

# legalTAPS

AXCELASIA GROUP

KDN PP 13829/7/2005

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## Equity Conditions on Malaysian Manufacturing Companies

### Introduction

Equity conditions or restrictions are without a doubt, one of the greatest concerns for any foreign investor wishing to invest in Malaysia. It is therefore imperative that the various governmental bodies involved take a consistent stand on this issue to avoid any confusion which may discourage foreign investment.



In the context of the manufacturing sector, the clear position taken by the Foreign Investment Committee ('FIC') and the Ministry of International Trade and Industry ('MITI') on this issue has been muddled by the guidelines on foreign involvement in distributive trade issued by the Committee on Distributive Trade ('CDT'). The CDT comes under the purview of the Ministry of Domestic Trade and Consumer Affairs and the said guidelines came into effect on 1 December 2004. Hopefully, the reign of confusion resulting from the said guidelines will come to an end when the CDT announces its revised guidelines.

### Foreign Investment Committee

The governmental body which is primarily responsible for foreign investments in Malaysia is the FIC which comes under the Economic Planning Unit of the Prime Minister's Department. Under the "Guideline on the Acquisition of Interests, Mergers and Take-Overs by Local and Foreign Interests" ('FIC Guidelines') issued by the FIC, transactions involving \*foreign interest\* which are subjected to the FIC Guidelines include *inter alia*:

- (a) *any proposed acquisition of interest in a local company or business in Malaysia which is RM10 million or more in value by foreign interests;*
- (b) *any proposed acquisition of interest of a local company or business in Malaysia by any means which results in the transfer of ownership or control to foreign interests;*
- (c) *any proposed acquisition of interest by:*
  - (i) *any foreign interest of 15% or more of the voting right of any local company or business in Malaysia (or which would result in an increase of the foreign interest's voting rights to 15% or more) ; or*
  - (ii) *any associated or non-associated*

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*group of foreign interests, in aggregate of 30% or more of the voting rights of any local company or business in Malaysia (or which would in aggregate, result in an increase of the foreign interests' voting rights to 30% or more);*

*regardless of whether the value is less than RM10 million with the exception of open market acquisitions on Bursa Malaysia meant for short term holdings;*

- (d) *any proposed merger or take over of any local company by foreign interests; and*
- (e) *any proposed joint venture involving 2 or more parties in a local company.*

The above transactions require the prior approval of the FIC and under the FIC Guidelines, the local company which is the subject matter of the acquisition, merger, take over or joint venture will generally, be required to have at least 30% bumiputera equity. In the case of an acquisition, merger or take over involving local business, the 30% bumiputera equity will be imposed on the acquirer.



However, acquisitions of interest in manufacturing companies licensed by MITI are expressly exempted from the FIC Guidelines and do not require the FIC's approval. Instead, such acquisitions fall within the jurisdiction of MITI.

Where the manufacturing company is not licensed by MITI, the approval of the FIC is still required. However, no equity condition will be imposed by the FIC for non-licensed manufacturing companies incorporated after 31 July 1998. Those incorporated on or before 31 July 1998 will still be subjected to the equity conditions set out in the FIC Guidelines.



### Ministry of International Trade and Industry

Under the *Industrial Co-ordination Act 1975*, manufacturing companies with shareholders' funds of RM2.5 million and above or engaging 75 or more full time paid employees, are required to apply for a manufacturing license from MITI.

Previously, the level of export had been used by MITI to determine the level of foreign equity participation in manufacturing projects. Foreign investors were generally allowed to hold 100% equity in projects which export at least 80% of their production. This was relaxed on 31 July 1998 for all applications for investments in new, as well as expansion or diversification projects in the manufacturing sector. Under this relaxation, foreign investors could hold 100% of the equity irrespective of the level of exports. However, this relaxation only applied to applications that were received by 31 December 2003. Further, this relaxation did not apply to specific activities and products where Malaysian companies had the capabilities and expertise namely paper packaging, plastic packaging (bottles, films, sheets and bags), plastic injection moulded components, metal stamping and metal fabrication, wire harness, printing and steel service centres. In such cases, specific equity guidelines prevailed.

To further attract more foreign investments, equity holdings in all manufacturing projects were fully liberalised by MITI with effect from 17 June 2003. Foreign investors can now hold 100% of the equity in all investments in new projects, as well as investments in expansion or diversification projects by existing companies regardless of the level of exports and without any product or activity being excluded.



## Committee on Distributive Trade

With effect from 1 December 2004, all proposals for foreign involvement in distributive trade must obtain the approval of the CDT under the "Guidelines on Foreign Participation in the Distributive Trade Services" ('CDT Guidelines') issued by the CDT. Distributive traders include wholesalers, retailers, franchise practitioners, direct sellers, product manufacturers and suppliers who channel their goods in the domestic market.

Manufacturing companies distributing their products in the domestic market are required to incorporate a separate legal entity as the marketing arm and this entity will be subjected to the CDT Guidelines which require the marketing arm to have at least 30% bumiputera equity and a minimum paid up capital of RM1 million.

## Effect of the CDT Guidelines

The net effect of the CDT Guidelines is that notwithstanding that a foreign investor may have been allowed to own 100% of a manufacturing company by MITI or may have been exempted from the equity condition by the FIC (in respect of non-licensed manufacturing companies incorporated after 31 July 1998), such an investor will still be indirectly subjected to the 30% bumiputera equity condition as the manufacturing company is required to incorporate a separate legal entity as the marketing arm which is then subjected to the CDT Guidelines, if it wants to sell or distribute its products in Malaysia. The CDT Guidelines clearly contradicts the more liberal approach adopted by MITI and the FIC and represents a step backwards.

Although the CDT Guidelines do not have the force of law and there is no direct sanction for non-compliance, a failure to comply can make it difficult for a person to operate its business. For example, applications for work permits or business premise licenses may be rejected by the Immigration Department or local authorities if not accompanied by the approval from the CDT.

## Changes to the CDT Guidelines

The CDT is in the midst of revising its guidelines after numerous calls from and consultation with various parties including the Malaysian International Chamber of Commerce and Industry ('MICCI'). In a recent dialogue with MICCI, the CDT has agreed *inter alia*, that companies

licensed by MITI will be exempted from the revised guidelines. With this, manufacturing companies licensed by MITI will no longer be required to incorporate a separate company as their marketing arm and be subjected to the 30% bumiputera equity condition. In relation to manufacturing companies that are not licensed by MITI, the CDT has agreed that decisions

**... acquisitions of interest in manufacturing companies licensed by MITI are expressly exempted from the FIC Guidelines and do not require the FIC's approval.**

already made by the FIC in respect of equity conditions that are more liberal or favourable to the investors would remain applicable. However, for the time being, until the revised guidelines are announced, there remains an uncertainty over the fate of foreign investments in manufacturing companies not licensed by MITI which are still pending the FIC's approval.

