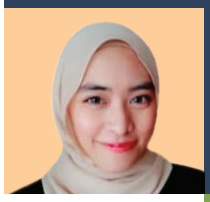


When a Debenture is Not a Debenture

by Nurul Afrina Zulkifli

The High Court in *Bank of Nova Scotia Bhd*[1] had the opportunity to consider whether a bank, which obtained a debenture as security for a banking facility granted to a borrower, would be considered a "debenture holder" under s 346 of the Companies Act 2016[2] (**CA 2016**). The court held that under s 346 of the CA 2016, "debenture holder" refers only to holders of debt instruments that are tradeable, and therefore excludes situations of holders of security given to bankers in consideration of commercial loans granted to a company.

The case helps to clarify the legal position that a debenture obtained by a bank in a banking facility would not be considered as a "debenture" for the purpose of the CA 2016.

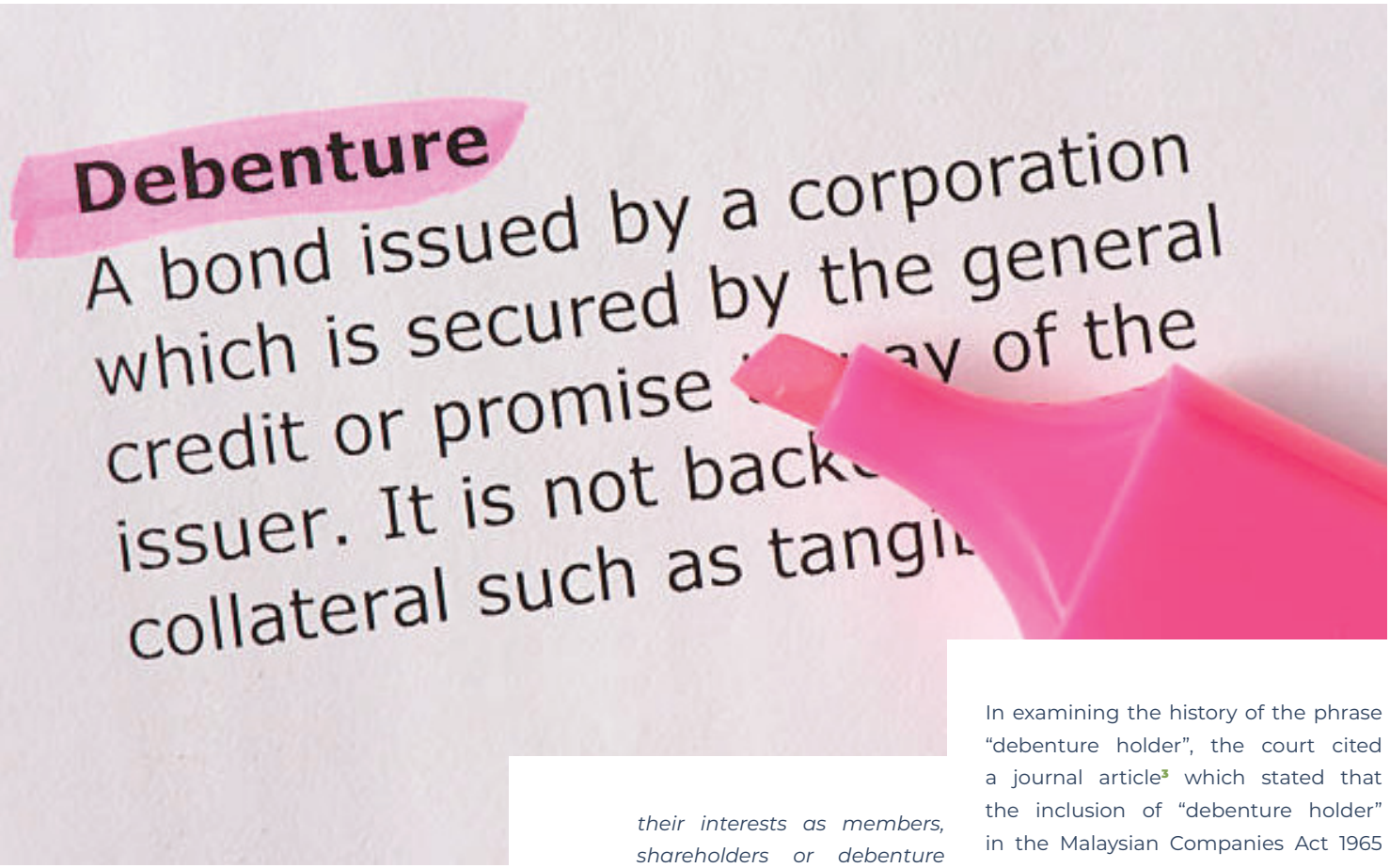
Background facts

Lion Dri Sdn Bhd (**first defendant/Borrower**) entered into an offtake agreement with Megasteel Sdn Bhd (**Offtaker**) to manufacture and supply hot direct reduced iron (**Product**) to the Offtaker. The first defendant/Borrower obtained banking facilities (**Facilities**) from the Bank of Novia Scotia Bhd (**Bank**) to purchase the raw materials to manufacture the Product. In return, the Bank granted various securities for the Facilities, one of which was a debenture over the assets and undertakings of the first defendant/Borrower. The first defendant/Borrower began drawdown and started manufacturing the Product for on-sale to the Offtaker. However, the Offtaker failed to make the stipulated payments to the first defendant/Borrower for the Product which eventually led to the first defendant/Borrower ceasing its operations. The second and third defendants were the directors of the first defendant/Borrower. The Bank then filed an originating summons under s 346 of the CA 2016. In defence, the defendants applied to strike out the originating summons, one of the grounds being that the Bank had no *locus standi* as they were not considered "debenture holders" for the purpose of s 346 of the CA 2016.

Decision of the High Court

For the purposes of this article, one of the issues discussed by the court was whether the Bank had *locus standi* to bring an action

1 *The Bank of Nova Scotia Bhd & Anor v Lion Dri Sdn Bhd & Ors* [2021] 2 CLJ 400
2 [*Act 777*]



against the defendants under s 346 of the CA 2016.

Section 346(1) reads:

> "*Remedy in cases of an oppression*
>
> *(1) Any member or debenture holder of a company may apply to the Court for an order under this section on the ground–*
>
> *(a) that the affairs of the company are being conducted or the powers of the directors are being exercised in a manner oppressive to one or more of the members or debenture holders including himself or in disregard of his or their interests as members, shareholders or debenture holders of the company; or*
