LIFTING OF CORPORATE VEIL AND PERSONAL LIABILITY OF DIRECTORS IS THE VEIL THINNER NOWADAYS?

by

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INTRODUCTION

Salomon v. Salomon, a case establishing the separate legal entity of a company and a veil between directors and the company has since developed into a legal principle that directors are not responsible for the debts of the company. This legal principle is so common that even a person on the omnibus may be able to cite it. But as time moves on, how has this principle from a hundred years ago evolved?

ELEMENTS FOR LIFTING THE VEIL

Like any other laws, there are provisos or exceptions to this principle of separate legal entity. In Malaysia, it has been codified under Section 540 of the Companies Act 2016 (previously Section 304 of the Companies Act 1965).

> ***Section 304 of the Companies Act 1965*** provides:
>
> *(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.

Section 540 of the Companies Act 2016 is a bulky section; there are a few issues to be addressed, namely:

a. the standard of proof;

b. the meaning of carrying on a business;

c. the definition of intention to defraud; and

d. persons who are personally liable without any limitation.

Standard of Proof- "it appears"

The Court of Appeal in the case of ***Siow Yoon Keong v. H Rosen Engineering BV*** [2003] 4 CLJ 68 held that: *"Note that the section only uses the term "if it appears" which indicates that a lower degree of proof is required."*

Expounding on this dicta, the High Court in ***Zung Zang Plantation Sdn Bhd v. Quek Siew Eng & Ors*** [2014] 9 CLJ 275 held that *"As such the plaintiff need not prove fraud beyond reasonable doubt. However I am of the opinion that such standard of proof should not be lesser than the usual balance of probability."*

Further, the Federal Court in the case of ***Sinnaiyah & Sons Sdn. Bhd. v. Damai Setia Sdn. Bhd.*** [2015] 7 CLJ 584 established that: *"We therefore reiterate that we agree and accept the rationale in In re B (Children) (supra)* ***that in a civil claim even when fraud is alleged the civil standard of proof, that is, on the balance of probabilities, should apply****."*

The Court of Appeal recently also affirmed this principle in ***Wong Chu Lai v. Wong Ho Enterprise Sdn Bhd (In Liquidation) & Another Appeal*** [2020] 4 CLJ 120 that *"with the Federal Court*

decision in ***Sinnaiyah & Sons Sdn Bhd v. Damai Setia Sdn Bhd*** *[2015] 7 CLJ 584; [2015] 5 MLJ 1, the applicable standard is now the civil standard. So, the standard now required to* ***establish a claim based on s. 304 of the CA 1965 is on a balance of probabilities.*** *"*

Therefore, it is plain and settled law that the standard of proof under Section 540 of the Companies Act, 2016 is on a balance of probabilities.

Carrying Business – "Any Business"

Section 540 states "any business of the company has been carried on" shows that the intention to defraud or fraudulent purpose has to be related to the business of the company.

The Court in ***LMW Electronics Pte Ltd v. Ang Chuang Juay & Ors*** [2010] 4 CLJ 849 at p. 861: *"The words 'any business of the company has been carried out...' has been interpreted in a number of cases to include (i) in a criminal case, the obtaining of credit for the company (R v. Grantham [1984] 3 All ER 166); (ii) providing letters of comfort to a subsidiary even though on the facts of that case it was held not to be fraudulent (Re Augustus Barnett & Son Ltd [1986] BCLC 170); (iii) the collection of assets acquired in the course of business and distribution of proceeds thereof in payment of debts (In re Sarflax Ltd [1979] 2 WLR 202); and payment of two cheques into the company current account with the bank thereby clearing the company's overdraft (In re FP & CH Matthews Ltd [1982] 1 All ER 338).* ***The said words have been interpreted to include a myriad of activities and transactions undertaken by a company****."*

The Court of Appeal in the case of ***Siow Yoon Keong v. H Rosen Engineering BV*** [2003] 4 CLJ 68 also says that: *"In the present*

case, by passing a resolution to ratify the investment and the use of the company's funds for the purpose of the investments and by paying the "loans" of the appellant the company, in our view, was clearly "carrying on business".

