

DP02

# Law on Banking and Finance

10 OCTOBER 2000

1. Time allowed : Three (3) hours
2. Total number of questions : Five (5) questions
3. Number of questions to be answered : Four (4) questions [25 marks each]
4. Answers should be supported by references to cases and/or statutes.
5. Begin each answer to a new question on a fresh page.
6. Answer **all** questions in **English**.

## ANSWER FOUR (4) QUESTIONS ONLY

1. (a) Describe the type of business carried on by merchant banks.  
(Your answer should be based on the statutory definition of “merchant banking business”.) [5]
- (b) Meng and Eddie are partners of ME Enterprise. ME Enterprise enjoys an overdraft facility of RM300,000 granted by Bank XY Bhd. The mode of operation of the current account is “either (Meng or Eddie) to sign”.
- On 13 January 2000, Eddie and Meng’s widow, Mrs Penny Meng, informed Bank XY Bhd that Meng died two days ago in a road accident. Eddie persuaded the officer of Bank XY Bhd to allow him to continue operating the current account since the current account was in a debit balance of RM800. Subsequently, the current account was active with substantial payments made in and out of the account.
- In September 2000, Eddie became a bankrupt while Mrs Penny Meng, administratrix of the estate of Meng, deceased became a millionaire, after winning a lottery. During this period, the current account was in excess (due to non-servicing of interest) with a debit balance of RM306,900.
- Advise Bank XY Bhd whether it can successfully sue Mrs Penny Meng as administratrix of the estate of Meng, deceased for the debt of RM306,900. Give reasons for your answer. [10]
- (c) Customers’ relationship with their bankers may be terminated by closure of the accounts by the bankers or the customers themselves. Sometimes, the relationship is terminated by operation of law.
- Describe **three** instances or situations whereby the relationship between a banker and a customer may be deemed or rendered suspended or terminated by operation of law. [10]  
(Total:25 marks)
2. (a) What are the essential documents required and procedures required to be taken by a bank in order for a company to open a company account? Explain the rationale why such documents and procedures are essential. [10]
- (b) (i) Define a promissory note. [2]  
(ii) Distinguish a promissory note from a bill of exchange. [8]
- (c) “A cheque is not valid until it is issued.”
- State the definition of the word “issue” as provided in the Bills of Exchange Act 1949 and explain the meaning of the terms or words used in that definition. [5]  
(Total:25 marks)
3. (a) (i) Explain the meaning of the word “negotiation” in relation to bills of exchange. [5]  
(ii) Describe how bills of exchange are negotiated. [5]  
(iii) With reference to the rights and titles of the respective parties involved in the process of negotiation of bills of exchange, state the essence of negotiability and the main feature or effect involved in such negotiation. [5]
- (b) One of your customers was adjudicated a bankrupt (the debtor) and now you would have to deal with the Official Assignee in respect of your bankrupt customer’s accounts.
- Describe the duties of the Official Assignee in relation to the following:
- (i) the debtor’s conduct; and [5]  
(ii) the debtor’s estate or property. [5]  
(Total:25 marks)

4. (a) Hamid and Fatimah, who are newly-weds, have just signed a Sale and Purchase (S&P) Agreement with Fast Developers Bhd for the purchase of their dream home, a three-room condominium unit in Bangsar, Kuala Lumpur. The document of title (strata title) in relation to the condominium unit has yet to be issued.

Assuming Hamid and Fatimah approach your bank for a housing loan to be secured by that condominium unit, explain to them the legal documentation and procedures required to be taken by your bank. [15]

- (b) Bank ZZ Bhd is granting an unsecured credit facility to AA Sdn Bhd. Mr X and Mr Y, the directors of AA Sdn Bhd, are to be the guarantors of the facility.

Bearing in mind that Bank ZZ Bhd is obtaining a guarantee from more than one person (i.e. Mr X and Mr Y), state the precautions regarding form, terms and execution of the guarantee and events occurring subsequent to the execution of the guarantee, which ought to be addressed by Bank ZZ Bhd in order to ensure that their rights thereunder are protected at all material times. [10]

(Total:25 marks)

5. (a) Encik Hamid, the manager of Fast Finance Bhd, was just served with a Mareva injunction, addressed to Fast Finance Bhd. The Mareva injunction issued was in relation to Fast Finance Bhd's fixed deposit and safe deposit box customer, Datuk Kaya.