>
> *(b) that some act of the company has been done or is threatened or that some resolution of the members, debenture holders or any class of them has been passed or is proposed which unfairly discriminates against or is otherwise prejudicial to one or more of the members or debenture holders, including himself.*"

Section 346(1) provides for two categories of persons who may make a claim for oppression: a member of a company and a debenture holder of a company. The issue here is whether the Bank, as a commercial bank/lender that is in the business of lending, falls within the category of a "debenture holder".

In examining the history of the phrase "debenture holder", the court cited a journal article[3] which stated that the inclusion of "debenture holder" in the Malaysian Companies Act 1965 was based on the Gower Report (1961) prepared for the purpose of passing Ghana's Companies Act. The Gower Report stated that such inclusion was on the basis that the section was intended to protect against a "fraud on the minority" and hence, such protection should be available to "debenture holders" since they are also susceptible to such fraud. The article further explained that "debenture holders" encompasses holders of corporate notes or bonds, whether privately or publicly issued.

In agreeing with the arguments of the defendants' counsel, the court considered the following points:

In construing the meaning of "debenture holder" in s 346 of the CA 2016, the court must confine itself to

3 "Bondholder Rights and the Section 216 Oppression Remedy" [2011] SJLS 432 at 433-434

the meaning as expressed and defined in s 2 in that a "debenture" includes debenture stocks, bonds, *Sukuk*, notes and any other securities of a corporation whether constituting a charge on the assets of the corporation or not. In addition, the term "securities" in the Capital Markets and Services Act 2007 (**CMSA 2007**) also includes shares in or debentures of, a body corporate or an unincorporated body.[4]

A close reading of the definitions of "debenture" and "securities" under the CA 2016 and the CMSA 2007 shows that "debenture" for the purpose of s 346 of the CA 2016 means debt or financial instruments issued for fundraising or arising from instruments or transaction effected in the money market. Therefore, the phrase "debenture holder" within s 346 of the CA 2016 must be construed to mean only members of the public who invest in debt instruments issued as debentures by a company to raise corporate finance.

Further, the definition of "debenture" under the CMSA 2007 expressly excludes loan agreements executed between the parties where the lending of money is in the ordinary course of business of the lender. Hence, an agreement relating to commercial bilateral lending, such as between a bank/financial institution and its customer, would be excluded.

