"The main contractor has sold his company ..."

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THIS scenario has been painted often enough. ABC Sdn Bhd has been awarded a sub-contract by XYZ Sdn Bhd who is the main contractor. Disputes arise as XYZ refuse, or is financially not able, to continue payment for works already done. ABC complains that Mr So-and-So who was the "owner" of XYZ has "sold" the company to someone else, and that someone else has claimed that they are not obligated to pay ABC.

This scenario raises several issues which need to be appreciated.

It must first be appreciated that Mr So-and-So does not actually "own" XYZ. The correct position is that he owns the shares in XYZ. He[1] may own all less one the paid up shares in XYZ, but he still does not technically "own" the company. He also does not "own" the assets of that company. He cannot own all the shares of XYZ for section 14(1) of the Companies Act 1965 infers that an incorporated company must have at least two shareholders. In short, Mr So-and-So is simply a shareholder of XYZ.

When a company is incorporated or formed, the original shareholders by this act of incorporating the company has given rise to another entity, namely, the company itself. The company can own property, enter into contract with other company, sue another company and be sued. So, it is the company that owns the property of the company, not its shareholders.

XYZ can also own shares in, for example, DEF Sdn Bhd. Even if DEF becomes a subsidiary company of XYZ, for this fact alone does not alter the position. DEF is an entity in its own right.

So, if ABC enters into a contract with XYZ, the contract is between the two companies, not between their shareholders. If there are any rights or obligations that arise from the contract, the rights can be enforced and the obligations must be performed by the company not its shareholders.

It is, therefore, the case that for the scenario painted above, despite Mr So-and-So having "sold" XYZ to someone else, the rights and obligations that exist between XYZ and ABC remain unchanged. This was explained by Justice Dr Zakaria Yatim in *People's Insurance Co (M) Sdn Bhd v. People's Insurance Co Ltd & Ors* [1986] 1 MLJ 68 where the learned judge said on p. 69:

> *"The plaintiff company is a legal entity by itself. Although it is a subsidiary of the first defendant company, the plaintiff company maintains its own separate entity."*

For that matter, it is strictly incorrect to say that Mr So-and-So has "sold" the company. It is more accurate to say that he has sold his shares in the company. The fundamental legal principle which must be understood is this: ***a shareholder is distinct and separate from the company in which he "owns", or "part owns"***.

Allow me to digress a little. Let us apply this principle to the following unusual example. I was woken up early on the morning of 9 March 2008 (yes, the day after that momentous General Election) by clients who wanted to know the status of their contracts. They had entered into contracts with the Selangor State Government when Barisan Nasional formed the government. What would happen after the "opposition" had "taken over" the State Government?

Their companies had entered into agreements with the State Government, not with the political party that formed the Government. So, the validity and continuing enforceability of the agreements cannot by that fact alone be called into doubt.

If one properly understood what has been stated above, it can also be inferred generally that:

(a) a shareholder can be an "employee" of the company even if he owns almost all the shares in that company; and
(b) a shareholder can also be a "director" of the company; i.e. be a member of the board of directors of that company.

That brings into focus the following monetary aspects:

(a) As an "employee" of the company, the shareholder can receive "salary";
(b) As a "director", he can receive "director fees" as approved by the annual general meeting of the company;
(c) As a "shareholder", he can receive "dividends" proportionate to his shareholdings of the company if recommended by the board of directors, then declared and approved in the general meeting of the company; and
(d) The shareholder cannot lawfully assume and take anything belonging to the company as his. Such act may cause him to be prosecuted for misappropriation of the company's property. ■

[1] *With all due respect to lady engineers, in this passage 'he' and 'she' are interchangeable.*