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BONDHOLDER RIGHTS AND THE SECTION 216 OPPRESSION REMEDY

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Notwithstanding that s. 216 of the Singapore *Companies Act*, on a literal construction, extends the oppression remedy to debentureholders of a company, there have to date been no reported cases in Singapore involving any attempted use of the oppression remedy by debentureholders. This article first explores the origins of the references to 'debentureholders' in s. 216. This article then proceeds to examine the scope of the s. 216 remedy in a debentureholder context, and concludes by discussing a number of principles upon which a fairness analysis in a debentureholder context may be undertaken.

I. INTRODUCTION

There have in recent years been an increasing amount of local literature and judicial rulings on s. 216 of the *Companies Act* of Singapore,[1] focussing mainly on actions commenced by minority shareholders alleging that the affairs of the company have been conducted in a manner that is oppressive to, in disregard of, discriminatory against or otherwise prejudicial to their interests (hereinafter, collectively referred to as "acts of oppression"). The scope of claimants that may potentially utilise the s. 216 relief is, however, not limited to shareholders, but extends in addition to "holder[s] of a debenture of a company" (hereinafter, "debentureholders"). References to 'debentureholders' have appeared in the oppression remedy provisions in the Malaysian and Singapore *Companies Acts* since their original enactment in 1965 and 1967 respectively.[2] That notwithstanding, in the last 45 years, there have been no reported cases before the Singapore or Malaysian courts in which the 'debentureholder' limb of s. 216 has been sought to be utilised. There is also a dearth of academic writing examining the circumstances under which a bondholder or class of bondholders might potentially seek relief under s. 216. This article traces the origins of the references to 'debentureholders' in s. 216, examines the scope of its applicability in a bondholder context, and discusses the principles for undertaking a fairness analysis where a s. 216 remedy is sought in a bondholder context.

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[1] Cap. 50, 2006 Rev. Ed. Sing. [*CA*]. Unless otherwise stated, all legislative provisions hereinafter referred to are to the *CA*.

[2] *Companies Act 1965*, No. 125 of 1965 (Malaysia) and *Companies Act* (No. 42 of 1967, Sing.) respectively.

II. Origins of References to Debentureholders in Section 216

The origins of s. 216 are, in the main part, fairly well documented,[3] lying in s. 210 of the United Kingdom ("U.K.") *Companies Act* of 1948,[4] the oppression provisions of the Australian Uniform Companies Acts of 1961,[5] as well as the relevant recommendations contained in the 1962 Jenkins Committee Report.[6] The foregoing, however, does not shed any light as to why an additional reference to 'debentureholders' was made in s. 181 of the Singapore *Companies Act* of 1967, the precursor to s. 216 of the current *CA*. Indeed, a review of the aforementioned legislation and reports suggests that the drafters only intended the oppression remedy to be available to 'members'[7] of a company.

Research into the various reforms of company law that were being considered in various jurisdictions at or around the time the original Malaysian and Singapore *Companies Acts* were enacted reveals that references to 'debentureholders' in the respective oppression relief provisions therein could in fact be traced to the recommendations made by Professor L.C.B. Gower to the Ghanaian legislature in 1961 outlining a compendious set of reforms to the *Ghanaian Companies Ordinance*.[8] In a commissioned report entitled "Final Report of the Commission of Enquiry into the Working and Administration of the Present Company Law of Ghana",[9] Professor Gower proposed that the *Ghanaian Companies Ordinance* similarly provide a remedy for minority oppression. The operative clauses of the oppression provisions proposed by Professor Gower (as contained in s. 218 of the *Draft Companies Code Bill* of Ghana[10]) appear to be mirror images of the corresponding clauses in s. 216. In the explanatory notes to the Gower Report, Professor Gower acknowledged that the additional references to 'debentureholders' in the proposed provisions were "novel",[11] and explained the rationale for their inclusion as follows:[12]

> If, however, the formula in subsection (1)(b) is to usurp the field formerly filled by "fraud on the minority" it seems clear that the remedy must be available to debentureholders as well as shareholders. Under the existing law they too may be able to set aside a resolution on the ground of fraud on the minority: see *British America Nickel Corpn. v. O'Brien*... Moreover, under modern conditions the distinction between shareholders and debentureholders is often a fine one, and the latter can be oppressed (or can oppress) as well as the former. Hence, I

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3 See Margaret Chew, *Minority Shareholders' Rights and Remedies*, 2nd ed. (Singapore: LexisNexis, 2007) at 124-129. See also Tan Cheng Han, ed., *Walter Woon on Company Law*, 3rd ed. (Singapore: Sweet & Maxwell, 2009) at paras. 5.45-5.47 [*Woon*].

4 *Companies Act, 1948* (U.K.), 11 & 12 Geo. VI, c. 38, s. 210.

5 See *e.g.*, *Companies Act 1961* (Vic.); *Companies Act 1961* (N.S.W.); *Companies Act 1961* (W.A.); and *Companies Act 1961* (Qld.).

6 U.K., Board of Trade, "Report of the Company Law Committee", Cmnd 1749 (1962) (Chairman: Lord Jenkins) at paras. 200-212 [Jenkins Committee Report].

7 As defined in s. 19(6) of the *CA*, *supra* note 1.

8 *Companies Ordinance 1907*, No. 14 of 1907 (repealed) [*Ghanaian Companies Ordinance*].

9 (Accra: Government Printer of Ghana, 1961) [Gower Report].

10 *Ibid.* at 160. This was enacted into law as s. 218 of the Ghana *Companies Code 1963*, No. 179 of 1963.

11 *Ibid.* at 161, para. 4.

12 *Ibid.* at 162, para. 10.

suggest that it would be useful if section 218 were available to them (and against them).

It is evident that Professor Gower's intention in including 'debentureholders' within the scope of the oppression remedy was to safeguard 'debentureholders' against "fraud on the minority"-type problems (hereinafter, "minority bondholder oppression cases").[13] While the definition of 'debentures' in the *CA* is far from clear,[14] it is generally understood to cover long-term[15] notes and bonds (hereinafter, collectively, "bonds") issued by companies. 'Debentureholders' therefore essentially encompasses holders of corporate notes or bonds, whether privately or publicly issued (hereinafter, collectively, "bondholders"). Like shareholders, bondholders are, under the terms of the indenture or trust deed governing the bond issuance (hereinafter, collectively, "bond contracts"), generally bound by the principle of majority rule in respect of any proposed actions affecting the bonds as a class.[16] To the extent that bondholders, like shareholders, are vulnerable to an unfair exercise of majority power, their express inclusion in s. 216 seems apposite. Indeed, Professor Gower cited the case of *British America Nickel Corporation, Ltd. v. M. J. O'Brien, Ltd.*[17] as illustrative of how minority bondholders might be prejudiced by actions taken by majority bondholders in a bondholder context.[18]

III. Scenarios in which an Oppression Remedy May Potentially Be Sought by Debentureholders

A. *Literal Construction of Section 216*

While s. 216 is modelled after the oppression provisions proposed by Professor Gower in relation to the *Ghanaian Companies Ordinance*, and Professor Gower had intended the references to 'debentureholders' to address minority bondholder oppression contingencies, Professor Gower's treatise cannot be elevated to the position of Hansard in the local context. Instead, a literal construction of s. 216 must be the starting point when construing the scope of the oppression remedy in the local context.

Construed literally, s. 216 in a bondholder context can potentially apply to two general scenarios:

(i) Where oppression is alleged by bondholders *as a class* in response to corporate action(s) implemented by the issuer which adversely affect the common

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13 It is clear that Professor Gower used the term "fraud on the minority" by way of shorthand only, to refer to cases of 'discrimination' or other instances of 'unfairness' towards minority shareholders or debentureholders: *ibid.* at para. 9. In this paper, references to "fraud on the minority" in the s. 216 context are avoided so as to avoid confusion with the 'fraud on the minority' exception to the proper plaintiff rule in the context of common law derivative actions.

14 See the unhelpful inclusionary interpretation of the term 'debenture' in s. 4 of the *CA*, *supra* note 1.

15 See Sing., Parliament, "Report of the Select Committee on the Companies (Amendment) Bill [Bill No. 9/86]", Parl. 5 of 1987 (1987) at A41, B73, D3 (Chairman: Dr. Yeo Ghim Seng).

16 The requisite majority threshold of bondholders whose votes would bind the bondholders as a class is usually mutually agreed upon and set out in the bond contract.

17 [1927] A.C. 369 (P.C.) [*British America Nickel*].

18 See *infra* Part IIIC of this article.

interests of all holders of a bond issuance (hereinafter, referred to as a "Category 1 Scenario"); and

(ii) Where oppression is alleged by *individual* bondholder(s) arising out of the conduct of the issuer and/or majority bondholders (hereinafter, referred to as a "Category 2 Scenario").

