Shareholder Dispute Briefs |

Pre-emptive Rights:
A Shield Against Dilution, but Not An Absolute One

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Article Focus

Pre-emptive rights give existing shareholders the first opportunity to subscribe for new shares, allowing them to maintain their proportionate shareholding and protect themselves against dilution.

In Malaysia, such rights are principally provided for under **Section 85** (“**S.85**”) of the **Companies Act 2016** (“**CA 2016**”).

However, this protection is *not absolute*. **S.85 CA 2016** is expressly subject to a company’s constitution, and its operation must be considered alongside other relevant statutory provisions, such as **Section 75** (“**S.75**”) **CA 2016.**

This article therefore considers:-

(1) the extent of protection afforded by **S.85**;
(2) the circumstances in which pre-emptive rights may be disapplied or waived;
(3) the interaction between **S.75** and **S.85**; and
(4) the consequences of a breach of pre-emptive rights.

What Does S.85 CA 2016 Actually Protect?

S.85(1) CA 2016 provides that:

> “Subject to the constitution, where a company issues shares which rank equally to existing shares as to voting or distribution rights, those shares shall first be offered to the holders of existing shares in a manner which would, if the offer were accepted, maintain the relative voting and distribution rights of those shareholders.” (*emphasis added*)

At first glance, the provision appears straightforward: where a company issues qualifying new shares, the existing shareholders should first be given the opportunity to subscribe to preserve their relative voting and distribution rights in the company.

However, there is an important qualification in the opening words of **S.85** – “*subject to the constitution*”. Ex facie, this suggests that the shareholders may, through the company’s constitution, determine the extent to which their pre-emptive rights apply.

This was recognised by the Federal Court ("**FC**") in ***Dato' Azizan bin Abd Rahman & Ors v Concrete Parade Sdn Bhd & Ors and other appeals***[1] ("**Dato' Azizan**"), where the FC held that the pre-emptive rights afforded by **S.85(1)** are:-

> "*dependent on how the shareholders, as investors, have contracted in their AA (or constitution), firstly with the company and secondly with other shareholders or members inter se*".[2]

Accordingly, where a company has a constitution, the constitution should be the starting point in determining whether and to what extent pre-emptive rights apply. The constitution may fortify such rights, modify their operation, or provide for their disapplication[3]. Where there is no constitution, **S.85** provides the statutory framework governing those rights.

How Are Pre-emptive Rights Displaced or Waived?

At its core, a pre-emptive right is a right of priority or first preference. It does not confer an interest in the shares themselves; rather, it gives shareholders a right of first choice. Such a right may be waived even if it arises from statute[4].

The more difficult question is: **what is sufficient to establish a valid disapplication or waiver of pre-emptive rights?**

1 Shareholders' Approval

Where a company's constitution expressly provides that the pre-emptive right is subject to the direction of the company at general meeting, can shareholders' approval of a transaction itself constitute such a direction, thereby disapplying those pre-emptive rights?

This was considered by the FC in **Dato' Azizan**. There, the constitution provided that the pre-emptive right was "*subject to direction to the contrary by the company at general meeting*". The FC held that the shareholders' approval of the proposed business merger / private placement constituted, in the circumstances, such a "*direction*", with the effect of disapplying their pre-emptive rights.[5]

Notably, the circular seeking shareholders' approval did not expressly refer to **S.85** or state that approval of the transaction would amount to disapplication of their pre-emptive rights. Nevertheless, the FC considered that in approving the transaction, the shareholders did, or ought to have, comprehended its dilutive effects and that they were thereby disapplying their pre-emptive rights[6].

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[1] [2024] 3 MLJ 223.
[2] ibid, para 136-138 & 154.
[3] ibid, para 122 & 158.
[4] ***LGB Engineering Sdn Bhd & Ors v Rayston Resources Sdn Bhd*** [2022] MLRAU 196, para 82-83.
[5] ***Dato' Azizan*** (n 1), para 174-176.
[6] ibid, para 171-187.

Thus, what matters is whether the shareholders' approval objectively demonstrates an informed acceptance of the proposed transaction and its consequences.

Shareholders' approval, however, is not a blanket cure for non-compliance with **S.85 CA 2016**. The manner in which shareholders' approval is obtained remains crucial.

In ***TAS Capital Sdn Bhd v Muhammed Shareef Mohamed Sagubar & Ors***[7], the shareholder complained that an issuance of shares had diluted its majority shareholding.

Although an EGM had been convened, the High Court found, amongst others, that it had not been properly convened and that the shareholder had not been given prior notice. The Court consequently found a breach of **S.85** and held that both the EGM and the share allotment were void[8].

The distinction, therefore, lies between valid and informed shareholder approval obtained at a duly convened meeting, and an irregularly convened meeting which, in itself, cannot defeat a shareholder's pre-emptive rights.

2 Contractual Waiver

Pre-emptive rights may also be waived by contract.

