

# LEGAL INSIGHTS

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## MESSAGE FROM THE EDITOR-IN-CHIEF

AS THE YEAR COMES TO A CLOSE, WE ARE LOOKING FORWARD TO YET ANOTHER FESTIVITY HERE IN MALAYSIA

Malaysians are really lucky to experience a myriad of religious festivities throughout the year. Our Muslims friends are still in the midst of celebrating Aidilfitri (marking the culmination of the holy month of Ramadhan), whilst our Hindu friends celebrated Deepavali (often referred to as the 'Festival of Lights') earlier this month. As we merrily move into December, our Christian friends have started getting busy with Christmas (the birth of Christ) preparations. How very blessed for this country to own such a gloriously cultured nation. Hence, it is rather timely for me to wish our Muslim readers, Salam Aidilfitri, our Hindu readers, a belated Happy Deepavali and our Christian readers, Merry Christmas in advance.

I am pleased that the firm has managed to produce seven issues of *Legal Insights* in the last two years. I hope my editorial team carries on with equal zest in their efforts to keep the firm's newsletter alive with the latest in legal information for you. This year-end issue provides some interesting case commentaries. Among them, the Metroplex case on page 3, where the High Court judge rejected an application for an extension of a restraining order; and the Tan Kong Min case on page 4 which deals with the right of a lender, to commence an action to recover the amount owing in respect of a loan concurrently with his right to enforce the security, upon a default by a borrower. Suaran Singh Sidhu's article on page 8 sets out the many ways in which information as a source of knowledge can be protected in Malaysia and how companies can implement suitable procedures to ensure minimum leakage and unfair competition. Lam Wai Loon has written a fairly enlightening overview of the development of the concept of pure economic loss throughout the Commonwealth, with the hope of giving a better understanding to readers about the Malaysian position on page 11.

There is more to legal practice than just knowing the law. To run a flourishing legal firm, lawyers need to ensure that there is a steady in-flow of business and an ever-expanding clientele. This is not easy, especially when the legal profession in Malaysia is strictly governed by a body of rules that controls its publicity strategies. With the hope of helping young lawyers implement some effective marketing strategies in their daily lives (an area that is not taught in law school), my recent book entitled *Marketing for Young Lawyers* (see page 5) will introduce them to various ways of reaching out to new clients and serving the further needs of the old ones.

I hope you find this issue helpful and informative. As always, I would like to thank you for all your support and for making our newsletter a successful production over the last two years. If you need any assistance or clarification about the contents of the newsletter, please contact us at [mas@skrine.com](mailto:mas@skrine.com). You may also send in article specific queries to the individual writers' at their email addresses that can be found at the end of their articles. As the new year is around the corner, it appears to be an opportune time for the editorial team to wish all our loyal readers a Happy New Year.



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## SECURITIES COMMISSION ACT 1993 - SOME RECENT AMENDMENTS TO THIS ACT

On 15 September 2005, the Securities Commission (“SC”) introduced several measures to enable local investors to diversify their investments in securities and to enhance the efficiency of the domestic capital market. The significant measures are discussed below.

### MARKET TRADES IN FOREIGN SECURITIES LISTED ON RECOGNISED FOREIGN EXCHANGES

An amendment to Paragraph 6 of Schedule 2 of the Securities Commission Act 1993 (“SCA”) now enables offers or invitations in relation to securities which are traded on foreign stock exchanges recognised by Bursa Malaysia to be made without the prior approval of the SC.

Bursa Malaysia has accorded recognition to 53 foreign stock exchanges listed in Appendix 1 of its Members’ Circular R/R 15 of 2005 (“Recognised Exchanges”). They include the New York Stock Exchange, National Association of Securities Dealers (NASD), American Stock Exchange, London Stock Exchange, Tokyo Stock Exchange, Deutsche Borse, Hong Kong Exchanges and Clearing, Taiwan Stock Exchange, Singapore Exchange and Stock Exchange of Thailand.

Further, by virtue of the amendments to Paragraph 15 of Schedules 2 and 3 of the SCA, issues, offers or invitations in relation to securities traded on a Recognised Exchange are now also deemed to be “*excluded offers*”, “*excluded invitations*” and “*excluded issues*” and therefore exempted from the prospectus requirements under the SCA.

Notwithstanding the above, a person (or his agent) who issues any information memorandum in relation to an “*excluded offer*”, “*excluded invitation*” or “*excluded issue*” that purports to describe the business or affairs of that person remains obliged under sections 38 and 39 of the SCA to ensure that the contents of such document are not misleading and to deposit a copy of the same with the SC within 7 days of its issue.

### OFFERING OF FOREIGN SHARES IN MALAYSIA

The SC also announced that the offering of foreign shares in Malaysia to “*sophisticated investors*” is permitted with the approval of the SC on a case-by-case basis. The SC is prepared to consider specific exemptions from its guidelines on offerings of securities based on the strength of the regulatory requirements in the home jurisdiction of the issuer.

Although the SC has not provided any guidance to assist market participants to determine who are deemed to be “*sophisticated investors*” for the purposes of offerings of foreign shares in Malaysia, it is likely that the SC will apply the same guidelines as those applicable to offering of non-ringgit bonds and to securities of unlisted public companies (see below).

### ISSUE AND TRADING OF NON-RINGGIT MALAYSIA DEBENTURES

Prior to 15 September 2005, the issue of Non-Ringgit Malaysia denominated debentures, both conventional and Islamic

(collectively “Foreign Currency Bonds”) to investors exclusively outside Malaysia were exempted from certain requirements of the relevant guidelines, such as the method of issue, rating and underwriting requirements. These exemptions have been extended to the issue of Foreign Currency Bonds to “sophisticated investors” in Malaysia as a result of the introduction of the revised Practice Note 1 of the Guidelines on the Offering of Private Debt Securities (“PN1-PDS”) and the revised Practice Note 1 of the Guidelines on the Offering of Islamic Securities (“PN1-IS”).

A new Paragraph 16 of Schedule 1 to the SCA and a new Guidance Note dated 15 September 2005 (“GN”) enables “sophisticated investors” to trade Foreign Currency Bonds in Malaysia without the prior approval of the SC.

“Sophisticated investors” is described in PN1-PDS and PN1-IS as:-

- (a) a person who acquires securities, as principal, for a consideration of not less than RM250,000 or its equivalent in foreign currencies per transaction; or
- (b) an individual whose total net personal assets exceed RM3 million or its equivalent in foreign currencies; or
- (c) a corporation (including an offshore company as defined in the Offshore Companies Act 1990) with total net assets exceeding RM10 million or its equivalent in foreign currencies, based on its last audited accounts.

Sophisticated investors who are “regulated sellers” (i.e. those who are licensed institutions under the Banking and Financial Institutions Act 1989 or the Islamic Banking Act 1983 or universal brokers or consolidated brokers) are required under the GN to observe certain best practices on fair dealings to ensure adequate level of investor protection and to submit monthly reports on trades to the SC.