Intuitively, it seems that s. 216 is meant to cover a Category 2 Scenario only, particularly given that s. 216 is entitled "*Personal remedies* in cases of oppression or injustice" (emphasis added). However, since s. 216 is on a literal construction wide enough to apply to a Category 1 Scenario, an analysis of whether s. 216 should be so extended is necessary. Indeed, bondholders *as a class* have on occasion been victims of corporate actions undertaken by corporate controllers, normally with the support of shareholders, which have unfairly prejudiced bondholders' interests by indirectly accomplishing a net expropriation of wealth from bondholders to shareholders generally (hereinafter, the "expropriation problem").

B. *Examples of a Category 1 Scenario*

The factual permutations in which expropriation problems may arise (thereby giving rise to allegations of unfairness by bondholders *as a class*) are infinite, as is evident from real life transactions in the United States ("U.S.") and Canada. A common thread running across all these examples is the enhancement of the value of equity at the expense of reducing the value of the company's debt.[19]

A paradigmatic example of a Category 1 Scenario involves the case of leveraged buy-outs ("LBOs"), in which an acquirer would acquire a controlling equity interest in the target company, with the purchase price being financed principally through new debt that is ultimately secured over the assets of the target company (the "LBO Cases").[20] Creditors of the target company, including its bondholders, are prejudiced to the extent that the target company's assets are pledged or otherwise used to secure the acquisition debt, notwithstanding that the target company does not beneficially receive the loan proceeds which are used by the acquirer to buy-out existing shareholders. The shareholders, on the other hand, tend to benefit as they are usually bought out at a premium. The increase in the debt burden of the target company as a result of the LBO would in many cases be perceived as increasing the risks of default on the target company's bonds, thereby triggering a credit downgrading and a fall in the prices of the relevant bonds.[21] So construed, such LBO activities have

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[19] Yakov Amihud, Kenneth Garbade & Marcel Kahan, "A New Governance Structure for Corporate Bonds" (1999) 51 Stan. L. Rev. 447 at 453.

[20] See David Gray Carlson, "Leveraged Buyouts in Bankruptcy" (1985) 20 Ga. L. Rev. 73 on the different ways LBOs are structured in practice.

[21] For a general discussion of the expropriation problems associated with LBOs: see generally Steven L. Schwarcz, "Rethinking a Corporation's Obligations to Creditors" (1996) 17 Cardozo L. Rev. 647 at 685, 686 [Schwarcz, "Rethinking"]; Thomas R. Hurst & Larry J. McGuinness, "The Corporation, the Bondholder and Fiduciary Duties" (1991) 10 J.L. & Com. 187; Marcel Kahan, "The Qualified Case Against Mandatory Terms in Bonds" (1994) 89 Nw. U. L. Rev. 565 [Kahan, "Qualified Case"]; and Morey W. McDaniel, "Bondholders and Stockholders" (1988) 13 J. Corp. L. 205 [McDaniel, "Stockholders"].

the net effect of transferring wealth from bondholders of the target company to its shareholders generally.[22]

In Singapore, while the risks of LBO activities being carried out to the detriment of a company's creditors are mitigated somewhat by rules prohibiting a company from granting financial assistance in the acquisition of its own shares,[23] the rules against financial assistance are not couched in absolute terms. At least three exemptions to the rules exist[24] and accordingly, LBO activities can still be undertaken in Singapore without contravening the rules against financial assistance.

Another example of a Category 1 Scenario involves cases of corporate spin-offs (the "Spin-off Cases"). Here, part of the assets of a company ("Oldco") is spun-off to a newly incorporated company (usually a subsidiary, "Newco"). The idea is to create two entities to carry out different parts of the business of the company separately, with the profitable business usually being spun-off to Newco and the less profitable business being retained by Oldco. The overall commercial objective is to achieve a new corporate structure where the combined value of the two companies exceeds the value of the original company.[25] Bondholders who have previously lent to Oldco are prejudiced as their debts are retained by Oldco, whose total assets have decreased following the spin-off. This often triggers a downgrade of the credit rating of the bonds and consequently a fall in the bond prices. Contrariwise, the shareholders of Oldco tend to benefit as the mechanics of implementing a spin-off typically involve a distribution of a proportionate amount of Newco shares to the existing shareholders of Oldco via a dividend distribution. The net result is that the shareholders would, post spin-off, hold shares in both Oldco and Newco, which would have a higher aggregate combined value than before.[26]

Other examples of Category 1 Scenarios include (but are not limited to): (i) redeeming refunding-protected bonds by simultaneously implementing an equity offering and borrowing lower-cost debt, so as to circumvent contractual restrictions in the bonds prohibiting redemption through the incurrence of lower-cost debt;[27] (ii) engineering a mandatory redemption of existing bonds by procuring a technical default in one or more of a company's private agreements (so as to trigger a cross default on the company's bonds), and thereafter, entering into new lower-cost borrowing; and (iii) instances where excessive amounts of debt are borrowed to increase the company's overall leverage so as to thwart a take-over bid.[28]

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22 For an overview of cases in which claims have been brought by bondholders against issuers in connection with LBOs, see *e.g.*, *Metropolitan Life Ins. Co v. RJR Nabisco, Inc.*, 716 F. Supp. 1504 (Dist. Ct. S.D. N.Y. 1989) [*RJR Nabisco*]; *Hartford Fire Insurance Co. v. Federated Department Stores*, 723 F. Supp. 976 (Dist. Ct. S.D. N.Y. 1989) [*Hartford Fire Insurance*]; and *BCE Inc. v. 1976 Debentureholders* 2008 SCC 69, 301 D.L.R. (4th) 80 [*BCE Inc.*].

23 See *CA*, *supra* note 1, s. 76.

24 See *ibid.*, ss. 76(9A), 76(9B), 76(10).

25 Schwarcz, "Rethinking", *supra* note 21 at 678, 679; Dale B. Tauke, "Should Bonds Have More Fun? A Reexamination of the Debate Over Corporate Bondholder Rights" (1989) Colum. Bus. L. Rev. 1 at 108, 109.

26 Morey W. McDaniel, "Bondholders and Corporate Governance" (1986) 41 Bus. Law. 413 at 421 [McDaniel, "Corporate Governance"]; Tauke, *ibid.*; Schwarcz, "Rethinking", *ibid.*

27 This is so that the "source" of the redemption proceeds could be argued to be derived from the equity funding and not the incurrence of lower-cost borrowing.

28 See Jonathan R. Macey & Geoffrey P. Miller, "Corporate Stakeholders: A Contractual Perspective" (1993) 43 U.T.L.J. 401 at 405, 406.

C. *Examples of a Category 2 Scenario*

The situations in which a Category 2 oppression action may arise primarily involve what have been termed 'minority bondholder oppression cases' in Part II above. The principal difference between a Category 1 Scenario and a Category 2 Scenario lies in the fact that in the latter case, only *individual* bondholders are affected by the oppressive act in question, whereas in the former case, *all* bondholders of the same class of bonds are collectively impacted by the relevant oppressive act. The facts of *British America Nickel*[29] offer an illustration of how a Category 2 oppression action might arise. In *British America Nickel*, a resolution was passed by the requisite majority of bondholders under the terms of a trust deed (being three-quarters in value of the outstanding bonds), approving the modification of certain terms of the trust deed. It was not disputed that the majority of the bondholders who voted in favour of the resolution had been offered certain benefits by the issuer to induce them to vote in favour of the amendments. Upon a challenge brought by certain minority bondholders opposing the amendments, the Privy Council held that the majority bondholders did not exercise their voting powers *bona fide* in the interest of the class, and accordingly invalidated the bondholder resolution.

Taking stock for a moment, a proponent of the strict contractarian approach would argue that any attempt at extending the s. 216 oppression remedy to bondholders amounts to conferring upon bondholders extra-contractual remedies, notwithstanding that bondholders already enjoy significant contractual protection under the bond contracts. A preliminary issue that should be considered is whether bondholder rights should be strictly regulated by contract, or whether there are limited instances in which bondholders ought to be entitled to seek extra-contractual remedies, such as those contained in s. 216.

IV. Arguments For and Against Extending Extra-Contractual Remedies to Bondholders

Advocating the extension of extra-contractual protection to bondholders is somewhat controversial in the common law world, given the well-recognised principle that "corporate [*viz*. corporation] law [is] for [shareholders] and contract law [is] for bondholders".[30] The conventional understanding is that creditors (including bondholders) generally derive their rights from contract. It is assumed that any creditor who desires any right or protection would expressly bargain for such provisions *ex ante* by contract. Contract primacy should therefore similarly prevail in a bond setting, with the result that contracting parties thereto should not be entitled to claim any rights beyond those expressly bargained for.

However, to state categorically that company law is wholly unconcerned with creditors' rights is far too sweeping a statement, and not completely accurate. For instance, the *CA* incorporates various capital maintenance provisions primarily aimed

[29] *British America Nickel*, *supra* note 17.

[30] See William W. Bratton Jr., "The Economics and Jurisprudence of Convertible Bonds" (1984) Wis. L. Rev. 667 at 672; McDaniel, "Corporate Governance", *supra* note 26 at 413. See also Paul L. Davies, ed., *Gower and Davies' Principles of Modern Company Law*, 8th ed. (London: Sweet & Maxwell, 2008) at 1148, 1150 [*Davies*].

at creditor protection,[31] a confirmation of the view that creditors' rights are not completely divorced from company law.

