ENFORCING DRAG-ALONG AND TAG-ALONG RIGHTS IN MALAYSIA

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Shareholders – shaking on the shareholders' agreement

Are you planning to sign a shareholders agreement? **Drag-along rights** and **Tag-along rights** are clauses commonly included into shareholder agreements. These are often recommended to be inserted, alongside reserve matters, rights of first refusal, rights of first offer, put and get options, non-dilution clauses.

It seems to be a fair question whether tag-along and drag-along rights can be enforced in Malaysia. It is also a pertinent question: Investors often become shareholders, putting in money in consideration of shares. These investors need to ensure that they are able to make an exit together with the founder(s).

A brief introduction – tag-along and drag-along rights

Drag-along rights are primarily for majority shareholders to compel minority shareholders to sell their shares. As a result, the majority shareholders can negotiate for a sale of most, if not all, of the shares, in the company. The majority, in this sense, can "drag" the minority shareholders along for the sale of shares.

On the flipside, tag-along rights are primarily for minority shareholders who want to ensure that they can participate in any deal that the majority shareholder has gotten into. If they are not allowed to participate, at the same pricing, then the majority shareholder cannot sell his or her shares. The minority, in this sense, can "tag along" with the majority shareholders to sell their shares.

These rights may also be used tactically, for example, when a party wishes to offer an exorbitant sum to a minority shareholder to gain majority control of a company. Other minority shareholders can force a prospective purchaser to also purchase their shares at the same price.

In a Court Of Appeal case, *Mars Equity Sdn Bhd v Tis Ata Ashar Sdn Bhd* [2004] 2 MLRA 470, Justice Gopal Sri Ram said,

It is a settled rule of construction that where several documents forming part of one transaction are executed contemporaneously, all the documents must be read together as if they are one (see *Manks v. Whiteley* [1912] 1 Ch 735. This principle was followed in *Idris bin Haji Mohamed v. Ng Ah Siew* [1935] 1 MLRH 506; [1935] MLJ 257, where Terrell J at p. 261 said:

It is a well-known rule of construction that where the arrangement between parties is contained in several documents all executed simultaneously, all the documents must be read together to ascertain the intention of the parties, and it is a corollary from this that the intention must be gathered from the documents as a whole. It has been held, for example, that when a bill of sale and a mortgage of a reversionary interest were executed simultaneously and related to the same debt, the bill of sale could be defeated by a condition contained only in the mortgage, Edwards v. Marcus [1894] 1 QB 587 (see also the dissenting judgment of Fletcher Moulton LJ in Manks v. Whiteley, which was approved on appeal to the House of Lords, sub-nominee Whiteley v. Delaney [1914] AC 132).

Drag-along rights – PKNS Holdings Sdn Bhd vs Nusa Gapurna Development Sdn Bhd and Anor (2013-2014)

From our reading, there are only a few reported Malaysian case laws on the issue of drag-along rights.

In 2013, the Kuala Lumpur High Court passed its decision in the unreported case of *PKNS Holdings Sdn Bhd V. Nusa Gapurna Development Sdn Bhd & Anor (Encl 3)* [2013] MLRHU 689. It was for an injunction.

The same case was later disposed of through a judgment by the same court in 2014, in another unreported case of *PKNS Holdings Sdn Bhd V. Nusa Gapurna Development Sdn Bhd & Anor* [2014] MLRHU 288.

Through a shareholders agreement dated 3 September 2010, PKNS Holdings Sdn Bhd (“PKNS Holdings”) and Nusa Gapurna Development Sdn Bhd (“Nusa Gapurna”) came together to form PJ Sentral Development Sdn Bhd.

PKNS Holdings would hold 30% of shares while Nusa Gapurna would hold 70% of shares.

On 8 February 2013, a third party, RHB Investment Bank Berhad ("RHB"), made a public announcement that it had entered into a conditional share sale agreement to acquire Nusa Gapurna's 70% in PJ Sentral Development Sdn Bhd.

Subsequently through a letter dated 22 April 2013, Nusa Gapurna sought to exercise its rights to compel PKNS Holdings to sell the 30% of shares held by PKNS Holdings to RHB. (This was the drag along right in the shareholders agreement.)

PKNS Holdings alleged that its preemptive rights under the shareholders agreement had been triggered when Nusa Gapurna entered into the share sale agreement with RHB.

During the application for injunction, the court found:

1. PKNS Holdings' rights of preemption under the shareholders agreement would not be triggered if (a) Nusa Gapurna proposed to sell all shares in PJ Sentral Development Sdn Bhd, and (b) the share sale price is above the Minimum Drag Along price;

2. The offer to sell by Nusa Gapurna was within the exception in the shareholders agreement;

3. There was delay as PKNS Holdings knew about the proposed sale of shares in February 2013, but only filed for injunction in June 2013;

4. There was a balance of convenience in favour of Nusa Gapurna, because (a) three other subsidiaries of Nusa Gapurna , which did not have any relationship to PKNS Holdings, were involved in the sale of shares, and (b) the consideration involved a huge sum of RM459 million.

The 2013 application for injunction was thus dismissed.

In the 2014 judgment, after the full trial, the court said,

"The Plaintiff does not have any pre-emption rights where the 1st Defendant sells its shares above the Minimum Drag Along Price. The proposed purchase price of the shares of RM199million is not less than the Minimum Drag Along Price as defined in Cl 8.1…"

It also found that,

"Pursuant to Cl 8.1, **once the drag along notice is issued the Plaintiff has no pre-emption rights.**"

Therefore based on the drafting of the shareholders agreement, Nusa Gapurna had a right to sell the shares of PKNS Holdings in PJ Sentral Development Sdn Bhd to RHB.

