Low Hua Kin v Kumagai-Zenecon Construction Pte Ltd (in liquidation) and Another [2000] SGCA 38

Case Number : CA 124/1999

Decision Date : 28 July 2000

Tribunal/Court : Court of Appeal

Coram : Chao Hick Tin JA; L P Thean JA; Yong Pung How CJ

Counsel Name(s) : Alvin Yeo SC and Nandakumar Ponniya (Wong Partnership) for the appellant; Anthony Lee and Rodney Keong (Bih Li & Lee) for the respondents

Parties : Low Hua Kin — Kumagai-Zenecon Construction Pte Ltd (in liquidation); Another

Companies – Directors – Duties – Breach of fiduciary duty – Whether loss suffered by company's loss caused by director's breach of duty

Companies – Winding up – Provisional liquidator – Primary duty of provisional liquidator – Whether sale of shares ultra vires – Whether provisional liquidators negligent is not seeking third party advise before sale of shares – Whether act of provisional liquidators break chain of causation

(delivering the grounds of judgment of the court): This appeal arose from the decision of GP Selvam J in OS 62/96, which was a misfeasance summons taken out by the liquidators of the respondent companies against the appellant under s 341 of the Companies Act (Cap 50, 1994 Ed). We dismissed the appeal, and now give our reasons.

The facts

The relevant facts that gave rise to this appeal were briefly these. The appellant started out as a lecturer in the then University of Singapore in the early 1970s or thereabouts. In 1972, the appellant while still a lecturer, was, with the consent of the university, engaged by a Japanese corporation, Kumagai Gumi Co Ltd (`Kumagai`), as a consultant and advisor. Kumagai had been doing business in Singapore as building contractors. Their relationship developed further and in 1976, the appellant resigned from the university and became a full time consultant and advisor to Kumagai.

In 1979, with the consent of Kumagai, the appellant incorporated his own company called Zenecon Pte Ltd (`Zenecon`) which, at all material times, was under his control. He was a director and the chairman of Zenecon and held the controlling shares. The other shareholders were his wife and brother; one Jason Lim was the company secretary.

In 1983, Kumagai and Zenecon decided to enter into a joint venture. On 25 April 1983, they executed a shareholders` agreement and memorandum of understanding whereby they agreed to incorporate a joint venture company for the purposes of engaging in the business of, inter alia, construction, civil and structural engineering and property development. Pursuant to their agreement, Kumagai-Zenecon Construction Pte Ltd (`K-Z`), the first respondent in this appeal, was incorporated on 3 June 1983. As provided in the agreement, Zenecon held 51% of the shares in K-Z, while Kumagai held the remaining 49% of the shares. Under the agreement, Kumagai was to supply the necessary technical expertise and working capital, while Zenecon was to assume the responsibility for the day-to-day management of the company. Both parties to the joint venture appointed three nominee directors to the board of K-Z respectively. The appellant was appointed the managing director.

In November 1984, with the agreement of Kumagai, a subsidiary of K-Z called Kumagai Property Marketing Pte Ltd (`KPM`) was formed for the purpose of marketing the housing development projects

undertaken by K-Z. This company is the second respondent. Soon after the incorporation, K-Z was allotted 9,000 shares of KPM, and one Lim Thye San, the brother-in-law of the appellant, who was then the property manager of KPM, was allotted 1000 shares. These 1000 shares were subsequently acquired by the appellant. The directors of KPM consisted of the appellant and his nominees, and there were no nominees from Kumagai on the board of this company. The appellant was appointed the representative to represent K-Z at general meetings of KPM. All these were carried out with the approval of Kumagai.

Subsequently, the appellant began to run KPM as if it were wholly owned by him. Without any prior consultation with Kumagai, he proceeded to make use of the company to purchase shares in certain public listed companies with a view to gaining control in these companies. For that purpose, he caused the name of KPM to be changed to Kumagai Investments Pte Ltd and also the objects clause in the memorandum of association of KPM to be altered so as to include the investing in shares as part of its business.

Among the shares of companies he directed or caused KPM to buy were the shares in a listed company called Pacific Can Investment Holdings Ltd (`Pac Can`). In May 1991, a total of some 7,321,000 shares in Pacific Can were purchased by KPM pursuant to the appellant`s directions. To finance the purchase of these shares KPM had to borrow moneys from the bank. On 10 May 1991, KPM entered into a loan agreement with Arab Bank plc (`Arab Bank`) under which a loan facility up to an amount of US$6m was provided by the bank to KPM, and as security for the loan the shares purchased were charged to the bank. Kumagai was not informed of these transactions. It only learnt of the change of name and purchase of the shares from newspaper reports. In August 1991, KPM bought 278,000 more shares in Pac Can, and this purchase was again made without Kumagai`s knowledge. In all, a total of 7,599,000 shares in Pac Can were bought by KPM at the direction of the appellant. There were other share transactions in which KPM was involved, but they were irrelevant for the purpose of this appeal.