Advise Encik Hamid on the following:

(i) What is a Mareva injunction? [4]

(ii) State the purpose of a Mareva injunction, by making reference to the relevant case(s) where applicable. [6]

(iii) What action should Fast Finance Bhd take? [5]

- (b) Bank AB Bhd wrote to Bank XY Bhd inquiring about the creditworthiness of its prospective customer, Mr Foo. Mr Foo's account with Bank XY Bhd has not been conducted satisfactorily and in fact, Bank XY Bhd is about to instruct its lawyers to issue Mr Foo a letter of demand recalling the RM400,000 credit facility granted to Mr Foo.

To avoid the time and expense of taking legal action against Mr Foo, Bank XY Bhd informed Bank AB Bhd that Mr Foo's account was conducted in an "active and satisfactory" manner. The officers of Bank XY Bhd were confident in giving this opinion because the opinion was typed on a printed form with the following words pre-printed on it, "CONFIDENTIAL. For your private use and without responsibility on the part of the bank and its officials."

Subsequently, Bank AB Bhd granted credit facilities to Mr Foo but Mr Foo defaulted in repayment.

Advise Bank AB Bhd whether they have any legal basis to claim against Bank XY Bhd as the opinion by Bank XY Bhd was given negligently and fraudulently. [10]

(Total:25 marks)

## OUTLINE ANSWERS

### Question 1

Candidates were assessed on the nature of merchant banking business, Clayton's rule and the meaning of "operation of law" as one of the means to terminate banker-customer relationship. Candidates fared badly mainly because they failed to read the question properly and hence provided irrelevant answers. For example, the last part of the question asked for three instances where banker-customer relationship may be deemed suspended or terminated. Candidates wasted time and effort explaining the ways to terminate the banker-customer relationship, instead.

1. (a) A "merchant bank" is defined in section 2 of the Banking and Financial Institutions Act 1989 as a person which carries on merchant banking business. "Merchant banking business" is the business of:
- (i) receiving deposits on deposit accounts;
  - (ii) provision of finance;
  - (iii) provision of consultancy and advisory services relating to corporate and investment matters;
  - (iv) making or managing investments on behalf of any person; and
  - (v) such other business as Bank Negara Malaysia, with the approval of the Finance Minister, may prescribe.

- (b) Bank XY Bhd is advised that they may not be able to sue the estate of Meng, the deceased, for the debt because of the operation of the rule in *Clayton's case (Devaynes v Noble)*. As the account was in debit balance, the bank should have stopped the account once they were informed of Meng's death.

*Clayton's rule* (put simply, "first in, first out") would mean that any payments in, subsequent to the notification of the death would go towards the extinguishing of the earlier debits. Thus, as there were substantial credits after the notice of death was given to the bank, the estate of the deceased is no longer liable for the firm's debt due to the application of the rule in *Clayton's case*.

In the absence of any specific appropriation, the law presumes in the case of a current account that appropriation follows the rule in *Clayton's case*. That is, it is the first item on the debit side of the account that is discharged, or reduced, by the first item on the credit side. Thus, the bank's officer was wrong to agree to allow ME Enterprise account to be continued and operated by Eddie. Mrs Penny Meng is no longer liable for the firm's debt and Eddie is already a bankrupt.

If the current account was in credit balance, then perhaps Eddie may be allowed to continue operating the account for the purpose of winding up the affairs of the partnership – s.40, Partnership Act 1961.

The bank should have frozen the account once they were informed of the death, if it intends to keep the debt intact. Both the estate of Meng and Eddie would have been jointly and severally liable for the firm's debt then. Moreover, the bank should peruse the legal documentation executed in relation to the overdraft facility, to examine if an event of default (through or by reason of Meng's death) has occurred resulting in the bank having the right to recall the overdraft facility. Mrs Penny Meng winning a lottery and having the means to repay has no relevance or bearing to the bank's claim. Thus, it appears that the bank may not succeed in its claim against Mrs Penny Meng.

