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## Fraudulent Trading

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Fraudulent trading in Malaysia is covered in Section 540 of the Companies Act 2016 (CA). This offence carries with it potentially both civil and criminal liability, which is provided for under Section 540(1) and Section 540(5) respectively.

Section 540(1) provides that the court may hold individuals such as directors personally liable if the company is discovered to have carried out business with fraudulent intent. Meanwhile, Section 540(5) additionally provides for criminal liability which on conviction carries 10 years imprisonment or a fine not exceeding RM 1 million or both.

### Tetuan Sulaiman & Taye Case

In the recent case of *Tetuan Sulaiman & Taye v Wong Poh Kun & Anor* [2021] 8 MLJ 550, the High Court dealt with Section 304 of the Companies Act 1965. This provision mirrors the current Section 540 of the CA.

Bistari Land Sdn Bhd (Bistari Land) was a company with 2 directors (the Defendants), who had control over the company's bank accounts. Tetuan Sulaiman & Taye (the Plaintiff) was a law firm engaged by Bistari Land to render legal services in respect of various litigations involving certain pieces of land belonging to Bistari Land. The Plaintiff issued a bill to Bistari Land for their legal fees. When the latter failed to make the necessary payment, the Plaintiff then initiated a suit against Bistari Land. There were various applications in the interim, but before anything substantial resulted from this suit, it was discovered that Bistari Land had been served a statutory demand by the Government of Malaysia resulting in the company being subsequently wound up. This had all occurred without the Plaintiff's knowledge.

Hence, the Plaintiff then filed a suit against the directors of Bistari Land to hold them personally liable for the legal bill. It is pertinent to note that prior to being wound up, Bistari Land had received a sum of RM 71 million from the sale of its land,

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which was more than sufficient to settle the debts owed to all Bistari Land's creditors, including the Plaintiff. However, the Defendants had permitted Bistari Land to be wound up instead of applying the RM 71 million to pay its creditors and had not provided explanation as to how the company had dealt with the monies.

### High Court's Decision

The High Court held that the Defendants had conducted fraudulent trading and were personally liable for the debts of Bistari Land to the Plaintiff and the Government of Malaysia. In coming to this decision, the High Court methodically addressed various facets of the law regarding fraudulent trading, and systematically ticked each item off the checklist.

#### 1. Standard of Proof

First, the necessary standard of proof must be satisfied as required by the recent Federal Court decision of *Dato' Prem Krishna Sahgal v Muniandy a/l Nadasan & Ors* [2018] 2 MLJ 693. The standard of proof in a civil action for fraud was on the balance of probabilities.

#### 2. Creditor

The interpretation of 'creditor', which was held to include a 'contingent or prospective creditor'. Thus, the High court held that the Plaintiff in the instant case, who had issued a bill to Bistari Land, was deemed to be at the very least a contingent creditor.

#### 3. The company had carried on business

Next, the High Court deliberated on whether the actions of the Defendants constituted 'carrying on the business'. An ordinary understanding of this phrase above might be that the company was conducting its usual activities by which it derives income or profit. However, the legal definition is far wider. It was held that the Defendants were indeed 'carrying on business', as they had admitted that they had received payments from the sale of its lands and had actually used these payments to pay its creditors, save for the Plaintiff and the Government of

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Malaysia. The court here referred to the case of *Dato' Gan Ah Tee & Anor (in their capacity as liquidators of Par-Advance Sdn Bhd (in liquidation)) v Kuan Leo Choon & Ors* [2012] 10 MLJ 706, where disbursement of payments (which in that case were dividends) was considered to be an activity that a company ordinarily carried out as part of its business.

#### 4. Intent to defraud or with a fraudulent purpose

In holding that the Defendants had the intention to defraud its creditors, the High Court had relied on the case of *Huatah Sdn Bhd v Yap Chee Kian & Ors* [2020] 8 MLJ 98 and drew an adverse presumption against the Defendants. In *Huatah*, the Court of Appeal applied *Malhotra v Dhawan* [1997] EWCA Civ 1096, where the English Court of Appeal set out the proposition that an adverse presumption may be drawn if a party is responsible for the unavailability of documents because of its actions.

The High Court took into account the following facts:

- a. It had been admitted that the proceeds from the sale of land was sufficient to settle all the debts to Bistari Land's creditors, including the Plaintiff and the Government of Malaysia. Yet, the Defendants had chosen to only pay the other creditors, intentionally avoiding paying the Plaintiff and the Government of Malaysia and had allowed Bistari Land to fall into liquidation.
- b. The Defendants could not proffer any explanation, the RM 71 million received by the company. This was despite them having control of the bank accounts, and thus having direct and personal knowledge as to how this sum had been spent.

In this context, the High Court held that the failure to adduce any documentary evidence whatsoever to show how the money had been spent was sufficient to invite the finding of an adverse presumption that the Defendants had the intention to defraud its creditors.

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#### About Us

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## 5. Knowingly a party to carry on business in a fraudulent manner

Finally, it was held that both the Defendants were knowingly a party to the carrying on of business in a fraudulent manner. In dealing with the assertion of the 2nd Defendant that he was merely acting on the 1st Defendant's instructions, the High Court took guidance from *Morris v State Bank of India* [2003] EWHC 1868 (Ch). There, it was stated that "*knowledge includes deliberately shutting one's eyes to the obvious*". The High Court found it incredulous to think that the 2nd Defendant had no inkling as to the whereabouts of the proceeds from the sale of land. It was further stated that a person does not have to know every detail of the fraud or how it is to be perpetrated. It is sufficient if he has a 'blind-eye' or 'Nelsonian' knowledge, namely, deliberately shutting his eyes to the obvious fact that fraud was involved.

### Commentary

The significance of this decision largely lies in an insolvency perspective, as the High Court had set out various principles in relation to fraudulent trading in the context of liquidation. Particularly, it was held that the High Court is not confined to ordering that payment be made to a plaintiff but is also empowered to direct that payment be made to the liquidator, to be shared *pari passu* with other creditors.

Another noteworthy point is the approval of the 'adverse presumption' principle in *Huatah*. Prior to this case, there appears to be no cases adopting this proposition, which was initially set out in *Malhotra*, a case decided in 1997. This case would seem to indicate that this permeation of this principle on firm footing, and that individuals such as directors should take proper care of their documents, lest they inadvertently commit fraudulent trading.

Authored by Rachel Tham Xi Wen, associate from the firm's Dispute Resolution team.

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