The relationship between Kumagai and the appellant became strained and very soon various disputes between them erupted. On 29 January 1992, Kumagai filed a petition seeking reliefs under s 216 of the Companies Act (Cap 50, 1990 Ed) in respect of K-Z. Kumagai also presented a petition for the winding up of K-Z under s 254(1)(i) of the Companies Act on the ground that it was just and equitable to do so by reason of the breakdown in the relationship between the two shareholders, Kumagai and Zenecon. Soon after the filing of these petitions, an order of court by consent was made on 11 February 1992 appointing Don Ho and Wee Aik Guan of Deloitte and Touche as provisional liquidators of K-Z.

On 15 April 1992, Arab Bank made a margin call on KPM requiring the company to pay up a sum of $220,000. KPM failed to meet this demand. On 22 April 1992, the bank indicated its intention to sell sufficient amount of shares to satisfy the margin shortfall, unless the shortfall was paid by 2.30pm that day. This impending crisis was averted only after the bank agreed to accept a partial payment of $30,000 from KPM. Subsequently, another margin call was made and KPM was requested to pay up a sum of $150,000. It became clear by this time that KPM was in dire financial straits. As at 23 April 1992, its bank balance stood at a meagre sum of $3,649.37.

The provisional liquidators of K-Z therefore started to make arrangements to sell the shares en bloc. Their solicitors wrote to the solicitors for KPM on 23 April 1992 informing the company of an offer that had been made to purchase all the Pac Can shares at 78 cents per share. The provisional liquidators took the view that as KPM had no income, no potential source of income or any other funds to meet further margin calls or even the next interest payment, the best solution in the circumstances was to sell the shares en bloc. A copy of this letter was extended to the solicitors for the appellant. The

appellant on his part was not receptive to the proposal of selling the shares en bloc. Through his solicitors, he informed the provisional liquidators that he agreed to the sale of only such amount of the shares as was necessary to meet the margin call. At the same time, he also demanded to know the identity of the intended purchaser of the shares.

The offer to purchase the shares at 78 cents per share was not taken up, and it lapsed. The provisional liquidators, nevertheless, continued to seek the appellant`s co-operation to sell the shares en bloc. The appellant`s response was that he did not think it was in the best interests of KPM to sell its entire shareholding in Pac Can, but made no alternative suggestion as to how to resolve the crisis. The provisional liquidators meanwhile explained that a piecemeal sale of the shares was not feasible, as it would only depress the share price further which in turn would trigger a further margin call. In light of the fact that KPM had no available funds or source of income, it was unlikely that they would be able to meet any margin call, whether then or in the future. It was also significant that the newspapers at or around that time were rife with rumours of an on-going boardroom tussle in Pac Can, a situation which looked set to push the company`s share prices down even further. Moreover, Pac Can had also recorded dismal profits in the financial year ending 30 September 1991.

On 12 June 1992, the appellant and his associates were removed as directors of KPM. K-Z, acting through the provisional liquidators, appointed two of their nominees to the board of KPM in place of the appellant and his associates.

The situation with Arab Bank meanwhile did not improve. On 22 June 1992, KPM defaulted on an interest payment amounting to $42,076.39. By a letter dated 24 June 1992, the bank gave notice that the failure to pay the interest constituted an event of default under the loan agreement and demanded payment from KPM of the entire outstanding sum inclusive of interest amounting in total to $3,074,040.37, in default of which they said that they would exercise all their rights under the loan agreement without further reference to the company.

Following this, the provisional liquidators through their solicitors wrote to the solicitors for Kumagai and Zenecon, the shareholders of K-Z, informing them of the action proposed to be taken by the bank and enquiring whether they or either of them would be prepared to make the necessary advances to enable KPM to discharge the loan. Both the shareholders declined to do so.

Thereafter, the provisional liquidators after discussion with the bank decided that the best course to adopt was to sell the entire block of Pac Can shares in a `married deal` transacted on the stock exchange. However, as the Pac Can shares represented substantially the whole of the assets of KPM, approval for the sale of all the shares had to be obtained from its shareholders at a general meeting under s 160 of the Companies Act. Accordingly, on 25 June 1992, the secretary of KPM sent to the shareholders of KPM a notice calling for an extraordinary general meeting of the company to be held on 10 July 1992 for the purpose of passing an ordinary resolution authorising the directors to sell the shares. The secretary also requested shareholders to consent to shorter notice of the meeting so that the matter could be resolved early.

