**IN THE FEDERAL COURT OF MALAYSIA**

**(APPELLATE JURISDICTION)**

**CIVIL APPEAL NO. 02(f)-35-04/2022 (B)**

**BETWEEN**

1. **LAI FEE**
   **(No. K/P: 491103-05-5143)**

2. **LAI YING HAUR**
   **(No. K/P: 801221-05-5401)** … **APPELLANT**

**AND**

1. **WONG YU VEE**
   **(No. K/P: 800522-14-5959)**

2. **LIEW FOO KIAT**
   **(No. K/P: 760121-14-5903)**

3. **MICHAEL ADRIAN REYES**
   **(No. K/P: 680517-10-5131)** … **RESPONDENTS**

**CORUM**

**Datuk Vernon Ong Lam Kiat, FCJ**
**Dato' Abdul Rahman bin Sebli, FCJ**
**Dato Rhodzariah binti Bujang, FCJ**

## GROUNDS OF JUDGMENT

## INTRODUCTION

[1] This appeal relates to a suit filed in the High Court ('**s 540 Suit**') against three individuals for fraudulent trading pursuant to s 540 of the Companies Act 2016 (**CA 2016**). The three individuals (defendants) were shareholders cum directors of a company. The company had entered into an agreement with the plaintiffs to purchase all of the plaintiffs' shares in a partnership firm, and having taken over the partnership firm, failed to pay the balance purchase price. The plaintiffs sued and obtained judgment against the company for the balance purchase price. However, the company did not satisfy the judgment debt.

[2] The plaintiffs wanted to make the defendants personally responsible for the unpaid balance purchase price on the ground that the business of the company has been carried on with intent to defraud the plaintiffs. In 2018, the plaintiffs brought the s 540 Suit against the defendants for fraudulent trading to declare the defendants personally liable for the RM2.5 million debt due and owing by the company to the plaintiffs. The Shah Alam High Court dismissed the plaintiffs' claim after a full trial. The plaintiffs' appeal to the Court of Appeal failed. In this judgment, the parties shall be referred to as they were in the High Court.

**Leave to Appeal to the Federal Court**

[3] On 11.4.2022, this Court granted leave to the plaintiffs to appeal to the Federal Court on three questions of law.

Question 1

Where a vendor agrees to the immediate transfer of an asset to a company relying on the representation of the company that the balance purchase price will be paid in the future and the company subsequently fails to pay the balance purchase price when it falls due, are the directors of the company, ipso facto liable to the vendor under s 540 of the CA 2016?

Question 2

Where a company has been adjudged in a previous suit to be liable for failure to pay the balance purchase price under a sale and purchase and a director of the company is subsequently sued under s 540 of the CA 2016 arising from the said debt: -

(i) is such a director barred by issue of estoppel and/or res judicata from asserting defences which had been unsuccessfully raised by the company in the previous suit?

(ii) may such a director raise as a defence that the company had a legitimate commercial reason not to pay the balance purchase price notwithstanding the judgment in the previous suit?

Question 3

Is the position by Lord Kerr in paragraph of the grounds in the English Supreme Court case *Takhar v Gracefield Developments Ltd and Others* [2019] UKSC 13, namely, *"… that the law does not*

*expect people to arrange their affairs on the basis that other people may commit fraud"* representative of the position of Malaysian law?

**Salient Facts**

[4] The 1st and 2nd plaintiffs were partners of a partnership business with timber logging rights known as Fave Enterprise (**'Fave'**). The defendants were involved in negotiations with the plaintiffs to acquire the timber logging rights from Fave.

[5] Pursuant to the negotiations, the plaintiffs entered into a sale and purchase agreement dated 11.1.2013 ('**the SPA**') with Centennial Asia Sdn Bhd ('**Centennial**') whereby the plaintiffs agreed to transfer their interest in Fave to Centennial for the purchase price of RM7 million ('**the Purchase Price**').

[6] Upon execution of the SPA, the plaintiffs relinquished and transferred their interests in Fave. Although Centennial was the designated buyer under the SPA, the defendants procured the registration of themselves individually as the new partners of Fave. Immediately thereafter the plaintiffs withdrew as partners, leaving the 1st and 2nd defendants as the only partners of Fave.

[7] Pursuant to the SPA, the Purchase Price was to be paid in three tranches: (i) an initial sum of RM2 million payable as deposit and part payment on the execution of the SPA; (ii) balance purchase price of RM2.5 million within 60 days from the SPA date (i.e., on or before

11.3.2013); and (iii) the final balance purchase price of RM2.5 million within 90 days from the SPA date (i.e., on or before 11.4.2013).

[8] The defendants procured another company known as Westhill Equity Sdn Bhd ('**Westhill**') to pay the initial two tranches of the Purchase Price to the plaintiffs. Later, Centennial defaulted in paying the final balance price of RM2.5 million under the SPA.

[9] Due to Centennial's default, the plaintiffs filed an action in the Shah Alam High Court ('**Suit 128**') against Centennial for a declaration for specific performance of the SPA and for an order that Centennial pay the final balance purchase price of RM2.5 million. In response, Centennial brought a counterclaim against the plaintiffs for misrepresentation. At the trial of Suit 128, the 3rd defendant testified that Centennial refused to pay the final balance purchase price because of the plaintiffs' misrepresentation.

[10] After a full trial, the Shah Alam High Court allowed the plaintiffs' claim. Centennial's counterclaim against the plaintiffs was dismissed. Notwithstanding the judgment in favour of the plaintiffs, Centennial failed to pay the final balance purchase price to the plaintiffs. Centennial did not appeal against the Shah Alam High Court decision in Suit 128.

[11] We will now go on to consider the decisions of the High Court and the Court of Appeal in the S 540 Suit.

**S 540 Suit - High Court Decision**

[12] The High Court dismissed the plaintiff's claim on the following findings of fact:

(i) the plaintiffs' allegations against the defendants' intention to defraud was based on general allegations without specifying the time the intention to defraud was committed;
(ii) the plaintiffs did not prove that the defendants had entered into the SPA with the intention to defraud the plaintiffs;
(iii) the plaintiffs did not check on Centennial's financial position or status before entering into the SPA with Centennial. A company search on Centennial was only done after Centennial defaulted in paying the final balance purchase price;
(iv) the defendants were under no obligation to disclose to the plaintiffs that the payment of the initial two tranches of the purchase price would be made by Westhill. That the monies paid by Westhill amounted to valid consideration under the SPA (s 2(d), Contracts Act 1950). Further, the plaintiffs never questioned the payments by Westhill;
(v) the defendants did not have the intention to defraud the plaintiffs when they decided to nominate Centennial to enter into the SPA;
(vi) the defendants agreed to enter into the SPA on the representations of the plaintiffs that the income from the extracted timber is RM80 million based on unrestricted right to extract timber logs of high quality on the land. The defendants only found out that the representations were incorrect after they had paid the initial two tranches of the purchase price. The defendants discovered that not all the trees on the land could be harvested

as timber logs. Consequently, the defendants believed that they would not be able to make any profits and accordingly decided that Centennial will not pay the final balance purchase price;

(vii) the defendants were entitled to raise the defence of misrepresentation to defeat the plaintiffs' claim. The doctrine of *res judicata* did not apply because the causes of action in Suit 128 and s 540 Suit were different;

**S 540 Suit - Court of Appeal Decision**

[13] The Court of Appeal agreed with the High Court that the two main issues in this case were (i) whether the defendants used Centennial with the intention to defraud the plaintiffs, and (ii) whether the plaintiffs had made any misrepresentation to the defendants.

[14] On issue (i), the Court of Appeal agreed with the High Court that the plaintiffs' allegation on the intention to defraud were only general allegations without specifying the time of the commission of the wrongful act. The Court of Appeal also decided that on the evidence the findings of fact of the High Court were not plainly wrong.

[15] On issue (ii), the Court of Appeal also agreed with the High Court that the defendants were induced to enter into the SPA because of the misrepresentations by the plaintiffs. The Court of Appeal also agreed that the causes of action in Suit 128 and s 540 Suit are different and that as such *res judicata* did not apply to bar the defendants from raising the issue of misrepresentation.

