

## DIRECTOR'S FAILURE TO INTERVENE: BREACH OF FIDUCIARY DUTY IN THE CONTEXT OF INSOLVENCY

### Introduction

A director owes fiduciary duties to a company to prevent the assets of the company from being depleted illicitly, especially when the company is insolvent. This is regardless of whether or not the director is a *de jure*, *de facto* or shadow director. The duty of a director includes taking action or intervening when it is required. A director's inaction can amount to a breach of fiduciary duty to the company as highlighted in the decision of the Privy Council in **Byers and others (Appellants) v Chen Ningning (Respondent) (British Virgin Islands)** [1] ("**Privy Council decision**"). In this article, we will look into the Privy Council decision and the corresponding position in Malaysia.

### Privy Council Decision

#### *Background facts*

- Miss Chen Ningning ("**Miss Chen**") was a director of Pioneer Freight Futures Ltd ("**PFF**"), a company incorporated in the British Virgin Islands. In May 2009, PFF had entered into a loan agreement with Zenato Investments Ltd ("**Zenato**") under which Zenato was to advance a loan to PFF totalling USD13 million. In November 2009, PFF repaid its indebtedness to Zenato in three tranches ("**Zenato payments**"). When the Zenato payments were made, PFF was insolvent.
- Joint provisional liquidators were subsequently appointed and brought proceedings against Miss Chen for her breach of fiduciary duties in 2014 as a director of PFF, or as someone whose role in the affairs of PFF justified the imposition of fiduciary duties, for causing and procuring the Zenato payments at a time when the company was insolvent.
- The trial judge found that Miss Chen had not acted in breach of her fiduciary duty as she was not a director at the time of the Zenato payments. The judge also found that

the Chief Operating Officer (“**COO**”) was responsible for the Zenato payments. The liquidators appealed to the Court of Appeal, which was subsequently dismissed. The case was then appealed to the UK Privy Council.

### *Judgment*

- The Privy Council held that Miss Chen was a director at the time of the Zenato payments. Privy Council stated that Miss Chen, as a director of an insolvent company:
  - had a fiduciary duty to act honestly and in good faith in what she believed to be the best interests of PFF and in the best interests of its creditors; and
  - had a duty to exercise her powers as director for proper purposes – in this case, once PFF became insolvent, Miss Chen had a duty to exercise her powers for purposes which would further the interests of PFF’s creditors.
- The Zenato payments were made for an improper purpose at the time of the Zenato payments, PFF was insolvent and the Zenato payments had been made for no proper reason. Miss Chen was the director of PFF and the sole authorised signatory of the account from which the Zenato payments were made. Thus, the Privy Council held that Miss Chen was in breach of her fiduciary duties by failing to intervene and prevent the Zenato payments from being made.
- The Privy Council further held that Miss Chen could not evade these duties by delegating to an employee or a *de facto* director her authority to make payments from PFF’s account. By delegating to the COO the ability to make the payments and failing to reasonably prevent the Zenato payments, Miss Chen had authorised and caused the Zenato payments.

### **The Malaysian Perspective**

In Malaysia, **Section 213 of the Malaysian Companies Act (“the Act”)** provides that a director of a company shall at all times exercise his powers in accordance with the Act for a proper purpose, in good faith and in the best interest of the company. He must also exercise reasonable care, skill and diligence with the knowledge, skill and experience, which may reasonably be expected of a director having the same responsibilities and any additional knowledge, skill and experience which he possesses.

In **CIMB Bank Berhad v Jaring Communications Sdn Bhd**[2], the company was wound up by the petitioner and the issue was whether the director was guilty of misfeasance and breach of fiduciary duty. The director had made advances of money and loans using the company’s money when the company was already insolvent. The court stated that by doing so, the director had violated the statutory duties as well as fiduciary duties. The court also agreed with the English case of **West Mercia Safetywear Ltd (in Liquidation) v Dodd**[3]

which states that when a company becomes insolvent, the interest of the creditors would override the interest of the shareholders because, at this point, the company's assets would be reserved for the creditors.

The case of **Dan-Bunkering (Singapore) Pte Ltd v The Owners of The Ship or Vessel 'PdZ Mewah' (IMO No.: 9064009) of Port Klang & Anor**[4] states that it is settled law that when a company is insolvent, the interests of the creditors become the dominant factor in what constitutes the "benefit of the company as a whole". In this case, the court stated that the director had breached his fiduciary duty to act in the best interest of the company and its creditors as a whole when they sold a vessel at an undervalue at a point that the company was already insolvent. This transaction was unlawful because it deprived the creditors of their rights. This case also cites the textbook authority of Chan & Koh on Malaysian Company Law, Principles & Practice, Second Edition, pp. 586-587 which provides the following:

*"In recent years, there is an emergent principle that the directors in discharging their duty in good faith for the benefit of the company as a whole, must have regard to the interests of creditors especially in a situation where the company is insolvent or nearing insolvency. It is said that where a company is insolvent or is nearing insolvency, the creditors are to be seen as having a direct interest in the company and that interest cannot be overridden by the members of the company. In such a case, the duty of the directors to consider the best interests of the company concerns not exclusively those of the members but may also include those of its creditors."*

Similarly, in **Ng Pak Cheong v Global Insurance Co Sdn Bhd**[5], the issue was whether there was a breach of fiduciary duty when the directors masked the true accounts of their company and when they transferred property during a time that the company was likely to become insolvent. The court referred to the Australian case of **Spedley Securities Ltd (In Liquidation) v Greater Pacific Investments Pty Ltd (In Liquidation)**[6], which provides that a director owes a duty to the company to act honestly and with a reasonable degree of care in the performance of his functions as a director. The Australian court averred that it is dishonest of the director to seek to disguise the true state of accounts of a company. To do so, it has misled shareholders, creditors and regulatory authorities.

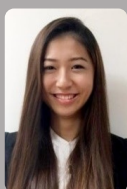
These Malaysian cases share the same sentiments as the Privy Council decision in that directors' fiduciary duties extend not only to the company but also to the company's creditors when the company is insolvent. However, the Privy Council decision shed light on the ability to sanction the directors' inaction rather than action as part of the directors' fiduciary duties in the context of insolvency.

## **Conclusion**

It is trite law that directors of a company have a duty to act in the best interest of the company. However, when a company becomes insolvent or is about to become insolvent, this duty extends to the creditors of the company. The director must take all reasonable steps to prevent the assets of the company from being misapplied. As the Privy Council put it, a director may not knowingly stand by idly and allow a company's assets to be depleted improperly. A director must play an active role and intervene when the best interest of the company or creditors of the company is being jeopardised. Against the backdrop of statutory duties, the directors should always keep abreast of the company's situation and discharge their duties according to different circumstances.

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1. [2021] UKPC 4
  2. [2016] MLJU 920
  3. [1988] BCLC 250
  4. [2020] MLJU 1574
  5. [1995] 1 MLJ 64
  6. [1992] 7 ACSR 155

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