On 1 July 1992, Arab Bank wrote to KPM agreeing to give the company a short period of time, until 3 July 1992, to arrange a `married deal` for the en bloc sale of the Pac Can shares. Following the receipt of this letter, the solicitors for the provisional liquidators, on the same day, wrote to the solicitors for the appellant informing the latter of the extension of time given by the bank. Their letter went on to explain, among other things, that the sale of the shares en bloc in a `married deal` was the best course to adopt, as such a transaction would fetch a premium on the prevailing price of the shares, and that a sale of the shares piecemeal by the bank to the extent of recovering the loan might have the result of depressing the price of the shares. In that letter, they also sought the

appellant`s consent to a shorter notice for calling the extraordinary general meeting of KPM scheduled to be held on 10 July, `in view of the urgency of [the] matter`.

The appellant did not really instruct his solicitors to respond to this letter. However, he himself, on 3 July 1992, wrote direct to KPM, in response to the secretary`s request for consent to a shorter notice of the extraordinary general meeting. In that letter he raised a series of queries on the sale of the shares, namely, the identity of the proposed buyer, the proposed selling price, whether the bank had consented to the sale, and what the directors of KPM proposed to do with the proceeds of sale and surplus funds after payment of the loan to the bank. On the same day, KPM replied by fax furnishing him the replies to his queries, and by a separate fax sought his consent to the shorter notice. Not content with the reply, the appellant on 4 July 1992 wrote to KPM raising a further query on what the fair price was for the sale of the shares en bloc. On 8 July 1992 he wrote to KPM requesting for `a right of first refusal to such shares` in the event of any sale of the shares.

On 10 July 1992, an extraordinary general meeting of the shareholders of KPM was held. K-Z was represented by Don Ho, one of the provisional liquidators. The appellant for his part did not show up. Instead, he sent Jason Lim as his proxy. At this meeting, a resolution authorising the directors to dispose of the whole or substantially the whole of the company`s undertaking was passed. Jason Lim abstained from voting.

On 14 July 1992, KPM wrote to the appellant asking him to offer a price for the purchase of the shares, if he wished to purchase them. The appellant did not reply. On 16 July 1992, KPM sent another letter to the appellant repeating the above request, giving the appellant up till the end of the working day on 17 July 1992 to make an offer. A separate letter to the same effect was also sent to the appellant`s solicitors.

The appellant replied through his solicitors on 17 July 1992, stating that he did not wish to make a first offer to purchase the Pac Can shares from KPM, and repeating his earlier request for a right of first refusal. The provisional liquidators` solicitors replied on 18 July 1992 denying that the appellant had any such right of first refusal. They maintained that their objective was to obtain the best possible price for the shares. Again, the appellant failed to revert. Finally, on 21 July 1992 KPM sent the following fax to the appellant:

> *We have an interested party to purchase all the Kumagai Investments` shares in Pacific Can for 70 cents per share. Are you interested to pay a higher price? If so, please revert before 5 pm today.*

No offer or indication of any interest from the appellant having been received by KPM by the time stated in the notice, the shares were sold on 22 July 1992 at 70 cents per share. However, it later transpired that the appellant had sent a fax to the directors of KPM dated 21 July 1992 making an offer to purchase the shares at 70.25 cents per share and further asked for 14 days to complete the sale. Don Ho did not see this letter until 23 July 1992, by which time he had already accepted the offer to sell the shares at 70 cents per share on behalf of KPM. The net loss incurred by KPM in the sale of the Pac Can shares amounted to $2,982,517.17.

At the hearing of OP 9/92, which was the application by Kumagai under s 216 of the Companies Act, Warren LH Khoo J found that the share purchases and associated changes of name and objects of KPM to enable the purchase of the shares were acts of oppression which were sufficient to found a claim under s 216. A finding that the investment in Pac Can was against the commercial interest of KPM and served only the appellant`s personal interests was also made. The learned judge made an

order on 1 July 1994 that both K-Z and KPM be wound up and liquidators be appointed. He further ordered the appellant to reimburse KPM the amount of $2,982,517.17, being the amount stated in the provisional liquidators` third interim report as the loss resulting from the purchase of the shares: see **Re Kumagai-Zenecon Construction Pte Ltd** [1994] 3 SLR 552 .

On appeal, this court affirmed Warren LH Khoo J`s finding that the appellant had acted oppressively in the affairs of K-Z, and upheld the orders made for the winding up of both companies. As for the order requiring the appellant to reimburse the sum of $2,982,517.17, the court found that there was insufficient evidence before it at that time to determine both the causation of that loss and the quantification thereof. The only evidence before Warren LH Khoo J at the hearing in 1993 was the provisional liquidators` third interim report. The provisional liquidators themselves were not called to testify in that action as a result of which everything which was stated in the said report was hearsay and not tested in cross-examination. As such, this court ordered that the order for the appellant to reimburse be quashed. This court expressed the view that the liquidators, who had been appointed pursuant to the winding-up orders, were in a position and had the power to investigate the causation of any loss suffered by KPM, and that if they found as a result of their investigations that the loss was caused by or attributable to any breach of duty by the appellant to either K-Z or KPM, then a misfeasance summons under s 341 of the Companies Act could be taken out at a later stage to determine the issue conclusively: see **Kumagai Gumi Co Ltd v Zenecon Pte Ltd & Ors and other appeals** [1995] 2 SLR 297 , 320.