There is also an inherent intellectual attractiveness in arguing for an extension of shareholder remedies (which are in large part extra-contractual in nature) to bondholders, given the contention that significant similarities exist between shareholders and bondholders. Commentators have argued that the economic interests of shareholders and bondholders are largely similar, in that the prices of shares and bonds are both dependent on the financial performance of the company and the fidelity and integrity of its management. In addition, both shares and bonds can be publicly issued and sold in impersonal financial markets. The public trading of both shares and bonds means that the average shareholder no longer views itself as the residual owner of the corporation, but as an investor that is free to enter or exit the company without any considerations of loyalty, very much like a bondholder. Furthermore, the increasing trend towards the public issuance of bonds implies that bonds now similarly attract a very wide and dispersed group of investors—including the proverbial moms and pops who, like unsophisticated shareholders, are equally in need of protection. That securities laws have not differentiated between public issuances of shares and bonds but have afforded similar securities law protections to investors in both cases further augments the view that the differences between shares and bonds are more apparent than real.[32]

The perceived net transfer of wealth from bondholders to shareholders in the LBO Cases, the Spin-off Cases and other analogous cases lends further weight to the view that bondholders are potentially just as vulnerable as shareholders, and therefore equally deserving of protection. This has generated active academic debate, particularly amongst academic circles in North America, as to whether bondholder remedies should be purely contractual in nature, or whether certain additional extra-contractual protections should be accorded to bondholders in appropriate circumstances; such as in the form of directors potentially owing fiduciary duties to bondholders, or the judicial endorsement of an expansive notion of contractual interpretation tempered by the doctrine of good faith in the interpretation of bond contracts, in reliance on § 205 of the U.S. *Restatement (Second) of the Law of Contracts*.[33] In the Singapore context, as Singapore law recognises neither an expanded notion of fiduciary duties being owed to creditors,[34] nor an implied covenant of good faith of general application,[35] s. 216 thus provides the most obvious avenue for bondholders to seek

[31] See *CA*, *supra* note 1, s. 76(1)(b) (rules against company purchasing its own shares), s. 76(1)(a) (rules against financial assistance), s. 403(1) (dividends payable from profits only), ss. 76A-76K (rules against capital reduction).

[32] See generally McDaniel, "Stockholders", *supra* note 21 at 218-221; Kahan, "Qualified Case", *supra* note 21 at 569, 570; McDaniel, "Corporate Governance", *supra* note 26 at 416; Bratton, *supra* note 30 at 734. See also *Securities and Futures Act* (Cap. 289, 2006 Rev. Ed. Sing.), s. 240 [*SFA*]; and Chapters 2, 3 and 6 of the *SGX Listing Manual: Mainboard Rules* (Singapore: Singapore Exchange Limited, Information Services & Pub. Department, 2002) [*Listing Rules*].

[33] *Restatement (Second) of the Law of Contracts* § 205 (1979) provides: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement". See also generally Bratton, *supra* note 30; Tauke, *supra* note 25; and arguments raised in *RJR Nabisco* and *Hartford Fire Insurance*, *supra* note 22.

[34] Except when the company is in the vicinity of insolvency: see *infra* note 74.

[35] *Ng Giap Hon v. Westcomb Securities Pte Ltd* [2009] 3 S.L.R.(R.) 518 (C.A.).

extra-contractual relief, when it is alleged that business affairs of the issuer are being conducted unfairly.

It is submitted that the above arguments which suggest that the interests of shareholders and bondholders are largely aligned, while superficially persuasive, overstate the similarities between these two classes of stakeholders of a company. As succinctly noted by Kahan, two crucial differences exist between bondholders and shareholders as stakeholders of a company, which merit differences in the treatment of the two groups, namely: (i) the differences in the institutional setting behind a share issuance and a bond issuance; and (ii) the fundamental differences in the nature of the economic rights possessed by shareholders and bondholders.[36] Against the backdrop of these two critical differences, it is submitted in this article that a s. 216 remedy *should not* be available to bondholders *as a class* in a Category 1 Scenario, but *should* under certain circumstances be available to *individual* bondholder(s) in a Category 2 Scenario.

V. Arguments for a Strict Contractarian Approach in a Category 1 Scenario

Key arguments for advocating a strict contractarian view in a Category 1 Scenario include the following:

A. *Relative Ease and Low Cost of* Ex Ante *Contracting by Bondholders (as a Class)*

Bond contracts are generally regarded as "one-shot" dealings between the bondholders and the issuer,[37] in which the bondholders would invest their funds with the issuer for a limited period of time for an agreed return. The primary concern of bondholders lies in ensuring that the debt servicing capabilities of the issuer are not compromised by the undertaking of corporate actions that might unjustifiably deplete the assets of the company. Such protection is generally easier and less costly for bondholders to contract for *ex ante*, via the insertion of appropriate covenants limiting the management's freedom to take actions that would unduly increase a risk of default on the bonds.[38] The ease of *ex ante* contracting in a bondholder context has also been facilitated by the emergence of standard form bond contracts which aid contracting by lowering the cost of evaluation of customary terms, and further by providing the basic platform from which the negotiation of additional deal-specific covenants and/or terms may be undertaken.[39]

In contrast, shareholder relationships with a company are essentially long-term relationships involving many unforeseen contingencies and potentialities for deviant

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[36] Kahan, "Qualified Case", *supra* note 21 at 570.

[37] Deborah A. DeMott, "Oppressed But Not Betrayed: A Comparative Assessment of Canadian Remedies for Minority Shareholders and Other Corporate Constituents" (1993) 56 Law & Contemp. Probs. 181 at 221.

[38] Macey & Miller, *supra* note 28 at 406, 417; Tauke, *supra* note 25 at 26, 27.

[39] Bratton, *supra* note 30 at 686-688; Kahan, "Qualified Case", *supra* note 21 at 586, 587.

management behaviour, which cannot easily be addressed in advance by contract.[40] Shareholder interests are further residual in nature, and are dependent on the management taking appropriate action to maximise the value of the firm, which cannot be clearly articulated in advance.[41] This, coupled with the difficulties of stipulating contractually enforceable obligations on the part of the management to maximise the success of the company, implies that comprehensive *ex ante* contractual protection is difficult to achieve in a shareholder context. Instead, extra-contractual protection (in the form of fiduciary duties owed by directors to shareholders) has been recognised by the law to act as "gap fillers" for the protection of shareholders.[42] So construed, relegating bondholder rights to the contractual sphere while according shareholders reliefs that are largely extra-contractual in nature is a reflection of the law's presumption about the adequacy of the contracting process in protecting bondholder rights on the one hand, and the relative inadequacy of such process in protecting shareholder rights on the other.[43]

B. *Adequacy of Market Forces in Protecting Bondholders as a Class*

Proponents of a strict contractarian view would further argue that bondholders are adequately protected by market forces which can adequately adjust to the probability of 'event risks'[44] by demanding adequate protective covenants in bond contracts or by demanding a higher yield for any additional risks undertaken.[45]

Strict contractarians argue that as a result of the size of the bond market and the domination of the bond market by sophisticated institutional investors, bond contracts have evolved over time to address new 'event risks' that have emerged.[46] For instance, in response to the expropriation of bondholder wealth occasioned by LBOs, underwriters and institutional bondholders have in the immediate aftermath of the LBO Cases required bond contracts to contain provisions allowing for a mandatory redemption of the bonds, or for an adjustment of interest rates, upon the occurrence of a LBO.[47]

Strict contractarians further argue that market forces also protect bondholders by demanding that a higher interest rate be paid when the contractual protections offered to bondholders under the bond contracts are weak.[48] Investments in bonds are therefore in essence a risk-reward trade. An associated line of reasoning is that shareholders ought to have the right to reserve to themselves flexibility in running the

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[40] Tauke, *supra* note 25 at 16; J. Anthony VanDuzer, "BCE v. 1976 Debentureholders: The Supreme Court's Hits and Misses in its Most Important Corporate Law Decision Since Peoples" (2010) 43 U.B.C. L. Rev. 205.

[41] VanDuzer, *ibid.* at 240.

[42] *Ibid.*; Tauke, *supra* note 25 at 15-17.

[43] Tauke, *ibid.* at 14.

[44] 'Event risks' has been defined as "the potential for a sudden and dramatic drop in credit quality (and bond values) resulting from an acquisition, leveraged buyout, or other corporate restructuring": see McDaniel, "Stockholders", *supra* note 21 at 244.

[45] Tauke, *supra* note 25. See generally Hurst & McGuinness, *supra* note 21.

[46] Bratton, *supra* note 30 at 687, 714.

[47] DeMott, *supra* note 37 at 214; Hurst & McGuinness, *supra* note 21 at 198, 199.