**\*Note:** *Foreign interest is defined in the FIC Guidelines as any interest, associated group of interests or parties acting in concert which comprises:*

- (a) *individual who is not a Malaysian citizen including permanent resident; or*
- (b) *foreign company or institution (i.e. those incorporated outside Malaysia); or*
- (c) *local company or local institution whereby the parties stated in item (a) and/or (b) hold more than 50% of the voting rights in the company or institution.*

By **Ng Pek Wan** ([pekwan.ng@taypartners.com.my](mailto:pekwan.ng@taypartners.com.my))

*Pek Wan is a Senior Associate at the firm and practices mainly in the areas of mergers and acquisitions.*

*For further information and advice on corporate, commercial and M & A, you may contact:*

**Tay Beng Chai** ([bengchai.tay@taypartners.com.my](mailto:bengchai.tay@taypartners.com.my))

**Chang Hong Yun** ([hongyun.chang@taypartners.com.my](mailto:hongyun.chang@taypartners.com.my))

# The Battle against Peer - to - Peer File Sharing



The Copyright Act of 1987 (“the Act”) gives a copyright owner a bundle of exclusive rights - to control the reproduction in any material form, the communication to the public, the performance, showing or playing to the public, the distribution of copies to the public (though this is confined to first distribution of the work in Malaysia) and the commercial rental to the public of a work (sec. 13(1)). Therefore, the unauthorised doing of any of such acts would constitute infringement of copyright.

The explosion of the Internet enabled the easy transmission of copyright works through the internet, depriving many copyright owners of their exclusive right to control use of their works. Identical copies of works can be reproduced and distributed on a large scale with minimal financial and time costs. The internet has empowered the individual but inadvertently threatened the rights of copyright owners.

Much to the dismay of copyright owners, these threats were further heightened when a young man named Shawn Fanning developed and popularised peer-to-peer file sharing whereby millions of users could exchange files from other users' computers.

**Peer-to-peer file sharing reduces the need for a centralised file server. Each user communicates with each other directly and shares files with one another. The network is ... distributed amongst many users rather than run from a central server.**

## What is Peer-to-Peer File Sharing?

Peer-to-peer file sharing reduces the need for a centralised file server. Each user communicates with each other directly and shares files with one another. The network is therefore distributed amongst many users rather than run from a central server. This differs from the client-server models where communications are to and from a central server.

There are basically 3 types of peer-to-peer networks. Firstly, a *hybrid* peer-to-peer network is where there is a central server which keeps information on its users and responds to requests for that information. This is used by Napster which operated through a central server. If a user opted to share his music files with other Napster users, Napster would maintain a list of files available at the particular user which is updated each time the user logged on. When another user searched for a music file, Napster would search these lists and report back an active location of the file. The two users then communicate directly to transfer the file.

Secondly, a *pure* peer-to-peer network is one where there is no central server managing the network and there is no central router. This allows for direct file sharing without a gateway between the two systems and is used by Gnutella. The individual users are able to directly search other computers for files.

A third variation would be a *mixed* peer-to-peer network which has both pure and hybrid characteristics.

All sorts of files can be shared such as songs, books, photographs, software and movies and these may very well be protected by copyright in the form of literary, musical and artistic works, films, sound recordings and broadcasts (sec. 7). Therefore, the very nature of peer-to-peer file sharing involves serious copyright issues.

Firstly, a work when transmitted via a peer-to-peer network from one user to another would result in a reproduction of the work in a material form on a user's hard drive, CD or RAM (Random Access Memory). Secondly, there would also be an unauthorised communication to the public of the work as a work would be transmitted through wire or wireless means to the public, which by definition includes the making available of a work to the public in such a way that members of the public may access the work from a place and at a time individually chosen by them (sec. 3).

## Infringement of Copyright by Individual Users

For individual users of the peer-to-peer networks, the pertinent question would be whether the use of a work is unauthorised. File sharing of works which do not have copyright protection, or use of which is authorised by the

owner or which is allowed under one of the “fair dealing” defences pursuant to sec. 13(2) of the Act would not involve any infringement. It must be noted that sec. 13(2) however sets out very narrowly, situations which may be considered as “fair dealing”. Short of these, each user would infringe the copyright owner’s exclusive rights of reproduction and communication, as indicated earlier.

However, to go after millions of end users for copyright infringement would be a daunting task. The Court in the US case of **Aimster (2003 US App. LEXIS 132229)** aptly quoted Randel Picker, “*chasing individual consumers is time consuming and is a teaspoon solution to an ocean problem.*” On the other hand, to leave unremedied infringements on such a large scale would be unimaginable.

## Global Legal Actions Against Peer-to-Peer Users

In the US, the Recording Industry Association of America (RIAA) has issued at least 2,947 subpoenas to ISPs to force the release of details of suspected downloaders. Thousands of lawsuits have been filed against individuals, including a 12 year old girl and a 66 year old grandmother, who illegally downloaded Snoop Dog.

**In Malaysia, whilst no suits have been filed against individual users by the Recording Industry of Malaysia, it is clear that such users of peer-to-peer networks would fall foul of the Act and infringe potentially the reproduction and communication copyright of copyright owners.**

In Canada, Italy, Germany and Denmark, the International Federation of the Phonographic Industry (IFPI) has announced hundreds of lawsuits against individuals and demanded settlements of up to EU8,000.

In fact, it is reported (27 January 2006, the Star Online) that the recording industry was victorious when a Hong Kong court ordered four Internet Service Providers to reveal names of 22 people who uploaded copyrighted music onto web sites. “*Protection of privacy is never and cannot be used as a shield*” to enable copyright violators to break the law. This had led to many individuals being sued, one of them an elderly man, who had uploaded music onto the Internet, making it available for illegal file sharing. (20 March, 2006, The Star).

In Taiwan, a user that used Kuro, Taiwan’s most popular peer-to-peer network to download more than 900 songs was handed down a four-month prison term in September 2005.



Closer to home, 2 men were jailed in Singapore for illegally sharing hundreds of music files over the Internet (28 February, 2006, The Star). The Recording Industry Association of Singapore has filed 33 criminal complaints against individuals alleged to be involved in the illegal file-sharing of music.

