

Clarifying Turquand's Rule

IN THIS ARTICLE, CRISTAL WONG AI MEI LOOKS AT THE APPLICATION OF TURQUAND'S RULE IN MALAYSIA.

Introduction

The rule in the case of **Royal British Bank v Turquand**¹ is commonly known as "*Turquand's Rule*" or the "*indoor management rule*". It stipulates that an "*outsider*" dealing with a company in good faith is entitled to assume that there has been compliance with the Articles of Association and bylaws of the company and that the "*outsider*" need not question the formalities of the internal proceedings of a company.

Turquand's Rule was applied in the Federal Court case of **Pekan Nenas Industries Sdn Bhd v Chang Ching Chuen & Ors**² and its application has recently been clarified by the Federal Court in the case of **Kang Hai Holdings Sdn Bhd & Anor v Lee Lai Bian**³ ("**Kang Hai Holdings**").

Brief facts

The first plaintiff, Kang Hai Holdings Sdn Bhd ("KHH") was the owner of two plots of land, namely Lot 2929 and Lot 2930. The second plaintiff, Kang Hai Realty Sdn Bhd ("KHR"), was the owner of Lot 2980. The first defendant, Sivananathan a/l Muthu Karpan ("Siva"), was a former director of KHH and KHR ("Companies") who ceased to be a director of KHH on 15 September 2008 and KHR on 19 August 2009 respectively.

Despite having ceased to be a director of the Companies, Siva engaged the second defendant, Lee Lai Ban ("Lee"), to extract earth from Lots 2929, 2930 and 2980 ("Lots") from May 2009. Siva issued a letter to Lee and both parties subsequently entered into a three-year tenancy agreement.

In September 2010, a director of the Companies informed Lee that Siva was not authorised to perform transactions on behalf of the Companies. In spite of this, Lee continued extracting earth from the Lots up to December 2010.

The Companies subsequently brought a claim against Siva and Lee for accounts and damages for fraud, forgery, trespass to land and conversion.

Decision of the High Court

The claim against Siva was premised on the fact that he had fraudulently presented himself as a director and manager of KHH and forged several documents in the course of doing so.

On the other hand, the Companies alleged that the Lee had gained unlawful entry to the Lots by acting under the directions of Siva. Further, Lee had been notified of the trespass on the Lots belonging to the Companies during a meeting, but had elected to remain oblivious and did not make any enquiries into the matter.

In his defence, Siva claimed that he was unaware of his removal as a director of KHH and that the Managing Director and owner of the Companies had delegated all powers and duties of managing

the Companies to him via two letters. Siva argued that he was acting within the authority that had been delegated to him and that there was a valid contract between both the Companies and Lee.

Similarly, Lee argued that he had relied upon the representations of Siva and had lawfully extracted the earth as per the tenancy agreement. In turn, Lee advanced a counterclaim for loss of profits due to the breach of the tenancy agreement.

After a full trial, the High Court allowed the Companies' claim against both Siva and Lee and dismissed the counterclaim. The Court held that Siva knew of his removal and that he was not authorised to act on behalf of the Companies. As the tenancy agreement and letter issued by Siva were invalid, Lee did not have the right to extract earth from the Lots.

Decision of the Court of Appeal

Siva and Lee filed appeals against the decision of the High Court. After hearing submissions, the Court of Appeal affirmed the High Court decision on Siva's liability as there was no appealable error. However, the decision on the Lee's liability was overturned as the Court of Appeal held that the High Court failed to fully appreciate the evidence before it and that Lee was entitled to invoke Turquand's Rule.

Leave questions

Dissatisfied, the Companies sought leave to appeal from the Federal Court. Leave was granted on two questions of law:

1. Can Turquand's Rule apply to a situation where an "*outsider*" dealing with the company is deemed to have constructive notice of the identity of the directors and managers of a company as shown in "*The Statement Giving Particulars In Register Of Directors, Managers And Secretaries And Changes Of Particulars*" ("Form 49") of the company?
2. Can an "*outsider*" rely on Turquand's Rule and the principles of ostensible authority of a person to bind a company where the "*holding out*" or representation of authority is made solely by the person with no authority?

Decision of the Federal Court

In order to invoke Turquand's Rule, the law imposes a minimum duty upon an "*outsider*" to perform the necessary checks, such as a land or company search. As Lee had not done so, the Federal Court found that the Court of Appeal had erred in allowing Lee to invoke Turquand's Rule. If the necessary searches were done, Lee would have easily discovered that Siva was not a director of the Companies and that he had no authority to enter into such a transaction.

The Federal Court held that the doctrine of constructive notice was applicable to Form 49, as it fell within the definition of a public document. Further, it was held that Turquand's Rule is inapplicable in instances whereby the representation of authority is made solely by a person with no authority.

Consequently, the Federal Court allowed the Companies' appeal and held that Lee was not entitled to rely on Turquand's Rule.

Companies Act 2016

It is vital to note that **Kang Hai Holdings** was decided based on the provisions of the **Companies Act 1965** ("CA 1965"). Under the CA 1965, the doctrine of constructive notice would operate in instances involving public documents such as the Memorandum and Articles of Association ("MAA") which were available for inspection at the Companies Commission of Malaysia.

The CA 1965 was repealed by the **Companies Act 2016** ("CA 2016") on 31 January 2017. Under the CA 2016, MAAs are no longer compulsory and, in view of section 39, the doctrine of constructive notice (save for instruments of charges) no longer applies. Section 39 states the following⁴:

"No person shall be deemed to have notice or knowledge of the contents of the constitution or any other document relating to a company, due to the fact —
(a) that the constitution or document has been registered by the Registrar; or
(b) that it is available for inspection at the registered office of the company,
with the exception of documents relating to instrument of charges."

In company law, the doctrine of constructive notice means that a party is deemed to have knowledge of a document due to the fact that it is public. It is apparent from the extract above that this section is at odds with the Federal Court's judgement in **Kang Hai Holdings** that the doctrine of constructive notice is applicable to Form 49 as it is a public document.

In this regard, Section 620(4)⁵ of the CA 2016 is relevant and states as follows:

"(4) Any right, privilege, obligation or liability acquired, accrued or incurred before the effective date or any legal proceedings, remedy or investigation in respect of such right, privilege, obligation or liability shall not be affected by this Act and shall continue to remain in force as if this Act has not been enacted."

It is arguable that section 620(4) preserves the right of a party to rely on the doctrine of constructive notice if the act or event complained of took place before the coming into force of the CA 2016 on 31st January 2017. That said, section 620(4) has yet to be judicially considered, and judicial guidance would be valuable in interpreting the scope and applicability of section 620(4).

Conclusion

Until further guidance is provided, the principles enunciated in **Kang Hai Holdings** remain applicable to cases following the CA 1965 as follows:

- An "outsider" may rely on Turquand's Rule provided that the "outsider" has performed the available checks to comply with the minimum duty imposed by law.
- The doctrine of constructive notice of public documents may continue to apply to events which transpired prior to the coming into force of the CA 2016.
- The doctrine of constructive notice of public documents (other than instruments of charges) will not apply to events which transpired after the coming into force of the CA 2016.
- Turquand's Rule is inapplicable in instances where the representation of authority has been made solely by the person with no authority.

¹ [1843-60] ALL ER Rep 435.

² [1998] 1 MLJ 465.

³ [2018] 2 CLJ 550.

⁴ Section 39 of the CA 2016.

⁵ Section 620(4) of the CA 2016.

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