### SECURITIES OF UNLISTED PUBLIC COMPANIES

An amendment to Paragraph 12 of Schedule 1 of the SCA exempts offers or invitations made to “sophisticated investors” in relation to existing securities of an unlisted public company from the requirement for SC approval.

“Sophisticated investors” are those described in Paragraphs 9, 10 or 11 of Schedule 2 of the SCA and is identical to the classes of sophisticated investors described in PN1-PDS and PN1-IS with the exception of the express reference to offshore companies.

### CONVERSION OF CONVERTIBLE SECURITIES

An amendment to Paragraphs 27 and 28 of Schedules 2 and 3 respectively of the SCA dispenses with the requirement for a prospectus for issuance of listed securities pursuant to the exercise of a conversion right under an option, a warrant, a transferable subscription right or a convertible note.

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## RESTRAINTS ON RESTRAINING ORDERS

### Metroplex Bhd & Ors v. Morgan Stanley Emerging Markets Inc & Ors; RHB Sakura Merchant Bankers Bhd & Ors (Interveners) [2005] 3 CLJ 801

Chris Soon examines the High Court's decision in **Metroplex Bhd & Ors v Morgan Stanley Emerging Markets Inc & Ors; RHB Sakura Merchant Bankers Bhd & Ors (Interveners)** [2005] 3 CLJ 801.

#### BACKGROUND

Metroplex Berhad and its group of companies ("Applicant") defaulted in various debt payment obligations sometime in 2000. On 22 October 2002, the Applicant obtained a restraining order ("RO") under sec. 176(10) of the Companies Act 1965 ("Act") from the High Court of Malaya ("Court"). The RO was extended by the Court on four occasions over two years, the last of which would end on 22 October 2004. On 19 October 2004, the Applicant proposed a new scheme of arrangement ("Draft Proposed Scheme") to its creditors.

#### THE APPLICATION

The Applicant then applied to the Court for a further 4-months extension of the RO pursuant to sec. 176(10A) of the Act ("Application"). Various creditors opposed the Application.

#### PRE-REQUISITES FOR EXTENSION

The learned judge, Dato' Vincent Ng J held that for an applicant to succeed in extending an RO, all conditions set out in sec. 176(10A) must be met afresh at the time of the application for extension.

First, the requirements set out in sec. 176(10A) must be satisfied, namely: -

- (a) there is a proposed scheme between the company and its creditors representing at least one-half in value of all creditors;
- (b) the RO is necessary to enable the company and its creditors to formalise the proposed scheme for approval of the creditors;
- (c) a statement in the prescribed form as to the affairs of the company made up to a date not more than three days before the application [for extension] is lodged; and
- (d) the proposed scheme approves a person nominated by a majority of the creditors to act as a director, or if the person is not already a director, appoints that person as a director.

Secondly, an RO may be extended "*if and only if*" there is a '*good reason*' to do so.

The learned judge noted that, the phrase '*good reason*' has been construed to mean that: -

- (a) a *bona fide* scheme has been presented to the scheme creditors with sufficient details to enable the creditors to make informed decisions as to its feasibility and merits (**Re Kuala Lumpur Industries** [1990] 2 MLJ 180);

- (b) the scheme presented must not be such that it is bound to fail (**Twenty First Century Oils Sdn Bhd v Bank of Commerce (M) Berhad** [1993] 2 CLJ 677); and
- (c) the interest of the scheme creditors i.e. the beneficiaries under the scheme is safeguarded (**Sri Hartamas Development Sdn Bhd v MBF Finance Bhd** [1990] 1 CLJ 827).

The judge further opined that the existence of a '*good reason*' ought to be predicated upon the applicant's *bona fide* conduct. Thus it must be shown that there had been reasonable progress towards achieving a viable and feasible scheme. Furthermore a scheme is not a feasible scheme if it is bound to fail.

#### DECISION

After considering the facts, the learned judge dismissed the Application on grounds that the conditions for extension laid down by him had not been met as:-

- (a) the Draft Proposed Scheme did not contain sufficient particulars to enable the scheme creditors to assess its feasibility;
- (b) as only 21% in value of the scheme creditors had agreed to the Draft Proposed Scheme (which is less than the required 50% in value), it was unfeasible and was bound to fail;
- (c) there had been unreasonable delay by the Applicant in formalising a scheme as it was still only '*at the initial meager stages of attempting to achieve a feasible scheme*' despite a lapse of 25 months since the RO was first granted, and
- (d) the Applicant would not be in a position to produce a scheme that was viable, reasonable or feasible even if the RO was extended.

#### CONCLUSION

Although the Metroplex Case is not the first reported case where the Court rejected an application for extension of a restraining order under sec. 176(10) of the Act, it is noteworthy as the judge has set out clearly the conditions which have to be fulfilled for a restraining order to be extended.

In particular, the learned judge has set out the criteria to be fulfilled in order to constitute '*good reason*' under sec. 176(10A).

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**Note: Kemayan Bhd & Ors v Affin Discount & Others** [2003] 5 CLJ 422 appears to be the first reported Malaysian case where the Court rejected an application for extension of a restraining order.

In the Kemayan Case, Kang, J held that the grant of a restraining order under sec. 176(10) of the Act is predicated on the existence of a proposed scheme which has been put before the Court. He then rejected the application for extension as the proposed scheme had failed by that time.

# CONCURRENT VS CONSECUTIVE ACTIONS - THE SAGA CONTINUES

## Tan Kong Min v. Malaysian National Insurance Sdn Bhd [2005] 4 AMR 745

### INTRODUCTION

**Tan Kong Min v Malaysian National Insurance Sdn Bhd** [2005] 4 AMR 745 (“the Tan Kong Min Case”) is the latest in a series of Malaysian cases that deal with the right of the holder of a loan secured by a guarantee or charge, upon a default by the borrower, to commence an action to recover the amount owing in respect of the loan concurrently with his right to enforce the security.

The principal issue in the Tan Kong Min Case was that of limitation, that is, whether the claim by the respondent was time-barred, and when a cause of action would accrue against the borrower for the balance principal sum after an action for foreclosure has been completed.

### CASE SUMMARY

The respondent’s claim in the Tan Kong Min Case was for the difference between the amount due under the housing loan and the amount realised from the sale of the land charged to it. The issue turned on the interpretation of Clause 7 of the charge document which provides:

*“if the amount realized by the Lender on a sale of the Said Land under the provisions of the National Land Code ... is less than the amount due to the Lender ... the chargor(s) shall pay to the Lender the difference between the amount due and the amount so realized...”*

The Federal Court (“FC”) held that the provisions of the annexure to the charge provide for two (2) separate causes of action. The first is statutory in nature i.e. the foreclosure action under the National Land Code 1965 (action in rem). The second is the claim against the chargor under Clause 7 for the differential amount remaining due to the respondent (action in personam).

