	No voting rights. Dividends’ rights.

WHERE TO FIND THE “RIGHTS”?

Rights associated with shares may be identified through a contractual agreement or a resolution passed by the Board of Directors. It is mandatory for the company’s Constitution to state the rights attached to preference shares explicitly.

When a company is newly incorporated, the rights of the shareholders need to be determined by the promoters at the time of incorporation. These rights may be changed at a later time. Information about the shares that have been issued, including any preferential rights, is publicly available. This information can be found in the company’s Constitution, annual report, and financial statement.

CLASSES OF SHARES VS CLASS RIGHTS

Although the Companies Act 2016 allows for the issuance of “classes of shares” and varying the “class rights”, it doesn’t offer much clarification on what distinguishes them from one another.^[13]

Reference is made to an English landmark case: *Cumbrian Newspapers Group Ltd v Cumberland & Westmorland Herald Newspaper & Printing Co Ltd*. The case concerned a dispute between two newspaper companies, Cumbrian Newspapers Group Ltd (‘CNG’) and Cumberland and Westmoreland Herald Newspapers and Printing Co Ltd (‘CWHNP’).^[14]

Cumbrian Newspapers Group Ltd v Cumberland & Westmorland Herald Newspaper & Printing Co Ltd

Background Facts: CNG acquired around 10.67% of the shares in CWHNP’s company. The goal was to consolidate the regional newspaper industry into one name and discourage an external party from obtaining a majority stake in the publication. To make the deal successful, when CNG bought the shares in 1968, the articles of association of CWHNP were altered to give CNG various rights.^[15]

Articles of Association of CWHNP

Art 5 : It had the right to preferences on unissued shares

Art 7 : not be subject to have a transfer of shares to it if refused by the directors

Art 9 : pre-emptive rights over the ordinary shares

Art 12: the right to appoint a director if shareholding remained above 10%

Subsequently, CWHNP's directors wanted to cancel CNG's special rights as conferred aforesaid.

CNG argued they were "class rights" and statutorily protected, which could only be varied with its consent.^[16]

Judgement: According to Scott J, CNG's rights as a shareholder cannot be changed without their consent. This is because, when these rights were initially given, they were considered class rights that provided special privileges to one or more members in their capacity as shareholders. Scott LJ held that "rights" contained in the articles can be divided into three categories:

Firstly, there are specific rights annexed to certain shares, such as the right to receive dividends and the right to get surplus assets during winding up. If the articles state that certain shares have rights that other holders do not possess, it is simple to determine that these shares belong to a specific class of shares under s. 630 Companies Act 2006 (UK).

Secondly, the type of rights is included in a company's articles but are granted to individuals who are **not** members or shareholders for reasons related to the company's operations. In the case of *Eley v. Positive Government Security Life Assurance Co Ltd*, the articles stated that the claimant, who is neither a member nor shareholder, should serve as the company's solicitor. This provision **cannot** be considered a class right.

Thirdly, this category comprises rights or benefits that, although not annexed to any particular shares, are conferred on the beneficiary in his capacity as a member or shareholder in the company. On the facts of the case, it was held that provisions in the company's articles that gave the claimant a pre-emptive right over the transfer of shares in the defendant company, together with the right to nominate a director to its board so long as it held 10 per cent of the ordinary shares in the company, were class rights.

Scott J concluded that the *first* and *third* categories are recognised as class rights.^[17]

Case of *Chew Meu Jong v. Lysaght (Malaysia) Sdn Bhd; Liew Swee Mio @ Liew Hoi Foo & Ors, (Intervenor)* had approved the approach in *Cumbrian Newspaper* to determine class rights.^[18]

WHAT AMOUNTS TO VARIATION OR ABROGATION OF CLASS RIGHTS?

In simple terms, variation refers to a change or alteration, while abrogation means the cancellation or nullification of something. The CA 2016 outlines the procedural requirements for both actions, but unfortunately, it does not provide a clear definition for these terms.

Courts have traditionally interpreted the term “variation of class rights” narrowly. A variation is typically recognised if the change directly impacts the description of the rights but not if it only affects the shareholding value, such as when modifying the rights of a different class of shares.^[19]

Such restrictive interpretations are reflected in the following cases:

White v Bristol Aeroplane Co Ltd

Background Facts: The company has ordinary and preference shares with equal voting rights. The company issued bonus shares solely to the ordinary shareholders. The preference shareholders raised an

objection, claiming it amounted to a change in their class rights and would diminish their voting influence.

Judgement: Held, this is NOT a variation of class rights. The shareholders' enjoyment is affected, but their rights are not varied. Sir Raymond Evershed MR sought to distinguish between an affecting of the rights and an affecting of the enjoyment of the rights. The case had taken into consideration of *Greenhalgh v. Arderne Cinemas Ltd* [1946] 1 All ER 512 and *Re Mackenzie & Co Ltd* [1916] 2 Ch 450.^[20]

Re Old Silkstone Collieries Ltd

Background Facts: The company's coal mine was nationalised by the government, and while waiting for compensation, the company reduced its capital twice for preference shareholders. The shareholders were promised they would not be wiped out entirely and could participate in the nationalisation compensation scheme. However, the company proposed a third reduction of outstanding capital to preference shareholders, which would cancel their class and disqualify them from compensation. Being prejudiced with the action, the preference shareholders have initiated legal action in Court.

Judgement: The Court of Appeal denied the approval of the reduction, stating that the proposal would result in a variation of class rights. The preference shareholders were guaranteed to be involved in the compensation program.^[21]

Some typical examples of variations would be:^[22]

- (1) The rights attached to the shares in that class are varied, e.g., dividends payout changed from 10% to 6% per annum (s. 91(1) of the CA 2016).
- (2) The provision in the company's Constitution for the variation of rights attached to shares in the class is amended (s. 339(6) of the CA 2016).