Thereafter, the liquidators, on behalf of K-Z and KPM, commenced the present action, OS 62/96, against the appellant claiming the reimbursement of the loss suffered by KPM arising from the purchase of the Pac Can shares. GP Selvam J, in the court below, found for the respondents and ordered the appellant to reimburse the sum of $2,982,517.17 to KPM. The learned judge was of the view that the appellant had breached his fiduciary duties as a director when he procured the purchase of the Pac Can shares by KPM on borrowed money. The purchase of the shares conferred no benefit whatsoever on KPM and was made purely to serve the appellant`s own goals in the boardroom of Pac Can. Against this decision, the appellant appealed.

Appeal

At the commencement of his argument in this appeal, counsel for the appellant raised two preliminary points. The first was that there was no evidence adduced before the trial judge to support the findings that the appellant`s breach of fiduciary duty occasioned the loss to KPM, and the second was that the party who sold the shares was not the company but the provisional liquidators and they had thus acted ultra vires their powers.

Absence of sufficient evidence

Counsel for the appellant submitted that before GP Selvam J, the respondents did not adduce any evidence in support of their assertion that the loss was caused by the breach of fiduciary duty on the part of the appellant, other than the evidence that was already before the court in OP 9/92. The finding by the learned judge that the loss was caused by the appellant was therefore not justified. We found no merit in this submission and had no hesitation in rejecting it.

In the appeal from the decision of Warren LH Khoo J in OP 9/92 (ie ***Kumagai Gumi v Zenecon*** (supra)) in 1993, this court quashed the order made by the learned judge ordering the appellant to reimburse the sum of $2,982,517.17 to KPM on the ground that the order was made purely on the basis of the provisional liquidators` third interim report which, in the court`s view, was hearsay as the

provisional liquidators themselves had not been called to give evidence in the proceedings before the learned judge. However, at the hearing before GP Selvam J, the respondents called Don Ho, one of the provisional liquidators, to give evidence of the circumstances surrounding the sale of the shares. At the same time, they also called Peter Chi, one of the liquidators appointed in the winding up of the respondents, to give evidence of the results of his investigations into the affairs of the companies, which investigations he had carried out as part and parcel of his duties as a liquidator. Peter Chi confirmed in his affidavit the substance of the provisional liquidators` report. There was therefore evidence adduced before GP Selvam J on the matters complained of, and he was entitled to accept such evidence in making his finding.

Proper party to the sale of the shares

The second preliminary point raised by counsel for the appellant was that it was not KPM, but the provisional liquidators, who sold the Pac Can shares on 22 July 1992, and that in so doing they acted ultra vires their powers. It was submitted by counsel that the sale of the Pac Can shares was procured by the provisional liquidators. They exercised the rights of K-Z as a shareholder and the latter held 90% of the shares in KPM. In particular, they appointed their nominees to the board of KPM, who acting strictly on their direction effected the sale of the shares. Counsel accepted that the legal entity which owned the shares and sold them was KPM. Nevertheless, he claimed that because a company cannot act by itself but only through the directing minds of individuals and the directing minds in this case were the provisional liquidators, it was they who directed KPM to sell the shares. In truth and in fact, it was the provisional liquidators who effected the sale of the shares. Counsel relied on the admission made by Don Ho, one of the provisional liquidators that they were `instrumental` in bringing about the sale of the shares. On the evidence, therefore, it was too artificial to find, as the learned judge did, that it was not the provisional liquidators who sold the Pac Can shares, but KPM in exoneration of the role played by the provisional liquidators. We did not find any merit in this argument.