**Submission of parties**

[Plaintiffs' Submission]

[16] Learned counsel for the plaintiff's submitted that Question 1 should be answered in the affirmative on the following grounds:

(i) s 540 of the CA 2016 is a statutory tool to pierce the corporate veil to protect innocent parties from opportunistic directors who appear to be carrying out business of the company with the intent to defraud innocent parties (***Dato' Prem Krishna Sahgal v Muniandy Nadasan & Ors*** [2017] 10 CLJ 385; ***Tradewinds Properties Sdn Bhd v Zulhkiple bin A Bakar & Ors*** [2019] 1 MLJ 421 CA; ***Lama Tile (Timur) Sdn Bhd v Lim Meng Kwan & Anor*** [2015] 4 MLJ 85; [2015] 3 CLJ 763 CA). A single act in the course of carrying on the company's business with intent to defraud the company's creditors is sufficient to amount to fraudulent trading (***JCT Ltd v Muniandy Nadasan & Ors and another appeal*** [2016] 6 MLJ 635 CA; ***Dato' Prem Krishna Sahgal v Muniandy Nadasan & Ors****, supra;* ***Re Gerald Cooper Chemicals Ltd (In Liquidation) [No. 001027 of 1977]*** [1978] Ch 262 at 264C);

(ii) that the meaning of the phrase '*any business of the company has been carried on with intent to defraud creditors*' in s 540 of the CA 2016 has been interpreted by the Court of Appeal in *Tradewinds*, supra at para [21] to mean '*that if a company continues to carry on business to incur debts at a time when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts. It is in general a proper inference that the company is carrying on business with intent to defraud*.' And at para [22] that '*[i]t was enough if the defendant realised at the time when the debts were*

*incurred that there was no reason for thinking that funds would be available to pay the debt when it would become due or shortly thereafter*.' That in order to establish dishonesty under s 540 of the CA 2016 the court must find that:

a) according to the ordinary standard of reasonable and honest people what was done was dishonest; and
b) that the actor himself must have realised that the act was by those standards. (*Tradewinds*, supra).

(iii) that 'intent to defraud' includes a situation where a director intends that the creditors shall never be paid or only be paid a fraction owed (***KHH (Puchong) Hardware Sdn Bhd v Chong Chee Onn & Ors*** [2022] MLJU 66; ***R v Grantham*** [1984] 3 All ER 166; ***Tan Hung Yeoh v Public Prosecutor*** [1999] 3 SLR 93). That the 'intent' is ascertained from '*the nature or foreseen consequences of his act*' of the person carrying on the business (***Re Gerald Cooper***, supra at 267).

(iv) that on the following undisputed facts –

a) the defendants intentionally incorporated Centennial for the sole purpose to purchase Fave;
b) Fave was transferred to the 1st and 2nd defendants, not Centennial;
c) By entering into the contract, the defendants represented the purchase price will be fully settled by Centennial;
d) The defendants knew Centennial had no money. The 3rd defendant admitted they refrained from injecting any monies into Centennial;

e) The defendants knew or would have known there was no prospect for Centennial to repay the final balance purchase price when it became due; and
f) The defendants failed to pay the final balance purchase price after ownership of Fave was transferred to the 1st and 2nd defendants.

it can be properly inferred Centenial under the defendants' control was carrying on business with intent to defraud. The defendants had acted with real dishonesty, by the current notions of fair trading among commercial men. That this is a case were 'there was no reason for thinking that funds would be available to pay the debt when it became due' (***Regina v Sinclair***, applied in *Tradewinds* at para [22]).

[17] Learned counsel for the plaintiffs further argued that Question 3 should also be answered in the affirmative. He submitted that the Court of Appeal and the High Court had set a dangerous precedent when the Court of Appeal found the plaintiffs '*entered into the Agreement voluntarily with conscious mind relating to Centennial position*' and '*reasons related to Centennial's assets, financial standing, bank account and business records are only excuses and afterthought*' (Court of Appeal written judgment paras [31] to [35] and High Court judgment at paras [20] and [21]). Learned counsel argued that it runs contrary to the principle that in a commercial contract, assumes '*each party will assume the honesty and good faith of the other, absent such an assumption they would not deal*' (***HIH Casualty and General Insurance Ltd v Chase Manhattan Bank*** [2003] 1 All ER (Comm) 349, para [15]; ***CIMB Bank Bhd v Maybank Trustees Bhd and other appeals*** [2014] 3 MLJ 169 FC at para

[165]). This is also consistent with the principle that '*the law does not expect people to arrange their affairs on the basis that others may commit fraud*' (*Takhar*, supra per Lord Kerr).

[18] Learned counsel next addressed Question 2 – issue of *res judicata*. The plaintiffs' argument relates to the findings of the High Court and the Court of Appeal that (i) the plaintiffs had misrepresented to the defendants on the profitability and or absence of restriction on the timber logging rights, (ii) that the defendants' decision not to pay the final balance purchase price upon discovering the existence of the restriction against logging at an area of 1,000 feet above sea level was not to defraud the plaintiffs, and that (ii) it was a business decision on account of the inability to obtain any profit from the timber logging rights. Learned counsel argued that the said findings disregarded the fact that under clause 9.1(f) of the SPA, the plaintiffs made no representations whatsoever to the defendants in respect of the potential of the timber logging rights and the land. The purchase price of RM7 million was not contingent or dependent on income being generated from the timber logging rights. The defendants' allegation is only an afterthought.

[19] Learned counsel emphasised that the defendants have raised the same defence of misrepresentation in Suit 128 but that defence was rejected by the High Court in that suit. The defendants were witnesses in Suit 128. There was no appeal against the decision. As the same issue has already been determined by the High Court in Suit 128, the principle of *res judicata* applies and the defendants, as directors, who are privies of Centennial are estopped and barred from relitigating the same allegation of misrepresentation in the s 540 Suit (***Asia Commercial Finance (M) Bhd v Kawal Teliti Sdn Bhd*** [1995] 3 MLJ 189 SC; ***Seri***

***Iskandar Development Corporation Sdn Bhd v Pembinaan Daya Tekad Sdn Bhd & Ors*** [2016] 1 LNS 627; ***Muhammad Nur Hafiz bin Roalan v Mohamed Izani bin Mohamed Jakel & Ors*** [2021] MLJU 2311; ***Lo Kai Shui v HSBC International Trustee Ltd & Ors*** [2021] 5 HKC 337). Accordingly, it was submitted that Question 2(i) should be answered in the positive and Question 2(ii) should be answered in the negative.

[Defendants' Submission]

[20] In reply, learned counsel for the defendants argued that there is no evidence to show that the findings of fact of the High Court which were affirmed by the Court of Appeal were plainly wrong (***Gan Yook Chin (P) & Anor v Lee Ing Chin @ Lee Teck Seng & Ors*** [2004] 4 CLJ 309; ***Ng Hoo Kui & Anor v Wendy Tan Lee Peng, Administrator of the Estates of Tan Ewe Kwang, Deceased & Ors*** [2020] 10 CLJ 1 FC). The plaintiffs knew of Centennial's financial standing when they entered into the SPA. The plaintiffs were legally represented in the transaction. The plaintiffs also accepted the initial two payment tranches from Westhill, a third party without any objections. The time period of 10 days under the SPA for the defendants to conduct the due diligence was too short. The defendants only discovered the logging restrictions about 8 months after the SPA was signed. As a result of the restrictions, most of the trees on the land could not be logged; the defendants' appeal to the authorities to lift the restrictions were rejected. It is clear from the findings of the High Court and the Court of Appeal that there was no intention to defraud. As such, Questions 1 and 3 should be answered in the negative.

[21] In respect of Question 2, learned counsel argued that *res judicata* does not apply to the s 540 Suit because of the different causes of action in Suit 218 (breach of contract against Centennial) and in the s 540 Suit

(fraudulent trading against the defendants in their personal capacities) (***Loh Holdings v Peglin Development*** [1984] 2 MLJ 105; ***Syarikat Sebati Sdn Bhd v Pengarah Jabatan Perhutanan & Anor*** [2019] 3 CLJ 157

**Doctrine of Corporate Personality**

[22] An action under s 540 of the CA 2016 underpins the existence of the statutory exception to the common law doctrine of corporate personality, also known as the separate legal entity principle: that the company is treated as an entity separate from its members. This doctrine was propounded in the landmark judgment of the House of Lords in *Aron Salomon v A Salomon & Co Ltd* [1879] AC 22. In *Sunrise Sdn Bhd v First Profile (M) Sdn Bhd & Anor* [1996] 3 MLJ 533 FC the Federal Court reaffirmed the basic principle of the fundamental attribute of corporate personality that the corporation is a legal entity distinct from its members.

