Directors Duties: The Foundation Of Good Corporate Governance (Part 2)

by

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This part continues from Part 1 on Directors Duties: The Foundation of Good Corporate Governance. However, the focus here is upon the perspectives of the obligation of a fiduciary, trust and remedies.

Fiduciary Duty

The origin of the law of fiduciary obligations has been said to arise from equity's treatment of relationship of trust and confidence. Lord Thurlow (during the time when common law and equity courts were yet to be fused) said that "if a confidence is reposed and that confidence is abused, a court of equity shall give relief." 96

Hence, the repository of fiduciary obligation find it repository under the source of law underpinning common law and equity (rule of law) domain though some of its concepts have been codified somewhat within Companies Act 2016 and its predecessors as will be seen later.

Fiduciary obligation; it has been said is imposed by “private law but its function is public and its purpose is social.” 97

While not established as a trust in the traditional sense, the obligation of a fiduciary has been treated as akin to that of a trustee. Thus, Lord Eldon (1820) said "relations formed between individuals in the matters in which they deal with each other, in which you can hardly say that one of them is a trustee and the other a cestui que trust; and yet you cannot deny that to some intents and some purposes one is a cestui que trust and the other a trustee." 98

According to Sealy, these relationships were then labelled as “fiduciary relationship” to distinguish them from trusts. 99 However, it is recognised that a breach of fiduciary duty gave rise to the same remedies against the wrongdoer in a breach of trust as will be covered later.

“What is a fiduciary relationship? It is one of which if a wrong arise, the same remedy exists against the wrongdoer on behalf of the principal as would exist against a trustee on behalf of the cestui que trust.” 100

As Parkinson points out, director of companies having management of property, discretion and undertake to act in the interest of another is a strong reason to impose a strict fiduciary duty. As suggested “The greater the independent authority to be exercised by the fiduciary, the greater the scope of the fiduciary duty.” 101

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The purpose of the law of fiduciary is to ensure the maintenance of high standards of honesty and propriety by those who are under a duty to act in the interest of others. The confiscation of gains arising from the abuse of a relationship of trust and the protection of one’s reasonable expectations that the other will act in his or her interest and not pursuit of contrary self-interest or conflicting duty.  

In the context of director and company, Mason J explains the imposition of a fiduciary relationship liability based on a relationship of trust and confidence, an undertaking to act in another’s best interest in the exercise of a discretionary power of a vulnerable beneficiary, i.e., the company.

The accepted fiduciary relationships are sometimes referred to as relationships of trust and confidence or confidential relations... viz director and company. The critical feature of these relationships is that the fiduciary undertakes or agrees to act on behalf of the interest of another person in the exercise of a power or discretion which will affect the interest of that other person in a legal or practical sense. The relationship between the parties is therefore one which gives the fiduciary a special opportunity to exercise the power of discretion to the detriment of that other person who accordingly is vulnerable to abuse by the fiduciary of his position. The expression, “for”, on “behalf of “and” in the interest of “signify that the fiduciary acts in a representative character in the exercise of his responsibility.

In the case of a director, all four elements of trust and confidence, undertaking, discretion and vulnerability are interlaced to provide for the strict expectation of the performance of fiduciary obligation to avoid possible conflicts and reclaim profits given the vulnerability of the company beneficiary.

The duties of the director are derived not only from overlapping equity and common law as stipulated above but also from the detailed statutory regulation and contractual relationship between the director and the company and also from the particular circumstances of a particular case that justifies the imposition of the duty as a fiduciary.

The contract may be a source whereby the duty is enlarged or modified. It is also noted that the contracted modification may be further subjected to further modifications which cannot be excluded as fiduciary duties can arise through voluntary undertakings by the fiduciary or reliance by the beneficiary or where in the circumstances it would be just to impose them for the protection of the beneficiary.

As Paul Finn said:

A fiduciary responsibility, ultimately is an imposed, not an accepted one... The factors which lead to its imposition doubtless involve recognition of what the alleged fiduciary has agreed to do. But equally public policy considerations can ordain what he must do, whether this be agreed to or not.
Hence, it is accepted trite law that a director owes a fiduciary duty of the highest calling to the company.\textsuperscript{108} It has been recognised that “the desire to protect and reinforce the integrity of social institutions and enterprises is prevalent throughout fiduciary law. The reason for this desire is that the law has recognised the importance of instilling in our social institution and enterprises some recognition that not all relationships are characterised by a dynamic of mutual autonomy, and that the market place cannot always set the rules.”\textsuperscript{109}

Hence, the statutory regulation and recognition of the rule of law as a source to impose obligations \textit{inter alia} on directors and officers should be given.