The Bank does not fall within the category of "debenture holders" in s 346 of the CA 2016 and, therefore, does not have the *locus standi* to make an application under the said section. The court was of the view that if it were to acknowledge that the Bank had the *locus standi* to bring an action under s 346, then it would open the floodgates for all banks or lenders who have obtained debentures as a form of security (i.e. a document creating a fixed and floating charge over assets in respect of commercial loans) to bring an action under s 346 to recover outstanding debts from the shareholders and/or directors of a company. Such "opening of the floodgates" would then permit all creditors of the company to file oppression actions as a means of recovering their debts.

Court's response to Bank's argument that 'debenture' in CA 2016 refers to debenture in a banking facility

The conflicting contentions between the Bank's counsel and defendant's counsel on the term "debenture holder" required the court to examine the interpretation as asserted by the Bank's counsel on the term "debenture holder" under s 346 of the CA 2016.

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While the Bank's counsel asserted that s 346 of the CA 2016 should be given a wider interpretation in that a "debenture" under the CA 2016 should include a debenture creating a security for a loan , the court disagreed with such contention as the CA 2016 provisions require a different meaning to be ascribed on the term "debenture", bearing the fact that these provisions are arranged under a different part of the CA 2016.[5] The court considered the term "charge" as an instance where the requirement of registration of charge under s 352(1)(a) of the CA 2016 will not apply to a charge to secure payment or performance of a financial obligation arising from any transactions or instruments effected in the money market which are governed by the Financial Services Act 2013[6] or Islamic Financial Services Act 2013: s 352(6)(a) of the CA 2016.[7] Similarly, a different interpretation of the term "debenture" would apply to a different part or division of the CA 2016.

The court disagreed with the Bank's counsel that exclusion (e) in the definition of "debenture" set out under s 2 of the CMSA 2007 (which refers to "an agreement for a loan") would not apply to a debenture creating security for a loan. The court, in rejecting such contention, was of the view that commercial loans which involves an "agreement of loan between lender and borrower and the lender in its course of ordinary business provide money lending" is expressly excluded from the definition of "debenture" in the CMSA 2007. Thus, the court held that the Bank, being a bank whose course of ordinary business involves lending services to the customer, does not fall under the term "debenture holders" of

4 [*Act 671*]
5 Companies Act 2016, ss 374-375, 379, 384-386, 388, 392, 408, 527 and 592
6 [*Act 758*]
7 [*Act 759*]

s 346 of the CA 2016 and therefore does not have *locus standi* to rely on s 346 of the CA 2016 to recover breaches of financial obligations by a Company.

On the contrary, the defendants' counsel argued that the term "debenture holders" in s 346 of the CA 2016 should refer to members of the public who invest in debt instruments issued as "debenture" by a company to raise corporate finance. They further contended that the term "debenture holders" in s 346 of the CA 2016 does not include a single banker who provides commercial loans to a company because the Bank is not an investor in the securities of the company in such a scenario. In support of their argument, the defendants' counsel referred to the definition sections in s 2 of the CA 2016 and the CMSA 2007 and contended that "debenture" for the purpose of the CA 2016 refers to financial instruments akin to bonds and clearly excludes debentures creating security for a loan in the context of commercial lending which was executed between the Bank and the first defendant/Borrower in the present case.

The court agreed with the defendants' counsel in that the term "debenture" in the CA 2016 should be understood as debt or financial instruments issued by the company for fundraising or arising from instruments or transaction effected in the money market. The court also took into account that the term "debentures" contained in the entire Subdivision 10 of Part III Division 1 of the CA 2016 refers to debentures as debt instruments issued by the company which are offered to the public for subscriptions as opposed to the debentures which are treated as security for a commercial lending granted by the bank or lender to a company. The court further stated that once the ground under s 346(1) of the CA 2016 is successfully established, one possible remedy for the aggrieved party is to obtain an order requiring a proof of purchase of the debentures by other debenture holders of the company or by the company itself.[8] Hence, the court was of the view that such order cannot take effect if the term "debenture" under s 346 of the CA 2016 were to include a debenture creating security for a loan, as contended by the Bank's counsel.

Conclusion

It is clear that a bank or lender that obtains a debenture from a borrower company in a banking facility is not entitled under s 346 of the CA 2016 to claim a remedy against such borrower company that owes financial obligations under a commercial loan agreement, because the term "debenture holders" under s 346 excludes banks or lenders who have obtained debentures as a form of security. For a claim under s 346 to be established, such claim must be brought by a member of a class of debenture holders in a company and not by a bank that obtained a security in consideration of a commercial loan granted to such borrower company, such as the Bank in the present discussion. **LH-AG**

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8 Companies Act 2016, s 346(2)(c)