[48] Tauke, *supra* note 25 at 49, 50.

company by bargaining for a weaker covenant package and paying higher interest rates in return.[49] Weaker contractual protections having already been "priced-in", affording the bondholders additional *ex post* judicial remedies upon the occurrence of any 'event risks' which have not been expressly adjusted by contract would be according bondholders protections they did not pay for.[50] Indeed, empirical studies suggest that the bond market is largely efficient in terms of pricing bonds, at least at the original issuance stage,[51] with the insistence of additional bondholder contractual protection often being met by a reduction of the interest rates to reflect the lower risk assumed by bondholders.[52]

In any event, it is also possible to draft covenants of a fairly generalised nature that are capable of shifting the risks associated with a wide range of contingencies to the issuer. Examples of such generalised covenants include net asset covenants, and various financial covenants such as debt-to-asset ratios, which are commonly found in private bank loan agreements. Commentators thus noted that the absence of certain protective covenants in bond contracts are not necessarily indicative of the bondholders' inability to draft or require such covenants, but are simply reflective of the bondholders' unwillingness to pay for such protection.[53] To grant bondholders as a class protection against such 'event risks' by way of a s. 216 remedy would arguably lead to an overcompensation of the bondholders.[54]

Finally, commentators have also pointed to the disciplinary effect inherent in the market, which serves as a further deterrence against opportunistic behaviours by issuers. An issuer may very well need to access the financing markets again in the future. Issuers who engage in opportunistic wealth expropriation activities are likely to face difficulties coming back to the market, and even if they succeed in doing so, may have to pay a higher price in future fund-raising exercises.[55]

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[49] See Steven L. Schwarcz & Gregory Sergi, "Bond Defaults and the Dilemma of the Indenture Trustee" (2007) 59 Ala. L. Rev. 1037 at 1066; *ibid.* at 50, 59-62; Hurst & McGuinness, *supra* note 21 at 195, 196 generally.

[50] Kahan, "Qualified Case", *supra* note 21 at 575; Hurst & McGuinness, *ibid.* at 199.

[51] See generally Kahan, "Qualified Case", *ibid.* But *cf.* Tauke, *supra* note 25 at 35-46, who argues that the empirical studies to date provide inconclusive results as to whether the Efficient Capital Market Hypothesis applies in a bond market. See also McDaniel, "Stockholders", *supra* note 21 at 240-243, questioning the informational efficiencies of the bond market. This author, however, submits that Kahan is correct in noting that whether the bond market is informationally efficient in the *secondary bond market* is not the focus here; rather, the focus should be whether the bond market does "price-in" protective covenants (or the lack thereof) *at the original issuance stage*. In this regard, the empirical research cited by Kahan is persuasive in showing that the presence or absence of specific covenants *does* affect pricing at the issuance stage. In that sense, the bond market is informationally efficient in semi-strong form, at least at the issuance stage.

[52] Kahan, "Qualified Case", *ibid.*, citing, for example, the effect of insistence of "super-poison put" covenants on bond pricing.

[53] Macey & Miller, *supra* note 28 at 417-419.

[54] Schwarcz noted that in the aftermath of the Spin-off Cases, covenants restricting such corporate splits were inserted at the behest of institutional bond investors and underwriters. However, such covenants were dropped over time as investors were not prepared to pay for such protection, preferring instead the higher interest rates offered by bonds without such covenants: Schwarcz, "Rethinking", *supra* note 21 at 681.

[55] Andrew Keay, "Directors' Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors" (2003) 66 Mod. L. Rev. 665 at 693; Tauke, *supra* note 25 at 49.

C. *Institutional Setting of the Bond Market*

Opponents of the strict contractarian view have, on the other hand, argued that a bond contract is a non-bargained-for and incomplete contract, hence meriting the availability of *ex post* remedies to bondholders against unforeseen risks occasioned by opportunistic behaviour by issuers.[56] They base their contention on a number of premises, including: (i) the fact that bond contracts are essentially negotiated *ex ante* between the issuer and the underwriter of the issuance (and not with the bondholders directly) and consequently cannot be regarded as a bargained-for agreement from the bondholders' perspective;[57] (ii) the fact that it is impossible to foresee in advance all possible future contingencies for which the bondholders may need contractual protection; and (iii) the disparity in the degrees of sophistication and bargaining powers of different bondholders, with less sophisticated bondholders often facing information asymmetry issues, and further lacking the expertise to evaluate complex bond contracts and, in any event, the ability to individually bargain with the issuer.[58]

While these are valid concerns, it is submitted that many of these concerns have been overstated and have, to a large extent, been mitigated by the institutional setting in which bond issuances take place.

First, these arguments underestimate the role played by intermediaries in the bond issuance process, in particular the underwriters, whose primary role is to negotiate the bond terms with the issuer, on behalf of the bondholders. Underwriters—which tend to be reputable merchant banks or investment houses—have an incentive to negotiate an optimal covenant package as they need to market the bonds to the eventual purchasers, the investing bondholders.[59] While it might be argued that underwriters may not be fully incentivised to seek optimal covenant packages for the benefit of bondholders since underwriters hold the bonds they underwrite for a limited period of time only, and further suffer from conflict of interests problems as they are appointed by the issuer and are hence more likely to be deferential to the issuer's wishes (especially in cases where the underwriters hope to secure repeat business from the same issuer),[60] such arguments fail to attach sufficient weight to the economic motivations of underwriters, which are to eventually market and sell the bonds to the investing public. A sub-optimal covenant package is likely to prejudice the marketability and pricing of the bonds, especially when the bond market is dominated by sophisticated financial institutions which would undertake their own analysis of the bond terms and detect any sub-optimal bond terms. Additionally, while the wish to procure repeat business from an issuer may operate in the mind of an underwriter, an equally important commercial objective from the underwriter's

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[56] Tauke, *ibid.* at 19-22.

[57] While institutional investors do not negotiate directly with the issuer, the underwriter would in most cases take into account any covenants or terms requested by key institutional investors who are likely to be the ultimate purchasers of the bulk of the bond issuance.

[58] See generally Martin Riger, "The Trust Indenture as Bargained Contract: The Persistence of Myth" (1990) 16 J. Corp. L. 211; Bratton, *supra* note 30 at 689; Keay, *supra* note 55 at 690-692; and Tauke, *supra* note 25 at 13, 20, 69.

[59] Schwarcz, "Rethinking", *supra* note 21 at 659; Tauke, *ibid.* at 22-26; *RJR Nabisco*, *supra* note 22 at 1509.

[60] Lawrence E. Mitchell, "The Fairness Rights of Corporate Bondholders" (1990) 65 N.Y.U. L. Rev. 1165 at 1183; Tauke, *ibid.* at 23-25; Riger, *supra* note 58 at 216-218.

perspective is to maintain its reputational standing. On balance, underwriters are unlikely to trade their reputation for short-term monetary rewards.[61]

In relation to the information asymmetry problem encountered by unsophisticated bondholders, these have been mitigated to a large degree by the disclosure regime under securities laws, which require all material terms of publicly issued notes to be disclosed.[62] It has been argued that unsophisticated bondholders, even if granted access to such information, would not be able to evaluate the information contained in lengthy prospectuses in any meaningful way. This concern is however addressed to some extent by the fact that the bond market is heavily dominated by institutional investors, with individual investors generally holding a very small proportion of all corporate bonds issued.[63] While unsophisticated bondholders may lack the resources and ability to carry out detailed evaluation of bond terms, they will be able to "piggy-back" on the expertise and contractual protection possessed or sought by institutional investors, since all bondholders would ultimately subscribe for the bonds on the same terms and at the same price.[64]

D. *Intellectual Coherence*

Bondholder and shareholder interests are inherently conflicting—bondholders are generally more risk averse (since they earn a fixed return), while shareholders, as residual claimants of the company's assets, are generally more amenable to risk-taking and supportive of corporate actions that are likely to maximise the value of the company.[65] In this context, to suggest that the management should owe fiduciary duties to shareholders while concurrently owing a fairness duty to bondholders as a class would impose severe constraints on management discretion and allow courts to second-guess management decisions.[66] The way corporate law tends to protect the management in these cases is to afford the management protection under the business judgment rule, which would, in the final analysis, lead to a net loss of accountability by managers to all stakeholders concerned.[67]

As mentioned, shareholders as residual owners of the company may often wish to preserve management flexibility so as to maximise shareholder wealth through appropriate risk-taking,[68] which includes paying higher interest rates to their lenders in return for such flexibility. To the extent bondholders desire that certain risk-taking activities be curtailed, this should be done *ex ante* by contract in the interests of certainty.[69] The extension of the s. 216 remedy to bondholders *as a class* is in this context undesirable, as it may lower the incentives of bondholders to clearly

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61 Schwarcz, "Rethinking", *supra* note 21 at 659-661; Kahan, "Qualified Case", *supra* note 21 at 591.

62 See *SFA*, *supra* note 32, s. 240; and Chapter 3 Part V of the *Listing Rules*, *supra* note 32 generally.

63 Kahan, "Qualified Case", *supra* note 21 at 583-586. The research cited therein suggests that individual bondholders hold less than 15% of all issuances of public bonds.