In respect of the cause of action under Clause 7, the FC (applying the principles laid down by the Malaysian Supreme Court (“SC”) in **Credit Corporation (M) Bhd v Fong Tak Sin** [1991] 1 MLJ 409) held that the point in time where all the material facts are said to be in existence to render the cause of action complete would be after the sale has been conducted and the differential amount remaining due to the respondent

has been ascertained. Therefore, the cause of action only accrues on the date the land is sold by auction, subject to there being a surplus owing to the respondent.

In coming to its decision, the FC affirmed the decision in **Hongkong & Shanghai Banking Corp Ltd v Wan Mohd b Wan Ngah** [1991] 3 MLJ 119 (“the Wan Mohd Case”) where the High Court held that a lender is not entitled to commence a civil action against a borrower to recover the full amount owing on the loan concurrently with foreclosure proceedings in circumstances where the only security held by the lender is a land charge which contains a covenant similar to Clause 7 of the Tan Kong Min Case.

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... it is not possible to commence  
foreclosure proceedings  
concurrently with a civil  
action for the full amount owing  
under the loan.

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### COMMENTARY

It is clear that in cases where the circumstances are identical to those in the Tan Kong Min Case and the Wan Mohd Case, it is not possible to commence foreclosure proceedings concurrently with a civil action for the full amount owing under the loan. Further, an action filed under a covenant similar to Clause 7 of the Tan Kong Min Case before the charged property is sold could be struck-off as pre-mature. In such circumstances, the proper mode of recovery is to first proceed by way of foreclosure and if there remains an amount owing on the loan thereafter, to initiate an action in personam against the chargor to recover such amount.

It is submitted that the Tan Kong Min Case does not affect the legal position established by earlier decisions of the apex court in Malaysia which have upheld a lender’s right to:-

(a) institute proceedings concurrently against the borrower and guarantors or other third-party security providers under their respective security documents; or

(b) commence foreclosure proceedings concurrently with civil proceedings against a borrower who has expressly undertaken, such as in a loan agreement, to repay the outstanding amount of the loan upon the occurrence of an event of default.

In this regard, the following pronouncement by Gopal Sri Ram, JCA in the FC case of **Low Lee Lian v Ban Hin Lee Bank Bhd** [1997] 1 MLJ 77, 93 (“the Low Lee Lian Case”) would appear to remain a summary of the present law:

*“Now it is trite that a chargee/creditor may pursue any or all remedies to recover monies lent by him. He may enforce his statutory charge against the chargor by way of proceedings in rem under sec. 256 of the Code. He may sue the principal debtor (who may or may not be the chargor) upon the personal covenant contained in any loan agreement that was entered into between the parties. He may proceed against the surety who has guaranteed the loan. And he may pursue all of these courses simultaneously, contemporaneously or successively.”*

The Tan Kong Min Case leaves untouched the SC’s decision in **Bank Bumiputra Malaysia Bhd v Esah Binti Abdul Ghani** [1986] 1 MLJ 16 where it was held that there is no obligation on the chargee to dispose of the charged property before instituting civil proceedings against the guarantor for the amount owing.

In conclusion, the decision in the Tan Kong Min Case would appear to be confined to situations where the charge document contains a provision similar to Clause 7 quoted above and there are no express covenants by the chargor to pay the outstanding amount of the loan upon the occurrence of an event of default. Nevertheless, it does emphasise to lenders the need to exercise utmost care in preparing legal documents if they wish to retain the right to commence foreclosure proceedings concurrently with civil proceedings to recover the full amount of the loan from a borrower.

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## LEGISLATION UP-DATE

## Marketing For Young Lawyers by Lee Tatt Boon

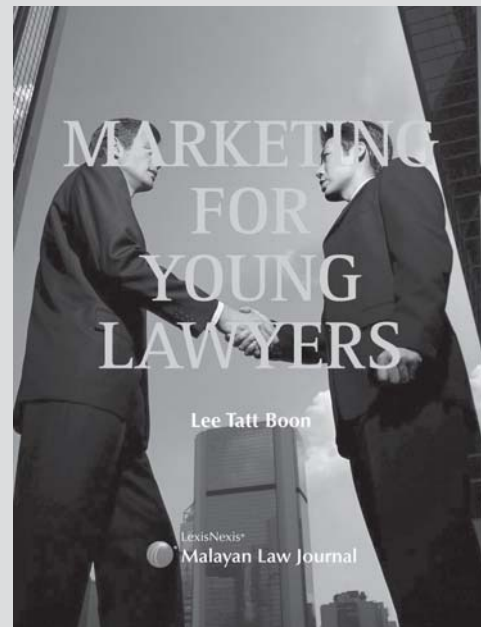
The following statutes came into force recently :-

- Malaysia Deposit Insurance Corporation Act 2005 [Act 642]  
c.i.f : 15 August 2005 [P.U.(B) 259/2004] and 1 September 2005 [P.U.(B) 278/2005]
- Malaysian Communications and Multimedia Commission (Amendment) Act 2004 [Act A1231]  
c.i.f : 1 August 2005 [P.B.(B) 251/2005]
- Armed Forces (Amendment) Act 2005 [Act A1243]  
c.i.f : 15 August 2005 [P.U.(B) 257/2005]
- Excise (Amendment) Act 2005 [Act A1245]  
c.i.f : 30 August 2005 [P.U.(B) 262/2005]
- Private Employment Agencies (Amendment) Act 2005 [Act A1246]  
c.i.f : 5 September 2005 [P.U.(B) 279/2005]
- Merchant Shipping (Oil Pollution)(Amendment) Act 2005 [Act A1248]  
c.i.f : 15 September 2005 [P.U.(B) 283/2005]
- Civil Aviation Offences (Amendment) Act 2005 [Act A1253]  
c.i.f : 30 September 2005 [P.U.(B) 290/2005]
- Insurance (Amendment) Act 2005 [Act A1247]  
c.i.f : 5 August 2005 [Act A1247]
- Syariah Court Evidence (Federal Territories)(Amendment) Act 2005 [Act A1250]  
c.i.f : 2 September 2005 [Act A1250]
- Syariah Court Civil Procedure (federal Territories)(Amendment) Act 2005 [Act A1251]  
c.i.f : 2 September 2005 [Act A1251]
- Syariah Criminal Procedure (Federal Territories)(Amendment) Act 2005 [Act A1252]  
c.i.f : 2 September 2005 [Act A1252]

For modern day lawyers, there is more to legal practice than just knowing the principle of law. Legal practice has become a business and to sustain it lawyers have to have clients to provide the work. To get new clients or to retain the old clients, lawyers have to market their services.

Marketing of legal services is not just about advertising the lawyer's services, nor is it about having lunches and cocktails or dishing out calling cards. It is much more than that and includes client relations, prompt service and many others.

Marketing, despite its importance, has never been part of the law school curriculum and hence lawyers, after graduation, have no inkling what marketing is all about.