It is true that KPM being a legal entity can only act through its agents, such as the directors and other officers of the company. In this case, factually, there is no doubt that it was the provisional liquidators who were the directing minds of KPM, and who decided on the sale of the shares and who also procured and arranged the sale. It is also true that they were not the provisional liquidators of KPM, but of K-Z. However, K-Z held 90% of the shares in KPM, and as such, as the provisional liquidators of K-Z they represented K-Z in relation to the affairs of KPM. In exercising the right of K-Z as a shareholder of KPM, they appointed their nominees to the board of KPM, which they were fully entitled to do. Thus, by virtue of K-Z`s shareholding, they controlled KPM and through the directors nominated by them they controlled the management of the company. There was no denying that the decision to sell the shares and to sell them en bloc was made by the provisional liquidators. Nonetheless, the fact remained that the owner of the shares was KPM and the sale of the shares was authorised by its shareholders at a general meeting pursuant to s 160 of the Companies Act. The role played by the provisional liquidators was that of an agent. Whatever the provisional liquidators did was done for and on behalf of KPM, and KPM was undoubtedly the party who entered into the transaction. The provisional liquidators` act of `selling the shares` was thus done purely in their capacity as the agents of KPM. As a matter of law, it is wrong to say that it was the provisional liquidators who sold the shares. The fact that it was the provisional liquidators who procured the sale of the shares by KPM did not change the fact that KPM was the true vendor in the sale of the shares. Indeed it could not have been otherwise, for beneficial ownership of the shares was at all times with KPM. The shares did not at any time belong to the provisional liquidators; nor were they registered in the name of the provisional liquidators. It was therefore impossible in law for the provisional liquidators to have sold the shares.

The situation here is no different, in principle, from one where a major transaction is entered into by a company for the purpose of its business. The directing minds of the company, no doubt, are its directors, and they are the ones who procure the transaction and decide whether or not the company should enter into it. As and when they approve the transaction, and pursuant to their approval the transaction is entered into, it is entered into by and in the name of the company. It is the company and not the directors who entered into that transaction. The directors` role is merely that of an agent.

Chain of causation

The main contention before us was that the circumstances under which the Pac Can shares were sold by the provisional liquidators broke the causal connection between the breach of fiduciary duty on the part of the appellant (ie the purchase of the shares) and the loss incurred in the sale of the shares. Before us counsel for the appellant advanced three main lines of argument in support of this contention: He submitted first, that the provisional liquidators acted ultra vires their powers; second, that they were negligent and/or in breach of their duties in effecting the sale of the shares in the manner in which they did; and third, that the sale of the shares was itself an independent act by the provisional liquidators that was sufficient to break the chain of causation - in other words, it was the sale of the shares which occasioned the loss to KPM. All of these, counsel submitted, were sufficient to cause a break in the chain of causation between the appellant`s breach of fiduciary duty to KPM and the loss arising from the sale.

Ultra vires

Counsel for the appellant submitted that the provisional liquidators acted ultra vires their powers in procuring the sale of all the Pac Can shares owned by KPM. In his submission, these powers were exhaustively contained in the order of court appointing them and did not include the power or authority to realise any of the assets of KPM, and in particular all the Pac Can shares owned by KPM. Counsel pointed out that the provisional liquidators were appointed in relation to the affairs of K-Z and not KPM, and the shares were an asset of KPM and not K-Z. The primary purpose of appointing a provisional liquidator is to preserve the status quo and the assets of the company as much as possible. In the instant case, however, the provisional liquidators pushed ahead with the sale, ignoring their primary role of maintaining the status quo, and disposed of the main asset of KPM.

On this issue, we turn first to the powers of a provisional liquidator as provided in the Companies Act. These powers are found in s 267, which is as follows:

> *The Court may appoint the Official Receiver or an approved liquidator provisionally at any time after the presentation of a winding up petition and before the making of a winding up order and the provisional liquidator shall have and may exercise all the functions and powers of a liquidator, subject to such limitations and restrictions as may be prescribed by the Rules or as the Court may specify in the order appointing him.*

The powers of a liquidator are in turn contained in s 272 of the Companies Act and are in two groups. First, under s 272(1) the liquidator is given a list of powers which he may exercise only with the authority of the court or the committee of inspection. Next, s 272(2) contains a further list of powers which the liquidator may exercise without the necessity of seeking leave of the court or the committee of inspection. Among the powers included under s 272(2) is the power to sell immovable

and movable property and things in action of the company. These powers are broad in scope and are intended to be exercised for the beneficial winding up of the company. A plain reading of s 267 shows that a provisional liquidator has the same powers as those exercisable by a liquidator proper under s 272, unless expressly curtailed or restricted by the order of court appointing him.

We therefore turn to the order made on 11 February 1992 appointing the provisional liquidators in this case. The order first expressly empowered the provisional liquidators `to carry out, continue and complete` a series of contracts specifically described in items A to G therein, and `to collect all sums already accrued or to accrue due and payable to the Company`. Next, the order went on to empower the provisional liquidators `to collect and realize all other sums already accrued or to accrue due and payable to, and assets of, the Company so far as is necessary for the beneficial winding up thereof.` Counsel for the appellant submitted that this part of the order `to collect and realize ... assets of`, must be read with reference to the contracts listed in items A to G only. We were unable to agree. As a matter of construction, the first part of the order relating to the contracts listed in A to G was clearly self sufficient, and did not require any amplification in the second part. The second part relating to collection and realization of `sums already accrued or to accrue due and payable to, and assets of the Company` was an addition to what had been ordered in relation to specific contracts, and was intended to be a confirmatory and sweeping-up provision to preserve to the provisional liquidators all the powers which were automatically conferred on them by statute. We did not find in this order any limitation or restriction on the powers of the provisional liquidators as contained in ss 267 and 272.