\textbf{Duty Owed To Others}

The exception to this rule that the duty is owed to the company is very rare and unusual. But as Lord Wilberforce recognises it:\textsuperscript{110}

\begin{quote}
a \dots{} limited company is more than a mere legal entity, with a personality in law of its own: \dots{} there is room in company law for recognition of the fact that behind it, or amongst it, there are individuals with rights, expectations and obligations \textit{inter se} which are not necessarily submerged in the company structure.
\end{quote}

\textbf{Special Facts Instances Of Director’s Duty}

Hence, in some instances, fiduciary duty has been held to exist to \textit{inter se} the shareholders or by the director to individual shareholders. In the first instance, a majority shareholder who failed to disclose the existence of negotiations for the purchase of the company shares at the time he was seeking to buy the only other minority shareholders share was held to be in breach of fiduciary duty to the other shareholder.\textsuperscript{111} Fiduciary obligations were held to exist in a small family company involving personal relationships of trust and confidence between the shareholders and the directors and the shareholders were not given full information on a takeover\textsuperscript{112} or where the directors acted as agents of the shareholders in a particular transaction.\textsuperscript{113} Directors of the company, as a general rule, do not owe a duty to the company creditors. However, a duty to consider the interest of creditor may be triggered when the company is near insolvency\textsuperscript{114} or insolvent.\textsuperscript{115}

Where a director or officer of an insolvent company acts in breach of duty to the company by causing its assets to be transferred in disregard of the interest of the creditors, he is answerable to the liquidator pursuant to the statutory scheme of liquidation, but there is no direct fiduciary duty owed to an individual creditor, nor is an individual creditor entitled to sue for the breach of fiduciary duty owed by the director of the company.\textsuperscript{116}
It has been held that a company secretary acting in their professional capacity who only follows the resolutions of board of directors and company are not considered fiduciaries of the company.\(^\text{117}\)

**Emerging Categories**

In recent times, the scope of an employee to be liable as a fiduciary is developing. In the Court of Appeal case of *Zaharen Hj Zakaria v. Redmax Sdn Bhd & Other Appeals*\(^\text{118}\) here the appeal was to hold the second defendant who was the director of finance and an employee liable jointly with the first defendant for liable for breach of s. 132 (s. 132) for the evidence of misuse of monies of the companies to make unauthorised payment to third party companies upon fictitious transactions. The case is also noteworthy in that the case also recognised that an employee may be a fiduciary. The court held that the second defendant, who was the director of finance and an employee of the company, was liable in breach of fiduciary duty as he was aware of improper dealings and involved in the creation of the numerous fictitious documents not only in his capacity as director but also as an employee.

There is more than one category of fiduciary relationship, and the different categories possess different characteristics and attract different kinds of fiduciary obligation. The most important of these is the relationship of trust and confidence, which arises whenever one party undertakes to act in the interests of another or places himself in a position where he is obliged to act in the interests of another. The relationship between employer and employee is of this character. The core obligation of a fiduciary of this kind is the obligation of loyalty. The employee must act in good faith; he must not make a profit out of his trust; he must not place himself in a position where his duty and his interest may conflict; he may not act for his own benefit or the benefit of a third person without the informed consent of his employer.

Likewise, in the case of the Court of Appeal of *Wong Kar Juat & Anor v. S7 Auto Parts (M) Sdn Bhd*\(^\text{119}\) the recognition of employee as fiduciary is found in the judgment that:

> We wish to express our understanding of the law. We apprehend that as regards a breach of trust and breach of fiduciary duty in the context of an employee and employer relationship, where the employee’s contract involves receipt of the employer’s property, notwithstanding whether the property consists of tangible assets or confidential information, a fiduciary obligation exists (see *Attorney General v. Blake (Jonathan Cape Ltd Third Party)* [2001] 1 AC 268). This obligation would in our view concern with the employee’s duty to look after the employer’s interest, the duty of fidelity towards the principal and the duty to act in good faith, not to make a profit out of the trust, not to place himself in a position where his duty and his interest may conflict and not to act for his own benefit or for the benefit of a third person without the informed consent of his principal. Who is a fiduciary in law is defined by Millett LJ in *Bristol and West Building Society v. Mothew* [1998] Ch 1 at p 11 as follows: A fiduciary is someone who has undertaken to act for or on behalf of another in a
particular matter in circumstances which gives rise to a relationship of trust and confidence. The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary.

There is also development in recognition of *quasi* partnership company or joint ventures where partners have a fiduciary duty to act in good faith to each other. This is ultimately to be decided as a question of fact by the court if the factors are warranting the imposition of a fiduciary relationship within the commercial relationship one.

The Federal Court in *Solid Investments Ltd v. Alcatel Lucent (Malaysia) Sdn Bhd* found the parties were in a contractual commercial relationship relating to telecommunication network system and the facts did not give rise to impose a fiduciary in the case.

Case law shows that the courts are quite reluctant to find a fiduciary relationship between businessmen who enter into commercial dealings. It has been said to be “of the first importance not to impose fiduciary obligations on parties to a purely commercial relationship,” but “it is altogether too simplistic, if not superficial, to suggest that commercial transactions stand outside the fiduciary regime.” It is clear that it is possible for fiduciary duties to arise in commercial settings. Agency, which is frequently a relationship between two commercial actors, provides a clear example: the primary source of duty between principal and agent is a matter of contract law, often applied in a commercial setting, and yet fiduciary duties will be owed by the agent unless they have been excluded. The reason fiduciary duties do not commonly arise in commercial settings outside the settled categories of fiduciary relationships is that it is normally inappropriate to expect a commercial party to subordinate its own interests to those of another commercial party. But if that expectation is not inappropriate in the circumstances of the relationship between the parties then fiduciary duties will arise.

It is also to be pointed out here cursorily lest it be overlooked that the causes of action may also be framed against the director under other causes of action like contract and tort which is outside the scope of this paper.

The rational for the fiduciary obligation is stated by Laskin J in *Canadian Aero Service Ltd v. O’ Malley*:

Strict application for fiduciary obligations against directors and senior management officials is simply a recognition of the degree of control which their positions give them in corporate operations, control which rises above their accountability to owning shareholders and which comes
under some scrutiny at annual general meeting or at special meetings. It is a necessary supplement in the public interest, of statutory regulation and accountability which themselves are, at one and the same time an acknowledgement of the importance of the incorporation in the life of the community and the need to compel obedience by it and by its promoters, directors and managers to norms of exemplary behaviour.