64 Tauke, *supra* note 25 at 12; Bratton, *supra* note 30 at 723, 724.

65 See Hurst & McGuinness, *supra* note 21 at 194, 195; and Tauke, *supra* note 25 at 20, 26, 27 generally.

66 See Jacob S. Ziegel, "Creditors as Corporate Stakeholders: The Quiet Revolution—an Anglo-Canadian Perspective" (1993) 43 U.T.L.J. 511 at 530.

67 As the saying goes, a corporate agent that serves many masters is a servant to none. See Macey & Miller, *supra* note 28 at 402, 403, 411, 412; and Tauke, *supra* note 25 at 55, 59, 63.

68 Tauke, *ibid.*

69 *Ibid.* at 55; Keay, *supra* note 55 at 681.

allocate risks *ex ante*.[70] When the management needs to balance the heterogeneous interests between different stakeholders, costly litigation may result.[71] Efficiency and intellectual neatness would therefore be fostered if the rights and obligations of the bondholders *as a class vis-à-vis* the issuer were determined strictly as a matter of contract.

E. *Other Avenues of Bondholder Protection*

Various other avenues of bondholder protection exist, which further militate against the argument that bondholders *as a class* should be afforded extra-contractual remedies by way of a s. 216 oppression relief. It is not proposed to go through all of these avenues in detail. In the main, these include: (i) the possibility of owning a diversified portfolio to guard against 'event risks';[72] (ii) the availability of other creditor protection provisions under various statutes,[73] such as rules prohibiting fraudulent trading, insolvent trading, unfair preferences, and undervalue transactions; (iii) the existence of specific common law rules aimed at creditor protection, such as the need for directors to have regard to the interests of creditors when discharging their fiduciary duties when the company is insolvent or at the brink of insolvency;[74] and (iv) possible recourse to contractual interpretation techniques, such as the *contra proferentem* rule,[75] to achieve a fair result for bondholders within legally permissible limits.

VI. Arguments for Extending the Section 216 Remedy to a Category 2 Scenario

In coming to the conclusion that bondholders *as a class* can adequately protect themselves by contract, one must also not lose sight of the fact that the bondholder group is a very diverse group, especially in the context of public bond issuances. As Bratton observed, that "they [*viz*. the bondholders] got what they paid for" is not a completely accurate statement because "'they' [are] a disparate group."[76] While it is probably accurate to say that the bulk of most bond issuances are owned by institutional investors, there remains the proverbial moms and pops, pensioners and other small time investors (hereinafter, referred to interchangeably as "uninformed bondholders" or "minority bondholders") who would own a small percentage of the bonds.[77] It is in relation to the latter more vulnerable group of bondholders that it is submitted that the fairness doctrine has a role to play (*viz*. in a Category 2 Scenario).

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[70] So as not to sacrifice yield.

[71] See Jeffrey G. MacIntosh, "Designing an Efficient Fiduciary Law" (1993) 43 U.T.L.J. 425 at 456, 458-460.

[72] Hurst & McGuinness, *supra* note 21 at 200; McDaniel, "Corporate Governance", *supra* note 26 at 436.

[73] See Keay, *supra* note 55 at 667, 668 generally.

[74] See *e.g.*, *West Mercia Safetywear Ltd v. Dodd* [1988] B.C.L.C. 250 (C.A.); and *Liquidators of Progen Engineering Pte Ltd v. Progen Holdings Ltd* [2010] 4 S.L.R. 1089 (C.A.).

[75] See Tauke, *supra* note 25 at 86-89.

[76] Bratton, *supra* note 30 at 703.

[77] Kahan, "Qualified Case", *supra* note 63.

A. *Argument that the Bond Contract is a Non-fully Bargained-for Contract Having Greater Force from the Perspective of Uninformed Bondholders*

As noted above, uninformed bondholders tend to "piggy-back" on institutional investors in relation to the evaluation of bond terms, due to their general lack of expertise and information asymmetry problems. Even if it were assumed that the bond market is informationally efficient, the prices of the bonds would in these circumstances be set by reference to the knowledge of the best-informed investors (*i.e.* the institutional investors), and would not take into account the uninformed bondholders' subjective risk preferences. The efficient market hypothesis is thus "too blunt as a fairness guide", especially when the interests of uninformed bondholders are considered.[78]

The juxtaposition of underwriters as intermediaries unfortunately does not improve the uninformed bondholders' position in any significant way with respect to the negotiation of minority-centric protective covenants, given that underwriters are primarily concerned with the overall marketability of the bonds. If at all, it is the interests of the institutional investors (who in most cases would be the subscribers of the bulk of the bond issuance) which would be the focus of discussions between the underwriter and the issuer.[79]

Furthermore, *ex ante* contracting for fairness protection by uninformed bondholders personally is impractical in a Category 2 Scenario, given that uninformed bondholders often lack the necessary bargaining power to negotiate specific terms with the company so as to contractually protect themselves against minority oppression contingencies. Other creditor self-protection measures which institutional investors typically utilise, such as owning a diversified portfolio, are further less available to uninformed bondholders as diversification can be costly[80] and/or impractical due to the relatively smaller amounts invested by uninformed bondholders. The contention that bond contracts are non-fully bargained-for contracts therefore has greater force in the context of uninformed bondholders.

B. *Achieving "Individualized Justice" for Minority Bondholders*

As noted above, a consequence of uninformed bondholders "piggy-backing" on institutional investors for contractual protection is that the terms of the definitive bond contracts would likely lack, or insufficiently incorporate, protective covenants aimed at safeguarding minority bondholder interests, given the relative lack of importance of these terms from the institutional investors' perspective and their general unwillingness to sacrifice yield.[81] Indeed, it has been suggested that sophisticated bond investors make their investment decisions based on six or seven commercial features summarised by a financial service such as *Moody's Bond Survey*, with little attention given to other bond terms.[82] Consequently, the legitimate expectations of

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[78] Bratton, *supra* note 30 at 706-708.

[79] See generally Riger, *supra* note 58 at 232-234. See also *supra* note 57.

[80] Due to the need to incur brokerage and other administrative fees and commissions: see McDaniel, "Stockholders", *supra* note 21 at 243.

[81] See Riger, *supra* note 58 at 243.

[82] Bratton, *supra* note 30 at 699.

minority bondholders with respect to minority-centric protection may not be fully "priced-in".[83]

Extending the s. 216 relief to a Category 2 Scenario thus accomplishes the objective of achieving "individualized justice"[84] for minority bondholders who are more vulnerable and in need of minority-centric protections, which are less likely to have been adequately addressed at the *ex ante* contracting stage. Concurrently, it avoids according corresponding benefits to sophisticated investors who are likely to have conscientiously decided not to seek such protections in order not to sacrifice yield.

C. *Effect of 'No-Action Clauses'*

A bondholder, in subscribing to a bond issuance, impliedly accepts the principle of collective decision-making by the bondholders of the particular issuance as a class. With respect to the enforcement of rights under the bond contract, the collective decision-making principle manifests itself, amongst other ways, in the form of 'No-Action Clauses' which have now become a standard provision in almost all bond contracts. To be sure, 'No-Action Clauses' found in bond contracts governed by the laws of different jurisdictions do differ in some respects, in part to reflect local market practices as well as local legislative requirements.[85] In the main, however, 'No-Action Clauses' have the effect of creating a contractual stay against the commencement of independent action by individual bondholder(s), subjecting the enforcement action instead to the collective decision of a contractually stipulated majority of bondholders. For instance, in trust deeds governed by Singapore law (which generally follow the conventions adopted in trust deeds governed by English law), a standard 'No Action Clause' would typically provide that the enforcement of rights under the bond contract must be brought by the bond trustee acting upon the instructions of a requisite majority of bondholders (usually bondholders owning 25% of the aggregate bond indebtedness).[86]

'No-Action Clauses' serve the useful purposes of preventing a race to collect by individual bondholders upon a default, preventing a multiplicity of lawsuits and preventing actions by individual bondholders which may prejudice the interests of the bondholders as a class.[87] However, the ubiquitous adoption of 'No-Action Clauses' in bond contracts have also heightened the risks of oppressive treatment of minority bondholders by majority bondholders, most acutely in circumstances where the majority of the bonds are effectively owned or controlled by insiders, or persons

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83 See generally Mark Gugiatti & Anthony Richards, "The Use of Collective Action Clauses in New York Law Bonds of Sovereign Borrowers" (2004) 35 Geo. J. Int'l L. 815, in particular the observation that bond markets have historically paid little or no attention to whether bond contracts included Eurobond-type 'collective action clauses' or *TIA*-type 'unanimous action clauses' when pricing bonds, the latter being more protective of minority bondholder interests.

84 To borrow a phrase from Bratton, *supra* note 30 at 710.

85 Such as the U.S. *Trust Indenture Act of 1939*, 15 U.S.C. §§ 77aaa-77bbbb (2000) (cited in the main text as §§ 301-328) [*TIA*], in the case of bond contracts required to be qualified under the *TIA*.