- (c) The term "operation of law" covers three instances where both the customer and the banker do not intend nor desire to terminate the relationship (i.e. they do not want to close the account). The instances are:
- (i) bankruptcy or liquidation,
  - (ii) death, and
  - (iii) mental incapacity .

When a company is being wound up or a winding-up petition is being presented against it, the bank must immediately freeze the account until it hears further from the liquidators. After the company has been wound up, it ceases to have any legal existence and all its contractual relationships come to an end.

Similarly, when bankruptcy proceedings are initiated against an individual customer, the bank should freeze the account to prevent the operation of the relation back principle – section 47(1) Bankruptcy Act. When the customer has been adjudicated a bankrupt, the bank may be requested to close the account and remit the credit balance to the Official Assignee.

The death of a customer terminates the mandate or authority given to the banker and therefore, it has the effect of terminating the relationship. The rights and interests of the customer are passed on to the personal representative of the deceased customer.

Mental incapacity of the customer terminates the banker-customer relationship, as the mentally disordered person would not have any legal capacity to contract. The banker would freeze the account and wait to hear from the guardian *ad litem*.

### Question 2

Only a few candidates passed this question on laws relating to negotiable instruments. Several candidates misunderstood the basic concepts and therefore, gave the wrong answer. For example, instead of defining a promissory note, most candidates gave the definition to bills of exchange.

2. (a) When opening an account for a company, the essential documents are:
- (i) certificate of incorporation;
  - (ii) Memorandum and Articles of Association;
  - (iii) Forms 24 and 49; and
  - (iv) certified copy of a resolution of the board of directors authorising the opening of account with the bank.

The essential procedure involves a search at the Registry of Companies and [if the account to be opened is a current account] a check that the applicant is not a bad cheque offender under Biro Maklumat Cek (BMC). The bank also has to verify the identities and signatures of the authorised signatories of the account and scrutinise and obtain copies of the identification documents such as identity cards or passports.

The rationale for the above are as follows:

The certificate of incorporation is the legal document evidencing the incorporation or the registration of the company. Secondly, the Memorandum and Articles of Association (M&A) are important as the Memorandum sets out the objectives or purpose of the company. Any act not authorised by the Memorandum is ultra vires the company. The Articles basically sets out how the company is run.

Forms 24 and 49 provide particulars of the company's shareholders and the company's directors and company secretary respectively. Lastly, the board of directors' resolution gives authority to the specified directors or persons to operate the account(s) on behalf of the company. The resolution gives detailed instructions on how the account is to be operated.

The company search is essential, as it would confirm the genuineness and correctness of the certificate of incorporation, the M&A, Forms 24 and 49. In other words, it confirms the very existence and make-up of the company and the persons behind that company. If searches are not made, and the authorised signatories' identification documents and their signatures are not verified, it may be likely that the account be opened for a non-existent person or that the company account be operated by bogus individuals.

- (b) (i) Section 88(1) of the Bills of Exchange Act 1949 defines a promissory note as an "unconditional promise in writing made by one person to another signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum

certain in money, to, or to the order of, a specified person or bearer". In short, a promissory note is a document which contains a promise by the maker that he will pay a certain sum of money.

- (ii) Promissory notes are a type of negotiable instruments and are negotiated in the same way as bills of exchange. However, it is not a bill of exchange as it is not drawn on a third party.

Where a promissory note is made payable at a particular place, it must be presented for payment at that place in order to render the maker liable. In any other case, presentment for payment is not necessary to make the maker liable. This is not the case with bills of exchange.

A promissory note both made and payable within Malaysia is an inland note. All other notes are foreign notes – section 88(4) Bills of Exchange Act 1949. It is not necessary in the case of a foreign note to protest for dishonour, but it is essential in the case of a foreign bill of exchange.

Where a promissory note payable on demand is indorsed, it must be presented for payment within a reasonable time for indorsement. Although this is similar for a bill of exchange, in practice what is reasonable differs between notes and bills. As a general rule, in determining what is reasonable, regard has to be made to the nature of the instrument, facts of the particular case and the usage of trade. Where a note payable on demand is negotiated, it is not deemed to be overdue, for the purpose of affecting the holder with defects of title of which he had no notice, by reason that it appears that a reasonable time for presenting it for payment has elapsed since its issue [s.91(3), Bills of Exchange Act 1949]. A bill payable on demand is usually intended to be presented and paid immediately.