[23] The application of the statutory exception to the corporate personality principle has been also described as the lifting of the corporate veil – the effect of which is to render the members or officers of the company personally liable for the debts and liabilities of the company under certain circumstances. Under s 304 of the former Companies Act 1965, responsibility and liability will attached to any person if it can be established that that person(s) has conducted a company's business with intent to defraud creditors. Section 540 of the current CA 2016 which is in *pari materia* with s 304 of the Companies Act 1965 reads as follows:

## Section 540 Responsibility for fraudulent trading

(1) If in the course of the winding up of a company or in any proceedings against a company it appears that any business of the company has been carried on with intent to defraud the creditors of the company or creditors of any other person or for any fraudulent purpose, the Court on the application of the liquidator or any creditor or contributory of the company, may, if the Court thinks proper so to do, declare that any person who was knowingly a party to the carrying on of the business in that manner shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court directs.

(2) Where a person has been convicted of an offence under subsection 539(3) in relation to the contracting of such a debt as is referred to in that section, the Court on the application of the liquidator or any creditor or contributory of the company may, if the Court thinks proper so to do, declare that the person shall be personally responsible without any limitation of liability for the payment of the whole or any part of that debt.

(3) When the Court makes any declaration under subsection (1) or (2), the Court may give such further directions as it thinks proper for the purpose of giving effect to that declaration, and in particular may make provision for making the liability of any person under the declaration a charge on any debt or obligation due from the company to the person, or on any charge or any interest in any charge on any assets of the company held by or vested in the person or any corporation or person on his behalf, or any person claiming as assignee from or through the person

liable or any corporation or person acting on his behalf, and may from time to time make such further order as is necessary for the purpose of enforcing any charge imposed under this subsection.

(4) For the purposes of subsection (3), "assignee" includes any person to whom or in whose favour by the directions of the person liable the debt, obligation or charge was created, issued or transferred or the interest created, but does not include an assignee for valuable consideration and consideration by way of marriage, given in good faith and without notice of any of the matters on the ground of which the declaration is made.

(5) Where any business of a company is carried on with the intent or for the purpose mentioned in subsection (1), every person who was knowingly a party to the carrying on of the business with that intent or purpose, commits an offence and shall, on conviction, be liable to imprisonment for a term not exceeding ten years or to a fine not exceeding one million ringgit or to both.

(6) This section shall have effect notwithstanding that the person concerned is criminally liable under this Act in respect of the matters on the ground of which the declaration is made.

(7) On the hearing of an application under subsection (1) or (2), the liquidator may give evidence or call witnesses himself.

[24] That responsibility for fraudulent trading under s 540 of the CA 2016 is the statutory exception to the corporate personality doctrine has been the subject of extensive discussion in a line of cases. Accordingly, it might be useful and desirable to set out a synopsis of the well-established

principles which govern the application of this statutory exception which are:

i. The words 'with intent to defraud creditors … or for any fraudulent purpose' in s 304 of the Companies Act 1965 should be read disjunctively even though on the facts of the case both limbs are relevant and applicable (*Siow Yoon Keong v H Rosen Engineering BV* [2003] 4 CLJ 68 CA);

ii. In the context of carrying on business, the phrase 'with intent to defraud creditors' it is in general a proper inference that the company is carrying on business with intent to defraud the creditors of the company if the company continues to carry on business to incur debts at a time when there is to the knowledge of the directors no reasonable prospect of the creditors ever receiving payment of those debts. (*R v Grantham* [1984] BCLC 270). It has also been interpreted to include an intent to deprive creditors, of an economic advantage or inflict upon them some economic loss (*Coleman v The Queen* [1987] 5 ACLC 766). The word 'intent' is being used in the sense that a man must be taken to intend the natural or foreseen consequences of his act (*Re Cooper,* supra at 267);

iii. The word 'fraud' is also defined under s 17 of the Contracts Act 1950. According to Sinnadurai, *Law of Contract*, Fourth Edition 2011 at para. [5.07], fraud is defined 'to include certain acts which are committed with intent to induce another party to enter into a contract.' Section 17 sets out five types of different acts which constitute fraud. These include 'a promise made without any intention of performing it' and 'any other act fitted to deceive': s 17(c) and (d), Contracts Act 1950.

iv. The words 'if … it appears' in s 304 of the Companied Act 1965 is indicative of a lower threshold in order to trigger the operation of s

304. It does not matter whether s 304 contains in it both civil and a criminal provision – the civil provision in sub-s(1) and the criminal sanction in sub-s (5) are properly carved out and they do not interfere in each other's operation (*Siow Yoon Keong v H Rosen Engineering BV* [2003] 4 CLJ 68; *JCT Ltd v Muniandy Nadasan & Ors and anor appeal* [2016] 6 MLJ 635; [2016] 1 CLJ 692);

v. The burden of proof is on the plaintiffs to establish fraudulent trading within the meaning of s 304 of the Companies Act 1965. The standard of proof in civil cases involving proof of fraud or fraudulent conduct is on the balance of probabilities (*Sinnaiyah & Sons Sdn Bhd v Damai Setia Sdn Bhd* [2015] 7 CLJ 574 FC);

vi. The existence of fraud is a question of fact. It is dependent on the circumstances of each particular case. Fraud must mean actual fraud, i.e., dishonesty of some sort (*PJTV Denson (M) Sdn Bhd & Ors v Roxy (Malaysia) Sdn Bhd* [1980] 1 LNS 55 FC);

vii. In order to establish dishonesty under s 304 of the Companies Act 1965, it must be shown that firstly, what was done was dishonest according to the ordinary standard of reasonable and honest people, and secondly that the actor himself must have realised that the act was by those standards dishonest (*Tradewinds*, supra);

viii. It is fraud if it is proved that there was the taking of a risk which there was no right to take which would cause detriment or prejudice to another. It need not be proved that the defendant knew at the time when debts were incurred that there was no reasonable prospect of creditors ever receiving payment of their debts. It was enough if the defendant realised at the time when the debts were incurred that there was no reason for thinking that funds would be available to pay the debt when it would become due or shortly

thereafter. These words import a criterion that is partly subjective and partly objective (*Regina v Sinclair* [1968] 1 WLR 1246);

ix. Whether there was any intention on the part of the defendants to defraud or to carry on any fraudulent purpose is a question of fact to be inferred from the surrounding circumstances and the subsequent conduct of the defendants, especially the concealment of material facts (*Rahj Kamal bin Abdullah v PP* [1998] 1 SLR 447; *LMW Electronics Pte, supra*);

x. Actual knowledge was required before a person could be said to be knowingly a party to the fraudulent transaction carried out by a company within the meaning of s 304 of the Companies Act 1965 – it must be shown that the person has participated, concurred or taken some positive steps in the carrying on of the company's business in a fraudulent manner – however, it is not necessary to show proof of his having assumed a controlling or managerial role over the company's business before he could be said to be a party to the carrying on of it (*Tan Hung Yeoh v Public Prosecutor* [1999] 2 SLR(R) 262 HC);

xi. It is not necessary to establish a scheme to defraud to trigger the invocation of s 304 of the Companies Act 1965. The wordings of s 304 do not lend itself to be read in such a manner – a single act of doing business to defraud a creditor would be sufficient to trigger an action for compensation against the errant person in his personal capacity. A business may be found to have been carried out with intent to defraud creditors notwithstanding that only one creditor is shown to have been defrauded, and by a single transaction (*Re Gerald Cooper supra*; *Morphitis v Bernasconi & Ors* [2003] BCLC 53; *Prem Krishna Sahgal, supra).*

[25] Ultimately, whether a person has conducted a company's business with intent to defraud its creditors is a question of mixed fact and law. As such, it is may be helpful to consider some recent decisions. In *Lama Tile* [2015], a man and his wife were, at all material times, the only directors and shareholders of LMK Edaran Sdn Bhd ('LMK') and SLMK Edaran Sdn Bhd ('SLMK'). Between the months of October 2004 and April 2005 LMK took delivery of building materials purchased from the plaintiff at the total cost of RM309,481.20. As the purchase price was not paid, the plaintiff sued LMK for the same in 2005 ('2005 Action'). In 2010 the plaintiff obtained judgment against LMK. Notwithstanding the judgment, LMK failed to settle the debt to the plaintiff. In 2013, the plaintiff filed an action against the couple as defendants for fraudulent trading under s 304(1) of the Companies Act 1965 ('2013 Action'). The plaintiff led evidence which showed that shortly after the letter of demand was sent prior to the filing of the 2005 Action, LMK changed its company signboard from LMK Edaran to SMLK Edaran. The change was done by adding the alphabet 'S' to the signboard in the Romanised script, but the Chinese characters were left unaltered, and similarly the facsimile number, telephone number and the logo. Further, SMLK was formerly known as Southern Taipan Sdn Bhd which was incorporated in 1996. The name change to SMLK was done in September 2005, about two months after the plaintiff sent the letter of demand to LMK. Company searches also showed that in 2005, whilst LMK was an active company, SMLK was a dormant company. But by 2008, the position was reversed, and remained as such until 2012. The defendants were also previously directors of the plaintiff from 1984 to June 2005, who were not re-elected as directors in 2005 because the relationship between the defendants and other members of the board of the plaintiff had broken down. The defendant husband was in fact an executive director of the plaintiff. The Court of Appeal found that the

plaintiff had adduced sufficient evidence of the intention to defraud on a balance of probabilities under s 304 of the Companies Act 1965.