In the UK, the Courts on 27 January, 2006, ruled in 2 landmark decisions against illegal file sharers that they were liable for illegally distributing music over the internet using peer-to-peer file sharing programs. These cases were the first of their kind to be heard in the British courts. Peter Jamieson of the British Phonographic Industry said,

“The courts have spoken and their verdict is unequivocal : unauthorised file sharing is against the law. We have long said that unauthorised file sharing is damaging the music industry and stealing the future of artists and the people who invest in them. Here is clear confirmation of what we also said – that unauthorised file sharing is illegal.”

In Malaysia, whilst no suits have been filed against individual users by the Recording Industry of Malaysia, it is clear that such users of peer-to-peer networks would fall foul of the Act and infringe potentially the reproduction and communication copyright of copyright owners.

Whilst the underlying technology of peer-to-peer file sharing networks may be legal, individual users who abuse the technology by sharing copyright works are clearly not. As of 15 November, 2005, the record industry’s global campaign against file sharing is almost 20,000 cases worldwide against individuals for illegally distributing music on the internet (British Phonographic Industry website article entitled “BPI doubles the pressure on illegal files sharers”).

## Infringement of Copyright by the Technology Manufacturers

The other half of the battle against peer-to-peer file sharing of unauthorised works is as against the technology manufacturers, or those who had developed and distributed the peer-to-peer file sharing tools. As the architecture of the peer-to-peer network is such that it does not involve the technology manufacturers directly (the transmission of files are being handled directly between users), therefore, actions taken against technology manufacturers are *indirect* as opposed to actions against the individual users which are direct.

### The US

Spearheading the battle against the technology manufacturers of peer-to-peer networks in the US are the RIAA and the Motion Picture Association of America (MPAA). This has taken place in 3 forms that is contributory infringement, vicarious liability and lately, inducement. Though the American Copyright Act does not expressly impose contributory or vicarious liability for infringement, many cases have utilised contributory or vicarious liabilities for indirect copyright infringement.

**For contributory infringement ... a copyright owner must prove ... direct infringement, there was knowledge on the part of the technology manufacturer of the underlying direct infringement, and the technology manufacturer must have caused or materially contributed to the underlying direct infringement.**

**As for vicarious liability, a copyright owner must prove ... direct infringement, the technology manufacturer has the right and ability to control and supervise the underlying direct infringement and there was direct financial benefit from the underlying direct infringement.**

For contributory infringement to prevail, a copyright owner must prove that there has been direct infringement, there was knowledge on the part of the technology manufacturer of the underlying direct infringement, and the technology

manufacturer must have caused or materially contributed to the underlying direct infringement.

As for vicarious liability, a copyright owner must prove that there has been direct infringement, the technology manufacturer has the right and ability to control and supervise the underlying direct infringement and there was direct financial benefit from the underlying direct infringement.



The recently decided Supreme Court case of **Grokster (Metro-Goldwyn-Mayer Studios v Grokster Ltd. 380 F.3d 1154 (9th Cir.2004)**, cert. granted, 125 S. Ct. 686 (2004) introduced a new form of indirect or secondary liability, inducement:

“One who distributes a device with the object of promoting its use to infringe copyright, as shown by clear expression or other affirmative steps taken to foster infringement, is liable for the resulting acts of infringement by third parties.”

To prove inducement, a copyright owner must show that there has been direct infringement, the technology manufacturer has taken active steps in encouraging infringing uses and the technology manufacturer intended to promote copyright infringement.

For more than 20 years, technology manufacturers relied upon the **Betamax case (Sony Corp v Universal City Studios 464 US 417 (1984))** where the Supreme Court found the manufacturers of video recorders were not liable for contributory infringement committed by users of the equipment:

“the sale of copying equipment, like the sale of other articles of commerce, does not constitute contributory infringement if the product is widely used for legitimate, unobjectionable purposes. Indeed, *it need merely be capable of substantial non infringing uses.*”

However, at the turn of the century, 3 cases have arisen, pinning indirect liability on technology manufacturers by way of contributory infringement, vicarious liability and inducement with a rather haphazard interpretation of the Betamax defence. Whilst the state of the law in the US pertaining to technology manufacturers of peer-to-peer file sharing software is less than certain, the following discussion

of the 3 cases outlines briefly how the respective courts found liability without delving into the intricacies of the judgments.

## Napster

In 2001, **Napster (A & M Records, Inc. v Napster, Inc., 239 F.3d 1004 (9th Cir. 2001))** developed a *hybrid* peer-to-peer file sharing software which used a centralised server to facilitate file exchanges. The Ninth Circuit Court of Appeal upheld the lower court's preliminary injunction based on contributory infringement and vicarious liability.

On the contributory infringement claim, the Court held that Napster had *actual knowledge* of the infringing activity based on a document authored by Napster's co-founder admitting that the users were exchanging "pirated music" and that a list of 12,000 infringing files were provided by the RIAA to Napster. There was material contribution on the part of Napster as "site and facilities" were provided to its users without which users could not download music.

**As for vicarious liability, similarly, the elements were satisfied as Napster had the ability to control the infringing activity of its users by virtue of its right to supervise the infringing conduct by blocking a user's ability to access its system. Napster obtained financial benefit from its users' activities as this acted as a large user base which would draw advertisers.**

The Court also limited the Betamax defence to contributory infringement cases. In any event, the Betamax defence was rejected here because although Napster was capable of substantial non infringing uses, Napster had *actual knowledge* of specific infringing material and failed to block access or remove the material.

As for vicarious liability, similarly, the elements were satisfied as Napster had the ability to control the infringing activity of its users by virtue of its right to supervise the infringing conduct by blocking a user's ability to access its system. Napster obtained financial benefit from its users' activities as this acted as a large user base which would draw advertisers.



## Aimster

Unlike Napster, Aimster's server provided a matching service but no files or names were uploaded onto Aimster's servers. The users could communicate directly with each other and share files by attaching them to their communications. The copyright owners once again claimed contributory infringement and vicarious liability against Aimster. Following in the footsteps of Napster, the Seventh Circuit in Aimster (**In re Aimster Copyright Litigation, 334 F.3d 643 (7th Cir., 2003)**) in 2003 upheld the preliminary injunction based on contributory infringement (the Court did not address vicarious liability) because Aimster had engaged in activities that demonstrated clear knowledge of infringing activities and had materially contributed to the infringement. The court had held that "tutorials" that encouraged Aimster users to download popular copyrighted music showed knowledge on Aimster's part. The Court rejected Aimster's argument that the network traffic was encrypted and this arguably made it impossible for Aimster to know exactly what files were being shared by users. The Court held that "*willful blindness is knowledge in copyright law...as it is in the law generally*".