The question now is whether the provisional liquidators in procuring the sale by KPM of all the Pac Can shares owned by it acted within the scope of the powers conferred on them. The provisional liquidators were appointed in relation to the affairs of K-Z. That company, among other things, held some 90% of the shares in KPM, and KPM itself had substantial assets and also substantial liabilities. As part of their overall management of K-Z, it was incumbent on the provisional liquidators to take over the control and management of the business of KPM, including its assets and liabilities. As KPM then owned some 7,321,000 Pac Can shares, it was the duty of the provisional liquidators to get in, collect and realize these assets. They were therefore entitled, in appropriate circumstances, to direct and procure the sale of all or any of the Pac Can shares then owned by KPM. Prima facie, the sale of the Pac Can shares procured by the provisional liquidators was not ultra vires their powers.

The complaint of the appellant, however, was that the provisional liquidators should not have procured all the Pac Can shares to be sold. The primary duty of the provisional liquidators was to preserve the status quo, the undertaking of the company and its assets, with the least possible harm to all concerned, so as to enable the court to decide after a proper and final hearing whether or not the company should be wound up: Re ML Industries Pty Ltd (1981) ACLC 33,229. Therefore, the provisional liquidators should have procured to be sold a much lesser amount, namely, such number of the shares, say about 4.4m shares, which would be sufficient for KPM to pay off entirely the amount due to Arab Bank. Such a sale would be consistent with their primary duty. It was pointed out that as a matter of fact if the lesser amount of shares had been sold to pay the amount due, which was all that the bank required, there would have been no loss to KPM as at the date of the winding up order on 1 July 1994.

We accept that as a general rule the primary duty of a provisional liquidator is to preserve the status quo with the least possible harm to all concerned so as to enable the court to decide, after a proper and final hearing, whether or not the company should be would up: per Street J in **Carpark Industries Pty Ltd (in liquidation) and Companies Act 161 (No 1)** [1967] 1 NSWR 337, 341. In our opinion, this is not an inflexible rule and the primary duty of a provisional liquidator is not absolute and unqualified in all circumstances. Much depends on the circumstances of each case. Sometimes

the only way to preserve the assets of a company is to sell them off quickly: per Bowen CJ in Eq in ***Re Codisco Pty Ltd*** (1974) 8 ACLC [para] 40-126 p 27,906.

Reverting to the facts in the instant case, we found that the submission of counsel was made with the benefit of hindsight. This question has to be determined in the context of the circumstances prevailing at the time. At the material time, KPM owed Arab Bank a large sum of money and what was then very worrying and problematical was that KPM did not have sufficient funds or income to service the debt. About two months after their appointment as provisional liquidators of K-Z, on 15 April 1992, they found that the bank had made a margin call on KPM and required the company to pay up an amount of $220,000. KPM was in no position to meet this margin call and the bank threatened to enforce the security by selling some of the Pac Can shares to satisfy the margin call. This crisis was averted after a partial payment of $30,000. Not long thereafter, another margin call was made by the bank, and on this occasion the company was required to pay up a sum of $150,000, which again the company could not meet. The financial position of KPM further deteriorated and on 22 June 1992 the company defaulted in its payment of interest and the bank declared that an event of default had occurred and demanded the payment of the entire outstanding sum owing.

The provisional liquidators were then confronted with the question whether to sell the shares en bloc or only such number of shares as would enable them to pay off the entire amount owing to the bank. The provisional liquidators decided to sell the shares en bloc for the following reasons. First, selling the shares en bloc in a `married deal` was likely to fetch a premium on the price for the shares. Second, selling a lesser amount of shares so as to realize a sufficient amount as would enable them to pay off the whole of the amount owing to the bank would or might bring down the price of the shares. This situation was compounded by the poor results of Pac Can at that time and the fact that the market was rife with rumours of an on-going boardroom tussle. In those circumstances, the provisional liquidators had to make a critical decision on the disposal of the shares and they decided to sell the shares en bloc. No one at that time could sensibly predict that sometime later the market would turn and that the price for these shares would soar up to $1.59 per share as at 1 July 1994, when the winding up order of KPM was made. In our judgment, the provisional liquidators should not be faulted for causing the disposal of the entire block of shares on 21 July 1992.