The High Court in the case of ***Muthu Lingam Samunathan & Anor v. Kerambit Sdn Bhd*** [2014] 1 LNS 1195 held: *"This Court finds that the 1st Defendant has clearly carried on business by the following: [i] passing a board resolution to approve the sale of the Property to the 4th and 6th Defendants; [ii] selling the Property to the 4th and 6th Defendants; [iii] DW1's own admission that the 1st Defendant was carrying on business."*

In conclusion, business of the company simply means "***a myriad of activities and transactions undertaken by a company"*** which includes any decision or resolution of a company.

Intention to Defraud

The Court had discussed in great detail on the meaning of "intention to defraud" and "fraudulent purpose" in ***LMW Electronics Pte Ltd v. Ang Chuang Juay & Ors*** [2010] 4 CLJ 849 at p. 861:

> ***[20]*** *The second issue to be determined is whether the business of IDSM has been carried on 'with intent to defraud creditors... or for any fraudulent purpose' within the meaning of s. 304(1)? What is an intent to defraud? It is an intention to deprive creditors, or some creditors, of an economic advantage or inflict upon them some economic loss (Coleman v. The Queen [1987] 5 ACLC 766). What is fraud? The existence of fraud is a question of fact. It is dependent upon the circumstances of each particular case as stated by the Federal Court in PJTV Denson (M) Sdn Bhd & Ors v. Roxy (Malaysia) Sdn Bhd [1980] 1 LNS 55. Raja Azlan Shah CJ*

(Malaya) (as HRH then was) said:

> *Whether fraud exists is a question of fact, to be decided upon the circumstances of each particular case. Decided cases are only illustrative of fraud. Fraud must mean "actual fraud, ie, dishonesty of some sort" for which the registered proprietor is a party or privy. "Fraud is the same in all courts, but such expressions as 'constructive fraud' are... inaccurate;"* ***but*** ***"'fraud'... implies a wilful act, on the part of one, whereby another is sought to be deprived, by unjustifiable means, of which he is entitled."*** *(per Romilly MR in Green v. Nixon). Thus in Waimiha Sawmilling Co. Ltd v. Waione Timber Co. Ltd. it was said that "if the designed object of a transfer be to cheat a man of a known existing right, that is fraudulent..."*

The Court in ***LMW Electronics Pte Ltd*** (*supra*) further listed a few cases which have interpreted the word "defraud":

> ***(i)*** *a situation where a company continues to carry on business and 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 (In re William C Leitch Bros Ltd [1932] 2 Ch 71);*
>
> ***(ii)*** *that fraud in the context of fraudulent trading constitutes 'actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame' (In re Patrick & Lyon Ltd [1933] Ch 786 at p 790);*
>
> ***(iii)*** *where a person who takes part in the management of a company's affairs obtains credit or further credit for the company when he knows that there is no reason for thinking*

that funds will become available to pay the debts when it becomes due or shortly thereafter (R v. Grantham, supra);

(iv) *where a company accepted the purchase price in advance knowing that it would not supply the goods and would not repay the advance paid (In re Gerald Cooper Chemicals Ltd, supra); and*

(v) *a person was knowingly party to the business of a company having been carried out with intent to defraud creditors if at the time when debts were incurred by the company he had no good reason for thinking that funds would be available to pay those debts when they became due or shortly thereafter and there was dishonesty involving real moral blame according to current notions of fair trading (In a Company (No 01418 of 1988) [1991] BCLC 198).*

The Court of Appeal in the case of ***Lama Tile (Timur) Sdn Bhd v. Lim Meng Kwang & Anor*** [2015] 3 CLJ 763 has shown another scenario of intention to defraud:

[23] *The* ***directors and shareholders of LMK Edaran purposely and knowingly engaged in a course of conduct to mislead the appellant (by adding the 'S' to the signboard), and by the same token transferred the business of LMK Edaran to SLMK Edaran (previously Southern Taipan Sdn Bhd) to render LMK Edaran a dormant company.*** *The witness for the appellant (SP1; Jeremy KH Chin, a director of the appellant) indeed testified that the first respondent himself told him that they had transferred the business from LMK Edaran to SLMK Edaran to avoid payment of the debt owing. This evidence remained unchallenged throughout the trial. Counsel for the respondents failed to put the respondents' case directly to SP1 to challenge or rebut this evidence, and we*