On the Betamax defence, Aimster failed to introduce any evidence of non infringing uses. It is not enough that a product or service is physically capable of non infringing use, but rather, there must be evidence that the service is actually used for non infringing purposes. Importantly, the Court went on to suggest, *obiter* that the application of the Betamax defence requires a consideration of the *proportion of the infringing to non infringing uses*. This is in direct conflict with the language contained in the Betamax defence where the Supreme Court held "*...it need merely be capable of substantial non infringing uses*". Even if Aimster could show substantial non infringing uses, it would have to "*show that it would have been disproportionately costly for it to eliminate or at least reduce substantially the infringing uses.*"



## Grokster

In Grokster, the software concerned, FastTrack, was decentralised in nature in that the technology manufacturers had no ability to monitor or control what the software was used for, nor did the technology manufacturers maintain a central server. FastTrack was a variant of a pure peer-to-peer network which added a new subset of nodes called supernodes and facilitated searches like central servers but is numerous and distributed amongst clients. Prima facie, it would seem to indicate lesser knowledge, contribution and control on the part of the technology manufacturer.

However, the copyright owners in this case claimed contributory infringement and vicarious liability against Grokster and the Supreme Court in June 2005 found that there was enough evidence on inducement to justify a trial. The Supreme Court found that there were evidence demonstrating inducing messages sent to users. Former Napster users were targeted to use Grokster's programs and advertisements. Grokster targeted former Napster users and used metatags to attract users searching for Napster to its site. There was no attempt by the Defendant to filter files or reduce infringements. The Court found that "the unlawful objective is unmistakable".



## Analysis in the Malaysian Context

In Malaysia, there has yet to be any judicial decision on whether technology manufacturers such as Napster, Aimster and Grokster may be found liable for copyright infringement based on contributory infringement, vicarious liability and inducement.

A cause of action against technology manufacturers of peer-to-peer file sharing networks may potentially be pursued in Malaysia firstly via the 2nd limb of sec. 36(1) of the Act in that the technology manufacturer "caused" the infringement (The 1st limb of sec. 36(1) envisages a situation where there is direct infringement and in peer-to-peer file sharing networks, the users who exchange files are the direct infringers and not the technology manufacturers.)

A second plausible cause of action is an indirect infringement claim based on general tortious principles. In certain circumstances, a person may be liable for infringement by reason of *joint tortfeasorship* or by reason of *vicarious liability*. Both these forms of infringement would be premised on there being copyright infringement as provided for in sec. 36(1) in the first place, whether based on the 1st or the 2nd limb. Therefore, there can be an indirect infringement claim based on the 1st limb, ie that the technology manufacturer is jointly or vicariously liable with the user who had infringed copyright. In peer-to-peer file sharing cases, the individual users would have infringed copyright when they share files without authorisation as mentioned above. Therefore, there would have been a commission of infringement by the user in place for the claim of indirect infringement against the technology manufacturer to attach to. Alternatively, there can be an indirect infringement claim based on the 2nd limb, i.e. that the technology manufacturer is jointly or vicariously liable with others who had caused infringement.

**In Malaysia, there has yet to be any judicial decision on whether technology manufacturers such as Napster, Aimster and Grokster may be found liable for copyright infringement based on contributory infringement, vicarious liability and inducement.**

More will be discussed in the next issue of LegalTAPS.

By *Choy Sook Yee* ([sookyee.choy@taypartners.com.my](mailto:sookyee.choy@taypartners.com.my))

*Sook Yee practises in the Intellectual Property and Technology Practice Group and advises on a broad range of IP issue. For further information and advice on IP and Technology, you may contact:*

*Linda Wang* ([linda.wang@taypartners.com.my](mailto:linda.wang@taypartners.com.my))

*Su Siew Ling* ([siewling.su@taypartners.com.my](mailto:siewling.su@taypartners.com.my))

# Caveat Emptor

## Employment Issues in Mergers & Acquisitions

Mergers and acquisitions, which involve the sale and purchase of a business undertaking, are both exciting and tedious affairs. This is especially so for the intended purchaser who will be expending substantial monetary investment to acquire the said business undertaking. The excitement and anticipation of expanding one's business operations through mergers and acquisitions must always be balanced with due care to ensure that the intended purchaser obtains what he will be paying for. As such, most intended purchasers will conduct an extensive and comprehensive due diligence to assess and evaluate the assets and liabilities of the subject matter, either existing, prospective or contingent, before any deal is finalised.

**The excitement and anticipation of expanding one's business operations through mergers and acquisitions must always be balanced with due care to ensure that the intended purchaser obtains what he will be paying for.**

It goes without saying that more often than not, the sale and purchase of a business undertaking will inevitably involve the transfer of employees from the intended vendor to the intended purchaser. However, it is noteworthy that the trend seems to suggest that most pre-merger and acquisition due diligence does not extend beyond the arithmetical calculation of employees head count and their wages.

### Standard Clauses

It is now common for an agreement for the sale and purchase of a business undertaking to contain the following standard clauses:-

1. The intended purchaser shall offer to engage all the employees of the business undertaking on a continuous contract of employment on terms and conditions of employment that are no less favourable than their existing terms and conditions of employment; and
2. The intended purchaser shall indemnify the intended vendor for all liabilities, damages and claims which the intended vendor may suffer should the intended purchaser fail to comply with the abovesaid condition.

The abovementioned standard clauses are not surprising in view of the volcanic liabilities that the intended vendor may suffer if the employees of the business undertaking are not engaged by the intended purchaser on terms and conditions not less favourable but have their contracts of employment terminated instead due to the sale and purchase of the business undertaking. In such a scenario, the intended vendor may be faced with a claim for termination benefits (see *Employment (Termination and Lay-Off Benefits) Regulations 1980*) for employees within the scope of the *Employment Act 1955* and reinstatement (see section 20 of *Industrial Relations Act 1967* i.e. an action for dismissal without just cause or excuse) or compensation in lieu of reinstatement and backwages for employees outside the scope of the *Employment Act 1955*.



## Contingent Liabilities

It is only natural for the intended purchaser to restructure its organisation after the completion of a merger and acquisition in order to ensure that the resources of the new entity can be utilised efficiently to maximise productivity. Although it is well settled that an employer is entitled to organise its business in the manner it considers best (see **William Jacks & Co. (M) Sdn. Bhd. v S. Balasingam [1997] 3 CLJ 235**), the transfer of employees from the intended vendor to the intended purchaser must be managed carefully to prevent it from potentially turning into a costly affair.

