

DIRECTOR'S LIABILITIES FOR INSOLVENT TRADING UNDER THE COMPANIES ACT 2016

Introduction

The number of company insolvencies in Malaysia has turned substantial of late.[1] When a company is on the brink of insolvency, directors ought to consider different stakeholders such as shareholders, creditors, and employees during the exercise of interest balancing. The Companies Act 2016 (“**CA 2016**”) codifies a general duty on directors’ conduct of trading in a company close to the point of insolvency and any potential liabilities on that account. In broad terms, ‘insolvent trading’ may also be referred to as ‘wrongful trading’ and ‘fraudulent trading’.

Wrongful Trading

In the CA 2016, an offence of wrongful trading is captured in section 539(3) that:

“...an officer of the company who knowingly was a party to the contracting of a debt had, at the time the debt was contracted, no reasonable or probable ground of expectation, after taking into consideration the other liabilities, if any, of the company at the time, of the company being able to pay the debt, commits an offence...”

Effectively, if the director is causing a company to incur debts without any reasonable or probable grounds of expectation that the company is being able to pay the debts, the director commits an offence. The court in **Bon Chong Hing & Anor v Gama Trading Company (Hong Kong) Ltd** made clear that “any person who contracts a debt when he knows that his company is hopelessly insolvent could rightly be classified as a person who contracted a debt without any intention of paying the debt”. [2] It follows that “this may pass off as carrying on the business of the company with the intention of defrauding creditors”. [3]

If an offence under section 539(3) has been made out, offenders may be punishable with a maximum imprisonment of 5 years or a maximum fine of RM500,000, or both. Reading together with section 540 of the CA 2016, it is added that the offender may even bear personal liabilities for the payment of the whole or any part of the company’s debt without

any limitation of liability upon a court's declaration.

Fraudulent Trading

Whereas section 540(1) of the CA 2016 stipulates an offence of fraudulent trading as below:

"If 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 may declare that any person who was knowingly a party to the carrying on of the business in that manner shall be personally responsible..."

Essentially, it must be proved that:

- a) the company business has been carried out with intent to defraud creditors, or for any fraudulent purpose; and
- b) the persons were knowingly parties to the company's carrying on of the business in that manner with intent to defraud creditors or for any fraudulent purpose.

Notably, as opposed to outright showing fraud, an element of dishonesty is required.[4] Whether there was intent to defraud or to carry out any fraudulent purpose is a question of fact to be inferred from the surrounding circumstances and subsequent conduct of defendants.[5]

Secondly, an intention to defraud is held to be that a company continues to carry on a business and incurs debts at a time when there is, to the knowledge of the director, no reasonable prospect of the creditors receiving payment of those debts.[6] To be knowingly party to the fraud, the person does not have to know every detail of the fraud. It suffices if *"he has a 'blind-eye' or 'Nelsonian' knowledge, namely, deliberately shutting his eyes to the obvious that fraud was involved"*.[7]

Notwithstanding the doctrine of separate legal entities, the Court of Appeal in **Chin Chee Keong v Toling Corporation (M) Sdn Bhd** explained that the primary object behind this provision *"is to statutorily provide for the lifting of the veil of incorporation in the specific circumstances of fraudulent trading with a view to ultimately pinning personal accountability and liability on the directing minds behind such trading of the company"*.[8] As such, if fraud is committed, the court is ready to lift the corporate veil and impose personal liabilities on directors. The court also held that the standard of proof is balance of probabilities which is a lower degree of proof.

Defence

It appears that there is no mention of statutory defence specific to insolvent trading. The case law also established that ignorance of laws would not accord a person defence.[9] Nevertheless, section 581 of the CA 2016 provides that if it appears to the court that a person is or may be liable for negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably and that, having regard to all the circumstances, he ought fairly to be excused, the court may relieve him either wholly or partly from his liability.

It remains to be seen as to how the scope and operation of this provision will play out as they are yet to be moulded by the courts. Be that as it may, this provision is foreseeable to be hardly invoked as defence should the court continue pursuing the requirement of dishonesty in fraud since, by any stretch, only an honest person may be afforded protection under this section. It is also foreseeable a narrow construction of this section is adopted in granting relief to directors.[10]

Conclusion

The laws gradually turn into the favour of creditors when companies are on the verge of insolvency. Bearing this in mind, directors shall act prudently when discharging their statutory obligations to not to invite any personal liabilities because it is conceivable that courts pierce through the corporate veil, given the statutory wordings. It is reiterated that the vehicle of limited liability through incorporation under the statute is not a license to avoid liability through fraudulent means.[11] Additionally, there may not be any recourse to defend the claims due to a narrow interpretation of section 581 and the presence of the element of 'dishonesty'.

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1. <https://www.theedgemarkets.com/article/over-10000-bankruptcies-and-1200-companies-forced-wind-down-during-pandemic-says-pm>
 2. [2011] 4 MLJ 52
 3. Ibid.
 4. Tetuan Sulaiman & Taye v Wong Poh Kun & Anor [2021] 8 MLJ 550
 5. LMW Electronics Pte Ltd v Ang Chuang Juay & Ors [2010] 1 MLJ 185 (HC)
 6. Huatah Sdn Bhd v Yap Chee Kian & Ors [2020] 8 MLJ 98
 7. Tetuan Sulaiman & Taye v Wong Poh Kun & Anor [2021] 8 MLJ 550
 8. [2016] 6 CLJ 666
 9. Fairview Schools Bhd v Indrani a/p Rajaratnam & Ors (No 2) [1998] 1 MLJ 110 (CA)
 10. Dinesh Kanavaji a/l Kanawagi & Anor v Virgin Properties Sdn Bhd & Anor [2016] 2 MLJ 525
 11. Mayland Development Sdn Bhd & Anor v Tanjung Teras Sdn Bhd [2016] MLJU 901

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