86 See Philip R. Wood, *Law and Practice of International Finance*, University ed. (London: Thomson Sweet & Maxwell, 2008) at 184, para. 12-31.

87 *Ibid.* at para. 12-32.

"friendly" to such insiders,[88] who may refuse to instruct the trustee to commence proceedings to pursue remedies upon the occurrence of an event of default.[89] The prevalence of 'No-Action Clauses' in trust deeds thus lends further support for the extension of the s. 216 *personal* remedy to minority bondholders.

D. *Absence of '*Pro Rata *Sharing Clauses'*

'*Pro Rata* Sharing Clauses' are common features of syndicated loan agreements. Such clauses were created by the syndicated loan market due to concerns that the borrower might prefer certain syndicate lenders over others, and effect payments to such lenders ahead of other syndicate members. If a financing agreement includes a '*Pro Rata* Sharing Clause', a syndicate lender who has received any disproportionate payments from the borrower would be required to turn over such payments to the other lenders, so that all syndicate lenders would share in all distributions received from the borrower on a *pro rata* basis.

'*Pro Rata* Sharing Clauses' are, however, typically not found in bond contracts for historical and practical reasons.[90] Historically, the provisions of the *TIA*[91]—which apply to all indentures required to be qualified[92] under the *TIA*—have had a large influence on the development of U.S. law governed standard form bond contracts. § 316(b) of the *TIA*[93] expressly prohibits the impairment in any way of the right of any bondholder to commence a lawsuit to enforce payment rights. This has led to '*Pro Rata* Sharing Clauses' being omitted from U.S. law governed bond contracts required to be qualified under the *TIA*, due to the concern that such clauses may run afoul of § 316(b). While the provisions of the *TIA* do not strictly apply to U.S. law governed bond contracts which are not required to be qualified under the *TIA*, nor to other foreign law governed bond contracts, a drafting convention has emerged to similarly omit '*Pro Rata* Sharing Clauses' from such bond contracts as well. Furthermore, from a practical angle, '*Pro Rata* Sharing Clauses' are also less efficacious in a bond context given the prevalent practice of holding and trading bonds through clearing systems[94] and account intermediaries, which results in bondholders being unable to ascertain the precise identities of other beneficial owners of the same bond issuance at any given time. Monitoring any preferential payments made

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[88] Whilst certain bond contracts may exclude 'related parties' from voting on bondholder resolutions, insider voting schemes could conceivably be structured in ways that avoid a technical contravention of such related party voting prohibitions.

[89] It is clear from the shareholder oppression cases that oppressive conduct need not be constituted by positive acts, but extends to passive inaction or omission by the controllers to advance the interest of the company, or to pursue legal rights and remedies which are available to the company for extraneous reasons: see *e.g.*, *Scottish Co-operative Wholesale Society Ltd v. Meyer* [1959] A.C. 324 (H.L.) and *Lim Swee Khiang v. Borden Co (Pte) Ltd* [2006] 4 S.L.R.(R.) 745 (C.A.) [*Borden*].

[90] See generally Lee C. Buchheit, "Changing Bond Documentation: The Sharing Clause" (1998) 17 Int'l Fin. L. Rev. 17.

[91] *TIA*, *supra* note 85.

[92] These are, essentially, indentures relating to publicly issued notes for which a registration statement needs to be filed pursuant to the *Securities Act of 1933*, 15 U.S.C. § 77A: see *TIA*, *ibid.*, § 77ccc(9) (2000).

[93] *TIA*, *ibid.*, § 77ppp(b) (2000).

[94] The main clearing systems being Depository Trust Corporation; Euroclear Bank SA/NV; and Clearstream Banking, société anonyme.

by the issuer to individual bondholders becomes commensurately difficult. The absence of '*Pro Rata* Sharing Clauses' in bond contracts, however, exacerbates the risk of issuers engaging in discriminatory conduct between different bondholders, thus providing further support for the extension of the s. 216 *personal* remedy to minority bondholders.[95]

VII. Construing Section 216 in a Category 2 Scenario

Thus far, it has been argued that the s. 216 remedy in a bondholder context should only be available in a Category 2 Scenario, and not in a Category 1 Scenario. A threshold question which should then be considered is whether clearer legislative guidelines (or indeed reforms) should be proposed to clarify the circumstances in which minority bondholders may claim s. 216 relief, given that there have been no reported cases in the last 45 years involving the use of s. 216 by minority bondholders.

A. *Possible Approaches*

To be sure, it is possible to safeguard minority bondholders against potential "fraud" by the issuer and/or majority bondholders via other legislative techniques, such as by legislating in advance specified acts which majority bondholders may not take so as to bind minority bondholders. This is the approach taken in the U.S. under the *TIA*,[96] § 316(b) of which specifically provides that all indentures required to be qualified under the *TIA*[97] must provide that the right of a bondholder to receive principal and interest payments under his notes on or after the due date thereof cannot be impaired without his consent. While a *TIA*-type approach has the benefit of certainty, § 316(b) of the *TIA* is one of the most heavily criticised provisions amongst U.S. academic circles, given its tendency to exacerbate the 'hold-up' problem, thereby stifling consensual out-of-court debt restructuring and forcing parties to invoke formal bankruptcy processes instead.[98] Separately, a *TIA*-type approach may well end up being unduly rigid and inflexible. As Professor Davies noted, commercially unfair behaviour often necessitates fact-specific assessments; it is impossible

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[95] While it is physically impossible for the issuer (particularly in the context of public note issuances) to obtain a definitive list of all beneficial owners of the notes at any time because of the secrecy rules of the clearing systems, the issuer might in certain cases be apprised of the identities of some (but not all) bondholders. This may, for example, be the case when the bondholder in question is a related entity of the issuer, or the bondholder personally approaches the issuer to negotiate a private deal to recover part of the indebtedness under the bonds in return for other financial accommodation which the bondholder would grant the issuer or its group companies. While other bondholders not involved in these side dealings may have difficulties detecting or proving such preferential dealings, detection is in practice not impossible. Suspicions that the issuer has privately dealt with certain selected bondholders often arise when a particular bondholder (say a hedge fund) suddenly ceases to own bonds of an issuer as gleaned from the bondholder's latest public filings, or abruptly withdraws from ongoing litigation against the issuer. Such suspicions may be further investigated through discovery or other similar applications.

[96] *TIA*, *supra* note 85.

[97] See *supra* note 92.

[98] Mark J. Roe, "The Voting Prohibition in Bond Workouts" (1987) 97 Yale L.J. 232 at 270, 271; Howard J. Kashner, "Majority Clauses and Non-Bankruptcy Corporate Reorganizations—Contractual and Statutory Alternatives" (1988) 44 Bus. Law 123 at 130, 131.

for the legislature to identify in advance an exhaustive list of actions which should in all cases be prohibited on the grounds that they will always be unfair to the minority.[99]

As an alternative to a *TIA*-type approach, it might at first blush be attractive to consider whether s. 216 in a bondholder context should be clarified as entailing a mere statutory codification of the principles laid down in *British America Nickel*, which was expressly referred to in the explanatory notes to the Gower Report.[100] Such an option can, however, be readily dismissed since, to the extent that the *British America Nickel* principle encapsulates in essence the 'best interests of the class' principle in a bondholder context, it attracts the same conceptual difficulties which plague the 'best interests of the class' principle in a shareholder context: namely, the failure to accord sufficient recognition to the proprietary nature of bondholder voting rights, and the difficulties in applying the 'best interests of the class' test where there are intra-bondholder conflicts of interest.[101]

In view of the foregoing, it is hereby suggested that, consistent with the approach in the shareholder oppression cases, a finding of commercial unfairness should similarly be the juridical basis for invoking the court's jurisdiction in a Category 2 bondholder context. A commercial test of fairness gives proper recognition to the proprietary nature of a bondholder's voting rights, while incorporating an inherent countervailing check to ensure that all powers conferred on majorities enabling them to bind minorities are exercised subject to general principles of law and equity. With respect to the concerns that an open-ended test of unfairness may engender uncertainty, this may be addressed by decisional rule-making by the courts clarifying the circumstances in which individual bondholder(s) may avail themselves of the s. 216 oppression remedy. In the remaining sections of this article, some principles upon which a fairness analysis might be undertaken by the courts in a bondholder context will be discussed.

B. *Existing Principles for the Fairness Analysis in a Shareholder Context*

The leading authority in Singapore as to what constitutes unfairness in a shareholder oppression context remains that in *Re Kong Thai Sawmill (Miri) Sdn Bhd*.[102] Under the *Kong Thai* test, unfairness is established where there is "a visible departure from the standards of fair dealing and a violation of the conditions of fair play which a shareholder is entitled to expect".[103] While s. 216 has been drafted to accord the

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[99] *Davies*, *supra* note 30 at 650.

[100] See *supra* note 12 and its accompanying text.