Therefore, before the intended purchaser commits to engage all the employees of the business undertaking he is purchasing and before it provides an indemnity as discussed above, it may do well to consider among other things the following:-

1. The number of the said employees in relation to the needs of the human resource structure of the new business entity;
2. The suitability of the said employees within the new business entity; and
3. The ability of the intended purchaser to engage the said employees within the new business entity on terms and conditions not less favourable.

It may well be too late to wait until the completion of the merger and acquisition to discover that there is a surplus of labour or that the employees since engaged by the intended purchaser are not suitable for the efficient operation of the new business entity.

## Conclusion

The discussion above on employment issues in mergers and acquisitions is by no means exclusive but hopefully, it will serve to give a preliminary insight into an area which has in the past been overlooked. With proper management planning and legal advice, litigation and contingent liabilities in relation to the engagement of employees pursuant to a merger and acquisition can be substantially reduced.

*Caveat Emptor!*

By **Alan Wong Teck Wei** ([alan.wong@taypartners.com.my](mailto:alan.wong@taypartners.com.my))

Alan practises in the area of civil, corporate and commercial litigation. He is involved in various litigation concerning labour and employment matters, shareholder disputes and defamation.

For further information on civil, corporate and commercial litigation, you may contact:

**Leonard Yeoh** ([leonard.yeoh@taypartners.com.my](mailto:leonard.yeoh@taypartners.com.my))

**Asmet Nasruddin** ([asmet@taypartners.com.my](mailto:asmet@taypartners.com.my))

# Is Joint Custody An Option?

When a marriage has irretrievably broken down and there are children from the marriage, the most important issue that arises is who shall have custody of the children.

What is the definition of “child”? Under section 87 of the *Law Reform (Marriage & Divorce) Act 1976* (Act 164) (hereinafter referred to as “the Act”), the word “child” is defined as “*child of the marriage*”. Further, pursuant to section 2 of the Act, “*child of the marriage*” means a *child of both parties to the marriage in question or a child of one party to the marriage accepted as one of the family by the other party* and who is under the age of 18 years.

The power for the Court to make an order for custody is provided clearly in section 88(1) of the Act i.e. that “*the Court may at any time by order place a child in the custody of his or her father or his or her mother or where there are exceptional circumstances making it undesirable that the child be entrusted to either parent, of any other relative of the child or of any association the objects of which include child welfare or to any other suitable person*”.

If the child is below the age of 7 years, section 88(3) of the Act provides that “*there shall be a rebuttable presumption that it is for the good of the child to be with his or her mother*”. As stated by Sir John Romilly MR in the case of **Austin v Austin [1865] 35 Beav 259** at 263, “*.....No person, and no combination of them, can, in my opinion, with regard to a child of tender years, supply the place of a mother, and the welfare of the child is so intimately connected with his/her being under the care of the mother, that no extent of kindness on the part of any other person can supply that place.....*”.

The view by Sir John Romilly MR has found judicial favour in respect of the child of tender years and in the case of **Re Orr [1973] 2 DLR 77** Muloch CJ has even commented that “*In the case of a father and a mother living apart and each claiming the custody of a child, the general rule is that a mother, other things being placed, the Court is fully aware that the paramount consideration is their welfare and after having regard, among others to:*





- *the conduct and attitude of the parties;*
- *the age of the children;*
- *the views of the children;*
- *the security and the stability of the contending parties;*
- *the advantages and disadvantages of maintaining a status quo;*
- *the desirability of not separating the siblings;*
- *the confidential report of the Social Welfare Officer; and*
- *even though a minimum consideration is attached to this factor, the current religious status of both parties especially the effect of any controversy in the differing views pertaining to the children's future religious upbringing."*

The Court will also take into consideration the fact that even though both parents are equally fond of the children and sincerely want the care and custody of the children but because of the bitterness and acrimony which exists between the parents, the question of joint custody could not be considered or is inappropriate to be considered to be in the interest of the children (refer to **Kok Yoong Heong v Choong Thean Sang [1975] 1 LNS 75**, and **Sivajothi K Suppiah v Kunathasan Chelliah [2000] 3 CLJ 175**).

However, in the case of **Karen Cheong Yuen Yee v Phua Cheng Chuen [2004] 7 CLJ 102**, the learned Faiza Tamby Chik J held that joint custody to both parents are suitable based on the following factors:-

- both parents live close by to each other;
- there was no proven violence, harassment and cruelty by the husband on the wife;
- this was not the case where the wife was chased out of the matrimonial home by the husband; and
- the parties did not sign any document whereby both agreed to be divorced immediately and to go their separate ways.

It needs to be pointed out that in some instances joint custody is preferred especially where the divorcing parties wish to preserve the status of family togetherness and ambience for the sake of their children, who are too young to understand their predicament and thus may be affected emotionally by the divorce.

Basically, the decision of the Court will differ depending on the facts of each case under consideration. As stated by the learned Arulanandom J in the case of **Kok Yoong Heong v Choong Thean Sang [1975] 1 LNS 75**, "*there are no hard and fast rules that can be laid down based on the sex of the parent or the child as to who should have his/her care and control and/or custody*".

In considering the question of custody of the children, even in the case of joint custody, the paramount consideration is the welfare of the children. No parent has prior right – per learned Arulanandom J in **Teh Eng Kim v Yew Peng Siong [1977] 1 LNS 138**.



By *Wan Azura Binti Dato' Seri Wan Fadzir (azura.fadzir@taypartners.com.my)*

*Azura practises in the Johor Bahru office and is fully involved in its litigation practice group.*

*For further information and advice on the article above or on any areas of civil litigation, you may contact:*

*Lau Lee Jan (leejan.lau@taypartners.com.my)*

*Neoh Lay Choo (laychoo.neoh@taypartners.com.my)*

# Malaysia Coming Full Circle with its International Obligations on IP laws



The long awaited news may finally arrive. The Malaysian Intellectual Property Office (MyIPO) has indicated that Malaysia, in its continued effort to comply with its commitments under the TRIPs Agreement, will be depositing its instrument of accession to the Nice Agreement, Vienna Agreement, Patent Co-operation Treaty and Budapest Treaty in May this year.

In this article, we will discuss briefly how these Agreements and Treaties will be and have been brought about.

## Nice Agreement

The Nice Agreement was first concluded at the Nice Diplomatic Conference on 15 June 1957 to establish an international classification of goods and services for the purposes of registration of trade marks – the Nice Classification.

Under the Nice Classification system, goods and services identified in trade mark applications must be organised into numbered classes which group similar or related goods and services. There are a total of 34 classes for goods and 11 classes for services under the Nice Classification system. The latest and current (8th) edition of the Nice Classification has been in force since 1 January 2002.