**Application Of No Conflict And No Profit Rule**

As stated previously, the office of a fiduciary is founded on selflessness. Selfishness is absolutely prohibited.\(^\text{125}\)

The conflict and no profit rules are overlapping rules where it can occur conjointly or severally. In most cases, there may be conflict that result in a profit to the fiduciary that is caught by the fiduciary obligation. But there could be instances where there is no real possibility of duty and conflict like when a fiduciary makes a profit out of confidential information in circumstances where there is no obligation to make a profit for the principal. It is also possible that there is a conflict and a breach of fiduciary duty but there is no profit. However, in such cases, the company may still pursue a claim of equitable damages.

The overlapping of the two themes is stated in *Furs Ltd v. Tomkies*\(^\text{126}\)

An undisclosed profit which a director so derives from the execution of his fiduciary duties belongs in equity to the company. It is no answer to the application of the rule that the profit is of a kind which the company could not itself have obtained, or that no loss is caused to the company by the gain of the director. It is a principle resting upon the impossibility of allowing a conflict of duty and interest which is involved in the pursuit of private advantage in the course of dealing in a fiduciary capacity with the affairs of the company.

The two rules or themes are nonetheless distinct as pointed out\(^\text{127}\) that:

Neither theme fully comprehends the other and a formulation of the principle by reference to only one of them will be incomplete.

It is possible to breach one rule and not the other. Where the no profit rule was breached but where no conflict of interest was involved like the case of *Regal Hasting v. Gulliver*.\(^\text{128}\) In that case, the opportunities availed themselves to the directors in the course of their directorship where the company did not have the funds or ability to take up the same. Hence, there was no conflict but the directors breached the no profit rule.

Lord Russel of Killowen said that:

The rule of equity which insists on those who by the use of a fiduciary position make a profit being liable to account for that profit, in no way depends on fraud or absence of *bona fide* ... the liability arises from the mere fact of a profit being made ...
Likewise in the case of *Green v Bestobell Industries Pty Ltd*\(^{39}\), a manager whose company tendered for a public tender of Government contract also tendered for it. This was held to be in breach of the no conflict rule irrespective of who gets the tender.

**Position Of A Conflict Of Interest**

**Conflict Of Interest And Duty**

This refers to the situation where the fiduciary enters into transactions which gives rise to or may give rise to a conflict between the fiduciary interest and that of his principal.\(^{130}\)

In the case of *Aberdeen Rly Co v. Blaikie Bros*\(^{31}\) (1854) 2 Eq Rep 1281:

> It is a rule of universal application, that no one having such duties to discharge, shall be allowed to enter into engagements in which he has or can have a personal interest conflicting, or which possibly may conflict, with the interest of those whom he is bound to protect. So strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into.

This would occur where no actual conflict is required; only a real sensible possibility of conflict from the lenses of the reasonable man.

This is stated in the case of *Boardman v. Phipps*\(^{132}\) that “A reasonable man looking at the relevant facts would think that there was a real sensible possibility of conflict”. There is no requirement of fraud, dishonesty or bad faith.\(^{133}\) The conflict may cover circumstances arising out of duties owed to two or more principals.\(^{134}\) It could cover the fiduciary placing self or another party interest over that of the principal or abusing his position.

Section 218 of the Companies Act 2016 codifies the manner in which a conflict or breach of fiduciary duties may arise. This is in addition to the proper purpose and best interest of the company and disclosure requirements of a fiduciary in position of conflict and profit.

The list below does not purport to be an exhaustive statement and it is open to the courts to apply the rule in new situations as yet to be envisaged fluid with responses to new age developments.

As stated by Laskin J in *Canadian Aero Service Ltd v. O'Malley* “new fact situations may require a reformulation of existing principle to maintain its vigour in the new setting.”\(^{135}\)

Section 218 of the Companies Act 2016 provides:

(2) A director or officer of a company shall not, without the consent or ratification of a general meeting:

(a) use the property of the company;\(^{136}\)

(b) use any information acquired by virtue of his position as a director or officer of the company.\(^{137}\)
(c) use his position as such director or officer;\textsuperscript{138}

(d) use any opportunity of the company which he became aware of, in the performance of his functions as the director or officer of the company;\textsuperscript{139} or

(e) engage in business which is in competition with the company, to gain directly or indirectly, a benefit for himself or any other person, or cause detriment to the company.\textsuperscript{140}

The criminal liability is preserved under s. 218(3) of the Companies Act 2016 but there is no preservation of civil liability unlike the repealed provision under s. 131(3) and (5) of the repealed Companies 1965 Act.

The recognition of above possible ways a director fiduciary duty may be in breach is cited in the case of \textit{CIMB Bank Bhd v. Jaring Communications Sdn Bhd}\textsuperscript{141} where it was stated that:

A number of facets to the requirements governing the discharge of the role of a director as a fiduciary is enacted in the CA, chief amongst which, as mentioned earlier is the most fundamental duty to act in good faith in the best interest of the company under s. 132(1) and the prohibition against improper use of company’s property, position, corporate opportunity or competing with the company under s. 132(2). Directors deciding to remunerate themselves in the absence of any authorisation by general meeting or any provision in the articles would clearly be infringing their role as fiduciaries and violate these statutory requirements, risking the penalty of imprisonment upon conviction, and being liable to the return of the secret profits or damages (see for instance the Privy Council’s decision in \textit{Mahesan v. Malaysian Government Officers Co-Operative Housing Society Ltd}\textsuperscript{142}.