> *agreed with the appellant's submission that this evidence must be deemed admitted on the strength of the case-authorities, such as Aik Ming (M) Sdn Bhd & Ors v. Chang Ching Chuen & Ors & Another Case [1995] 3 CLJ 639; [1995] 2 MLJ 770 and Sivalingam Periasamy v. Periasamy & Anor [1996] 4 CLJ 545.*

To borrow the words of ***LMW Electronics Pte Ltd*** whether there was any intention on the part of the defendants to defraud or to carry out any fraudulent purpose is a question of fact to be inferred from the surrounding circumstances and the subsequent conduct of the defendants.

Person to be personally liable –"any person who was knowingly a party"

The Companies Act of Malaysia (An Annotation) has discussed:

> *A person must participate, concur in, or take some positive steps if he is to be a party. However, it is not only officers who may be parties to fraudulent trading. From* ***Re August Barnett & Sons Ltd*** *[1986] BCLC 170, it appears that persons such as financiers who passively concur in the fraudulent intention of the active parties may be liable. A principal shareholder who is not a director, or a judicial manager may also be liable.*

Under Companies Act *"officer"* in relation to a corporation includes *"a director, secretary or employee of the corporation"* and the officer normally would constitute the knowing person as they are responsible for running the company "*having direct and personal knowledge of the dealings of the company"* (see ***Tetuan Sulaiman & Taye v. Wong Poh Kun & Anor*** [2020] 10 CLJ 121).

Further, a '**shadow director**' or '***de facto* director**' could also be

held liable under **Section 540** of the Act. This is seen in the case of ***TLS Marketing Sdn Bhd v. Pokiong Sdn Bhd*** [2017] 1 LNS 1609: *"As for the 4th Respondent, he is neither a shareholder nor a director or an officer of PSB. ... Based on his averments in his affidavits and his evidence in Court, there was no denying that the 4th Respondent was the person that was in control of PSB running its business and managing it. ... In my judgment, there was no doubt at all that the 4th Respondent was knowingly a party to the carrying on of the business of the 1st Respondent in the manner described earlier, with intent to defraud its creditors"*

RECENT DEVELOPMENTS

(1) *Wong Chu Lai v. Wong Ho Enterprise Sdn Bhd* [2020] 4 CLJ 120

The directors were found to have siphoned off the company's monies. A claim under Section 304 of the Companies Act 1965 was established.

(2) *Tradewinds Properties Sdn Bhd v. Zulhkiple A Bakar & Ors* [2019] 2 CLJ 261

Incorporation of multiple companies with similar names. A claim under Section 304 of the Companies Act 1965 was established.

(3) *Tetuan Sulaiman & Taye v. Wong Poh Kun & Anor* [2020] 10 CLJ 121

In the absence of any satisfactory explanation as to the dissipation of company's monies, the directors of a wound-up company, being the mandatory signatories of the company's bank accounts and having direct and personal knowledge of the dealings of the company, can be considered delinquent in their duties and having the intention to defraud the creditors of the company. (Abstract

taken from CLJ)

(4) *Dato' Prem Krishna Sahgal v. Muniandy Nadasan & Ors* [2017] 10 CLJ 385

The appellant and the company continued to carry on business and to incur debts at a time when there was to their knowledge no reasonable prospect of the employees ever receiving payment of their salary or their statutory contribution. A claim under Section 304 was established.

(5) *TLS Marketing Sdn Bhd v. Pokiong Sdn Bhd* [2017] 1 LNS 1609

The conduct of the company in refusing to satisfy the judgment sum, obstructing the garnishee proceedings and then ceasing the business operations leaving the Petitioner unpaid, amounted to carrying on business with intent to defraud the Petitioner, its judgment creditor.

CONCLUSION

With the impact of ***Sinnaiyah*** in reducing the standard of proof to a "balance of probabilities", it is now less of a burden to establish the personal liabilities of directors or officers. Cases have shown a myriad of conducts which amount to intention to defraud. The veil is now thinner and cannot be so readily used to hide defrauders.

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