Although Malaysia is not a member of the Nice Agreement, it has long adopted and applied the Nice Classification under its trade marks laws. In fact, Malaysia was one of the very first few countries which introduced all 11 service mark classes into its laws when service marks were first recognised in Malaysia on 1 December 1997. Prior to the introduction and enforcement of the 8<sup>th</sup> Edition of the Nice Classification, only 8 classes were allocated for services. Malaysia, apart from adopting these existing 1 to 41 classes of the 7<sup>th</sup> Edition of the Nice Classification, has also through the *Trade Marks (Amendment) Act 1994*, introduced and adopted a new class 42 and additional classes 43, 44 and 45. The new classes 42 to 45 were introduced to cope with expanded categories of services instead of using class 42 which would have caught all miscellaneous services that could not be classified in the other service marks classes.

As Malaysia has long adopted and applied the Nice Classification, its accession to the Nice Agreement will purely be a matter of formality and will not result in the need to amend existing laws.

## Vienna Agreement

The Vienna Classification was established under the Vienna

Agreement Establishing an International Classification of the Figurative Elements of Marks signed at the Vienna Diplomatic Conference in 1973.

The Vienna Classification serves to classify the figurative elements of marks. It constitutes a hierarchical system that proceeds from the general to the particular, dividing all figurative elements into categories, divisions and sections. The Classification comprises a total of 29 categories, 144 divisions and 1,887 sections in which the figurative elements of marks are classified.

Malaysia is not a contracting party of the Vienna Agreement and neither does it have an existing classification system that classifies the figurative elements of marks or device marks. Thus, conducting availability searches for device marks at the Malaysian Trade Marks Registry is particularly cumbersome as there is no proper system for classifying and describing the appearance of device marks in Malaysia. Unlike word marks which can be easily searched by way of keying in the relevant keywords into the Registry's electronic database, searches for device marks at the Registry will still have to be conducted manually by going through the scores of printed trade mark records kept at the Registry. Such problems will hopefully be issues of the past once Malaysia accedes to the Vienna Agreement and the full computerization of the search database is implemented.

The introduction of a classification system for device marks in Malaysia will not only help trade mark owners and agents describe the appearance of device marks, it also facilitates and expedites availability searches of trade marks containing figurative elements at the Registry. Further, the classification system obviates the need for substantial re-classification work when documents are exchanged at the international level.

## Patent Cooperation Treaty

The Patent Cooperation Treaty ('PCT') was signed in Washington on 19 June 1970 at the very end of the Washington Diplomatic Conference on the Patent Cooperation Treaty. PCT came into effect on 21 January 1978 with only 18 contracting states. The PCT was subsequently amended in 1979, and modified in 1984 and 2001. As of October 2005, there are 129 contracting states to the PCT.

The PCT provides for an efficient and cost effective way of filing patent applications internationally in many different signatory countries.

Under the PCT, patent owners need only file one international application and that application will automatically designate with it all contracting states to the PCT. This means any application to the PCT covers all contracting states unless the applicant specifically designates the desired countries only. This allows patent applicants the chance to expedite the filing of patents internationally whilst minimising the time and costs that would need to be incurred.

Filing a PCT application may also delay entry into the national stage of the patent application process for quite a considerable period. Patent applicants are given generally up to 30 months from the date of filing to enter the national phase of filing and paying the national fees in the individual designated countries. Under the domestic filing system, the applicant has only 1 year from the date of filing to claim priority for filing in other countries.

This is often a financial strain on the applicant as the period is too short for any realistic return on investment of the invention and the applicant will have to be equipped with the financial resources for international filing at the very early stage of commercial exploitation of the invention.

The additional period is also crucial as applicants will have more time to explore commercial opportunities without the immediate need to commit to any particular country. In the event the patent applicant no longer wishes to continue with its application in any of the countries covered under its application, he may opt to withdraw the same without the need to incur further costs.

Malaysia, in its effort to prepare itself to accede to PCT, has taken steps to amend its laws to cater for PCT applications in Malaysia. The *Patents (Amendment) Act 2003* (Act A196) (which has yet to come into force) by the government is clear indication of Malaysia's seriousness in acceding to the PCT. However, enforcement of the Act has been greatly delayed and this is also due in part to the amendments made to the PCT Regulations.

The ratification of the PCT by Malaysia will no doubt benefit local and foreign patent owners tremendously. Local inventors in particular will be more encouraged to invest in protecting their patents due to lower filing cost and at the same time take full advantage of the longer filing period allowed under the PCT to develop their patent strategy. Enforcement of the PCT in Malaysia is therefore a much awaited development in the IP arena.

## Budapest Treaty

The Budapest Treaty on the International Recognition of the Deposit of Microorganisms for the Purposes of Patent Procedure (Budapest Treaty) was signed in Budapest, Hungary on 28 April 1977. It came into force on 9 August 1980 and was later amended on 26 September 1980. As of October 2005, 61 countries were party to the Budapest Treaty.

The Budapest Treaty is a treaty concerning the deposit of microorganisms that are the subject of a patent application.

For a patent to be granted, it is a prerequisite requirement for the invention to be sufficiently disclosed. Usually, in order to meet the requirement of sufficiency of disclosure, patent applications and patents must disclose in their description the subject-matter of the invention in a manner sufficiently clear and complete to be carried out by the person skilled in the art. Where an invention involves a microorganism or the use of a microorganism, it can be very difficult or often impossible to describe the invention properly in writing. In these situations it is necessary instead to deposit samples of the microorganism concerned with a recognised institution.

Depositing samples of a microorganism in each country in which protection is sought is difficult and expensive. The Budapest Treaty therefore provides that the deposit of a microorganism with any one "International Depository Authority" acts as deposit for the purposes of patent procedure in each of the contracting States and before any regional Patent Office (if such a regional office recognises the Treaty). **The Budapest Treaty makes the patent system of contracting states more attractive because it is primarily advantageous to the depositor if he wishes to file applications for patents involving microorganism in several contracting states.** Considerable time and money can be saved if the microorganism is deposited under the procedures provided under the Budapest Treaty. **The requirement of depositing the microorganisms in each and every contracting state which the patent application referring to that microorganism is filed is no longer necessary.** Only one deposit is required with a recognised International Depository Authority. The treaty increases the security of the depositor because it establishes a uniform system of deposit, recognition and furnishing of samples of microorganisms.

As Malaysia is moving towards establishing itself as a regional biotechnology hub, the decision and timing to accede to the Budapest Treaty could not be more opportune and it is hoped that this will put Malaysia on a faster track to achieving its goals.