\textbf{Conflict Of Duty And Duty}

The scope of fiduciary obligation demarcation is important. It serves as a parameter of what a director is able or not to do. The principle that the fiduciary is allowed to explore profit making opportunities that does not impede the fiduciary scope of duty to the company.

A person under a fiduciary obligation to another should be under that obligation in relation to a defined area of conduct and exempt from the obligation in all other respects. Except in the defined area, a person under a fiduciary duty retains his own economic liberty.\textsuperscript{143}

The fiduciary duty of no conflict of interest does not preclude a person from holding multiple directorships.\textsuperscript{144} However, should the consequence of the same may result in potential conflicts or subordination of interest of one to the other, then it must be disclosed to the company and approved to get an informed consent to sanction any conflicts.\textsuperscript{145} When a person is a director in more than one company, the competing interest to the different companies affecting the director duties has been held to warrant a “sensible
approach”¹⁴⁶. In this regard, it is also pertinent to bear in mind the duty not to engage in a rival company in competition imposed under s. 218(e) of the Companies Act 2016 above.

There is authority for the proposition that a director can be a director of another company which is in not in competition or if in competition (assuming consent under s. 218(e) is given) if he does not disclose confidential information gained as a director of one company to another.¹⁴⁷ So in such cases, it will be a case of evidence to support the alleged breach by director as stated by Frankfurter J¹⁴⁸

To say a man is a fiduciary only begins the analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?

The scope of the duty is dependent on circumstances which includes the undertaking of the fiduciary, from contractual and statutory instruments that relate to the same but also from a course of dealing. This is perhaps not emphasised or recognised in the current amendment under the Companies Act that relate to fiduciary duties since it relates to a rule of law that is excluded rather than written law.

Dixon J said that:

> the subject matter over which the fiduciary obligations extend is … to be ascertained, not merely from the express agreement of the parties, whether embodied in written instruments or not but also from the course of dealing actually pursued by the firm.¹⁴⁹ (emphasis added)

The UK Companies Act, s. 175(7) specifically state and incorporates the dual aspects of conflict.

Any reference in this section to a conflict of interest includes a conflict of interest and duty and a conflict of duties.

**Profit Or Making Improper Gain**

The underlying rule that the fiduciary is to act in the best interest of the principal which is the source of the no conflict and no profit rule imposed on the fiduciary.

In *Phipps v. Boardman*¹⁵⁰ Lord Hudson said:

> The proposition of law involved in this case is that no person standing in a fiduciary position, when a demand is made upon him by the person to whom he stands in the fiduciary relationship to account for profits acquired by him by reason of his fiduciary position and knowledge or either, resulting from it is entitled to defeat the claim upon any ground save that he made profits with the knowledge and assent of the other person.
A fiduciary owes a duty not to profit from his position. It is also argued that the no profit rule is an extension of the wider principle of no conflict rule that a fiduciary should not assume a position in which his interest and duty may possibly conflict.\textsuperscript{151} It has been discussed early in this chapter that both rules of no profit and no conflict are distinct though it may be overlapping. An example cited is the case of \textit{Reading v. R}\textsuperscript{152}, where a fiduciary employee who agrees for a reward to wear his official uniform (after office hours) whilst accompanying a vehicle across customs with a view to facilitate clearance made a profit from his position as public officer. However, as he was not doing this during his working hours, he is not assuming a position where his interest and duty may conflict.

A fiduciary cannot be permitted to retain a profit or benefit which he has obtained by reason of his breach of fiduciary duty.\textsuperscript{153} The proper plaintiff to sue the fiduciary in breach is the company. The making of any sort of gain is prohibited, regardless of whether it harmed the principal or whether it was even available to principal or whether it actually benefited the principal as well.\textsuperscript{154} The ability to retain a profit or benefit based on informed consent or subsequent ratification has been discussed earlier.

**Avoiding Liability**

**Under Equity**

It is possible for a fiduciary to exclude liability for breaches of fiduciary duties in a limited context. The exclusion of liability for honest breach of fiduciary duty for the acts of the fiduciary in good faith believed were for the best interest of the company has been accepted.\textsuperscript{155} However, it is also recognised that not all restrictions on the duty of the fiduciary will be given effect as there is a minimum score of fiduciary duties out of which the parties cannot opt-out of. Further, that exclusion of liability for fraud or illegality may be impermissible for reasons of policy of law.\textsuperscript{156}

**Under Companies Act**

Section 288 of the Companies Act 2016 provides that any provision whether contained in contract or in the constitution which exempts or indemnifies any officer or auditor from any liability which is attached to him under any law relating to negligence, default, breach of duty or breach of trust is void.\textsuperscript{157}

The court power to relief liability has been construed where the director is being sued by the company and not where the director is subjected to a civil suit from a third party.\textsuperscript{158} It does not authorise the relief against a criminal liability.\textsuperscript{159}

However, the section does not apply to excuse directors who have received the company's property in breach of trust.
In *Hytech Builders Pte Ltd v. Tan Eng Leong*¹⁶⁰ Warren Khoo J stated:

[This section] appears to be more applicable to a case where the misfeasance has resulted in a loss to the company. It would be meaningful then to speak of exoneration or excusing. It seems far-fetched and unreal to speak of exoneration when the result of it would be to let the offending director keep gains which should have gone to him in the first place.

