02 Apr 08

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LEGALUPDATE

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CASE UPDATE

COURT OF APPEAL HOLDS THAT CREATION OF SECURITY DID NOT VIOLATE SHARE TRANSFER RESTRICTION

***Pacrim Investments Pte Ltd v Tan Mui Keow Claire & Anor* [2008] SGCA 16**

Executive summary

Restrictions on the "assignment" or "disposal" of shares during a specified period may not prohibit the creation of security in circumstances where the sale of the pledged or mortgaged shares is not contemplated during the moratorium.

Background

A listed company, Mediastream Ltd ("**MSL**") acquired a business and allotted and issued new MSL shares (the "**Consideration Shares**") to the sellers (the "**Sellers**") by way of consideration for the acquisition. The acquisition agreement (the "**Agreement**") contained a clause by which the Sellers jointly and severally undertook not to "*sell, assign or dispose of any of the Consideration Shares allotted and issued to them on Completion, for a period of one (1) year from Completion ...*". The Singapore Exchange Securities Trading Limited (the "**SGX-ST**") gave approval for the listing and quotation of the Consideration Shares on the Stock Exchange of Singapore Dealing and Automated Quotation System ("**SESDAQ**") upon their allotment and issue.

One of the Sellers (the "**Mortgagor**") used part of the Consideration Shares as security to obtain credit facilities from Pacrim Investments Pte Ltd (the "**Mortgagee**") during the moratorium. Under the credit arrangements, payment was deferred to the date coinciding with the last day of the moratorium. Upon default, the Mortgagee was entitled to transfer the mortgaged Consideration Shares (the "**Mortgaged Shares**") to itself or its nominees and to sell the same only after the expiry of the moratorium.

However, before the moratorium expired, MSL purported to rescind the Agreement and commenced an action against the Sellers. The Mortgagor was also adjudged a bankrupt in separate proceedings.

After the expiry of the moratorium, the Mortgagee submitted the signed transfers of the Mortgaged Shares to MSL for registration. MSL refused to register the transfers.

Decision of the Court of Appeal

The Court of Appeal held that the restrictions against the "assignment" and "disposal" of the Consideration Shares only prohibited the transfer, during the moratorium, of *all rights* in the Consideration Shares *absolutely*. The share transfer restrictions did not prohibit the creation of security (such as the

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equitable mortgage in the present case) in circumstances where the sale of the shares pledged or mortgaged by way of security was *not* contemplated during the moratorium.

Recognition of a shareholder's freedom to deal with his shares

Shares are personal property and therefore *prima facie* transferable, although their transfer may be made subject to certain legal restrictions. The court noted that *"[t]he freedom of a shareholder to deal with his shares should generally be given a broad, rather than narrow, interpretation*".

Restrictions on the transferability of shares would be interpreted strictly. If there is any ambiguity or uncertainty, the interpretation that gives the shareholder the greatest freedom to transfer will generally be preferred.

A purposive approach to the construction of the terms "sell", "assign" and "dispose of" in the context of share transfer restrictions

Where a restriction on the transfer of shares is concerned, it is important to appreciate "*why the restriction was imposed and why the shareholder agreed to it*". The meaning of the terms "sell", "assign" and "dispose of" would be "*coloured by the purpose*" for which the restriction was agreed to or imposed.

The primary aim of a moratorium on the trading of new shares in a context such as the present is "*to ensure that the market price of existing shares is not destabilised by the immediate or sudden influx of a large number of shares of that company in the market*". In the present case, the moratorium was intended to restrict dealing with the Consideration Shares in such a way that they could not be sold on SESDAQ during the moratorium. The court accepted that there were other objectives as well, eg., MSL wanted to ensure that the Sellers would be committed to act in the interests of the company for the period of the moratorium.

A restriction on the *sale* of the Consideration Shares was consistent with the above objectives. However, a restriction on their *use as security* was not; such a restriction would have merely prevented the Sellers from maximising the use of their resources.

Nothing in the Agreement was intended to prevent the Sellers from utilising their economic resources insofar as such use was not inconsistent with the objectives of the share transfer restrictions. As the Consideration Shares were listed and quoted on SESDAQ upon their allotment and issue, they were valuable property rights which the Sellers were entitled to deal with as they pleased, subject only to the share transfer restrictions during the moratorium.

Comment

By placing the emphasis it did on the *substance* of the transaction, the court has signalled that restrictions on the transferability of shares would be construed purposively. Parties should therefore be clear as to their objectives and the legal means by which these are to be accomplished. Their intentions should be set out plainly in the legal documentation.

This decision also illustrates that any restrictions on a person's right to deal with property will be strictly construed. If the parties' intentions are not clearly expressed, any ambiguity is likely to be construed against the party imposing the restriction.

If you would like more information about this case or wish to discuss how it may potentially affect you or your business, please feel free to contact the banking and corporate lawyers in Drew & Napier LLC (please refer to the Directors' Profiles on our **website**), or:

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