[26] In *Aneka Melor Sdn Bhd v Seri Sabco (M) Sdn Bhd* [2016] 2 CLJ 563 CA, a sub-contractor filed an action against the main contractor for payment under a construction sub-contract. In the same action, the directors of the main contractor were also sued for fraudulent trading pursuant to s 304 of the Companies Act 1965. The directors, who are husband and wife, were managing the main contractor company. It was contended for the sub-contractor that the directors knew that the main contractor would not pay the sub-contractor when they invited the sub-contractor to commence work at the construction site. The action against the main contractor was dismissed. The Court of Appeal found that there was no cogent and convincing evidence to suggest that the directors had the intention of not performing their contractual obligations to the sub-contractor when they approached and invited the sub-contractor to undertake the contract works. This was not a case where the main contractor 'was already in financial difficulties, and in debts, but continued to invite the plaintiff to undertake the contract works despite the directors having knowledge that the company had no reasonable prospect of paying the plaintiff for work done.'

[27] In *Chin Chee Keong v Toling Corporation (M) Sdn Bhd* [2016] 6 CLJ 666 CA, the plaintiff supplied resin to Pacific Plastic Industries Sdn Bhd ('PPI') for the period between October 2003 and February 2004 amounting to RM588,093.00. As PPI failed to pay for the resins supplied, the plaintiff sued and obtained judgment in default against PPI. The judgment debt was not satisfied. The plaintiff then filed an action under s 304(1) of the Companied Act 1965 against the two directors of PPI to

make them personally liable for the debt owed by PPI. In this case, the High Court found that there was cogent and convincing evidence to suggest that the directors had from the beginning the intention of not paying or seeing the plaintiff being paid. PPI was already in financial difficulties and in debt. Despite having knowledge that PPI had no reasonable prospect of paying the plaintiff for the purchases made, the two directors who are the only directors of PPI, went ahead with the purchases. The findings of the High Court which were affirmed by the Court of Appeal were premised on the following facts: (i) the two directors were the only shareholders and directors of PPI, (ii) PPI's audited reports for years 2002, 2003 and 2004 show that PPI was experiencing cash flow problems and was in financial difficulties, (iii) the balance sheet show that PPI had no reasonable prospect of paying its debts in 2003 and 2004, (iv) the directors did not challenge or explain that PPI was not in debt and that it was able to pay its creditors, (v) despite knowing of PPI's inability to pay for its purchases, PPI under the directions of the directors proceeded to place "unusual large orders of raw materials from the plaintiff during the material period", (vi) the directors' contention that PPI was unable to pay the plaintiff because they were unable to collect on a debt of RM600,000.00 from one of its customers was rejected by the trial court as the directors did not produce any documentary evidence to support their contention, (vii) the second director ran the daily operations of the company, placing orders with the plaintiff despite knowing full well that PPI was not able to pay and PPI was not going to pay for the purchases, (viii) the first director's evidence that he was not involved in the operations of PPI was contrary to their own pleaded case that both directors ran PPI, and (ix) the statutory declaration to PPI's audited reports for years 2002-2004 were signed by the first director who acknowledged that he was the director responsible for the financial management of PPI.

[28] In *Prem Krishna Sahgal* [2017], the executive managing director (defendant) of a public listed company ('CNLT') was sued by CNLT's employees for fraudulent trading under s 304 of the Companies Act 1965. CNLT was wound up in 2009 and the employees filed their action against the defendant claiming for arrears of salary and workers' compensation amounting to RM2,910,201.78 in 2013. It was the employee's case that CNLT's business was carried on from 2006 onwards until it was wound up in January 2009 with intent to defraud creditors of CNLT, or for a fraudulent purpose. The High Court found that the employees' complaint of fraudulent trading was made out on the following facts: (i) CNLT, primarily through its managing director prepared or issued fictitious invoices in 2007 to a third party for RM4,271,745.06 with a view to inflating or overstating its revenue, such that CNLT would appear to be a 'going concern', or at the very least, not as insolvent as it actually was, (ii) overstating the value of CNLT's plant and machinery, (iii) CNLT's assets amounting to USD1,250,000 were dissipated or channelled to CNLT's largest shareholder, JCT Limited, after CNLT had been listed a PN17 company, (iv) CNLT, through inter alia, the defendant caused three cheques in the sum of RM160,000.00 to be issued and encashed in September 2007, (v) failure to cause CNLT to remit contributions to EPF and SOCSO despite deducting the employees' contribution since August 2007, (vi) the defendant's action in dissipating assets out of the reach of provisional liquidators in May 2008, and (vii) payments made to preferred unsecured creditors as well as some shareholders amounting to RM2,841,696.00 without validation at the time of the restraining order dated 26.10.2007 was in force. The Court of Appeal upheld the High Court's findings of fact and observed that the EPF contributions from the employees in 2007 though deducted from their salaries were not remitted

to the Employee's Provident Fund; neither were CNLT's contributions in respect of the employees remitted to the said Fund. Yet during these times, the CNLT, primarily through acts attributable to the defendant who was then, the Managing Director of CNLT, had continued to do business, in order to exhibit to the creditors that it was a going concern when in fact, it was not. That this is an incidence of fraudulent carrying on business.

[29] In *Tradewinds Properties* [2019], the Court of Appeal lifted the corporate veil in the light of evidence showing a clear intention on the part of the defendants to defraud the plaintiff. In February 2009, the plaintiff sued the 1st and 2nd defendants for the recovery of monies owed ('2009 Action'). The 1st defendant was one of the two directors and held 100% shareholding in the 2nd defendant company. In 2011, a consent judgment was recorded whereby the defendants agreed to pay the plaintiff RM1,150,000.00 in instalments. It was agreed that the 1st defendant's liability is discharged after RM500,000.00 is paid. The defendants defaulted on the terms of payment as they only paid a total sum of RM654,000.00 leaving the balance of RM496,000.00 unpaid. Subsequently, the plaintiff discovered certain facts which prompted the plaintiff to file a fresh action against the 1st and 2nd defendants under s 304 of the Companies Act 1965 for fraudulent trading. It transpired that after the 2009 Action was filed in February 2009, the 1st defendant had incorporated a new company in September 2009; that in 2011, the 2nd defendant company passed two resolutions to reassign the consultancy fees due and payable to the 2nd defendant under three projects amounting to RM2.3 million to the new company. The Court of Appeal held that the 1st defendant was the alter ego of both the 2nd defendant company and the new company in the light of the following facts: (i) that the 1st defendant was not only a director in the 2nd defendant company and held 100%

shareholding but that he was also a director in the new company with 85% shareholding, (ii) the 1st defendant also exercised total control of the 2nd defendant company, (iii) the new company was incorporated to receive the payment of the professional fees for work undertaken by the 2nd defendant, (iv) the 2nd defendant's expenses were also borne by the new company, (v) the 2nd defendant became a dormant company after the reassignment of the consultancy fees to the new company. The Court of Appeal also opined that the incorporation of the new company by the 1st defendant prior to the 2009 Action and the consent judgement can be equated to fraudulent trading as defined under s 304(2) of the Companies Act 1965. The contemporaneous evidence clearly showed that the new company was incorporated prior to the consent judgment, making it possible for the 1st defendant to have incorporated a company in contemplation of evading payments about one and a half year prior to the consent judgment.

**Decision**

[30] We begin with Question 1. The central issue is whether there was intent to defraud within the meaning of s 540 of the CA 2016 so as to impose personal liability on the directors of the company. In order to determine this issue, it is pertinent to note the following facts which are not in dispute:

a) Centennial was incorporated as a private limited company on 28.6.2012. The defendants are directors of Centennial and the 3rd defendant is a shareholder;
b) the defendants incorporated Centennial for the sole purpose of acquiring Fave for its timber logging rights;

c) the defendants became directors of Centennial not long after they became aware that Fave had been awarded the timber logging rights and the negotiations regarding the sale of Fave began;
d) Centennial did not have any business dealings or history of business prior to the SPA;
e) as at the date of the SPA, Centennial did not have any funds, assets of value and/or any bank accounts;
f) the defendants had full control, power and were actively involved in the management of Centennial;
g) Centennial has no auditors;
h) the defendants did not open any bank account for Centennial. Centennial did not have a business address;
i) Centennial shares the same registered address and company secretary with Westhill;
j) Westhill is the majority shareholder of Centennial;
k) The defendants are directors and majority shareholders of Westhill;
l) Westhill does not have a business address;
m) neither Centennial nor Westhill filed their audited financial statements.