Realising the importance of marketing for a modern day lawyer, this book is written for young lawyers to learn the principles of legal marketing in a structured approach. Lawyers will find this book useful as it not only tells them why and how lawyers should market, it also provides lawyers with tips and measures to build a reputation, an important ingredient of marketing; how lawyers should position themselves and disseminate their reputation as well as building a relationship with the clients. The book also provides measures, both essential as well as discretionary, to keep the clients which the lawyers have tried so hard to acquire.

“Marketing for Young Lawyers” was written by Lee Tatt Boon, a Senior Partner in Skrine, and the Head of the Intellectual Property Department since 1981. The book is already on sale and is priced at RM60.00 per copy. Should you wish to get more information about this book, you may contact its publishers, Malayan Law Journal (A member of Lexis Nexis), at 603 - 7718 6811 (phone) or customer.care@mlj.com.my (email).

## THE ART OF WAR AGAINST VIRUSES AND WORMS - A LEGAL PERSPECTIVE OF IT SECURITY

Chew Yu Shen provides some insight into the legal elements involved in the technical

IT systems and computers are increasingly becoming the target of attacks and intrusions. The rapid progress of technology has inadvertently brought about unparalleled security risks to IT systems and computers. IT security is widely understood as the protection of information technology against unauthorised access or modification and the denial of service to authorised users. IT security addresses both the nature of threats and the mechanisms for countering such threats. The three basic components of IT security are confidentiality, integrity and availability. “Confidentiality” is the assurance that certain information, data or resource is concealed and not disclosed to unauthorised persons whilst “Integrity” is the assurance that the information, data or resource is trustworthy and reliable and finally, “Availability” is the assurance that authorised users have the ability to access and use such information, data or resource.

### WHAT YOU'RE UP AGAINST

Knowing and understanding the nature and motives behind attacks is essential in preventing and countering them! There are various categories of attacks. Common ones include financial attacks i.e. those which seek to embezzle, steal or access financial information; business attacks i.e. competitive intelligence gathering; grudge attacks i.e. disgruntled employees aiming to sabotage the company; and fun attacks i.e. those perpetrated by thrill seekers who are motivated by sheer challenge and excitement. Forms of attack these days often range from snooping to spreading of malicious codes (such as viruses and worms) to unauthorised modification of information or data.

### BE PREPARED!

Poor systems and network administration, lack of understanding and training in IT security, unsafe systems and network design - these are some common factors which leave your systems vulnerable to attacks. IT security entails a whole host of activities such as planning, risk assessment, design, audit, testing, maintenance and consistent monitoring. The responsibility for IT security lies not only within the IT department but at all levels throughout an organisation from top-level management to the end user. There are various concepts and approaches in developing and achieving an effective IT security framework. Most if not all IT security frameworks should comprise of an appropriate security policy, regular security audits and an effective incident handling plan.

Security policies are rules and practices that regulate how organisations secure and protect their systems, in particular systems which are critical or sensitive in nature. From a legal perspective, these policies set out the scope of the users' obligations vis-à-vis security as well as use and access of the system. Contracts entered into between the organisation and users (such as employment contracts in the case of employees, contracts for services in the case of independent contractors, etc.) should contain provisions obliging the user to comply with any policies of the organisation. In the event of a claim or legal proceeding, the policy should be read in conjunction with the contract in ascertaining whether there has been a breach by the user.

Policies should therefore be reviewed by in-house legal or even external lawyers not for content but rather for language and consistency as well as compliance with any applicable laws such as local industrial relations law. Language in the policies should be as precise as possible in order to avoid ambiguity but at the same time not overly legalistic or technical since it must be comprehensible to lay users.

Equally important to an effective IT security framework is the deployment of appropriate security mechanisms such as firewalls and anti-virus software. Digital signatures, which is a type of security mechanism has been given legal recognition in Malaysia. Digital signature technology which involves the use of encryption algorithms and protocols provides what is termed as “data security”. The Digital Signatures Act 1997 (“DSA”) regulates the use of digital signatures and remains one of the primary cyber laws aimed at facilitating the validity, authenticity and enforceability of electronic contracts and documents in a paperless environment. It's important to note however that the DSA only accords legal recognition to one form of digital signature technology, namely, Private Key-Public Key Cryptography (or PKP) and the digital signature must be certified by a certification authority licensed under the DSA. For purposes of admissibility as evidence in legal proceedings, a digitally signed message (which complies with the DSA) is deemed to be an original and written document.

### IF YOU'VE BEEN HIT

Besides activating the incident handling plan, organisations which have been attacked should immediately take all necessary measures to gather and preserve evidence. Common measures include activating all auditing software, sealing disks which contain original and complete logs in a safe or alternatively copying the entire log to another location and securing the same appropriately. Wherever possible, a full back-up to capture evidence should be performed as soon as an attack takes place. In serious attacks, organisations should consider engaging computer forensics experts to conduct investigations on the attack. Computer forensics is the use of unique investigation techniques to identify, analyse and preserve electronic evidence for purposes of admitting such evidence in Court. It is important especially in the case of electronic evidence which can be easily modified to ensure that there is a chain of evidence. Preserving this chain of evidence entails documenting the sequence of individuals who handled the evidence and the sequence of locations where the evidence has been stored. The dates and times should be specific and there should not be any lapse in time or date. The aim is to enhance the integrity of such evidence in the event it is challenged in Court.

Computer generated evidence is admissible in Court by virtue of sec. 90A of the Evidence Act 1950. The test in determining its admissibility is whether the same was “produced by the computer in the course of its ordinary use”. This may be achieved by tendering a certificate signed by the person who is responsible for the management/operation of that computer or for the conduct of the activities for which that computer was used.

## area of IT Security.

Organisations which have suffered attacks can lodge reports/complaints with the Malaysian Computer Emergency Response Team (“MyCERT”), the Malaysian Communications and Multimedia Commission (“MCMC”) and/or the Technology Crime Investigation Branch (Commercial Crime Investigation Division) of the Royal Malaysian Police.

### WHAT LIES IN LAW?

Criminal prosecutions may be initiated by the Attorney General’s Chambers against perpetrators under the Computer Crimes Act 1997 (“CCA”). Most forms of attack can possibly constitute an offence under the CCA. For example, the CCA prohibits any person from gaining unauthorised access to any program or data in a computer or making unauthorised modifications to the contents of any computer. The CCA is extra-territorial in that it extends to offences committed from outside Malaysia. Criminal prosecutions may also be initiated under specific sections of the Communications and Multimedia Act 1998 (“CMA”). Acts such as improper use of network facilities or network services or the interception and disclosure of communications without lawful authority are considered offences under the CMA.

Apart from criminal prosecutions, organisations may themselves bring civil claims against the perpetrators. The causes of action will depend on the facts of each case as well as the nature of the attack or breach. Possible causes of action include breach of contract, for example employees who are in breach of their employment contracts; breach of confidence, for example where there has been unauthorised access and use of sensitive data; copyright infringement, for example where hacking is done to circumvent a security feature of a program; and as established in the US but not tested in Malaysia, the tort of trespass. Depending on the cause of action, remedies available to the successful plaintiff range from injunctions to costs and damages.