In deserving cases, there is s. 581 that reserves the discretion of the court to provide relief if it appears the fiduciary acted (a) honestly, (b) reasonably and (c) having regard to the facts of the case ought fairly to be excused for negligence, default or breach wholly or in part as the court deems fit. All the three limbs must be fulfilled.¹⁶¹

The factor to guide the court decision whether the director has acted reasonably is to ask the question whether he acted in the affairs of the company as he would in relation to his own affairs.¹⁶² The burden is on the director to show he acted honestly and reasonably. A director who stands by and does nothing while the company assets are dissipated is not acting reasonably.¹⁶³

**Standard Of Care And Burden Of Proof**

The standard of care as a fiduciary is the highest known in law as has been discussed previously. It is founded on selflessness with the duty to advance and protect the interest of the principal overriding any other interest.¹⁶⁴ The burden lies on the plaintiff to prove their loss which were caused by the defendant’s breaches of fiduciary duties. Then the burden shifts to the defendant to show that the plaintiff would have incurred the losses even if there was no breach of fiduciary duty.¹⁶⁵

**Court Pleadings And Limitation Period (Practical Considerations)**

The Federal Court case of *Instantcolour Systems Sdn Bhd v. Inkmaker Asia Pacific Sdn Bhd*¹⁶⁶ has made it expressly clear that it is not sufficient to merely aver a fiduciary breach of duty. The cause of actions and issues of facts in relation to the same need to be specifically pleaded in the pleading (as to fraud, breach of trust, constructive trusts and any other heads of claim) that is alleged against the defendant. If there is reliance on the exceptions to limitation period¹⁶⁷ this fact too has to be pleaded.

**Remedies**

The Court of Appeal case of *Protasco Bhd v. Tey Por Yee & Another Appeal*¹⁶⁸ and another evidence in part the array in forms of relief which is claimed against the directors namely to compensate Protasco in equity for the breach of fiduciary duties; to account to Protasco for the monies misappropriated by them; to account for secret profits held by them; hold all such monies as constructive trustees in favour of Protasco; reconstitute assets held on trust for Protasco. The case also demonstrates that an arbitration agreement
between the company and third parties to submit dispute to arbitration does not necessarily stay the action against the directors in court for the breach of fiduciary duties.

Secret Profits, Bribes And Commission

In the case of CIMB Bank Bhd v. Jaring Communications Sdn Bhd as stated previously, it was highlighted that:

A number of facets to the requirements governing the discharge of the role of a director as a fiduciary is enacted in the CA, chief amongst which, as mentioned earlier is the most fundamental duty to act in good faith in the best interest of the company under s. 132(1) and the prohibition against improper use of company’s property, position, corporate opportunity or competing with the company under s. 132(2). Directors deciding to remunerate themselves in the absence of any authorisation by general meeting or any provision in the articles would clearly be infringing their role as fiduciaries and violate these statutory requirements, risking the penalty of imprisonment upon conviction, and being liable to the return of the secret profits or damages (see for instance the Privy Council’s decision in Mahesan v. Malaysian Government Officers Co-Operative Housing Society Ltd [1974] 1 LNS 83).

In Magnifire Sdn Bhd v. Yap Mun Him, Tan Sri Richard Malanjum J (now CJ) held at 424:

It is trite law that directors are fiduciaries and as such they are subject to the no-conflict principle in equity. They are not allowed to put themselves in a position where their duties conflict with their interests. And ‘the taking of commissions or bribes or any kind of undisclosed benefits by a director from any party with which a company is dealing with is the most obvious form of conflict between duty and interests or the making of secret profits’ - Corporate Powers Accountability by Loh Siew Cheang (2nd edn). (See also: Tan Kiong Hwa v. Andrew SH Chang [1974] 1 LNS 168; [1974] 2 MLJ 188; Boston Deep Sea Fishing and Ice Company v. Ansell [1888] 39 Ch 339; Fur Ltd v. Tomkies [1936] 54 CLR 583).

The situation here is where the fiduciary has been given a secret commission or a bribe to act in a certain way in relation to the affairs of the company. There is a fiduciary breach which is actionable by way of recovering the amount of bribe or suing for damages or property acquired by the bribe on the concept of constructive trust.

In the case of Reading v. AG, the sergeant took bribes to smuggle goods. It was held that any position that enable a servant to earn money by its use gave the master the right to receive the money so earned notwithstanding it was a crime. In AG v. Reid, Reid used his position to block charges against criminals in return for bribes. The sum totalled $12.4 million and was invested in three properties which rose in value in New Zealand in the names of Reid, his wife and his solicitor.
It was held that there was a constructive trust and the fiduciary was accountable not only for the original amount but if it was invested advantageously also for the increase of value. That the wife and solicitor were also liable as trustees in receipt of trust property. Hence, here the money was traced into the invested properties.

**Account For Profits**

A fiduciary is liable to account for any unauthorised benefit or profit he obtained as a result of exploiting his position.

An account of profits is restitutionary whereby the fiduciary hands over the profits made, regardless of whether the principal incurred a loss. This is usually the appropriate remedy. Since it is an equitable remedy, it is subject to the court’s discretion to be decided on the facts of the case.