[31] In the first place, the fact that the defendants procured Centennial as the vehicle to enter the SPA as the buyer is a pertinent fact. Centenial was a dormant company. It did not have any assets, it was not doing any business or trading, and it did not have any income. Even though the defendants have incorporated Centennial for the sole purpose of acquiring Fave, the defendants have not injected any capital into Centennial in anticipation of Centennial's contractual obligation under the SPA to pay the purchase price to the plaintiffs. In short, Centennial had no funds to pay the purchase price.

[32] Another unusual feature which presented itself is this: the defendants have procured another company, Westhill, as a vehicle to effect part payment of the first and second tranches of the purchase price to the plaintiffs. It is unusual because Westhill is not a party under the SPA and there is no provision in the SPA referring to this arrangement.

[33] The third unusual feature which, in our view, was particularly significant is that Fave was transferred to the defendants and not to Centennial. This is despite the fact that (i) Centennial is the designated buyer under the SPA and (ii) there is no provision under the SPA which allows for Centennial to appoint a nominee or nominees to take up the shares in Fave. We also noted that the SPA provides for the immediate transfer of ownership of Fave upon the execution of the SPA - even though the full purchase price has yet to be settled. In other words, the defendants as the new owners of Fave enjoyed the full benefit of the SPA. Meanwhile, the contractual obligation for the balance purchase price under the SPA remained solely with Centennial.

[34] Applying the principles to the circumstances described above, it is our considered view that the scheme orchestrated by the defendants were obviously calculated to insulate themselves against any personal liability for the purchase of Fave. On the uncontroverted facts, the plaintiffs had been induced to agree to the immediate transfer of their interests in Fave to the defendants on the representation that the balance purchase price would be paid by Centennial in the future. Having derived the full benefit under the SPA, the defendants were content to let the plaintiffs take legal action against Centennial for the balance purchase price. The procurement of Centennial and Westhill in the defendants' scheme was

intended to create corporate layers to obfuscate themselves from the transaction. Both Centennial and Westhill are dormant companies. There was no prospect of Centennial paying the balance purchase price. Westhill was not a party to the SPA; no contractual liability could attach to it because it was not privy to the SPA, and neither did Westhill derive any benefit under the SPA. We also noted the fact that in Suit 128, the defendants had given evidence on behalf of Centennial; that their defence and counterclaim premised on misrepresentation was dismissed.

[35] As such, we have no hesitation in concluding that what was done was dishonest according to the ordinary standards of reasonable and honest people. The fact that Centennial and Westhill were utilised as layers to insulate the defendants leads to an inference that the defendants must have known that their act was by those standards dishonest. The subsequent conduct of the defendants in raising the defence of misrepresentation in the s 540 Suit when that very same defence and counterclaim was dismissed in Suit 128 gives rise to yet another inference as to the intention of the defendants to defraud the plaintiffs. The fact of the defendants' participation in the SPA transaction both at the negotiation stage (pre-SPA), execution stage and post-SPA is not disputed; they were the real controlling arm behind both Centennial and Westhill. In all the circumstances, the fact that this was a single transaction does not negate the inferences arising from the settled facts.

[36] In our considered view, the courts below had failed to properly apply the settled principles and to judicially appreciate the totality of evidence. Accordingly, we are constrained to set aside the findings of the courts below. For the foregoing reasons, we would answer Question 1 in the affirmative

[37] We now turn to Question 2 on *res judicata*. We have dealt with the issue of the defendants relying on the same defence of misrepresentation in Suit 128 which was rejected by the High Court. We are also constrained to hold that in upholding the defendants' defence of misrepresentation, the courts below erred for the following reasons. First, both the High Court and the Court of Appeal disregarded the fact that under the SPA, the plaintiffs made no such representations whatsoever. Clause 9.1(f) of the SPA expressly provided that 'the Seller made no representation whatsoever to the Buyer in respect of the Land and/or its potential in respect of the logging and related activities and the Buyer has seek (sic) independent advice verification exercise as to the same'. Secondly, pursuant to clause 1(b) of the SPA, the defendants were given a grace period of ten days to conduct a due diligence on the status and validity of Fave's timber logging rights, and to terminate the SPA in the event that the timber logging rights were invalid for any reason whatsoever. However, the defendants did not terminate the SPA after the due diligence period had elapsed. Third, and more pertinently, the defendants testifying for Centennial in Suit 128 have raised the same defence of misrepresentation which was rejected by the High Court; Centennial did not appeal against the High Court's ruling. As the law on *res judicata* is well settled we do not propose to restate the principles and authorities referred to by learned counsel for the plaintiffs. We only need to say that we agree with the submissions of learned counsel for the plaintiffs on this issue. For the foregoing reasons, we would answer Question 2(i) in the affirmative and Question 2(ii) in the negative.

[38] Question 3 posits whether the common law principle that 'the law does not expect people to arrange their affairs on the basis that other

people may commit fraud' is representative of the position of Malaysian law. This question must be considered in the light of the opinion of the Court of Appeal which upheld the findings of the High Court. In particular, the Court of Appeal opined that the plaintiffs had entered into the SPA voluntarily with 'conscious mind relating to Centennial (sic) position', and (ii) the High Court's findings that the plaintiffs were aware of Centennial's financial standing before they entered into the SPA, that the plaintiffs never raised any complaint, question or objection relating to Centennial's financial standing, that the plaintiffs agreed to sign the SPA with Centennial despite the fact that Centennial was only registered six moths prior to the SPA and that Centennial did not have any assets and business. In other words, the Court of Appeal and High Court took the view that the plaintiffs only have themselves to blame for not checking up on Centennial's financial ability to pay the purchase price.

[39] In our view, this issue relates to the notion of good faith in contract. The words 'good faith' has been defined in the Australian Legal Dictionary to mean 'propriety' or honesty. A thing is done in good faith when it is in fact done honestly, whether it be done negligently or not. It has also been defined as '[a] state of mind indicating honesty and lawfulness of purpose; honesty, absence of fraud, collusion or deceit (*Words, Phrases & Maxims, Legally & Judicially Defined*, Ananda Krishnan, Lexis Nexis at para. [G0225]).

[40] Under the English common law however, there is no general principle of good faith in contract - that a party to a contract exercise his rights in good faith, whether the right in question concerns the creation of a contract, its performance or its non-performance. There is no general requirement that a person act in good faith, reasonably and fairly (C*hitty*

*on Contracts, General Principles* Thirty-Third Edition Vol 1 para. 1-044). There is no general obligation to act in good faith during negotiations of commercial contracts. The general rule is that mere non-disclosure does not constitute misrepresentation, for there is in general no duty on the parties to a contract to disclose material facts to each other, however dishonest such non-disclosure may be in particular circumstances. Nonetheless, there are exceptions to this general rule to disclose, namely, (i) where the contract is within the class of contracts *uberrimae fidei*, (ii) where there is a fiduciary relationship between the parties, (iii) where the agreement in question is a 'relational' contract giving rise to an implied term of good faith, and (iv) where failure to disclose some fact distorts a positive representation.

[41] A contract *uberrimae fidei* is a contract based on utmost good faith. All insurance contracts are *uberrimae fidei*, whatever their subject matter, whether they be marine, fire, life, burglary insurance, or to any other risk. If good faith is not observed by either party the contract may be avoided by the other party. The obligation to observe good faith is also a continuing one, which does not cease on execution of the insurance contract, although the ambit of duty in pre-contract and post-contract situations will not necessarily be the same. The reason for this principle of insurance law is that contracts of insurance are founded on facts which are nearly always in the exclusive knowledge of one party (usually the assured) and, unless this knowledge is shared, the risk insured against may be different from that intended to be covered by the party in ignorance. The duty which arises is threefold: a duty to disclose material facts; a duty not to misrepresent material facts; and a duty not to make fraudulent claims (C*hitty on Contracts, General Principles* Twenty-Seventh Edition Vol 1 para. 6-087).