### NO BORDERS, NO BOUNDARIES

The very nature of the Internet allows attacks to be staged from anywhere in the world which inevitably poses problems in tracing, investigation and ultimately, enforcement. For civil claims, under the Reciprocal Enforcement of Judgments Act 1958 a plaintiff may institute a claim in a Malaysian Court and enforce the judgment obtained in the country where the perpetrator resides provided that country is a reciprocating country under the Act. Problems naturally arise when the country in question is not a reciprocating country. At the criminal front, there is certainly a need for greater harmonisation of national laws and extradition laws as well greater cooperation among international law enforcement agencies.

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## C/A REITERATES PRINCIPLE OF NON-INTERFERENCE WITH ARBITRAL AWARDS

### Federal Flour Mills Bhd v. Fima Palmbulk Services Sdn Bhd & Another Appeal [2005] 4 CLJ 47

The Court of Appeal in its recent decision in **Federal Flour Mills Bhd v. Fima Palmbulk Services Sdn Bhd & Another Appeal** [2005] 4 CLJ 47 has upheld the principles relating to the setting aside of arbitral awards as set out in its previous decisions of **Future Heritage Sdn Bhd v. Intelek Timur Sdn Bhd** [2003] 1 CLJ 103 and **Hartela Contractors Ltd v. Hartecon JV Sdn Bhd & Anor** [1999] 2 CLJ 788. Whilst not in itself laying down any new principles of law, the decision reinforces the recent and encouraging trend against unwarranted judicial interference with arbitrators’ decisions.

In this case the High Court had dismissed the appellant’s application for leave under sec. 27 of the Arbitration Act 1952 to enforce the Award of the arbitrators dated 8 October 1999 and allowed the respondent’s application to set aside the Award. The respondent’s complaint was that there was error on the face of the Award. The learned Judge did not agree with several findings of fact made by the arbitrators in relation to the evidence adduced during the course of the arbitral proceedings including the arbitrators’ preference for the evidence given by the witnesses for the appellant as opposed to the witnesses for the respondent. The Judge also found that the arbitrators had relied on inaccurate notes of proceedings as a technical acronym ‘FAC’ (Fatty Acid Composition) had been erroneously recorded as ‘FFA’ (free fatty acid).

The Court of Appeal reiterated that issues of facts are matters falling solely within the jurisdiction of the arbitrators. The Court would not intervene merely because the arbitrators might have drawn a wrong inference from the facts. The arbitrators’ decision to accept the evidence given by witnesses for the appellant was a matter strictly within their purview. The Court of Appeal pointed out that it was a settled principle of law that the court may not set aside an award solely on the ground that there has been misunderstanding or misapprehension of facts by the arbitrator and went on to find that there was no apparent error on the face of the award that warranted curial interference. The Court of Appeal emphasised that any error in the notes of proceedings was of a trivial nature, not affecting the outcome of the case, and as such did not constitute a valid reason to interfere with the findings of the arbitrators.

The Court of Appeal in allowing the Appeal and hence reinstating the award, has reaffirmed the principles (laid down in the cases mentioned above) that the Courts are reluctant to interfere with arbitrations in general, and in particular with findings of fact made in such proceedings, and has also given a welcome and concrete indication of the practical limits of judicial intervention.

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## THROWING THE BABY OUT

### How companies neglect and compromise

*“Information is the oxygen of the modern age.” Ronald Reagan.*

We live in an age where the person who controls information will have the upper hand in commerce and politics. However, controlling information will not be sufficient, he would have to manage, develop and have the ability to exploit the information to his advantage.

The same would apply when it comes to company information. Data and facts are intangibles but the ‘knowledge’ that can be gleaned from such information is what sets apart success from mediocrity. Hence, protecting such knowledge and its building blocks becomes not only necessary but critical to beating your competition. It is thus the aim of this article to set out the various ways in which information as a source of knowledge can be protected in Malaysia and how companies can put in place various procedures to ensure minimum leakage and unfair competition.

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... it is imperative for companies to register their designs or drawings as industrial design under the Industrial Designs Act 1996. Failure to do so is detrimental because once the design is available to the public, its registrability becomes threatened by virtue of the fact that it would have lost its novelty.

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#### THE RIGHT TO COPY?

The Malaysian Copyright Act 1987 provides protection to works that fall under certain categories, such as written works, tables or compilations, computer programs, graphical works, sculpture, works of architecture and musical works, amongst others.

By virtue of Malaysia becoming a member of the Berne Convention in June 1990 and pursuant to regulations made thereafter, any work, namely literary, artistic or musical, created by a national of a member country or published in a member country would be given similar protection in Malaysia as if it were created by a Malaysian. This reciprocity aspect of the Berne Convention means that works originating from almost 160 countries would be protected in Malaysia so long as the works are recognized as copyrightable works and within its duration of protection.

At this juncture, it is crucial to point out that companies dealing with works involving designs or technical drawings should take extra precaution in protecting their rights. Pursuant to the Copyright (Amendment) Act 1996 (which came into effect on 1.9.1999), copyright protection for industrial designs, design documents and models have been to a large extent removed.

The crucial date is 1.9.1999. Any functional drawings or designs created after this date are unlikely to attract copyright protection. In such circumstances, it is imperative for companies to register their designs or drawings as an industrial design under the Industrial Designs Act 1996. Failure to do so is detrimental because once the design is available to the public, its registrability becomes threatened by virtue of the fact that it would have lost its novelty. As such, it is pertinent at the outset to determine the date when the designs or drawings were created. Please note that any copyright subsisting prior to 1.9.1999 will not be affected by the changes to the law mentioned herein.

One good news for employers and persons commissioning third parties is that works created in the course of employment or by way of a commission are deemed to belong to the employer or commissioner. It would of course be good to ensure that this is underscored by inserting similar understanding into the necessary contracts, be they for the services of a servant or an independent contractor.

#### BREACHING CONFIDENTIALITY

Apart from understanding your rights in protecting information by copyright, the law on the equitable doctrine of confidence plays a vital role in ensuring that your commercial information remains that way. There are many types of information which may not attract copyright protection but would nevertheless be important for your company to protect, for e.g. ideas behind manufacturing processes or sales and marketing information, status of on-going negotiation with customers, the basis for formulae and trade secrets.

However, the common folly amongst many companies is that despite knowing the importance of keeping certain information secret, they fail to do so. This could be attributed to the companies’ neglect in identifying which information is valuable to their business and hence to be kept under lock and key; and secondly, protective mechanisms or safeguards have not been implemented to ensure that the information remains locked and the key is in the hands of the keeper of secrets.

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... companies dealing with works involving designs or technical drawings should take extra precaution in protecting their rights... the common folly amongst many companies is that despite knowing the importance of keeping certain information secret, they fail to do so.

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## WITH THE BATH WATER?

the need to protect their information.