Hence the remedy awarded against the fiduciary will vary in accordance to the facts and circumstances. Allowance may be given for skill and work especially in the case of an honest fiduciary.

The court may modify the remedy by ordering an account of profits over a certain period (eg, six months) if full account of profits more than what is equitable if it can be shown that the fiduciary has put in resources that deserves to be given account for. The case of *Warman International Ltd v. Dwyer* serves as an illustration.

Dwyer was the director of Warman. He did not like policies and especially refused to enter a joint venture (JV) with one of their manufacturers. He resigned and then entered the JV with the manufacturer.

It was held that by appropriating the business with the manufacturer, Dwyer breached his fiduciary duty. In terms of damages, the court held that where there is breach of a fiduciary duty, the principal may elect to have either an account of profits or equitable compensation (the choice which the principal will make will depend on which sum is greater.)

An account of profit is most appropriate despite its harshness. If profits are more than is required to achieve fairness, the court can limit it by: ordering partial account of profits (eg, account of profits over a certain period of time); discounting from the sum to be paid by the defendant an equitable allowance to compensate for the expenses, skill, effort and resources required to make the profit. It is for the defendant to establish that it is inappropriate to order an account of the entire profits.

**Breach Of Trust, Tracing And Constructive Trust**

Directors who use their position as directors to misappropriate to themselves property of the company are in breach of their duty. Where a director has misapplied the company funds or property, he holds the misapplied funds or property or their traceable forms (under evidential recourse of tracing) in trust for the company.
The directors with regard to company assets are considered trustees and subjected to a high standard of accountability.

In the case of Selangor United Rubber Estates Ltd v. Craddock (a bankrupt) (No 3)\textsuperscript{177} Ungoed - Thomas stated:

Directors are so far as regards to the employment of the funds of the company, trustees \ldots and are answerable to their \textit{cestui que} trust for the due employment of the funds entrusted to them.

It is to be noted in addition to civil and statutory penalties, criminal penalties for example of criminal breach of trust under the Penal Code may lie against the director.

This duty may not be waived or consented to at the general meeting by the use of the defaulting director’s votes as shareholders.\textsuperscript{178}

\textbf{Constructive Trust}

The doctrine of constructive trust is of wide application that its runs as an undercurrent for the possible recovery of property or monies of the company against the wrongdoer and third parties in given instances in varying circumstances of unconscionability on any deserving case facts which the courts seek to give effect against.

\textbf{When Appropriate}

To reign in the use of constructive trust, the approach of the courts is to tie into property rights. In the case of LAC Mineral v. International Corona Resources Ltd\textsuperscript{179}(1989) 61 DLR (4th) 14, the Canadian Supreme Court per La Forest J observed that:

There is no unanimous agreement on the circumstances in which a constructive trust will be imposed and identified a number of factors that may be relevant in determining whether to award a proprietary remedy:

A constructive trust should only be awarded if there is reason to grant to the plaintiff the additional rights that flow from recognition of a right of property. Among the most important of these will be that it is appropriate that the plaintiff receives the priority accorded to the holder of a right of property in a bankruptcy. More important in this case is the right of the property holder to have changes in value accrue to his account rather than to the account of the wrongdoer \ldots The moral quality of the defendants’ act may also be another consideration in determining whether a proprietary remedy is appropriate. Allowing the defendant to retain a specific asset when it was obtained through conscious wrongdoing may so offend a court that it would deny to the defendant the right to retain the property.

The scope of constructive trust (and thereupon resulting trust) was applied in the case of RHB Bank Bhd v. Travelsight (M) Sdn Bhd & Ors And Another Appeal\textsuperscript{180}
A constructive trust arises whenever the circumstances are such that it would be unconscionable of the owner of the legal title to assert his own beneficial interest and deny the beneficial interest of another. Atlas and the liquidators should have known that the property was not that of Atlas to deal and dispose as its own. It would therefore be unconscionable of Atlas and the liquidators to treat the property as unencumbered asset and deny the beneficial interest of Travelsight and RHB and therefore, it gave rise to a constructive trust. (paras 30 & 31).

The case concerned proceeds of a property that was sold by Atlas to Travelsight and assigned absolutely to RHB and that was subsequently rescinded. The rescission was not able to be effected as the monies paid to Atlas was not returned to the purchaser whereas the legal title remained with Atlas which was then liquidated and whose liquidators treated Travelsight and RHB as unsecured creditor who did not hold interest in the property which is the subject of rescission. Travelsight filed action (Kuala Lumpur 28-946-2008), pursuant to ss. 236 and 279 of the Companies Act 1965, for orders to set aside the act and/or decision of the liquidators to sell the property and to prohibit them from selling and or transferring the property, and for an order to declare that the property was held by the liquidators upon trust for Travelsight.

The court imposed constructive trust to impugn the unconscionable behaviour Atlas and her liquidators who were seeking to benefit from a rescission without complying with the requirements for returning the benefit received.

**Third Parties Who Receive Company Property**

A constructive trust will be imposed on a third party for receipt of trust property who receives the property as a volunteer or with knowledge of the breach of duty. It is imposed by courts. However, the equity’s darling namely a *bona fide* third party who has provided consideration will not be liable.

A third party may be liable as an accessory to the trustee’s breach of trust. The liability is independent of the director’s state of mind or receipt of trust property. It requires a trust or fiduciary obligation, a breach of the trust or fiduciary obligation, assistance rendered by the third party to the breach and the assistance rendered by the third party must be dishonest, in the sense not acting as an honest person would in the circumstances.