[42] Another category of contracts imposing a duty to act in good faith are contracts to take up shares in a company. Contracts to take share in companies may be classified *uberrimae fidei* because the knowledge of the material facts lies with one party alone, namely, the promoters, directors and others responsible for the issue of the prospectus. It was long ago recognised that invitations to invest, made through a prospectus, could lead to much enrichment of individuals at the public expense, and at least from promoters the utmost good faith was required (C*hitty on Contracts, General Principles* Twenty-Seventh Edition Vol 1 para. 6-093).

[43] Good faith is also an implied term in family settlements. In these and in negotiations for these there must not only be an absence of misrepresentation but a full communication of all material facts known to the party. Any failure to disclose may be a ground for setting aside the settlement, and it is immaterial that information was withheld because of a mistaken opinion as to its accuracy or importance (*Gordon v Gordon* (1816-19) Swans, 400; *Fane v Fane* (1875) L. R. 20 Eq. 698).

[44] Similarly, good faith is also implied in partnership agreements. The fundamental duty of every partner is to show utmost good faith in his dealings with the other partners. This applies not only during the continuance of the partnership, but also during the negotiations leading to its formation and during the winding up after dissolution (*Fawcett v Whitehouse* (1829) 1 Russ. & M. 132). The principle of *caveat emptor* does not apply to the making of a partnership agreement. In negotiating such an agreement a party owes a duty to the other negotiating party to disclose all the material facts which he has knowledge of which the other

negotiation party may not be aware (*Bell v Lever Brothers Ltd* [1932] AC 161 at 227).

[45] The traditional English common law antipathy to the notion of duty of good faith in contract was called into question in two notable cases: *Yam Seng Pte Ltd v International Trade Corp Ltd* [2013] EWHC 111 (QB) a decision of the English High Court, and *Bhasin v Hrynew* [2014] SCC 71 a watershed decision of the Supreme Court of Canada.

[*Yam Seng* - English High Court Decision]

[46] *Yam Seng* was a case concerning a contract for an exclusive licence to distribute and for the supply of fragrances bearing the brand name 'Manchester United' in the Middle East, Asia, Africa and Australasia. Yam Seng sued the defendant for breach of contract and misrepresentation on the grounds of late shipment of orders, failing or refusing to supply all the specified products, undercutting prices and for providing false information. Yam Seng contended that there was an implied term in the distribution agreement that parties would deal with each other in good faith. Leggatt J noted that while a duty of good faith is implied by law as an incident of certain categories of contract (e.g., employment contracts, partnership contracts, contracts between parties in a fiduciary relationship), he doubted whether English law has reached the stage where it is ready to recognise a requirement of good faith as a duty implied by law, even as a default rule, into all commercial contracts. However, Leggatt J advocated the adoption of the established methodology of English law for the implication of terms in fact, in implying such a duty in any ordinary commercial contract based on the presumed intention of the parties. The two principal criteria used to identify terms implied in fact being that (i) the term is so obvious that it goes without saying, and (ii) that the term is

necessary to give business efficacy to the contract. In the context of the particular facts in *Yam Seng*, Leggatt J opined that the relevant background against which contracts are made includes not only matters of fact known to the parties but also shared values and norms of behaviour. Norms included those that command general social acceptance; whilst other norms may be specific to a particular trade or commercial activity; others may be more specific still, arising from features of the particular contractual relationship. He added that many such norms are taken for granted by the parties and are not spelt out in the contract. Leggatt J said that an expectation of honesty is a paradigm example of such a norm which underlies almost all contractual relationships; which expectation is essential to commerce which depends critically on trust. The fact that commerce takes place against a background expectation of honesty was recognised by the House of Lords citing Lord Bingham's dicta in *HIH Casualty*, supra.

[47] Interestingly, the learned authors in C*hitty on Contracts, General Principles* Thirty-Third Edition Vol 1 at para. 1-058 opined that Leggatt J appeared "to go further and argue in favour of the implication of a term requiring good faith in performance not merely in what he referred to as 'relational contracts' but in most, if not all, commercial contracts on the ground of the expectation of the parties". The implication of such an implied term applicable generally to commercial contracts would undermine to an unjustified extent English law's general position rejecting a general legal requirement of good faith; that subsequent judicial comments have suggested that it should not be seen as establishing a principle of general application to all commercial contracts, but rather recognising a particular example of a contract where a term as to good faith should be implied (*Mid Essex Hospital Services NHS Trust v*

*Compass Group UK and Ireland Ltd (t/a Medirest)* [2013] EWCA Civ 200; *Greenclose Ltd v National Westminster Bank Plc* [2014] EWHC 1156 (Ch); *Marks & Spenser Plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2015] UKSC 72).

[48] The aforesaid view appears to be borne out in the light of recent decisions of the UK Supreme Court and Court of Appeal which suggest that English common law has never recognised a general principle of good faith in contracting.

[49] In *Pakistan International Airline Corporation (Respondent) v Times Travel (UK) Ltd* (Appellant) [2021] UKSC 40, the issue was whether, and if so in what circumstances, a party can set aside a contract on the ground that it was entered into as a result of the other party threatening to do a lawful act. Put another way, the question was whether a party can rescind a contract for lawful act economic duress. In that case Times Travel ('TT') was a travel agent whose business consisted almost exclusively of selling plane tickets to and from Pakistan. Pakistan International Airline Corporation ('PIAC') was the sole operator of those flights. It allocated tickets to TT and paid commissions to TT for the tickets sold. This contractual arrangement could be terminated by PIAC at one month's notice. A dispute arose in 2011 and 2012 when certain travel agents, including TT, alleged that PIAC had not been paying them certain commission payments. Claims were brought to recover the unpaid commission. Under pressure from PIAC, TT did not join those claims. However, in September 2012, PIAC cut TT's normal fortnightly ticket allocation from 300 to 60 tickets, and gave notice that it would terminate their existing arrangement at the end of October 2012. This would have put TT out of business and so on 24 September 2012 TT agreed to accept

new terms ('the New Agreement') by which it waived any claims it might have for the previously unpaid commission. One of the directors of TT had been shown a draft of the New Agreement a few days beforehand but PIAC had refused his request to take a copy with him to discuss it and obtain legal advice. TT subsequently brought a claim against PIAC for the unpaid commission. It argued that it could rescind the New Agreement for lawful act economic duress. The trial judge agreed but also found that PIAC had genuinely believed that the disputed commission was not due. The Court of Appeal allowed PIAC's appeal as PIAC had not acted in bad faith in that sense. TT's appeal to the Supreme Court was dismissed – ruling that TT cannot rescind the New Agreement for lawful act economic duress. For the purposes of this judgment it is only relevant to note that the UK Supreme Court affirmed the principle that there is in English common law no doctrine of inequality of bargaining power in contract, although such inequality may be a relevant feature in some cases of undue influence; that it is for Parliament and not the judiciary to regulate inequality of bargaining power where a person is trading in a manner which is not otherwise contrary to law (para. [26]). More pertinently, whilst the Supreme Court affirmed the principle that the English law of contract seeks to protect the reasonable expectations of honest people when they enter into contracts (adding that it is an important principle which is applied to the interpretation of contracts), English law has never recognised a general principle of good faith in contracting. That instead, English law has relied on piecemeal solutions in response to demonstrated problems of unfairness (para. [27]). Consequently, the absence of these doctrines restricts the scope for lawful act economic duress in commercial life.

[50] In *Candey v Bosheh & Anor* [2022] EWCA Civ 1103, Candey, a legal firm had entered into a retainer with its client known as a conditional fee

agreement (CFA) under which it was only entitled to payment if the client recovered the amounts in litigation. The litigation between the client and the other party was settled on a "drop hands" basis – both parties agree to withdraw their respective claims against each other and each side being responsible for its own costs. This meant that Candey would not receive payment from its client. Candey sued its client on the basis that the CFA with its client was a relational contract which imposed an implied duty of good faith on both parties, that its client had breached that implied duty of good faith. The matter came up at an interim stage to the Court of Appeal to consider Candey's application to amend its Particulars of Claim to include a breach of the implied duty of good faith. The Court of Appeal held that Candey could not plead a claim for a breach of an implied duty of good faith. Candey's argument that a client owned his solicitor a duty of good faith was rejected. The Court of Appeal opined that (i) a solicitors' retainer generally, and CFAs in particular, had never before been regarded as relational contracts and were not commonly understood to impose an obligation of good faith on the client; (ii) that the implication of a duty of good faith into the retainer would mean that a CFA would cease to be a truly conditional fee agreement; since the proposed implied duty would be inconsistent with the CFA's express terms. The Court of Appeal also held that there was no basis for the term to be implied in fact because the proposed implied term was neither so obvious as to go without saying nor necessary for the retainer to work.