[101] See *Davies*, *supra* note 30 at 653-662, and *Woon*, *supra* note 3 at 193, for an excellent overview. Note also that Professor Gower was clearly aware of the conceptual difficulties surrounding the 'best interests of the class' test and therefore clarified in the Gower Report that he intended the Ghanaian oppression provisions to target cases involving "discrimination" or "unfairness", and "not the nebulous and misleading test of whether those who voted did so in the interests of the class as a whole": see Gower Report, *supra* note 9 at 161, 162, paras. 8, 9.

[102] [1978] 2 M.L.J. 227 (P.C.) [*Kong Thai*]. The *Kong Thai* test has been endorsed in numerous judgments by the local Court of Appeal: see *e.g.*, *Low Peng Boon v. Low Janie* [1999] 1 S.L.R.(R.) 337 at 353 (C.A.); *Over & Over Ltd v. Bonvests Holdings Ltd* [2010] 2 S.L.R. 776 (C.A.) [*Over & Over*]; *Borden*, *supra* note 89 at 773.

[103] *Kong Thai*, *ibid.* at 229.

courts a wide discretion to address incidents of unfairness in the conduct of corporate affairs in a business context,[104] it has been definitively accepted that "a balance has to be struck between the breadth of the discretion given to the court and the principle of legal certainty."[105] The fairness remedy available under s. 216 must therefore be "applied judicially", based upon "rational principles",[106] and not merely based on a judge's subjective notions of fairness.

In view of the importance of certainty when ascertaining the scope of the fairness remedy in a commercial context, Lord Hoffmann proceeded to lay down, in the House of Lords decision of *O'Neill v. Phillips*, what academic commentators have regarded as a 'contractual approach' towards the establishment of unfairness.[107] The *O'Neill v. Phillips* test, in essence, involves a two-pronged enquiry:

(1) Whether the majority action is contrary to the provisions of the company's constitutional documents or other express agreements that set out the relations between the shareholders *inter se* ("Limb 1"); and
(2) If not, whether the majority has nevertheless acted in breach of a 'legitimate expectation'[108] of the shareholders thereby giving rise to an equitable restraint preventing the majority from exercising their strict rights under the constitutional documents ("Limb 2").

The Singapore Court of Appeal has on occasion applied the *O'Neill* approach in the context of s. 216 actions brought by shareholders: see *e.g.*, *Over & Over Ltd v. Bonvests Holdings Ltd*.[109] It is however doubtful that the 'contractual approach' laid down in *O'Neill*'s case, which is more restrictive than the more open-ended test of 'commercial unfairness' laid down in *Kong Thai*, represents the sole and exclusive test for determining fairness in the context of s. 216 in Singapore,[110] given the Singapore Court of Appeal's repeated affirmation of the wider *Kong Thai* test of 'commercial unfairness' as the "touchstone" underpinning the availability of a s. 216 remedy.[111] It

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104 See U.K., Board of Trade, "Report of the Committee on Company Law Amendment", Cmd 6659 (1945) (Chairman: Justice Cohen) at para. 60.

105 See *O'Neill v. Phillips* [1999] 1 W.L.R. 1092 at 1099 (H.L.) [*O'Neill*].

106 *Ibid.* at 1098, and quoted with approval by the Singapore Court of Appeal in *Borden*, *supra* note 89, and *Sim Yong Kim v. Evenstar Investments Pte Ltd* [2006] 3 S.L.R.(R.) 827 [*Sim Yong Kim*].

107 However, not all academics share the view that *O'Neill*, *ibid.*, laid down a 'contractual approach' for ascertaining unfairness: see *e.g.*, P. Paterson, "A Criticism of the Contractual Approach to Unfair Prejudice" (2006) 27(7) Comp. Law. 204.

108 The term 'legitimate expectation' is used by way of short-hand only, bearing in mind Lord Hoffmann's reservations about using a term borrowed from public law: *O'Neill*, *ibid.* at 1102.

109 *Over & Over*, *supra* note 102 at paras. 84, 85, though it should be noted that *O'Neill*, *ibid.*, was not expressly referred to by the Singapore Court of Appeal. The Singapore Court of Appeal, however, did cite *Re Saul D. Harrison & Sons plc* [1995] 1 B.C.L.C. 14 (C.A.), an earlier decision of Hoffmann L.J., which was to be a harbinger of Lord Hoffmann's subsequent judgement in *O'Neill.*

110 While the Singapore Court of Appeal had in various cases, for *e.g.*, *Borden*, *supra* note 89, and *Sim Yong Kim*, *supra* note 106, cited the relevant passages from *O'Neill*, *ibid.*, which contained, amongst other things, the two-stage 'contractual approach' for determining unfairness, the relevant passages were always quoted *in extenso*, with the Singapore Court of Appeal falling short of endorsing the 'contractual approach' as the sole test for ascertaining fairness in a s. 216 action. Indeed, in *Over & Over*, *supra* note 102, the latest local Court of Appeal decision on the s. 216 remedy, no express reference was made to *O'Neill*, with the Court of Appeal relying instead on the *Kong Thai* test: see *Over & Over*, *supra* note 102 at paras. 77, 81.

would be more appropriate to view the *O'Neill* two-pronged approach as representing a useful guide, but by no means the exclusive test, by which commercial unfairness is ascertained in the Singapore context.

C. *Clarifying the Unfairness Analysis in a Category 2 Scenario*

1. Kong Thai *Test of 'Commercial Unfairness' as the General Test*

It is fairly obvious that the principles for ascertaining unfairness in a shareholder and a bondholder context cannot be identical in all respects, given the contextual differences in which shareholder and bondholder relationships arise. It is submitted that while the broad *Kong Thai* test of unfairness can (and indeed should) continue to be the overarching test of unfairness in a bondholder context, other case law principles for establishing unfairness in a shareholder context cannot be transported indiscriminately into a bondholder setting.

Thus, considerations peculiar to quasi-partnerships, which have often served as important indicia of unfairness in shareholder oppression cases,[112] would necessarily be of minimal relevance in a bondholder setting. By the same token, Limb 2 of the *O'Neill* test, which affords relief based on breaches of 'legitimate expectations' between the parties so as to attract equitable considerations, is also less useful in a bondholder context, given that the 'personal relationships or dealings' necessary to trigger the application of Limb 2 of the *O'Neill* test[113] are generally absent in a bondholder context. Bond contracts are negotiated by underwriters and issuers at a time when bondholders are not yet identified. The tradability of public bonds further means that the identities of the ultimate holders of a particular bond issuance are likely to be ever-changing, and in any event, difficult to ascertain with precision, especially if the bonds are issued in global form and held and traded through clearing systems and/or account intermediaries.[114] The net result is that any attempts at distilling any unwritten 'legitimate expectations' of the parties to a bond issuance based on their personal relationships and history of dealings would have a somewhat hollow ring to them.

2. *Rational Principles for Determining Unfairness in a Bondholder Context*

While 'legitimate expectations' in the strict sense envisaged by Lord Hoffmann in Limb 2 of the *O'Neill* test may be difficult to discover in a bondholder setting, Margaret Chew argues that 'legitimate expectations' can potentially encompass two separate and distinct concepts, which she terms 'informal understandings' and 'implied understandings' respectively. The main difference between 'informal understandings' and 'implied understandings' lies in that 'informal understandings'

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[111] See *e.g.*, *Over & Over*, *ibid.*

[112] Such as loss of mutual trust and confidence or exclusion from management: see *Ebrahimi v. Westbourne Galleries Ltd* [1973] A.C. 360 (H.L.).

[113] *O'Neill*, *supra* note 105 at 1101.

[114] Steven L. Schwarcz, "Intermediary Risk in a Global Economy" (2001) 50 Duke L.J. 1541 at 1547, 1548, 1583.

generally depend on the finding of an unmemorialised agreement that is clearly evidenced by or can be clearly inferred from the circumstances surrounding the association of the parties, in particular the prior personal relationship and dealings between them.[115] 'Implied understandings', on the other hand, do not depend entirely for their inference on the existence of a close and personal relationship between the parties; instead, they are understandings that are implicit within a particular form of corporate transaction or relationship, particular regard being had to the nature and commercial purpose of the corporate relationship or transaction undertaken.[116] Based on the foregoing, the type of 'legitimate expectation' referred to by Lord Hoffmann when his Lordship discussed Limb 2 of the *O'Neill* test in a shareholder context would necessarily fall under the rubric of 'informal understandings'.

It is submitted that Chew's argument that the concept of 'legitimate expectations' can be analysed under the separate rubrics of 'informal understandings' and 'implied understandings' is insightful and persuasive. Not only is Chew's argument that 'legitimate expectations' could be extended to cover 'implied understandings' indirectly supported by authority,[117] the concept of 'implied understandings' in the sense advocated by Chew further provides a rational and principled basis for undertaking a fairness analysis in a s. 216 setting. This is especially since the *nature* and *purpose* of particular corporate transactions (*e.g.*, a bond issuance) often engender expectations amongst the participants as to the types of conduct that would be reasonably expected of participants dealing fairly and even-handedly with one another in the context of such transactions. Any failure to observe such 'implied understandings', which are ultimately based on the presumed intentions of the participants engaging in the particular type of corporate transaction in question[118], should, as a matter of logic, be a relevant consideration when determining if the parties have acted fairly in the given context.