Some provisions in the Bills of Exchange Act 1949, that apply to bills of exchange do not apply to promissory notes. These provisions are in relation to presentment for acceptances, acceptance, acceptance supra protest and bills in a set [s.94(3), Bills of Exchange Act 1949].

- (c) Section 2 of the Bills of Exchange Act 1949 defines "issue" as "the first delivery of a cheque complete in form to a person who takes it as a holder". The term "holder" refers to the payee or indorsee of a cheque who is in possession of it, or the bearer, whereas, the term "delivery" means "the transfer of possession, actual or constructive from one person to another". Actual delivery involves the physical handing over of the cheque to another person. On the other hand, constructive delivery is effected, not physically but by the mere intention of the transferor. An example of constructive delivery is when the drawer fills in all the details of a cheque and signs it, and then advises the payee that he or she is holding the cheque on behalf of the payee.

### **Question 3**

An unpopular two-part question amongst candidates was on bills of exchange and functions of an Official Assignee. Candidates managed to explain "negotiation" in relation to bills of exchange, its process and essence, but could not cite the relevant provisions of the Bankruptcy Act.

- 3. (a) (i) The word "negotiation" means the transfer of a bill of exchange by one person to another in such a way that it makes the transferee the holder of the bill. Negotiation is a much more elaborate concept than transfer. A negotiable instrument must not only be transferable in the sense that rights arising under it can be transferred by delivery of the instrument so that it can be sued upon by the person, who is for the time being in possession of it, but it must be so transferable as to convey a perfect title to the transferee, who takes it in good faith and for value, regardless of any defects in the title of his transferor.

(ii) Bills of exchange are either payable to order or to bearer. Bills of exchange payable to bearer are negotiated by mere delivery, that is, the transferor physically handing it over to the transferee – section 31(2) Bills of Exchange Act 1949. On the other hand, bills payable to order are negotiated by both indorsement and delivery – section 31(3) Bills of Exchange Act 1949.

(iii) The effects of the negotiation of a bill are that in the negotiation of a bill, the legal title passes to the person who takes it in good faith and for value and without notice of any defect in the title of the transferor (such person being known as a “holder in due course”). Thus, the transferee can acquire a better title to the instrument than that of his transferor. This is contrary to the *nemo dat quod non habet* rule and is the essence of negotiability. The holder, for the time being, can sue in his own name. The title passes free from equities of which the transferee has no notice.

The essence of negotiability is that under certain conditions a person to whom the bill is transferred is entitled to require payment according to its terms regardless of any defect in the entitlement, to the bill, of previous holders. Thus the bill creates rights and obligations quite independent of the underlying transactions that brought it into existence. Therefore, the main feature of negotiable instruments are their ability to pass better title to a transferee than that of a transferor, the fact that they are legally enforceable in their own right and ease of transfer.

(b) (i) The duties of the Official Assignee as regards to the debtor’s conduct, as provided under section 72 of the Bankruptcy Act, are:

- to investigate the conduct of the debtor and report to the court if there is reason to believe the debtor has committed an offence under the Bankruptcy Act or the Penal Code, which would justify refusing, suspending or qualifying an order for the bankrupt’s discharge;
- to make such other reports on the debtor as requested by the court;
- to participate in the public examination of the debtor if required; and
- to assist in the prosecution of any fraudulent debtor or any other person charged under the Act as the Public Prosecutor may direct.

(ii) The duties of the Official Assignee with regards to the debtor’s estate as provided under section 73 of the Bankruptcy Act are:

- to act as receiver or receiver and manager of the debtor’s estate;
- to raise money or make advances, and authorise the special manager to do so where it is in the interests of the creditors;
- to issue proxy forms for use at creditors’ meetings;
- to summon and preside at creditors’ meetings, including report to the creditors of any proposal made by the debtor; and
- advertise the date of the receiving order, the debtor’s public examination, and any other matter which should be advertised.