In **Northbourne Developments Pty Ltd v Reiby Chambers Pty Ltd & Ors** [1990] 8 ACLC 39, a provisional liquidator was appointed in respect of each of two companies. In exercise of his powers he sold a property of each company and the sales were challenged on the grounds, inter alia, that he had misconceived his duty which was to preserve the existing status quo and that there was no reason for any urgency for him to do so and that in so doing he took into account irrelevant considerations. McLelland J of the Supreme Court of New South Wales dismissed the application and upheld the transactions. He said at pp 44-45:

> *In the present case I am satisfied that Mr Harkness as provisional liquidator of Reiby Chambers and Hooker Corporation had power to enter into the two subject contracts without the approval of the court and without making the transaction subject to subsequent approval by the court, and I am not satisfied that he did so otherwise than in the belief that the transaction would be for the benefit of creditors of those respective companies and would not be opposed by those creditors ...*
>
> *Considerable attention was given, both in evidence and argument, to the question of the commercial wisdom of the transaction. I do not propose to canvass the various considerations in detail. It is sufficient to say that I am unable to conclude that the transaction was so commercially imprudent as to indicate either bad faith or incompetence on the part of Mr Harkness. For*

> *reasons analogous to those which I have already mentioned which inhibit a court in giving directions on matters of commercial judgment, the court in considering a challenge on commercial grounds to a liquidator`s decision must approach the matter on the basis that the liquidator `is recognised as having both the qualifications and the access to the multiplicity of information which may be necessary in order to make ... commercial decisions` and, except where bad faith is established, will treat the liquidator`s decision as a proper one unless satisfied that he acted `in a way which no reasonable liquidator should have acted` (see **Re Mineral Securities Australia** (supra) at CLC pp 27, 588-27, 589; NSWLR pp 230-232). I am not so satisfied here.*

Counsel for the appellant relied on the case of **Re ML Industries** [1981] ACLC 33 in support of his argument that the primary role of the provisional liquidators was to preserve the status quo of KPM and its assets. We did not find that case of any assistance. First, the relevant legislation there, which governed the appointment and powers of a provisional liquidator, was s 231A(2) of the Queensland Companies Act 1961-1981. Section 231A(2) provided as follows:

> *The Court may appoint an official liquidator provisionally at any time after the presentation of a winding up petition and before the making of a winding up order or, where there is an appeal against a winding up order, before a decision in the appeal is made, and the provisional liquidator shall have and may exercise such functions and powers as may be prescribed by the rules or as the Court may specify in the order appointing him.*

This provision is materially different from the provisions of s 267 of our Companies Act. Under s 231A(2), the powers of a provisional liquidator depended on the terms of the order appointing him. The material terms of the court order appointing the provisional liquidators in that case were these:

> *(1) to take possession of, collect and protect any assets of the abovenamed company;*
>
> *(2) to carry on the business of the company so far as is necessary for the beneficial winding up thereof.*

Secondly, the facts in ***Re ML Industries*** were miles apart from those of the instant case. There, the provisional liquidators intended to dismiss the staff and terminate the lease of the premises at which the company was carrying on business. They took out an application for direction and the learned judge held that the provisional liquidators should preserve the status quo, the undertaking of the company and its assets, with the least possible harm to all concerned, so as to enable the court at the hearing of the winding up to decide whether or not to wind up the company, and having regard to all the circumstances of the case, the learned judge declined to authorise the provisional liquidators to dismiss the staff and terminate the lease.

Negligence in the sale

Counsel for the appellant advanced the argument that the provisional liquidators had acted negligently in disposing of the Pac Can shares en bloc. The allegation of negligence was based primarily on the ground that the provisional liquidators should have but did not seek the advice of

stockbrokers and investment or merchant bankers before procuring the sale of the shares. In counsel`s submission, the provisional liquidators` fault laid in their not having considered any other option aside from selling the shares en bloc.

We found this argument wholly unrealistic and completely out of line with the practicalities of the situation confronting the provisional liquidators. The mere fact that the provisional liquidators had not made the relevant inquiries with stockbrokers or investment bankers did not on its own support an allegation of negligence, especially when this failure is seen in the light of the urgency of the situation at the material time, which we have narrated. Under such pressure and the constraint of time, it is unrealistic to expect the provisional liquidators to be able to seek helpful advice from any third party. In any event, we could not see what advice any stockbroker or investment banker could usefully give to the provisional liquidators, particularly on the question whether they should sell the shares en bloc or sell a lesser amount of the shares. Nor could we see what other options the provisional liquidators had at the time; their option was either to sell the shares en bloc or to sell a lesser amount of shares which would be sufficient to enable KPM to pay off the amount owing to the bank. They adopted the first option in preference to the second, and we could not see how in so doing they could be said to have acted negligently There was no question that they acted bona fide in what they perceived to be in the best interests of the company. We did not find that their actions were unreasonable or such that no other reasonable provisional liquidator would have undertaken under the circumstances. They certainly should not be judged in the light of subsequent events.