### PATENT THIS, DESIGN THAT AND BE READY TO COMBAT!

Companies that are involved in the business of manufacturing or creating new products could rely on the Patents Act 1983 to protect their inventions. Similar to patent laws elsewhere, Malaysian patent system requires the invention to be new, involve an inventive step and is industrially applicable, provided it is not an excluded subject matter.

However, with regards to the novelty requirement, if the inventor had disclosed his invention to the public, the Act gives him 1 year grace period to file his patent. Other countries may not recognize such an exemption and if a similar patent were to be filed elsewhere in the world, the said disclosure could defeat novelty in countries which require absolute novelty for patentability.

With regards to foreign patents, within one year from filing of a patent in specified member countries, a patent could be filed in Malaysia claiming a priority date as that in the original country.

The rights in any inventions of an employee or a commissioned person would be deemed to belong to the employer or the commissioner, provided there are no agreements to the contrary. However, companies should take heed to the wording of sec. 20 which basically provides that where the invention becomes a success beyond the expectation of the parties involved, the inventor would be entitled to an “equitable remuneration”. This remuneration could either be fixed by the Court or by agreement.

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Similarly, it is very often the case  
that companies fail to recognise the  
potential of what they have and in their  
ignorance or neglect, end up compromising  
or losing the most important  
asset in their organisation.

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### 10 WAYS TO KEEP THE BABY

In the English expression, “do not throw the baby out with the bath water”, the baby is a reference to something important that sometimes gets thrown out after a bath together with the dirty bath water. It is a metaphor for not throwing out the good bits when we throw out the unwanted party.

Similarly, it is very often the case that companies fail to recognize the potential of what they have and in their ignorance or neglect, end up compromising or losing the most important asset in their organisation.

We set out below some steps that can be put in place to ensure that your prized possessions remain with you and grow to bring you good returns.

1. **The Fort:** to put in a place proper information and knowledge management unit which collates, filters, compiles and tracks various information that should be protected through the proper means.
2. **Trace the Owner:** to trace the root of title in your information and data to ensure that what you think belongs to you is indeed the case.
3. **Storage in the Fort:** to list down the types of information that are relevant to the business and classify them accordingly. To mark them as confidential and as being the property of your company.
4. **Protect the Fort:** to ensure that valuable information is not lying around the premises making it vulnerable to theft, be it in the form of physical disappearance from a location or technical thievery.
5. **Gag the Guards:** to put in place confidentiality and ownership clauses in contracts with your workers.
6. **Mark your Territory:** to register your rights in company information wherever possible.
7. **Fortify the Fort:** to implement reminder systems. This is crucial to preempt lapsing of grants for patents, designs, trade marks and domain names. In addition, statutory declarations should be prepared to protect copyrightable works. Password protect areas of your office or database and monitor the movement of workers.
8. **Keeper of the Key:** to ensure that the person in control of the information is someone higher up in the management.
9. **Examine the Fort:** to seek legal advice on whether your information is sufficiently protected before exploiting it. This would be relevant to manufacturers of products due to the draconian and absolute prerequisites for protection under design and patents laws.
10. **Guard the Fort:** to be vigilant at all times. This requires constant policing and enforcement of your rights in the information.

Protecting, managing and developing your company assets in a proper and structured manner would bear fruit one day. With the above measures in place, your company could realise the true worth of all the information acquired and created over the years.

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## 2006 BUDGET HIGHLIGHTS

### Elaine Lee gives a summary of some of the salient points of the recent 2006 Budget.

The highlights of the 2006 Malaysian Budget announced by the Finance Minister Y.B. Datuk Seri Abdullah Ahmad Badawi (Prime Minister of Malaysia) on 30 September 2005 are as follows:-

- A group relief of up to 50% of the current year adjusted loss for all locally incorporated resident companies may be set-off against the income of another company within the same group with minimum 70% ownership between them.
- Accumulated losses and unabsorbed capital allowances of a company may not be carried forward if there is a change of more than 50% in its shareholdings.
- The estimated losses of low cost housing projects may be set-off against estimated profits of other property development projects.
- Audit fees to be deductible as allowable expenses in the computation of income tax.
- Consultancy, legal and valuation fees incurred in the establishment of Real Estate Investment Trusts to be deductible.
- Corporations issuing bonds to be given tax deductions for expenses incurred on discounts or premiums on an accrual basis until the maturity date of the bonds. Income derived from investment on bonds by corporations will also be taxed on an accrual basis.
- Income of an investment holding company listed on Bursa Malaysia to be treated as business income and expenses to be given full deduction but unutilised tax losses and unabsorbed capital allowances may not be carried forward.
- Industrial building allowance for 10 years to be given to the owners of new buildings (including completed but yet to be occupied buildings) occupied by MSC-status companies in Cyberjaya.
- Accumulated losses and unabsorbed capital allowances incurred during pioneer period may be carried forward and deducted from post-pioneer income of a business relating to the same promoted activity or promoted product.
- Companies may estimate tax payable at minimum of 85% of preceding year's tax estimate compared to 100% currently.
- 100% capital allowance for small value assets not exceeding RM1,000 each and the total value of such assets not exceeding RM10,000 for each year of assessment.
- Interest expense to be apportioned between leasing and non-leasing activities based on the respective amount of fund used.
- Deductions to be amortised for 3 years to be given to the Private Higher Education Institutions on expenses incurred on the development of new course and compliance with regulatory requirements for introducing the new course.
- The application period for pioneer status, investment tax allowance and infrastructure allowance in promoted areas to be extended to 31 December 2010.
- Tax incentives for projects in the Eastern Corridor, including Sabah and Sarawak, extended for a further 5 years to 31 December 2010.
- Selected companies recommended by the Multimedia Development Corporation which operate outside Cybercities to be given pioneer status with 50% tax exemption for 5 years or investment tax allowance of 50% of qualifying capital to be set-off against 50% of statutory income for 5 years.
- For companies generating energy from renewable sources, tax exemption under the pioneer status to be increased from 70% to 100% for 10 years and investment tax allowance to be increased from 60% to 100% to be set-off against 100% of statutory income for 5 years.

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**Mergers and acquisitions undertaken by companies listed on Bursa Malaysia that are approved by the Securities Commission from 1 October 2005 until 31 December 2007 are exempted from real property gains tax and stamp duty.**

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- The application period for pioneer status, investment tax allowance, import duty and sales tax exemptions for companies generating energy from renewable sources and providing energy conservation services to be extended to 31 December 2010.
- Investment tax allowance of 60% for 5 years to be set-off against 70% of the statutory income to be given to companies incurring capital expenditure for conserving energy for own consumption.
- Mergers and acquisitions undertaken by companies listed on Bursa Malaysia that are approved by the Securities Commission from 1 October 2005 until 31 December 2007 are exempted from real property gains tax and stamp duty. Such transactions must be completed by 31 December 2008.
- Commencing 3 October 2005, the Securities Commission will review prospectuses on a post-vetting basis to expedite the issue of prospectuses.
- Time frame for issue of offer documents by companies involved in takeovers to be reduced from 35 days to 21 days from the date of the takeover notice.
- Section 132G of the Companies Act 1965 to be abolished.