In ***Pan Choon Weng v Mexvin Chow Yew Hoong & Ors*** ("**Pan Choon Weng**"),[9] the High Court held that the shareholder had waived his pre-emptive rights (and the operation of **S.85**) and agreed to allow the directors to issue shares for the specified purposes, particularly by agreeing to Clause 3 of the shareholders' agreement, which expressly waived the right of first offer of shares[10].

Pertinently, the Court observed that a statutory right such as the pre-emptive right may generally be contracted out of, subject to applicable public policy considerations.[11]

3 Conduct & Acquiescence

A waiver of pre-emptive rights may also arise through a shareholder's conduct.

In ***Kyowa Kanko Kaihatsu Co Ltd v Vasseti Berhad***, the Court found that a waiver of the shareholder's pre-emption rights could be inferred from the various correspondence and communications objectively demonstrating that the shareholder did not intend, or was unable, to subscribe for the new shares.[12]

In ***Pioneer Motor Service Company Sdn Bhd v Chin Cheng Hong Sdn Bhd***, the Court of Appeal rejected an argument that the shareholder's past conduct or a purported "*common practice*" of disregarding pre-emptive rights was sufficient to establish a waiver binding on the shareholder in respect of subsequent breaches.[13]

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[7] [2026] MLRHU 2410.
[8] ibid, para 80-87.
[9] [2023] 10 MLJ 544.
[10] ibid, para 83 & 90-91.
[11] ibid, para 85-89.
[12] [2019] CLJU 2392, para 133-135.
[13] [2003] 1 MLRA 264, pg 267.

These cases therefore suggest that waiver may be inferred from conduct in appropriate circumstances, but cannot simply be presumed from past conduct, acquiescence or "common practice". The shareholder's conduct must objectively demonstrate an intention to relinquish the relevant rights.

Interaction Between S.75 and S.85 CA 2016

Briefly, **S.75 CA 2016** requires shareholders' approval before directors may exercise certain powers to allot shares. **S.75(2)** provides the exceptions to this general rule.

In **Pan Choon Weng**, the defendants argued that **S.75** and **S.85** should be construed such that, where an allotment falls within an exception under **S.75(2)**, the shares need not first be offered to existing shareholders under **S.85**[14].

The High Court ultimately dismissed the plaintiff's claim. In this regard, the High Court held that the two provisions should be construed so as to "*complement*" each other and applied according to the circumstances of each case; otherwise, the statutory exception under **S.75(2)(c)** would be deprived of its efficacy[15].

However, this position must be considered alongside the subsequent FC decision of ***Dato' Azizan***. While the FC also emphasised that **S.75** and **S.85** should be read harmoniously, it expressly observed that **S.85(1)** is "*not subject to s.75*"[16].

The extent to which an exception under **S.75(2)** affects the operation of **S.85** therefore warrants careful consideration.

What Happens When Pre-emptive Rights Are Breached?

When a company proceeds with issuance of shares without complying with applicable pre-emptive rights, the affected shareholder may have various remedies depending on the circumstances, including declaratory relief[17], rectification of the register of members[18], oppression relief[19] or other appropriate orders.

However, a breach of pre-emptive rights does not necessarily mean that the resulting allotment is incapable of being cured. The Court may, in appropriate cases where it is just and equitable to do so and where no substantial injustice would result, exercise

[14] ***Pan Choon Weng*** (n 9), para 49.
[15] ibid, para 80-81.
[16] ***Dato' Azizan*** (n 1), para 128 & 134.
[17] ***TAS Capital*** (n 7), where the Plaintiff successfully sought *inter alia* a declaration that the issuance of shares was void and illegal.
[18] ***Pioneer Motor*** (n 13), where the Respondent sought *inter alia* rectification of the register of members under **S.162** of the **Companies Act 1965** to remove a third-party company as the holder of shares.
[19] ***Chiptar Holdings Sdn Bhd v THC Rice (K.L.) Sdn Bhd & Ors*** [2023] 1 LNS 585, where the Plaintiff successfully established a case of oppressive conduct under **S.346** of the **CA 2016**.

its statutory powers to validate or regularise any issuance or allotment of shares that would otherwise be irregular[20].

Key Takeaways 💡

- ✓ **S.85 protects shareholders against dilution, but this protection is not absolute.** It is subject to the company's constitution and must be read together with other relevant statutory provisions, particularly **S.75 CA 2016**.
- ✓ **Pre-emptive rights may be disapplied or waived.** This may arise through the constitution, shareholders' approval, contractual arrangements or, in appropriate circumstances, inferred from conduct.
- ✓ **The manner in which rights are disapplied or waived matters**. An intention to preserve, waive or disapply pre-emptive rights should be clearly documented; past acquiescence alone may not suffice.

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[20] **CA 2016**, **S.108**. See also ***Kelapa Sawit (Teluk Anson) Sdn Bhd v Dr. Yeoh Kim Leng & Ors*** [1991] 1 CLJ (Rep) 194 at pg 204, where the Supreme Court drew a distinction between an act which does not bind the company and an act that is capable of regularisation or validation.