If the foregoing is accepted, then the *O'Neill* test can be applied with the appropriate modifications in a bondholder setting, such that the 'legitimate expectations' contemplated under Limb 2 of the *O'Neill* test would focus mainly on the 'implied understandings' between the participants to the bond issuance *inter se*, as inferred objectively from the nature of the corporate transaction undertaken. Consequent thereto, the courts could give effect to a standard of fair dealing between participants to the bond issuance through a term implication technique,[119] even though the interests and expectations that are sought to be enforced have not been memorialised, nor could they be said to have arisen as a result of personal relationships or dealings

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[115] Chew, *supra* note 3 at 140.

[116] *Ibid.* at 140, 151.

[117] See *Latimer Holdings Ltd v. SEA Holdings NZ Ltd* [2005] 2 N.Z.L.R. 328 (C.A.) cited by Chew, *ibid.* at 161, 162. See also *BCE Inc*, *supra* note 22 at paras. 68-88, where the Supreme Court of Canada laid down seven factors for determining whether a "reasonable expectation" for the purposes of claiming oppression relief existed, the first of which (relevancy of "general commercial practice") also supports the view that in determining whether an alleged "reasonable expectation" should be given effect to, a court can look beyond personal dealings and focus on "normal business practices" expected in particular commercial transactions.

[118] Chew, *ibid.* at 152.

[119] *Ibid.* at 159.

between the parties.[120] Such a modified version of the two-pronged approach in *O'Neill* would, it is submitted, provide a principled and rational basis for assessing unfairness in a bondholder context.

3. *Proposed Test for 'Implied Understandings'*

It is well settled that what constitutes unfairness in the s. 216 context is to be objectively determined without reference to the subjective intentions of the parties.[121] In relation to the test to be applied by the courts in deciding whether an 'expectation' asserted by an oppressed minority bondholder should be elevated to the status of an 'implied understanding' (such that conduct contrary thereto would be deemed to be commercially unfair), it is submitted that the relevant enquiry should focus on whether the alleged expectation in question is one that would have been hypothetically bargained for (whether it be the fact or not) by reasonable, honest and impartial participants to the bond issuance, had they thought about the issue. This would, in essence, involve an objective postulation of whether it is within the reasonable expectations of reasonable, honest and impartial participants to the bond issuance that such an understanding ought to be an inherent attribute of their relationship with one another, bearing in mind at all times the nature and purpose of the transaction undertaken.[122]

Without attempting to lay down an exhaustive list of 'implied understandings' which reasonable, honest and impartial participants to a bond issuance would have, it is submitted that they should at the very least cover the following matters:

(a) *No discriminatory treatment by the issuer*: It is reasonable for a bondholder to expect, subject to any express contrary provisions in the bond contract, that the bonds he holds would rank rateably, and that he would be treated equally with other bondholders of the same issuance. In the context of an issuer's dealings with its bondholders, there is always a danger that the issuer may for various improper reasons make preferential payments to or confer special benefits on specific bondholders, or otherwise undertake acts that unfairly discriminate between bondholders owning the

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[120] *Ibid.* at 152.

[121] See *e.g.*, *Tong Keng Meng v. Inno-Pacific Holdings Ltd* [2001] 3 S.L.R.(R.) 311 (H.C.); *Re a Company (No 005134 of 1986) ex p. Harries* [1989] B.C.L.C. 383 (Ch.).

[122] The suggested test is based on a consideration of the tests proposed by Chew to facilitate a fairness analysis in a shareholder context involving a listed company (Chew, *supra* note 3 at 136, 137), as well as Keay's observations at *supra* note 55 at 679. Based on the test proposed in this article, given that the finding of an 'implied understanding' is derived from the presumed intentions of the parties, it would follow that sophisticated bondholders (*e.g.*, institutional investors) are likely to face greater difficulties in establishing oppression by asserting breach of an 'implied understanding', since a reasonable man is less likely to objectively postulate that the sophisticated investor intended such an understanding to govern his relationship with the other bond participants when such investor had not expressly bargained for such terms at the *ex ante* contracting stage. Associated therewith, it would also follow that 'implied understandings' are less likely to be found in private issuances in which a small number of institutional investors typically subscribe for the entire issuance. Here, the nature of the commercial transaction, which entails more negotiation at the *ex ante* contracting stage with a small group of institutional investors, leaves less room for any further undocumented understandings to be inferred.

same class of bonds. The expectation of equality of treatment is, it is submitted, an understanding that is implicit in bondholder relationships, a disregard of which ought to give rise to a personal remedy under s. 216.

(b) *No vote manipulation by issuer and/or insiders*: While all bondholders undertaking a bond investment impliedly accept majoritarian rule, there is a concurrent expectation amongst bondholders that the issuer does not unduly influence the voting process or take inappropriate steps to engineer a desired outcome. It is, however, not uncommon for insiders to directly or indirectly purchase bonds from the market so as to build up majority positions with a view to influencing voting outcomes.[123] A further instance of vote manipulation involves issuers offering secret payments or benefits to selected groups of bondholders conditioned upon such bondholders voting in favour of resolutions proposed by insiders. Such actions are contrary to a reasonable bond investor's 'legitimate expectation' that there be an element of even-handedness and fair dealing in the bondholder voting process, and if proved, should give rise to a bondholder oppression remedy. *British America Nickel*, if litigated under s. 216, would arguably attract a remedy under both sub-paragraphs (a) and (b) of this article.

(c) *No coercion of minority bondholders to influence voting outcomes*: A corollary of the independent bondholder's 'implied understanding' that bondholder voting should be carried out in an even-handed manner is that any attempt by the issuer to coerce minority bondholders into accepting proposals put forward by the issuer should generally not be allowed. An obvious example occurs in the context of coercive consent solicitations to approve amendments to a bond contract where only those bondholders voting in favour of the amendments would be entitled to receive a "consent payment".[124] A variant of such coercive behaviour by issuers might also occur where 'exit consent' strategies are resorted to as part of the out-of-court restructuring of the bond indebtedness of an issuer-company. Such 'exit consent' techniques typically involve issuers restructuring their bonds via a voluntary exchange offer, in which the consenting bondholders' acceptance of the exchange offer is conditioned upon their consenting to amend the terms of the old bonds by removing the key covenants contained therein ("covenant stripping").[125] The effect of the covenant stripping exercise is effectively to coerce dissenting minority bondholders into accepting the debt restructuring plan by severely impairing the value of the unrestructured bonds. This is yet another instance in which a s. 216 remedy could *potentially* be available, especially in cases where the restructuring plan has not been put forward in good faith.[126]

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[123] Roe, *supra* note 98 at 251, 252.

[124] Kahan, "Qualified Case", *supra* note 21 at 604 *et seq.*

[125] See *e.g.*, *Katz v. Oak Industries Inc.*, 508 A.2d 873 (Del. Ch. 1986) [*Katz*], where the use of such 'exit consent' strategies was upheld. See also generally Roe, *supra* note 98 at 248, 249; George W. Shuster, "The Trust Indenture Act and International Debt Restructurings" (2006) 14 Am. Bankr. Inst. L. Rev. 431 at 434; and Lee C. Buchheit & G. Mitu Gulati, "Exit Consents in Sovereign Bond Exchanges" (2000) 48 UCLA L. Rev. 59.

[126] Although the U.S. courts have in a number of cases upheld the legality of 'exit consents' (*e.g.*, *Katz*, *ibid.*), whether they would do so in every case is not clear: see Hal S. Scott, "A Bankruptcy Procedure for Sovereign Debtors" (2003) 37 Int'l Law. 103 at 118; Roe, *supra* note 98 at 248, 249. The outcome may well depend on whether the 'exit consent' strategy is primarily used to prevent opportunistic hold-outs from stifling a restructuring plan that is in the best interests of the issuer and bondholders, or whether

VIII. Conclusion

Bond issuances have grown exponentially in the last three decades. With bonds becoming an increasingly important source of financing for businesses, a consideration of the remedies available to bondholders has correspondingly grown in importance as well. The 'debentureholder' limb of the s. 216 remedy has been present in the *CA* since its inception in 1967 but does not appear to have ever been used, in large part due to the general perception that bonds are essentially creatures of contract and hence the rights of bondholders should be strictly confined to the contractual realm. However, bondholders have the potential to be subject to majority abuses to the same extent as shareholders have. As this article has sought to argue, while bondholder rights are largely contractual in nature, protective covenants to safeguard minority bondholders against oppression contingencies are often difficult to achieve at the *ex ante* contracting stage. The oppression relief as extended to bondholders in s. 216 is therefore a welcome alternative remedy for minority bondholders. It is hoped that this article has laid down a basic theoretical framework and a number of suggested principles upon which local jurisprudence on the protection of minority bondholder rights via the oppression remedy could be further developed.

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there is a predominant coercive intent to push through an unreasonable workout plan via an 'exit consent' strategy: see generally Buchheit & Gulati, *ibid.*