[51] In *Mark Faulkner & Others v Vollin Holdings Ltd & Others* [2022] EWCA Civ 1371, two minority shareholders and directors in a company who were removed as directors by a resolution argued that their removal as directors was a breach of the good faith clause contained in the shareholders' agreement. The High Court held that the minority

shareholders having being ‘entrenched’ as directors by the company’s Articles of Association and the shareholders’ agreement, their removal from office was in breach of contract. It opined that the words ‘good faith’ imported certain ‘minimum standards’, including a requirement to act honestly, a requirement of fidelity to the bargain, a requirement of fair and open dealing, and a requirement to have regard to the interests of minority shareholders. The Court of Appeal however, emphasising that each case turns on its own facts, rejected the notion of ‘minimum standards’. Good faith requires the parties to act with honesty and, depending on the context, it may also require the parties not to act in a manner that is commercially unacceptable to reasonable and honest people. In some cases, the duty of good faith could have a broader meaning, but only if the broader meaning can be “derived… from the other terms of the contract in issue”. That broader meaning is not automatically implied the use of the words ‘good faith”. Snowden LJ held that the shareholders’ agreement did not have an entrenching effect. The roles of the minority shareholders were not a contractual right and their removal as directors did not breach the duty of good faith provided under the shareholders’ agreement.

[*Bhasin* - Supreme Court of Canada Decision]

[52] In *Bhasin*, supra the Supreme Court of Canada held that there was a common law duty which applies to all contracts to act honestly in the performance of contractual obligations. At para. [60], Cromwell J said that “[c]ommercial parties reasonably expect a basic level of honesty and good faith in contractual dealings. While they remain at arms’ length and are not subject to the duties of a fiduciary, a basic level of honest conduct is necessary to the proper functioning of commerce.” He premised his opinion on the “organising principle of good faith” that underlies and

manifests itself in various more specific doctrines governing contractual performance. The organising principle being that parties generally must perform their contractual obligations honestly and reasonably and not capriciously or arbitrarily; otherwise described as a common law duty of honesty in contractual performance. He also emphasised that the duty of honest performance 'should not be thought of as an implied term, but as a general doctrine of contract law that imposes as a contractual duty a minimum standard of honest contractual performance (at para. [74]). More significantly, he accepted that recognising a duty of honest performance flowing directly from the organising principle of good faith is a modest, incremental step. It does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract (at para. [73]). In this case, Bhasin was a long-term retail dealer who had an automatic renewal dealership agreement with Canadian American Financial Corp ('Can-Am') subject to Can-Am's right of non-renewal. Even though the notice of non-renewal was given by Can-Am within the stipulated time frame, the court found that Can-Am had committed a breach of the duty of good faith contractual performance when Can-Am had misled Bhasin about a plan not to renew the contract but instead work with a new retail dealer.

[53] Recall that in *Bhasin* the Supreme Court of Canada clarified the principle of good faith in contract law and introduced the duty of honest performance – the requirement not to lie or mislead a counterparty regarding contractual performance. Two recent decisions of the Supreme Court of Canada appear to have endorsed and expanded the principle of good faith propounded in *Bhasin*.

[54] In *C.M. Callow Inc v Zollinger* 2020 SCC 45, the Supreme Court of Canada expanded upon the scope of the contractual obligation of good faith in *Bhasin* when it ruled that silence that misleads a counterparty could amount to a breach of honest performance. *Callow* concerned the termination of a two-year winter maintenance contract between the appellant (CM Callow) and ten condominium corporations (acting through a Joint Use Committee ('JUC')). The issue in the appeal revolved around a clause in the contract which provided that the condominium corporation were entitled to terminate the contract unilaterally without cause, subject to the giving of ten days' notice. In early 2013, even though the JUC had already decided to terminate the contract after only one winter of the two-winter term had been completed, they did not inform CM Callow of its decision to terminate the contract. Meanwhile, unaware of the JUC's decision to terminate the contract CM Callow in casual conversations with two JUC members came away with the impression that the winter contract would likely be renewed. CM Callow even performed additional "freebie" work in the hope of incentivising the JUC to renew the winter contract. The JUC did not tell CM Callow about its decision to terminate the contract until September 2013, when it gave the required notice of termination. CM Callow sued for breach of contract arguing that even though the required ten days' notice was given pursuant to the contract, the JUC's failure to exercise the termination right in accordance with the required duty of honest performance amounted to a breach. The Supreme Court of Canada held that the JUC breached its duty to act honestly in the performance of the contract by "knowingly misleading Callow into believing the winter maintenance agreement would not be terminated." The dishonest exercise of the termination clause was a matter directly linked to the performance of the contract, notwithstanding that the ten days notice requirement was met. The Supreme Court of Canada

affirmed the principle enunciated in Bhasin that the duty to act honestly means that a party to a contract may not lie or otherwise knowingly mislead another party about matters that are directly linked to the performance of the contract. That while the duty of honest performance does not amount to a positive duty to disclose, it does include an obligation to refrain from misleading a party in the exercise of the termination clause, and to correct any false impressions created by that party's own actions. Put another way, action, in the form of direct communications, as well as inaction, in the form of omissions or silence, can amount to a breach of the duty of honest contractual performance, depending on the circumstances.

[55] In *Wastech Services Ltd v Greater Vancouver Sewerage and Drainage District* 2021 SCC 7, pursuant to a twenty-year contract with the City, Wastech a service provider agreed to remove and transport the City's waste to three disposal facilities. Wastech was paid a different rate depending on which facility the City directed the waste to; the farther away the facility, the more profitable it was. The contract had a target operating ratio which would give Wastech 11% profit. However, the contract did not guarantee Wastech what profit Wastech would achieve in any given year. In 2011, about 15 years after the contract was first entered into, the City directed Wastech to a facility that was closer. As a result, Wastech only achieved a 4% operating profit in 2011. Wastech initiated arbitration proceedings against the City for breach of contract alleging that by unilaterally reallocating the distribution of waste between the three facilities, Wastech was deprived of the possibility of achieving the 11% profit target. Wastech claimed $2.8 million which was the additional amount which Wastech would have earned if the waste distribution had not been reallocated. The arbitrator ruled that the duty of good faith

applied and that the City had breached that duty. The contract was a long term contract and a relational contract and good faith required the City to have proper regard for the legitimate contractual interests of Wasteh. The City's appeal to the British Columbia Supreme Court succeeded and the arbitral award was set aside. Wastech's appeal to the British Columbia Court of Appeal was dismissed. Wastech then appealed to the Supreme Court of Canada. The issue for the Supreme Court of Canada's determination was what constraints the duty to exercise contractual discretion in good faith imposes on parties. The Supreme Court of Canada opined that the duty of good faith in the exercise of contractual discretion is an implied term in all contracts regardless of the intentions of the parties or the language of the contract. Accordingly, the arbitrary or capricious exercise of contractual discretionary power is a breach of contract. The Supreme Court stated that a party exercising contractual discretion in good faith is required to exercise discretion in a manner consistent with the purpose for which the discretion is provided under the contract. As such, the Court must ascertain the purpose for which the discretion was created under the contract. The duty of good faith is breached only where the discretion is exercised unreasonably, in a manner not related to the underlying purpose for which the discretion was given. On the facts, the Supreme Court found that the City's decision to reallocate the waste distribution fell within the range of permitted choices under the contract. As such, the City's decision was not unreasonable, given the purpose of their discretion under the contract – which was to give the City discretion to maximise efficiency and minimise costs of the operation.

[56] So much for the common law jurisprudence which developed in England and Canada post *Yam Seng* and *Bhasin*. Be that as it may, it is

in our view, important to note that the principles propounded by Leggatt J and Cromwell J in *Yam Seng* and *Bhasin* respectively, relate to the notion of good faith in contractual performance, and not to the duty of good faith in the creation of a contract. This distinction is significant because in *Yam Seng* and *Bhasin*, the wrongful acts complained of related to contractual performance whereas in our case the wrongful act complained of relates to the defendants' fraudulent conduct leading to the creation of the SPA.