By *Tepee Phuah Hooi Ling*

([tepee.phuah@taypartners.com.my](mailto:tepee.phuah@taypartners.com.my))

*Tepee practises exclusively in the field of intellectual property, specialising in the area of trade marks and industrial designs.*

*For further information and advice on IP and Technology, you may contact:*

*Linda Wang ([linda.wang@taypartners.com.my](mailto:linda.wang@taypartners.com.my))*

*Su Siew Ling ([siewling.su@taypartners.com.my](mailto:siewling.su@taypartners.com.my))*

# Credit Card Transactions: Is It Moneylending?



## Credit Cards and Charge Cards

Credit payment is rapidly evolving into a preferred choice or method of payment in recent times, hence the term “Credit Cards”. [The term “credit card” is used generically to include charge cards. The difference is that in cases of credit cards, payment may be deferred and a late payment interest is charged; whereas in cases of charge card transactions, there is no allowance for deferring payment and therefore no interest is charged although a late payment charge may be levied.]

A credit card transaction may be two-party (a two-party situation commonly involves a departmental store or a petrol station which issues cards to their regular customers to pay for their purchases) or three-party. In a two-party transaction, the issuer of the card is also the supplier of the goods or services which are bought on credit and the cardholder purchases the goods or services from the issuer. On the other hand, in a three-party transaction, the issuer of the card is not the same person as the supplier but a separate entity. The issuer enters into an arrangement with the supplier who undertakes to supply goods or services to the cardholder upon presentation of the card. The payment will be made by the issuer of the card on the supplier rendering an account in a form of a sales slip which is signed by the customer/cardholder. Similarly, a separate agreement is entered into between the issuer and the cardholder establishing the cardholder’s credit limit and terms of payment.

## Legal Analysis – Is It Moneylending or Assignment?

An important question in commercial law that remains unresolved is whether the analysis underlying a credit or charge card transaction is one of moneylending or assignment.

By applying the ‘moneylending’ analysis for credit card agreements, whether two-party or three-party, made between the issuer and the cardholder under which an extended credit is provided to the cardholder, this will almost invariably be regulated by agreements. The issuer lends or provides credit to the cardholder, albeit payment is made to the supplier, instead of the cardholder, in settlement of the cardholder’s ‘debt’ owed to the supplier for the goods or services supplied to the cardholder

By applying the ‘assignment’ analysis, in some three-party

credit card transactions the documentation may be so formulated as to involve an assignment or an agreement to assign, by the supplier to the issuer, of the cardholder’s account with the supplier, which was created by the purchase. This means that the rights of the issuer are derived from the sale contract between the cardholder and the supplier. The supplier assigns the debt owed to him by the cardholder to the issuer who subsequently collects payment directly from the cardholder. [The uncertainty remains despite numerous academic writings such as that written by KF Tan in ‘Credit Cards and Moneylending [1976] 2 MLJ’.]

A correct analysis is important for a few reasons. First, to determine whether it may be defined as a moneylending transaction which may render it void under the *Moneylenders Act 1951*. Secondly, to determine the legal nature of the relationships between the parties (i.e. between cardholder and issuer, supplier and issuer and cardholder and supplier). Thirdly, to ascertain whether the cardholder can raise any equity he has against the supplier, for example a set-off in price for any defective goods supplied, against the issuer. Fourthly, whether the cardholder is under any legal obligation to pay the supplier in the event the issuer defaults in paying the supplier.

The legal implications of credit card transactions have not come before the courts and English decisions are also rare. However, in **Victor Kee Yong Poey v Diners Club Malaysia Sdn Bhd [1976] 2 MLJ 30**, the cardholder, who was the appellant, incurred an indebtedness to the issuer, who is the respondent, a sum of \$18,055.33 out of which \$559.76 was claimed by the respondent as service charge for late payment whereas the appellant claimed that the sum was in fact interest charged on the debt. Chang Min Tat J held that “*the onus was on the appellant cardholder to show the payment of interest in order to raise the defence of moneylending...*”. The Court held that the appellant cardholder failed to show that the \$559.76 was interest charged and therefore failed to obtain the protection under the *Moneylenders Act 1951*.

Was the Court correct to say that the transaction was not moneylending within the *Moneylenders Act 1951*? It was submitted that the assumption of the Court in stating that the dealing between the respondent issuer and the appellant cardholder was a loan transaction was probably right but its judgment that it was not moneylending under the Act because

the appellant cardholder failed to prove that the \$559.76 was interest charged was wrong.

## What does the Moneylending Act 1951 provide?

Section 5(1) states that – “No person shall conduct business as a moneylender unless he is licensed under the Act”. Section 2 goes on to define “moneylender” as – “any person who lends a sum of money to a borrower in consideration of a larger sum being repaid to him”. Section 15 states that “No moneylending agreement in respect of money lent after the coming into force of this Act by an unlicensed moneylender shall be enforceable”.

Does this therefore mean that a person is a moneylender if he lends a sum of money in consideration of being paid more than what he has lent although he is not in the business of lending money and the act of lending was a one-off transaction?

In **Lek Peng Ling v Lee Investments (Pte) Ltd & Ors [1992] 2 SLR 150**, a Singapore case, the plaintiff housewife stated in her affidavit that she had not, apart from the two sums in question, lent any money to anyone else at interest or otherwise. The defendants on the other hand had not shown anything to the contrary. Warren LH Khoo J held that this was not a moneylending transaction. Accordingly, a lender who grants casual or isolated loans is therefore not treated as a moneylender and is only correct in so far as it relates to the assumption that the lender is not in the ‘business’ of moneylending but it is incorrect in so far as it relates to the fact the no ‘interest’ was charged on the loan.

Conversely, there is also another school of thought which is of the opinion that a loan made even without interest is still caught within the *Moneylenders Act 1951* if the lender is a moneylender within the meaning of the Act. The fact that a person is carrying on a business of moneylending or otherwise was not considered. A moneylending transaction is an advance of money by one person to another person upon the promise that it is to be repaid with or without interest. In **Karupiah Pillai v Kaka Singh [1973] 1 MLJ 96** loans made to a friend without interest by a licensed moneylender was held within the *Moneylenders Act 1951*.

## Credit Card Transactions = Moneylending?

Consequently, the issue under consideration is whether a credit or charge card is caught by the onerous regime of the *Moneylenders Act 1951*. If the relationship between the issuer and the cardholder in a credit card arrangement is moneylending under the *Moneylenders Act 1951*, then the next question is whether the issuer is a moneylender within the meaning of the Act. A company which issues credit cards is deemed to be carrying on the business of moneylending by being engaged in this business through the credit card

transactions. Therefore, all issuers of credit cards are moneylenders within the *Moneylenders Act 1951* unless exempted.