- (3) Amending the method to vary the class rights in the Constitution of the company (s. 339(6) of the CA 2016).
- (4) Deletion or abrogation of existing rights (ss. 96(1) and 339(6) of the CA 2016).
- (5) Issue new preference shares ranking equally with existing preference shares (s. 91(5) CA 2016); arguably, this effect of dilution might be relaxed by “pre-emptive rights” as provided in s. 85 of the CA 2106.

It is important to keep in mind that cancelling a class of shares during a reduction of capital is not typically considered a change in class rights. This action is seen as being in line with the terms of the shares involved, referring to the case of *House of Fraser plc v. ACGE Investments Ltd* [1987] BCLC 293.^[23]

STATUTORY PROCEDURES FOR VARIATION OF CLASS RIGHTS^[24]

Section 91 of the CA 2016 provides for the procedures for variation of class rights:

- (1) If the Constitution of the Company provides the procedure for variation, it must be strictly adhered to and followed, s. 91(1)(a) CA 2016;
- (2) Where there is no such provision for variation of class rights in the Constitution of the company, s. 91(2) of the CA 2016 provides that:
 - (a) A written consent representing not less than 75% of the total voting rights of the shareholders in that class must be obtained; or
 - (b) A special resolution passed by shareholders in the class sanctioning the variation.

Subsequently, the company shall give written notice to each class shareholder within 14 days from the date the variation is made pursuant to s. 92 of the CA 2016.

Section 95 of the CA 2016 also requires the company to lodge the following documents with the ROC within 30 days from the effective date of the variation:

- (1) A copy of the resolution or other document authorising the variation; and
- (2) A notice as may be determined by the Registrar, including a statement of capital, as at the date on which the variation takes place.

The company and every officer who contravenes s. 95 of the CA 2016 commit an offence and shall, on conviction, be liable to a fine not exceeding RM10,000 and, in the case of a continuing offence, to a further fine not exceeding RM500 for each day during which the offence continues after conviction.

REMEDIES FOR AFFECTED SHAREHOLDERS OF CLASS RIGHTS

As individuals affected by the variation procedures, the shareholders may seek their remedies under ss. 93 and 96(2) of the CA 2016.^[25]

According to s. 93 of the CA 2016, holders of shares representing 10% of the total voting rights in that class may apply to the Court to have the variation disallowed. The said application shall be made within 30 days from the date the variation is made and may be made on behalf of the shareholders by any shareholder appointed in writing by all shareholders in that class. The Court may exercise discretion to disallow the variation based on the “unfairly prejudice” principle.

Section 96(2) of the CA 2016 provides that any procedural proviso for variation of class rights in the Act or Constitution of the company shall not operate as to limit or derogate from the rights of shareholders in that class' rights to obtain relief under any remedy in cases of oppression. In the other word, the affected shareholders may have a remedy in cases of oppression under s. 346 of the CA 2016, see oppression suit related to *Lysaght (Malaysia) Sdn Bhd (supra)*.^[26]

CONCLUSION

The legislation has generally provided flexibility in response to the complex environment of the corporate world. While a company's Constitution can grant rights to shareholders, it can also lay out procedures to revoke these rights. Consequently, understanding the different classes of shares and their associated rights is crucial for lawyers specialising in corporate litigation.

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Endnotes:

[1] Prof Alan Dignam and Prof John Dowry, *Company Law* (Oxford University Press, 11th ed, 2020).

[2] *Borland's Trustee v. Steel Bros & Co Ltd* (1901) 1 Ch 279.

[3] Dignam and Dowry (n 1).

[4] *Salomon v. A Salomon & Co Ltd* [1896] UKHL 1.

[5] Companies Act 2016, s. 71.

[6] WM Chan, *Essential Company Law in Malaysia: Navigating the Companies Act 2016* (Sweet & Maxwell, 2017).

[7] ‘Shares’, *Bursa Malaysia* (Web Page) <https://www.bursamalaysia.com/Trade/Our_products_services/Equities/Shares>.

[8] Companies Act 2016, ss. 2 and 72.

[9] *Ibid*, s. 72(2).

[10] Dignam and Dowry (n 1).

[11] Chan (n 6).

[12] *Ibid*.

[13] Dignam and Dowry (n 1).

[14] *Cumbrian Newspapers Group Ltd v. Cumberland & Westmorland Herald Newspaper & Printing Co Ltd* [1986] BCLC 286.

[15] Dignam and Dowry (n 1).

[16] ‘Cumbrian Newspapers Group Ltd v. Cumberland & Westmoreland Herald Ltd’, *Wikipedia* (Web Page) <https://en.wikipedia.org/wiki/Cumbrian_Newspapers_Group_Ltd_v_Cumberland_%26_Westmoreland_Herald_Ltd>.

[17] Ann Ridley and Chris Shepherd, *Key Facts Key Cases Company Law* (Routledge 1st ed, 2015).

[18] [2018] 1 LNS 1132.

[19] Susan McLaughlin, *Unlocking Company Law* (Routledge 2nd ed, 2013).

[20] *White v. Bristol Aeroplane Co Ltd* [1953] Ch 65.

[21] *Re Old Silkstone Collieries Ltd* [1954] Ch 169.

[22] Chan (n 6).

[23] AJ Dignam and JP Lowry, *Corporate Finance and Management Issues in Company Law Module A: Capital I* (University of London Press, Rev ed, 2022).

[24] Companies Act 2016, ss. 91, 92 and 95.

[25] Chan (n 6).

[26] *Ibid.*