#### **Question 4**

This two-part question was generally well answered. Several of the answers given to the first part of the question on legal documentation and the procedures were very impressive, with a few candidates even citing the relevant cases. However, most candidates lost marks when they attempted the second part of the question on credit facility, as the answers in this section lacked substance.

4. (a) As the strata title has not been issued, it would not be possible for the bank to secure the loan with a charge on the property financed. The documentation would be an assignment of the property concerned. The assignment may be effected either by a Deed of Assignment, or it may be incorporated into the Loan Agreement (referred to as “Loan Agreement cum Assignment”). In *Hipparion (M) Sdn. Bhd. v Chung Khiaw Bank Ltd.* the Supreme Court held that the legal effect of the Deed of Assignment [in that case] was that the assignee had all the rights, title and interest of the assignor and the assignment was construed by the Court as a absolute assignment and not as an assignment purporting to be by way of charge only within

the meaning of s.4(3) of the Civil Law Act. The recent Federal Court case of *Chuah Eng Khong v Malayan Banking Berhad [1999] 2 CLJ 917* has held that the Loan Agreement cum Assignment is valid and effective in creating an equitable mortgage in favour of the assignee (i.e. the Bank).

The other document required (if the Loan Agreement cum Assignment is not used) would be the Loan Agreement or the Facility Agreement. The terms and conditions of the credit facility are contained in this agreement which represents the contract between the bank and the borrowers (Hamid and Fatimah).

The other documentation and procedures to be taken are:

- (i) notice of assignment to vendor/developer  
When the purchasers/borrowers assign their rights in the property to the lender/bank, notice must be given to the vendor/developer of the property. If notice is not given, the assignment is not a legal but an equitable assignment.
  - (ii) prohibition on assignment  
In the event that the S&P Agreement prohibits any assignment in the absence of the developer's consent, which is usually the case, then the developer's prior consent should be obtained.
  - (iii) protection of interest through private caveat  
A private caveat should be lodged in respect of the interest over the unit concerned over the master title – *Chor Phaik Har v Farlim Properties Sdn. Bhd.* The purchasers (upon payment of the deposit under the S&P) and/or the bank (when releasing the redemption sum to the bridging financier) can lodge private caveats.
  - (iv) procedure on assignment  
The Loan Agreement or the Facility Agreement must be stamped on an *ad valorem* basis and the power of attorney clause contained therein (or a separate deed of Power of Attorney) stamped and registered with the High Court. The original S&P Agreement will be deposited with the lender/bank for safe keeping. The developer will give an undertaking to transfer the condominium unit to the purchasers and to hand over the strata title to the lender/bank when it is issued.  
  
A land search over the master title will also have to be conducted to check for existing encumbrances.
  - (v) chargee's undertaking to omit property from foreclosure proceedings and discharge the charge  
In event of the existence of a bridging financier, it is necessary to obtain the Chargee's Undertaking to omit the property (i.e. the condominium unit) in question from any foreclosure proceedings, and to undertake to discharge the charge upon the issue of a separate (or strata) title.
- (b) When the bank takes a guarantee from more than one person, it has to take a joint and several guarantee. This is because where a surety/guarantor is jointly but not severally liable with his or her co-surety, there is the risk that the surety's liability would come to an end on the surety's death. The surviving guarantors become liable for the entire debt, while the personal representatives of the deceased guarantor are excused from any liability.

It is also important to ensure that all guarantors (i.e. both Mr X and Mr Y) must sign the guarantee – *Indian Bank v Ramachandran & Ors.* Any variation of the terms of the guarantee also must be consented by all parties – s.97, Contracts Act 1950 and the Court of Appeal case of *Len Min Kong v UMBC [1998] 2 MLJ 478.*

The bank has to ensure that the guarantors' signatures are not forged. Forgery of a guarantor's signature can invalidate the whole guarantee. Thus, guarantees should preferably be signed or executed with the independent advice of the guarantor's own legal counsel.