In any case, the appellant had not led any evidence whatsoever to support his allegation of negligence on the part of the provisional liquidators. The burden was on him to prove his case, which he had not even started to do. No evidence whatsoever was led by the appellant to show that the provisional liquidators would have acted any differently had professional advice been sought. It was thus impossible for the court to make a finding of negligence against the provisional liquidators. It must be remembered also that in any case the provisional liquidators were not a party in the present proceedings.

The chain of causation

The last contention of the appellant was that the following acts or omissions on the part of the provisional liquidators broke the chain of causation, namely:

(1) failing to prevent or seek ways to prevent the loan from going into default, when it was open to them to do so;

(2) making a commercial decision (without making inquiries or taking professional advice) to sell the shares, even before the loan went into default; and

(3) after the entire loan had been recalled by the bank, deciding to dispose of all the shares as opposed to only such number of shares that would have been sufficient to repay the loan.

It was submitted that what the provisional liquidators did or omitted to do as stated above was unreasonable in the circumstances and amounted to an independent and unforeseeable act which broke the chain of causation. This contention was no different, in substance, from those submissions which we have dealt with above. It is not necessary to replicate what we have said. Suffice it here to say this. At the material time, KPM had no funds or source of income to service the loan owing to Arab Bank, and we do not see how the provisional liquidators could have prevented the loan from going into default. Quite clearly, there was nothing the provisional liquidators could have done to prevent the loan from going into default. The provisional liquidators did try to avert the sale of the

shares by inquiring if either Kumagai or Zenecon were willing to inject the necessary funds to pay off the bank. Neither party however was willing to advance the requisite funds to KPM. In these circumstances, the Pac Can shares had to be sold.

With regard to the sale of the shares, the appellant`s only bone of contention was that the shares should not have been sold en bloc but only such number of shares as would be sufficient to enable KPM to pay off the entire loan. The simple answer to this is that in the circumstances prevailing, the provisional liquidators took the view that the sale of the shares en bloc would yield the highest price for them. What the provisional liquidators did was based purely on their commercial judgment at that time, and we could find no valid ground for questioning it. The appellant had not for his part adduced any evidence to show that the same price of 70 cents per share would have been offered for the shares, if only a fraction of them were being offered for sale. Before effecting such sale the appellant had been given ample opportunities to make an offer for the shares; yet at no time did he take up this offer until the very last minute. In all the circumstances, it did not now lie in his mouth to say that the provisional liquidators had acted unreasonably in the circumstances.

Of course, with the benefit of hindsight the prudent course the provisional liquidators should have taken was to sell such number of shares as would enable KPM to pay off the entire loan owing to the bank, and hold back the balance to be sold at later dates when the price went up. However, it should not forgotten that, at that time, there was a real risk that a sale of such lesser amount of shares might have had the effect of bringing down further the price of the shares. At the price of about 70 cents per share, the amount of shares required to be sold for that purpose would be in the region of 4.4m shares, which by any standard is a sizeable block. Bearing in mind that Pac Can shares were thinly traded, a sale of such a large block would most likely depress the price of the shares. Had the price of Pac Can shares never recovered above that price or had it gone down further, the appellant would not have complained of the sale of the shares en bloc. It must be remembered also that Pac Can shares were a somewhat speculative counter, and Pac Can itself was far from being a `blue chip` company; indeed it was not even a `second liner`. It was purely fortuitous that the market, as far as Pac Can shares were concerned, eventually turned around and by 1 July 1994, when the winding-up order was made, the share price had soared to $1.59 per share. No one making a decision on the sale of the shares in June 1992 could have foreseen this price.

In our view, the propriety or reasonableness of the provisional liquidators` action in disposing of all the shares en bloc should not be judged with the benefit of hindsight, but in the context of the circumstances then prevailing. These circumstances have been discussed above and it is unnecessary to rehearse them here. Suffice here to say that in those circumstances, the provisional liquidators made a commercial decision and sold the shares en bloc in a married deal. Where such a decision is challenged, as was challenged here, the court must approach the matter on the basis that the provisional liquidators, being appointed by the court, are recognized as having both the qualifications and access to the multiplicity of information for making such a decision, and, except where bad faith is established, will treat the provisional liquidators` decision as a proper one, unless the court is satisfied that they acted in a way which no reasonable provisional liquidator should have acted: per McLelland J in ***Northbourne Developments*** (supra) at pp 44-45. It is thus not proper for the court to intervene and substitute its own decision for that of the provisional liquidators.

For the reasons given, the appeal obviously could not be sustained. We thus dismissed it with costs accordingly.

Outcome:

Appeal dismissed

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