Tracing in equity in this regard is linked to the cause of action of breach of trust nor fiduciary where the property has flowed into hands of third parties who are not *bona fide* purchaser for value without notice of the breach of trust. As the parties are in fiduciary relationship, the property may change forms and be mixed with other property and still be traceable though the hands that receive them are tainted with the knowledge of the breach of trust.
In the Court of Appeal case of *PT Gunung Madu Plantations v. Muhammad Jimmy Goh Mashun* the claim against the second to eighth defendants were premised on knowing receipt, fraud, conspiracy and constructive trust. The first defendant an Indonesian national was sued for breach of duty, fraud, breach of trust, conspiracy to defraud an action which was filed in Indonesia. He allegedly without approval, consent or authority caused to transfer the appellant monies IDR 600 billion to the two to eighth defendants who were Malaysian in Malaysian banks for which tracing into the funds were sought to be employed. The Court of Appeal treated the claim as a separate matter of which the Malaysian court had jurisdiction over since the cause of action differs and there is evidence of monies (trust property) being traced into the Malaysian banks.

The case of *LNE Network Systems (Asia) Sdn Bhd v. Loi Chew Ping & Ors* is very instructive on the elements required to be proved on knowing receipt and accessory liabilities both of which are equitable claims. This differs from common law remedies of restitution and money had and received.

(i) In the case of knowing receipt, the recipient’s state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt (See *dicta* of Nourse LJ in *BCCI (Overseas) Ltd v. Akindele*[6], applied by the Court of Appeal in *Ooi Meng Khin v. Amanah Scotts Properties (KL) Sdn Bhd & Another Appeal* [*2014*] 1 LNS 719; [*2014*] 6 MLJ 488[7]).

(ii) In order to establish accessory liability in a case of dishonest assistance, the essential ingredient is dishonesty, or conscious impropriety. This is an objective moral standard judged in the light of what the person actually knew at the material time. In other words, it will not be open to a defendant to escape liability by simply saying that he saw no wrong in his own behaviour (*Royal Brunei Airlines v. Tan*[8]). Dishonesty requires knowledge by the defendant that what he was doing would be regarded as dishonest by honest people, although he should not escape a finding of dishonesty because he sets his own standards of honesty and does regard as dishonest what he knows would offend the normally accepted standards of honest conduct (per Lord Hutton in *Twinsectra Ltd v. Yardley*[9]).

(c) The elements of knowing receipt were stated by Hoffmann LJ in *El Ajou v. Dollar Land Holdings plc* [*10*]:

This is a claim to enforce a constructive trust on the basis of knowing receipt. For this purpose the plaintiff must show, first, a disposal of his assets in breach of fiduciary duty; secondly, the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and thirdly, knowledge on the part of the defendant that the assets he received are traceable to a breach of fiduciary duty.
The defence of change of position should not have any application where the cause of action is knowing receipt or dishonest assistance (unlike unjust enrichment discussed at paras. 20 to 25, ante), on the basis that liability for these equitable causes of action is fault-based, and therefore it should not be open to a defendant who has behaved dishonestly or unconscionably to plead that he has changed his position.

**Equitable Compensation**

This remedy is appropriate where the breach has resulted in the principal suffering a loss but the fiduciary has not gained so much profit. The company has the option to sue for loss of profit or equitable compensation for loss if it stems from the breach of a fiduciary duty. As decided in the case of *Maguire v. Makaronis* "equity intervenes … not so much to recoup a loss suffered by the plaintiff as to hold the fiduciary to, and vindicate, the high duty owed to the plaintiff."

How is it different from common law damages? There is no remoteness test and damages are assessed at the time of judgment. The company would be able to obtain equitable compensation when the company has suffered loss because of a breach of the directors duties. In *Kea Holdings Pte Ltd v. Gan Boon Hock* the company could recover the amount for deposit which it had forfeited based on the director’s advice to cancel the contract. In *CTI Leather Sdn Bhd v. Hoe Joo Leong & Ors* it was held that the director’s decision to sell company assets at a gross undervalue was a breach of fiduciary duty for which losses were recoverable.

*Kumagai–Zenecon Construction Pte Ltd v. Low Hua Kin* is the case where the director caused the company to purchase shares in another company. This was done in order to support his ambition to be a director in the latter company. Shares pledged were pledged for a loan with the bank, when the shares declined in value demanded full payment as a result of which the shares were disposed of at a loss. The director was held liable to pay equitable compensation for the loss arising from his breach of fiduciary duty to act in the best interest of the company.

It is possible when the company has knowledge of an intended breach of fiduciary duty to seek an injunction to prevent the breach.

**Rescission And Resulting Trust**

Rescission is the act of setting aside a contract and restoring the parties to their original positions. In this context, it would be an appropriate remedy when a fiduciary enters a contract which might lead to a breach of fiduciary duty. Instances of this is where the director makes a contract outside his powers or when in contravention of s. 221 fails to disclose interest in proposed or contracts with the company.
As discussed previously, the case of *Tan Bok Seong v. Sin Bee Seng & Co (Port Weld) Sdn Bhd & Ors* by Abdul Malik Ishak J, the right to rescind is forfeited when it is not possible to restore the asset or cash or where the company has been indemnified against any loss and where a third party has acquired rights for value without notice of the prohibited contract and thereby suffer by the avoidance.