[57] Whilst it is helpful to review the English common law position on the notion of good faith in contract, we think that a consideration of whether the position in *Takhar* is representative of Malaysian law must of necessity begin with a brief analysis of the law governing contracts in Malaysia. As a starting point, the law governing all contracts is the Contracts Act 1950. However, as the Contracts Act is not a complete code on the law of contracts, other statutes will, depending on the individual facts and circumstances of each case, be applicable in conjunction with the Contracts Act: for example, Sale of Goods Act 1957, National Land Code, Hire Purchase Act 1967, Housing Developers (Control and Licensing) Act (Act 118), Employment Act 1955, Insurance Act 1996, Companies Act 2016, Bills of Sale Act 1950, Partnership Act 1961, Government Contracts Act 1949, Specific Relief Act 1950, Civil Law Act 1956, to name a few.

[58] There are, in law, several essential ingredients present in a valid contract. First, there must be an offer ('proposal') which is communicated to the other party (ss 2(a), 3 and 4(1), Contracts Act). Second, the party accepting the offer must also have communicated his acceptance to the proposer (ss 4(2), 7 and 8, Contracts Act). Third, the contract must be for a lawful consideration (s 10, Contracts Act), in the sense that the consideration of a contract must be lawful within the meaning of ss 24 and

25, Contracts Act. Fourth, all contracts must be made by the free consent of the parties (s 10, Contracts Act). The parties to a contract are said to consent 'when they agree upon the same thing in the same sense' (s 13, Contracts Act); this is also known by the Latin phrase '*consensus ad idem'* – which has been defined in the *Australian Legal Dictionary as '*Agreement to do the same thing. The common consent necessary for a binding contract'. Consent is said to be only free within the meaning of s 14 of the Contracts Act (This requires a more detailed discussion and will be dealt with below). Fifth, the parties to the contract must be legally competent or have legal capacity to enter into a contract (ss10, 11 and 12, Contracts Act). Sixth, all contracts must have certainty – contracts which are vague or where the meaning of which is not certain, or capable of being made certain, are void (s 30, Contracts Act). Lastly, contracts must be for a lawful object (ss 10, 24 and 25 Contracts Act).

[59] For the purposes of this judgment, it will be pertinent to consider the element of free consent of parties to enter into a contract. Consent is defined under s 13 of the KA as: 'Two or more persons are said to consent when they agree upon the same thing in the same sense.' The words 'free consent' is defined as consent which is not caused by (a) coercion, (b) undue influence, (c) fraud, (d) misrepresentation, or mistake: see s 14, KA. In other words, sans these vitiating factors, consent is said to be free consent. Put another way, without consent that is free, there can be no *consensus ad idem*.

[60] Applying the law to the circumstances of this case, it may be inferred that the plaintiffs' consent to enter into the SPA was caused by fraud on the part of the defendants. In this case, the fraud was committed by the defendants with intent to induce the plaintiffs to enter into the SPA with

Centennial (see also para. [24(iii) above]). The plaintiffs were also induced to immediately part with their interests in Fave to the defendants upon the execution of the SPA. The defendants who had the immediate benefit under the SPA attempted to insulate themselves against any obligations or liabilities under the SPA through Centennial and Westhill. The plaintiffs had acted honesty and in good faith and in the expectation that the balance purchase price would be paid in accordance with the terms and conditions of the SPA. In these circumstances, should the plaintiffs be faulted for acting as they did?

[61] In our considered view, the principle that the law does not expect people to arrange their affairs on the basis that others may commit fraud is not inconsistent with the principle of free consent under the Contracts Act. We say this because the Contracts Act starts on the assumption that all contracts are valid. It is only if it can be proved that the consent was procured by coercion, fraud, misrepresentation or undue influence, then the contract becomes voidable at the option of the innocent party.

[62] It is arguable that vitiating factors such as coercion, fraud, misrepresentation or undue influence denotes the absence of good faith. It may also be argued that the duty to act in good faith is therefore a *sine qua non* in every contract, the absence of which renders the contract voidable at the option of the innocent party.

[63] In *CIMB Bank Bhd v Maybank Trustees B*hd, supra, the Federal Court ruled that a party which had committed fraudulent misappropriation of trust monies could not benefit from its own fraud and that that party cannot rely on the exemption clause under the contract as a defence. Ariffin Zakaria CJ writing for the Federal Court referred to the following

remarks of Lord Bingham in *HIH Casualty and General Insurance Ltd*, supra at para.[15]:

> '… fraud is a thing apart. This is not a mere slogan. It reflects an old legal rule that fraud unravels all: *fraus omnia corrumpit*. It also reflects the practical basis of commercial intercourse. Once fraud is proved, 'it vitiates judgments, contracts and all transactions whatsoever': *Lazarus Estates Ltd v Beasley* [1956] 1 QB 702 at p 712, per Lord Justice Denning. **Parties entering into a commercial contract will no doubt recognise and accept the risk of errors and omissions in the preceding negotiations, even negligent errors and omissions. But each party will assume the honesty and good faith of the other; absent such an assumption they would not deal.'** [Emphasis added]

[64] In the context of whether an exemption clause covers fraud, Lord Hoffmann' observations in *HIH Casualty and General Insurance Ltd*, supra on the distinction between fraudulent non-disclosure and negligent non-disclosure is also noteworthy. At para. [68], he said:

> The next question is whether the words relieve Chase from liability to avoidance of the contract or damages in cases in which the misrepresentation by its agent has been fraudulent or avoidance in cases in which the non-disclosure has been dishonest. Here again I agree with Rix LJ that fraud is quite different from negligence: '**Parties contract with one another in the expectation of honest dealing**', particularly in an insurance context. I think that in the absence of words which expressly refer to dishonesty, **it goes without saying that underlying the contractual**

> **arrangements of the parties there will be a common assumption that the persons involved will behave honestly.** As Lord Loreburn LC said of the exemption clauses in *S Pearson & Son Ltd v Dublin Corp* [1907] AC 351 at 354, [1904-7] All ER 255 at 257 'They contemplate honesty on both sides and protect only against honest mistakes'. (Emphasis added)

[65] In *Takhar*, supra, Lord Kerr opined that the aforesaid observations reflect the basic principle that insofar as commercial contracts are concerned, the law does not expect people to arrange their affairs on the basis that others may commit fraud (see also *Takhar*, supra at paras [43] & [44]).

[66] In the light of the foregoing, we are of the considered view that the sentiments expressed above are not inconsonant with the general tenor of the Contracts Act. Parties entering into a contract whilst accepting the risks and omissions in the preceding negotiations will assume the honesty and good faith of the other. As such, contracts that are entered into are presumed to be valid and enforceable. However, once it is established that the consent to an agreement was caused by coercion, fraud or misrepresentation, then the contract is no longer automatically valid and enforceable. Such a contract is voidable by operation of law (s 19(1), Contracts Act). It is voidable at the option of the innocent party; that is to say, the innocent party may elect to set aside the contract or insist that the contract shall be performed (s 19(2), Contracts Act).

[67] The fact that the Contracts Act starts on the footing that a contract is valid and enforceable underscores the premise that parties to a contract

are not expected to arrange their affairs on the basis that other people may commit fraud. Indeed, parties who are engaged in negotiations for the purposes of entering into a commercial contract conduct themselves on the expectation of honesty, good faith and fair dealing. That expectation is essential to commerce which depends critically on trust. Absent such an assumption we do not think that there would be any agreement. Accordingly, we would answer Question 3 in the affirmative.

**Conclusion**

[68] For the foregoing reasons, we are of the view that in a situation where a vendor has agreed to the immediate transfer of an asset to a company relying on the representation of the company that the balance purchase price would be paid in the future, and the company subsequently fails to pay the balance purchase price when it falls due, then the directors of the company are *ipso facto* liable to the vendor under s 540 of the CA 2016. Accordingly, Question 1 is answered in the affirmative.

[69] As explained in para [37] above, Question 2(i) is answered in the affirmative and Question 2(ii) is answered in the negative, i.e., to say that firstly, the s 540 Suit and Suit 128 are based on the same facts and issues, and secondly the defence of misrepresentation which was raised in Suit 128 had been rejected by the Court. Accordingly, the directors are barred by *res judicata* from raising and asserting that very same defence in s 540 Suit.

[70] For the reasons adverted to in paras. [38] to [67] above, we answer Question 3 in the affirmative. We are of the view that the principle that the law does not expect people to arrange their affairs on the basis that others may commit fraud is representative of the position of Malaysian law. This

principle is consonant with the Contracts Act which underlines the importance of free consent in a contract. Free consent is an integral part of the process of negotiations preceding the contract; and this underscores the duty of good faith in the creation of a contract, i.e., the duty to act honestly.

[71] In the light of the foregoing, the appeal is allowed with costs. The orders of the High Court and Court of Appeal are hereby set aside.

*signed*

**Vernon Ong**
Judge
Federal Court of Malaysia

Dated : 01 Mac 2023

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