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Rules On Companies On Directors' Loans

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The Companies Act 2016 (Act) specifies the duties and liabilities of directors as officers of a company. Pursuant to the Act, a director is generally not allowed to take loans from the company or any related company even though the company is in a good financial position to give a loan. That being said, there are instances whereby a company can grant a loan to its director.

This alert seeks to provide a clear view of such instances and the consequences whereby a director would be deemed to have breached the provisions under the Act.

General Principle

The governing provision is found under Section 224(1) of the Act which provides that a company shall not:

- a) Make a loan to a director of the company or of a company which by virtue of Section 7 is deemed to be related to that company.
- b) Enter into any guarantee or provide any security in connection with a loan made to such a director to another person.

However, it must be noted that Section 224 does not apply to an exempt private company. As per Section 224(2), Section 224 will also not be applicable in the following circumstances: -

- a) To provide such director with funds to meet the expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company.
- b) To provide such a director with funds to meet expenditure incurred or to be incurred by him in purchasing or otherwise acquiring a home.

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- c) Where the company has passed a resolution to approve a scheme for the making of loans to employees of the company and the loan is in accordance with that scheme.

As seen above, the law is clear that loans to directors may only be granted subject to certain conditions. The difficulty arises when a director of a company enters into an agreement that requires security. An example would be where directors obtain loans to disguise the misappropriation of funds from the company. This point specifically touches on Section 224(1)(b) of the Act.

Penalty

When there is no authorisation given by the company to give a loan or security, the director who authorized the loan or who entered the said guarantee will be jointly and severally liable to indemnify the company in the event if the company suffers losses. The company may also initiate an action against the director for contravening his statutory and fiduciary duties owed to the company. These are provided under Sections 224(6) and 224(7) of the Act.

Pursuant to Section 224(10) of the Act, where a director who is found to have improperly taken loans from the company, the director shall, on conviction, be liable to imprisonment for a term not exceeding five years or to a fine not exceeding three million ringgit or to both.

Issue

Is a security made via an agreement which conflicts with the interests of the company be deemed valid? The Federal Court in *Koperasi Rakyat Bhd v Harta Empat Sdn Bhd* [2000] 3 MLJ addressed this matter.

Harta Empat is a private company limited by shares and Koperasi Rakyat is a cooperative society regulated by the provisions of the Co-operative Societies Act 1948. Koperasi Rakyat had applied to become a member of the society and had created a first legal charge over the subject property in favour of Harta Empat, to secure a loan of RM5 million to the director of Koperasi Rakyat. Some years later, Koperasi Rakyat took out an originating summons claiming a

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declaration that the charge was void and hence, could not be enforced, relying on the then Section 133 of the Companies Act 1965 (CA 1965). The High Court dismissed Koperasi Rakyat's summons but the Court of Appeal reversed the decision of the High Court judge. Harta Empat then appealed to the Federal Court.

Decision

In arriving at its decision, the Federal Court was in full agreement with the judgment in *Co-operative Central Bank Ltd (In receivership) v Feyen Development Sdn Bhd* [1994] 1 MLJ 75, which held as follows:

"This court will not be astute to lend its aid to enable the chargor company to take advantage of its own default or wrong by relying on its own breach to avoid the charge transactions and thereby escape its obligations thereunder, unless this is what the clear language of the statute is thought to require.."

The judgment in this case serves as a significant reminder to companies that they must not rely on their unlawful actions as a means of circumventing their obligations and commitments. Here, the order of the Court of Appeal was set aside.

Conclusion

There are a number of factors to consider before directors can borrow money from the company or any related companies as improperly managed unauthorised directors' loans may negatively impact a company's overall financial stability. Although there is no voidness or unenforceability attached to the loan or the charge transactions given by a company to a director, it is important for companies in Malaysia to be mindful of the statutory consequences that follow to ensure good governance practices.

Authored by Stephanie Nora, a pupil with firm's corporate practice.

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