As discussed in the case of *RHB v. Travelsight*, the party to a rescinded contract would hold the property of the other party liable to be restored in resulting trust towards that purpose. The point of a resulting trust arising on failure of a mutual restitution is reproduced below.

Upon failure of mutual restitution, a resulting trust arose as reversion of the property to Atlas was wholly reliant on mutual restitution. Atlas and the liquidators still disposed of the property on 16 June 2011 and refused to refund the purchase price, in defiance of the order dated 15 November 2002 and in breach of the duty imposed by equity to account. Hence, Atlas should not be allowed to benefit from the rescission. The conduct was wholly unconscionable and therefore no order could be made in favour of Atlas and the liquidators. In the circumstances, Travelsight and RHB had a proprietary right to the refund.

The other equitable remedies available includes specific performance, injunction and rectification which deserves mention but will not be expanded upon as it is not conditional upon breach of fiduciary duties.

To conclude, the directors hold a position of trust imbued with integrity.

As Oprah Winfrey remarked, real integrity is doing the right thing, knowing that nobody’s going to know whether you did it or not.

**Endnotes:**

96. *Gartside v. Isherwood* (1788) 1 Bro CC 558 at 560.


100. *Re West of England & South Wales District Bank; Ex parte Dale & Co* (1879) 11 CH D 772 at 778.


103. *Hospital Products Ltd v. US Surgical Corporation* (1984) 156 CLR 41 which was cited and applied in the case of *Tengku Abdullah Ibni Sultan Abu Bakar & Ors v. Mohd Latiff Shah Mohd & Ors & Other Appeals* [1997] 2 CLJ 607 by Gopal Sri Ram JCA (as he then was).

104. On the issue of vulnerability, McLachlin J in *Canson Enterprise Ltd v. Boughton & Co* (1991) 85 DLR (4th) 129 at 155 recognised “Because the fiduciary has superior information concerning his or her acts, it will be difficult to detect and prove breach of these wide obligations; and because the fiduciary has control based on the notions of implicit trust, there is a substantial potential for gain through such wrongdoing.”

105. *Gilford Motor Co Ltd v. Horne* [1933] Ch 935 where a clause in the service contract of Horne the managing director not to solicit the customer of Gilford Motor during the time of his employment after he left was enforceable by way of an injunction.


114. *Nicholson v. Permakraft (NZ) Ltd (inlig)* [1985] 1 NZLR 242 Somers J held *Nicholson v. Permakraft (NZ) Ltd (In Lig)* [1985] 1 NZLR 242 where a company adopted a reconstruction scheme when it was facing liquidity problems that had the effect of prejudicing the creditors. Somers J held: In the case of an insolvent company, at least in the sense that its liabilities exceed its assets, directors in the management of a company must have regard to the interest of creditors. That is because according to the order of the application of assets on a winding up, they are trading with the creditors money.
115. *Kinsela v. Russell Kinsela Pty Ltd (in Liq)* (1987) 10 ACLR 395 where the company entered into a transaction to place asset beyond the reach of creditors. The transaction in issue was a lease of the premises to two of the directors on questionable terms. The company was insolvent at the date of lease. The shareholders have unanimously approved the director actions. It was held that lease entered was a breach of duty to the company in that it directly prejudiced the interest of the creditors of the company and the shareholders did not have the power or authority to absolve the directors from that breach.


118. [2016] 7 CLJ 380.

119. [2015] 9 CLJ 590.


121. *Hospital Products Limited v. United States Surgical Corporation & Ors* [1986] 156 CLR 41.

122. [2014] 3 CLJ 73.


126. (1936) 54 CLR 83 at p 592 per Rich, Dixon and Evatt JJ.


131. (1854) 2 Eq Rep 1281.
135. (1973) 40 DLR (3d) 371 at 383.
147. London & Mashonaland Exploration Co v. New Mashnoaland Exploration Co [1891] WN 165; Bell v. Lever Bros [1932] AC 161. This rule is to be read with modification to the rule under s. 218(e) Companies Act.


151. Consul Development Pty Ltd v. DPC Estates Pty (1975) 132 CLR 373 at 393, Aust HC.


157. The section shares similarity with s. 63 Trustee Act 1949 (Act 208).


159. Re IDEAGLOBAL.COM Ltd [2000] 1 SLR (R) 804.


166. [2017] 4 CLJ 1.

167. Section 22 Limitation Act.

168. [2018] 5 CLJ 299.


170. [2005] 6 CLJ 413.
177. [1968] 2 All ER 1073 at 1094.
181. Travelsight filed action (Kuala Lumpur 28-946-2008), pursuant to ss. 236 and 279 of the Companies Act 1965, for orders to set aside the act and/or decision of the liquidators to sell the property and to prohibit them from selling and or transferring the property, and for an order to declare that the property was held by the liquidators upon trust for Travelsight.
184. [2015] 3 CLJ 663.
185. Halsbury Laws of Malaysia vol 11 (1) Reissue 2015 Equity and Remedies para. 290.228 p. 255. See comment that not firmly settled but basis of award may be said to be partly restitutionary and partly compensatory.
186. (1996) 188 CLR 449 at 465 (case concerned rescission of a mortgage on the condition of repaying the principal and interest on a loan).
187. Youyang v. Minter Ellison (2003) 212 CLR 484. See also Millet LJ in Bristol and West Building Society v. Mothew [1997] 2 WLR 436. It may be argued by some that this is a distinction without a difference.
188. [2000] 3 SLR 129.