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## RECOVERING PURE ECONOMIC LOSS IN NEGLIGENCE: AN OVERVIEW

Lam Wai Loon traces the evolution of English law in the first instalment of a two-part article.

Of all areas of the law the area known as tort most reflects the civil rights and duties of men to and against their fellow members of society. As such, it is not to be wondered at that it is this area of the law which has witnessed the most prolific and burgeoning growth, in terms of the development of new law, over the last century, which has in turn witnessed arguably the most accelerated social change in human history. Much of that growth has centred around the “new” tort of negligence. As ever in the case of rapid change, growing pains are inevitable, and perhaps the most vexed aspect of the tort of negligence is the scope it offers for the recovery of what is often termed “pure” economic loss. This two-part article will seek to review the development of the concept of pure economic loss throughout the commonwealth, as a means of putting into perspective Malaysian efforts at applying the concept: efforts which have been thrown into sharp focus by two recent judgments of the Court of Appeal.

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“... as ever in the case of rapid change, growing  
pain is inevitable ...”

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In **Steven Phoa Cheng Loon & Ors v Highland Properties Sdn Bhd & Ors** [2003] 1 MLJ 567, the Court of Appeal, unlike the Courts in England and other commonwealth jurisdictions, took the view that under the well established “neighbour” principle, any loss is recoverable, whether it be pure economic loss or injury to person or property, provided that it is a kind of damage which is reasonably foreseeable. In reaching this conclusion, the Court of Appeal overruled not only the trial judge’s decision in the same case, but also a previous High Court decision of the same Judge in **Dr. Abdul Hamid Rashid v Jurusan Malaysian Consultants** [1997] 3 MLJ 546; decisions which the Court of Appeal characterised as based on policy rather than the well established “neighbour” principle enunciated in *Donoghue v Stevenson*. It is to be noted that recently, the Dr Hamid’s decision has been upheld by the Court of Appeal. Pending the Court of Appeal handing down its grounds of judgment in that case, it remains to be seen whether a difference of approach to economic loss claims exists within the Malaysian judiciary.

At the outset, one point should be made clear for the non-legally trained reader. The term “economic loss” may be misleading, the usual remedy for tortious claims is damages, i.e. a monetary award. Thus, the physical harm suffered is generally translated into monetary terms, as being the most universal measure of loss. Such loss is not “economic loss”, which, for purposes of this article may be defined as pecuniary loss not consequent upon personal injury or physical damage to property belonging to the Plaintiff.

To assess the Malaysian position on the recovery of pure economic loss in tort, it is helpful to look at the development of this “new” tort of negligence in England, as well as in some other commonwealth countries. In the first part of this article, we will consider the English position.

### DONOGHUE VS STEVENSON - “THOU SHALT LOVE THY NEIGHBOUR AS THYSELF”

The development of the law of negligence began with the landmark decision of the House of Lords in the case of **Donoghue v Stevenson** [1932] AC 562. Prior to this case, where a person suffered physical injury or damage to his property by reason of a defective article manufactured by another party who had failed to exercise his duty of care in the manufacture or repair of that article, the general rule was that the injured person would have no cause of action against that other party in tort subject to two exceptions:-

- (a) where the article was dangerous in itself, and
- (b) where the article although not in itself dangerous was in fact dangerous, by reason of some defect or for any other reason, and this was known to the manufacturer.

In respect of the first exception, a peculiar duty was imposed upon those who send forth or install such articles to take precaution when it is necessarily the case that other parties will come within their proximity. As to the second exception, this depended on the fact that the knowledge of the danger created a duty to warn, and its concealment was in the nature of fraud.

The case itself concerned an action brought by a consumer, i.e. the plaintiff, against a manufacturer of ginger beer for damages that arose from personal injuries (consisting of shock and gastro-enteritis) which the plaintiff had suffered as a result of consuming the part of the contents of a bottle of a ginger beer which contained decomposed remains of a snail. The purchase of the bottle of ginger beer was made not by the plaintiff herself, but by a friend of hers from a café. There was thus no contract between the plaintiff and the manufacturer, and no knowledge on the part of the manufacturer that the article (i.e. the ginger beer) had become dangerous. As such, the claim, under the accepted law at the time, was doomed to failure, and was dismissed by the Court of Session in Scotland.

Notwithstanding this, the House of Lords, by a majority of 3 to 2, upheld the plaintiff’s claim, and in place of the rigid concept outlined above expounded the “neighbour” principle that identifies the relations of parties giving rise to a duty of care.

Lord Atkin, one of the majority Law Lords, in a well-known passage (at page 580) in the case stated the principles in the following words:-

*“The rule that you are to love your neighbour becomes in law, you must not injure your neighbour, and the lawyer’s question, Who is my neighbour? receives a restricted reply. You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour. Who, then, in law is my neighbour? The answer seems to be – persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question.”*

## RECOVERING PURE ECONOMIC LOSS IN NEGLIGENCE (CONT.)

It is to be noted that in *Donoghue v Stevenson*, no claim for pure economic loss was made by the Plaintiff. As such, the ‘neighbour’ principle was often perceived to be confined to physical damage cases, e.g. **Old Gate Estates v Toplis & Harding** [1939] 3 All ER 209.

### RECOVERY OF PURE ECONOMIC LOSS IN NEGLIGENT MISSTATEMENT CASES: **HEDLEY BYRNE & CO. LTD V HELLER & PARTNERS LTD**

The House of Lords in this case held that the recovery of pure economic loss sustained as a result of negligent misstatement (as opposed to negligent acts per Lord Reid, at page 482) was allowable in principle where there was a special relationship between the parties.

The plaintiffs via their bank made enquiries to the defendants (also a bank) about the financial standing of a particular company with which they intended to enter into a business relationship. The defendants without charge, and apparently negligently, replied that the company was financially sound. The statement which was made by the defendants contained a disclaimer. Relying on this statement, the plaintiffs proceeded to enter into business transactions with the company. Subsequently, the company became insolvent and as a result the plaintiffs sustained financial losses.

The House of Lords held that, but for the disclaimer, the defendants would have been liable for such financial losses sustained by the plaintiffs as a result of their reliance on the negligent misrepresentation. Although the plaintiffs lost because of a disclaimer clause, the Court’s dictum set a new course. Their Lordships held that in principle a duty could be imposed for negligent words causing pure economic loss where there exists a special relationship between the plaintiff and defendant. The criteria for determining if there is a “special relationship” were left open, but it seems clear that it was based in this case on an assumption of responsibility by the bank, and reasonable reliance by the plaintiff on the bank.