In the case of the joint and several guarantee, the bank has to be careful whenever certain events happen – such as the death, mental incapacity or bankruptcy of the guarantor or the winding up of the principal debtor. The account may have to be ruled off:

- (i) to avoid the rule in *Clayton's* case from operating;
- (ii) because a guarantor who has been declared incapable is discharged as regards future transactions of the principal debtor as soon as the banker has notice of the incapacity of the guarantor; and
- (iii) if the principal debtor's account is not ruled off and should a receiving order be made against the guarantor within six months, the bank will not be able to submit any proof of debts which are incurred within this period after the act of bankruptcy of the guarantor.

Another event could be when one of the guarantors gives notice to determine the guarantee (unless the guarantee specifically provides otherwise). The bank then has to decide if there should be a substitution in guarantor, restructuring of the facility or if the facility needs to be recalled.

#### Question 5

The question on Mareva injunction was generally well answered. Candidates managed to provide accurate answers and cases to support them. However, in the second part, candidates failed to identify the two main issues, i.e. elements necessary to prove Bank AB Bhd's claim and the effect of the "disclaimer". They instead provided answers on banking secrecy and permitted disclosure which were totally irrelevant.

5. (a) (i) A Mareva injunction is an ex parte or interlocutory injunction granted by the court to restrain the defendant from removing assets from the jurisdiction or dissipating the assets within the jurisdiction pending trial. The defendant might want to transfer the assets out of the jurisdiction or otherwise deal with assets within the jurisdiction so that they would not be available to the plaintiff if his or her claim succeeds. It may also be granted to prevent a defendant from dissipating his or her assets in order to defeat any judgment awarded against the defendant.
- (ii) The Mareva injunction is intended to preserve the status quo between the parties and to ensure that the subsequent court orders are not rendered nugatory. It is intended to be neutral as between the parties and it is not in itself supposed to incorporate any views of the Court as to the ultimate merits of the case. The injunction may be granted before or after judgment is obtained.

The Mareva injunction took its name from the case *Mareva Compania Naviera SA v International Bulkcarriers SA*. In that case, the plaintiff had issued a writ against the defendant claiming for unpaid rentals and damages for repudiation of a charterparty. The English Court of Appeal upheld the decision of Donaldson J. to grant an injunction restraining the defendant from removing out of the jurisdiction the credit balance in the defendant's bank account in London.

The Malaysian cases on point are *Aspatra Sdn. Bhd. and 21 Others v Bank Bumiputra Malaysia Berhad and Anor.* and *Raja Letchumi a/p Ramarajoo v HSBC*.

- (iii) A Mareva injunction may take the form of a general order freezing all the assets of the defendant with a particular bank or it may take the form of a maximum sum order. A general order is usually easier to comply with as the bank may simply freeze all the customer's assets with the bank.

In *Z Ltd. v A and Others*, the Court of Appeal held that as soon as a bank had notice of a Mareva injunction, it must freeze the defendant's account and other assets, such as valuables in a safe deposit box. It would be contempt of court to knowingly assist in the disposal of the defendant's assets.

Thus, it is advised that the bank should follow and comply with the order contained in the Mareva injunction, for example, to freeze both the fixed deposit and safe deposit box accounts. However, if there are any doubts as to either the coverage or interpretation of the injunction, the bank should seek guidance from the courts.

- (b) Bank AB Bhd is advised there will be legal basis to their claim against Bank XY Bhd if they can prove the following elements:
- (i) that the statement or advice was given to a known recipient;
  - (ii) that it was given for a specific purpose known to the maker of the statement or advice; and
  - (iii) the recipient had relied upon it and acted to his or her detriment.

- *Caparo Industries plc v Dickman* and *Hedley Byrne & Co. Ltd. v Heller & Partners Ltd.*

The other issue is that Bank XY Bhd may claim that they are protected by the disclaimer clause in the opinion since in *Hedley Bryne & Co. Ltd. v Heller & Partners Ltd.*, the House of Lords held that the defendants were not liable because their written reply contained a disclaimer clause.

But in *Commercial Banking Co. of Sydney Ltd. v RH Brown and Co.*, the court held that a disclaimer in a banker's opinion did not provide protection against fraud. An example of a fraudulent opinion is when the opinion is given without caring whether it is true or false.