

Dishonesty must be present before debtor in assignment can be made liable

ganpartnership

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Litigation, Malaysia

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Introduction

The recent Federal Court decision in *Cimb Bank Berhad v Sebang Gemilang Sdn Bhd*(**1**) has simply reaffirmed the position of Malaysian law in relation to breaches of trust following *CIMB Bank Bhd v Maybank Trustees Bhd*.(**2**)

In *Maybank Trustees Bhd* the Federal Court, when faced with the issue of a breach of trust, applied the combined test propounded in *Twinsectra Ltd v Yardley*:(**3**)

There is a standard which combines an objective test and a subjective test, and which requires that before there can be a finding of dishonesty it must be established that the defendant's conduct was dishonest by the ordinary standards of reasonable and honest people and that he himself realised by those standards his conduct was dishonest.

Referring to the earlier decision, the majority of the Federal Court in the instant case held that imputed constructive knowledge of an assignment is insufficient to hold the debtor liable to the assignee for the debt.

Facts

The appellant partially financed three government projects that had been awarded to the second respondent. As an additional security for the financing, a sinking fund account was created and operated solely by the appellant.

A deed of assignment and a power of attorney were executed by the second respondent in favour of the first respondent to enable the first respondent to complete the projects. Later, the second respondent applied to the appellant to add one of the first respondent's directors as another signatory to its current account with the appellant. A board resolution was passed by the second respondent to that effect.

When the projects were completed, the appellant closed the sinking fund account on the second respondent's request and credited the fixed deposit to the second respondent's current account.

This was discovered by the first respondent only when it approached the appellant for the release of the monies in the sinking fund after the expiry of the defects liability period.

The first respondent then sued both the appellant and the second respondent.

High court and Court of Appeal decisions

Both the high court and the Court of Appeal found in favour of the first respondent. It was held that the appellant, despite having knowledge of the assignment, had committed a breach of trust by releasing the said monies to the second respondent without informing the first respondent.

Federal Court decision

Leave was granted to the appellant to appeal on, among others, the following question of law:

Where there is no written notice of an absolute assignment pursuant of Section 4(3) of the Civil Law Act 1956, and the trial court make a finding that the debtor has knowledge of an assignment between its customer and third party, can the debtor be held liable to that third party for the debt where the debtor has made payment of the same to its customer?

Answer to leave question

It is settled law that failure to give a statutory notice in writing will not prevent an assignee from proceeding with its action on the basis that it is an equitable assignee. Here, there was a valid equitable assignment of the monies in the sinking fund to the first respondent.

Thus, the central issue was whether the appellant could be held liable to the first respondent for the debt when the appellant had made payment of the same to the second respondent.

In this content, the court referred to *Maybank Trustees Bhd.*

Four out of five of the bench held that there was no evidence that the appellant had been dishonest based on the ordinary standards of reasonable and honest people, under which it would have had to have known, based on the subjective dishonest test, that it had acted dishonestly when closing the sinking fund and paying the monies to the second respondent.

The appellant had acted in accordance with the normal banker-customer relationship when it closed the sinking fund and paid the monies to the second respondent.

The appeal was allowed.

Minority judgment

A distinction was made between the liability of:

- an accessory to a breach of trust by a trustee or fiduciary; and
- a constructive trustee in a breach of trust.

In the former, a finding of dishonesty must first be established before a party can be held liable for assisting in the breach of trust.

However, in the latter, no evidence of dishonesty is required before a trustee or constructive trustee can be held liable for the breach of trust.

Comment

Although the failure to give a written notice of assignment does not preclude the finding of an equitable assignment, such notice should be given to ensure an absolute legal assignment.

The Federal Court's majority decision also illustrates a disinclination to depart from the established law on the requirement of dishonesty in a breach of trust. The threshold upon which a debtor can be held liable to an assignee remains high; there must be a prior finding of dishonesty. Otherwise, a debtor or trustee may be said to have been subject to overly wide liability by mere knowledge of assignment.

For further information on this topic please contact Gan Khong Aik at Gan Partnership by telephone (+603 2201 1130) or email (khongaik@ganlaw.my). The Gan Partnership website can be accessed at www.ganlaw.my

Endnotes

- (1) [2018] 1 LNS 324.
- (2) [2014] 3 CLJ 1.
- (3) [2002] 2 All ER 377.

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Gan Khong Aik