In making its decision, the High Court was minded that the Court would not rewrite any commercial terms or contract agreed by the parties. Instead, the contracting parties must "respect and uphold the sanctity of the terms of the agreement that they had agreed upon."

Some authorities relied upon for this point included *Tindok Besar Estate Sdn Bhd v. Tinjar Co* (Federal Court decision, 1979), *Ayer Hitam Tin Dredging Malaysia Bhd v. YC Chin Enterprises Sdn Bh*d (Supreme Court decision, 1994), and *Berjaya Times Squares Sdn Bhd (formerly known as Berjaya Ditan Sdn Bhd) v. M Concept Sdn Bhd* (Federal Court decision, 2009).

The court cited Lord Denning's passage in *Amalgamated Investment & Property Co Ltd (In liquidation) v. Texas Commerce Bank* [1982] QB 84:

"If parties to a contract, by their course of dealing, put a particular interpretation on the terms of it – on the faith of which each of them – to the knowledge of the other – acts and conducts their mutual affairs – they are bound by that interpretation just as much as if they had written it down as being a variation of the contract. There is no need to inquire whether their particular interpretation is correct or not – or whether they were mistaken or not – or whether they had in mind the original terms or not. Suffice it that they

have, by the course of dealing, put their own interpretation on their contract, and cannot be allowed to go back on it.".

Finally the court cited with approval, *Berjaya Times Squares Sdn Bhd (formerly known as Berjaya Ditan Sdn Bhd) v. M Concept Sdn Bhd* (Federal Court decision, 2009) which laid down the guidelines regarding the factual matrix of a case:

"Here it is important to bear in mind that a contract is to be interpreted in accordance with the following guidelines. First, a court interpreting a private contract is not confined to the four corners of the document. It is entitled to look at the factual matrix forming the background to the transaction. Second, the factual matrix which forms the background to the transaction includes all material that was reasonably available to the parties. Third, the interpreting court must disregard any part of the background that is declaratory of subjective intent only. Lastly, the court should adopt an objective approach when interpreting a private contract.".

Singapore case – Pacific Century Regional Development Ltd v Canadian Imperial Investment Pte Ltd [2001] SGCA 21

Malaysia being a Commonwealth jurisdiction, we may consider case law from Common Law countries, which have similar laws.

The Court of Appeal in *Glamour Green Sdn Bhd V. Ambank Bhd & Ors & Another Appeal* (2006) affirmed the Singapore Court of Appeal decision in *Pacific Century Regional Development Ltd v. Canadian Imperial Investment Pte Ltd* (2001), regarding reference to the "factual matrix" when interpreting contracts.

Incidentally, the Singapore case touched on tag-along rights during the trial.

In 1997, Pacific Century Regional Development (PCRD) entered into a shareholders agreement with Orient Freedom Property Ltd (OFPL) to form Quinliven Pte Ltd (QL).

PCRD owned 75% of shares, while OFPL owned 25% of shares in QL.

Through a novation, OFPL's rights were transferred to Canadian Imperial Investments Pte Ltd (CIIP), a Canadian company.

The shareholders agreement contained a tag-along clause. If PCRD were to receive an offer to sell its shares to a third party, PCRD must also get the offeror to offer to purchase a proportional amount of OFPL's shares. PCRD's shares to OFPL's shares must be maintained at 3:1.

However, if it was an offer to transfer to an associated company, the tag-along rights would not be triggered.

One day, PCRD and its parent company, Pacific Century Group Holding Ltd (PCG) wanted to conduct a "backdoor listing" in Hong Kong. Under the plan, PCRD and PCG would transfer their assets (including shares in QL) to a subsidiary called Newco. In return, PCRD and PCG would obtain new shares and bonds in Newco.

PCRD and PCG would inject the Newco shares and bonds into the Hong Kong listed company, Tricom Holdings Ltd (Tricom). In consideration, Tricom would issue its shares to PCRD and PCG.

CIIP claimed that PCRD breached the shareholders agreement by failing to get Tricom to make an offer to CIIP for CIIP's shares in QL. This argument was accepted by the court and CIIP seemed to win. The trial judge felt the substance of the transactions mattered more than the form.

PCRD appealed. At the appeal, PCRD argued that Newco was a subsidiary of PCRD and thus an "associated company". The QL shares would be transferred to Newco, not to Tricom. PCRD argued that it was in fact a restructuring exercise, and there was no "sale" to any third party. It alleged that there was never any bona fide offer to acquire PCRD's shares in QL.

The Singapore Court of Appeal accepted the restructuring argument, and subsequently found that there was never any sale (and therefore never any offer from a third party). Subsequently, the tag-along rights in the shareholders' agreement was never triggered.

Conclusion

The existence of tag-along rights and drag-along rights is well known by now. It seems that lawyers preparing a shareholder's agreement would recommend them. But the enforceability tag-along and drag-along rights needs further confirmation from the Malaysian courts. For now the unreported cases of *PKNS Holdings Sdn Bhd vs Nusa Gapurna Development Sdn Bhd and Anor* (2013 and 2014) serves as a precedent for the enforceability of drag-along rights.

Important Notice

This article is prepared for purpose of general information, and is not intended to be a substitute for professional legal advice. Please consult with a legal practitioner before making any decision about enforcing your tag-along and drag-along rights.

Thank you for reading!