Back to the case of **Victor Kee Yong Poey [1976] 2 MLJ 30** the respondent issuer is a moneylender within the *Moneylenders Act 1951* because they were engaged in moneylending business by issuance of credit or charge cards. The sum of \$559.76 claimed by the respondent issuer over the debt is by definition an “interest” in the Act (see section 2). However, since the respondent issuer is an unlicensed moneylender and the loans were not made in writing (see section 16(1)) between the parties under the Act, it was held that the entire loan and the interest were irrecoverable (see section 15).

## What is the Conclusion?

From various analysis (i.e. academic writings, articles, journals and cases), issuers of credit cards who are not exempted (unless the issuer is a licensed bank under the *Banking Act 1973*) by the Act are carrying on illegal moneylending business, if they are not licensed under the Act. However, all said and done, the legal position at best is inconclusive. Credit or charge card operations by banks are not at risk as they fall within section 2A(1)(c) of the Act. [This section exempts any bank or merchant bank licensed under the *Banking and Financial Institution Act 1989* or *Islamic Banking Act 1983*.] Non bank-based credit or charge card companies are also exempted if they are issuers approved under the *Payment Systems Act 2003*.

Another point to consider would be to take heed of the recommendations of the UK Crowther Committee’s Report on Consumer Credit recommending basic changes to the law on consumer credit. The time is probably ripe to review and enact a comprehensive piece of legislation along the lines of the UK Consumer Credit Act. Until that happens, it will remain an open discussion.



By **Toh Mi Mi** ([mimi.toh@taypartners.com.my](mailto:mimi.toh@taypartners.com.my))

Mi Mi practises in the area of corporate and commercial advisory and related work mainly in unit trust industry and due diligence exercises.

For further information on corporate and commercial advisory work, you may contact:

**Tay Beng Chai** ([bengchai.tay@taypartners.com.my](mailto:bengchai.tay@taypartners.com.my))

**Chang Hong Yun** ([hongyun.chang@taypartners.com.my](mailto:hongyun.chang@taypartners.com.my))



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## Editorial Committee

**Neoh Lay Choo**  
**Melanie Ann Selvalingam**  
**Shaikh Mohamed Noordin**  
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**Leonard Yeoh**

This publication provides a summary only of the subject matter covered and is not intended to be nor should it be relied upon as a substitute for legal or other professional advice.

## Tay & Partners

### Kuala Lumpur Office

6th Floor Plaza See Hoy Chan  
 Jalan Raja Chulan  
 50200 Kuala Lumpur, Malaysia  
 Tel: 603 2050 1888  
 Fax: 603 2072 6354  
 Email: mail@taypartners.com.my

### Johor Bahru Office

Suite 15.02, 15th Floor,  
 Menara MAA,  
 15, Jalan Dato' Abdullah Tahir,  
 80300 Johor Bahru, Malaysia  
*(new address as of 1 June 2006)*  
 Tel: 607 331 6316  
 Fax: 607 332 2898  
 Email: mail\_jb@taypartners.com.my

## T & P News

**TAY BENG CHAI**, our Managing Partner and Head of the Corporate and Commercial Practice Group was the chairperson for a seminar on the topic "Understanding Financial Statements", an exclusive seminar for the Malaysian Bar, organised by the Corporate & Commercial Committee of the Bar Council and RSM Strategic Business Advisors held at the Bar Council Auditorium on 24 February 2006. Beng Chai also participated in a luncheon talk on Implications of Competition Law in Malaysia ... Are We Ready?, organised by the American Chamber of Commerce (AMCHAM) which was held at The Regent, Kuala Lumpur on 6 April 2006. He was also a Chairperson for the seminar on the topic "Inhouse Legal Counsel", organised by m2asia, held at the Ritz-Carlton, Kuala Lumpur from 24 to 25 April 2006.

**LINDA WANG**, our partner in the IP and Technology Practice Group attended the Pharmaceutical Trade Marks Group's (PTMG) 72<sup>nd</sup> Conference in London from 19 to 21 March 2006. There were over 200 participants at the Conference.

**LEONARD YEOH** our partner in the IP and Technology Practice Group was recently nominated and voted to appear in the *Guide to the World's Leading Labour and Employment Lawyers* by *Euromoney*. Leonard presented a paper entitled "Managing Labour and Employment Issues in M&As" at the conference organised by The Asia Business Forum on Legal and Tax Aspects of JVs and M&As held on 13 and 14 February 2006 at Hotel Nikko Kuala Lumpur. Leonard also recently attended and was a Chairperson for the seminar on "Inhouse Legal Counsel" organised by m2asia, held at the Ritz-Carlton, Kuala Lumpur from 24 to 25 April 2006.

**ASMET NASRUDDIN** our partner in the Litigation and Dispute Resolution Practice Group attended the celebrations for the World Arbitration Day, organised by the American Arbitration Association and the Singapore International Arbitration Centre held at the City Hall in Singapore on 16 February 2006. Asmet also attended the International Bar Association's 9<sup>th</sup> International Arbitration Day – Legitimate Procedures or Derailment Tactics? Conference held in Singapore at Grand Copthorne Waterfront Hotel on 17 February 2006. Asmet and two other partners from the firm, Leonard and Siew Ling, also attended the 2006 International Arbitration Conference organised by the Malaysian Branch of the Chartered Institute of Arbitrators, held at the Westin Hotel, Kuala Lumpur, from 31 March 2006 to 1 April 2006.

**SU SIEW LING**, our partner in the IP and Technology Practice Group presented a paper on the legal aspects of conducting business in Malaysia in the 2006 Southeast Asia IP Networking Meeting held on 16<sup>th</sup> February 2006 which was attended by members of the Licensing Executives Society of Malaysia, Korea and various Southeast Asian countries, Sri Lanka as well as the local Korean business community.

**RONALD H.L. TAN** joined us as a Partner in our Kuala Lumpur Office on 23 March 2006. Ronald heads the Firm's Debt Capital Markets Practice Group. Ronald's main scope of work will revolve around Capital Markets, Corporate Finance, Corporate and Debt Restructuring.

**LIM PUI KENG** joined us as a Partner in the IP and Technology Practice Group in our Kuala Lumpur Office on 21 April 2006. Pui Keng will focus on contentious and non-contentious IP work, ranging from litigation, protection and enforcement of IP rights to general advisory work relating to IP law.