It should be noted from the various speeches of the Law Lords in this case that the principle in *Donoghue v Stevenson* was not directly applicable to the situation before them. Notwithstanding this, following **Hedley Byrne & Co. Ltd v Heller & Partners Ltd** [1939] 3 All ER 209, several attempts were made to argue that it was implicit from that decision that direct injury to the person or property of the plaintiff was no longer a necessary condition to support an action in negligence. However, these arguments were generally rejected by the Courts. (Notably the judgment by Widgery J in *Weller & Co v Foot and Mouth Disease Research Institute* [1966] 1 QB 569 ; *Konstantinidis v World Tankers Corporation (The World Harmony)* [1967] P 341.)

### ANNS TWO-STAGED TEST: A ‘NEW’ CONCEPT OF DUTY OF CARE

From 1972 to 1990, several crucial decisions were made by the appellate courts in England which essentially centred on what should be the bounds of the duty of care in negligence. Most of these decisions turned on cases involving claims for economic loss arising from defective premises.

It began with the Court of Appeal case of **Dutton v Bognor Regis UDC** [1972] 1 Q.B. 373. Here, the plaintiff was the second purchaser of a house which was less than 2 years old. Soon after the plaintiff moved in, serious cracks and defects developed in the internal structure of the building. Investigation revealed that this was due to subsidence of an internal wall which, in turn, was due to the fact that the wall had inadequate foundations. At an early stage in the building works a building inspector of the local council inspected the excavations for the foundations and approved them. However, he did so negligently in failing to detect that the foundations were constructed on the site of a rubbish tip, so that the foundations should have had extra reinforcements. The builder was aware of this, but had not told the inspector.

The plaintiff sued both the builder and the local council for the cost of the repairs and depreciation in the value of the house. Before the Court of Appeal, the counsel for the local council submitted that if the council was liable, its liability was limited to those who had suffered physical damage, and not damage to the premises *per se*, which was pure economic loss.

This submission was rejected by the Court of Appeal. In allowing the Plaintiff’s claim, Lord Denning MR labelled the distinction between loss which arose from injury suffered by reason of the defective premises and loss for the defective premises itself as an “impossible distinction” (at page 396), and stated that the Council would be liable in either case. Lord Denning did not regard the loss for the defective house *per se* as pure economic loss. (c/f Lord Keith’s view in *Murphy v Brentwood D.C.* [1978] 1 AC398, at page 466 that this type of damage was a pure economic loss)

*Dutton* was later referred to, and approved, by the House of Lords in **Anns v Merton London BC** [1978] AC 728. The facts of this case are very similar to those in *Dutton*. Here, the plaintiffs were long lessees of maisonettes in a block of flats which had been constructed by a certain building company. Eight years later cracks appeared in the wall and some of the floors started to slope. The cause of these defects was the fact that the block had been erected on inadequate foundations. Unless remedied, these defects could have become worse and the flats would have become uninhabitable. The plaintiffs sued the local authority for negligently approving the builder to construct the building on the inadequate foundation or alternatively in failing to carry out necessary inspection. Again this claim was based on the defective premises *per se*. At issue was whether a duty of care was owed by the municipal body to the tenant leaseholders.

The House of Lords held that the local authority owed a common law duty of care to the plaintiffs. In this case, as in *Dutton*, the damage to the premises in question was characterised by the House of Lords as physical damage.

Lord Wilberforce in delivering the judgment formulated a two-staged test (at page 751) in determining as to when a duty of care arises:

## RECOVERING PURE ECONOMIC LOSS IN NEGLIGENCE (CONT.)

*“First, one must ask whether, as between the alleged wrongdoer and the person who has suffered the damage there is a sufficient relationship of proximity or neighbourhood such that, in the reasonable contemplation of the former, carelessness on his part may be likely to cause damage to the latter—in which case a prima facie duty of care arises. Secondly, if the first question is answered affirmatively, it is necessary to consider whether there are any considerations which ought to negative, or to reduce or limit the scope of the duty or the class of person to whom it is owed or the damages to which a breach of it may give rise.”*

Following *Anns*, and until that case was overruled in 1990, this two-staged test was taken to be a formula of general application to be used to deal with the duty of care issue in a variety of situations.

### THE RISE AND FALL OF ANNS TWO-STAGED TEST

The greatest extension of the *Anns* test was the House of Lords case of **Junior Books v Veitchi** [1983] AC 520. In that case, the plaintiff entered into a contract with a building contractor for the construction of a new factory. The contractor in turn entered into a contract with the defendant as a nominated sub-contractor under the main contract, to lay the flooring of the production area of the plaintiff’s factory. The defendant was a company specialized in the laying of floors. There was no privity of contract between the plaintiff and the defendant. Some time after the completion of this work the flooring showed defects, allegedly due to bad workmanship and /or bad materials.

The question for the House of Lords was whether the defendant, having negligently laid a floor which was defective, but which had not caused danger to the health or safety of any person nor risk of damage to any other property belonging to the owner of the floor, was liable for the economic loss caused to the owner by having to replace the floor.

The House of Lords, applying *Anns* two-staged test, answered the question in the affirmative. The majority of the House decided that the duty of care was not limited to a duty to avoid causing foreseeable harm to person or property, but also extended to a duty to avoid causing pure economic loss by reason of defective works or article. Lord Roskill, in delivering the main judgment for the majority of the House, at page 546, said *“I see no reason why what was called during the argument ‘damage to the pocket’ simpliciter should be disallowed when ‘damage to the pocket’ coupled with physical damage has hitherto always been allowed.”*

What had emerged in English law as a result of *Anns* was that proximity had become equated with reasonable foreseeability of harm. Once a plaintiff had established the reasonable foreseeability of harm, a *prima facie* duty of care arose. The onus then shifted to the defendant to establish that public policy negated such a duty.

The broad extension of the original neighbour principle caused by *Anns* two-staged test became the subject of academic criticism: The authors of the English textbook, *Streets on Torts* [10<sup>th</sup> Edition], at page 175, state *“the tort of negligence looked set to undermine the very boundaries of contract and tort long established in the English law of obligations and, in particular, to undermine the doctrines of consideration and privity of contract”*.

A retreat from *Anns v Merton Borough* began soon after *Junior Books*. A series of decisions in the House of Lords and the Privy Council in the mid-1980s cast doubts on the *Anns* two-stage test. These decisions stated in clear terms that in cases other than cases of direct physical injury the reasonable foreseeability of damage is not of itself sufficient to found a duty of care.

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Once a plaintiff had established the reasonable foreseeability of harm, a *prima facie* duty of care arose. The onus then shifted to the defendant to establish that public policy negated such a duty.

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In *Governors of the Peabody Donation Fund v. Sir Lindsay Parkinson & Co. Ltd* [1985] AC 210, a development company claimed against a local authority for the financial loss occasioned to them by an inadequate drainage system, alleging the authority had negligently approved it. In denying a remedy, the House of Lords (per Lord Keith) warned against treating the *Anns* two-staged test as being definitive in analysing the duty of care issue. The *Peabody* case required that policy considerations be considered before finding a duty of care, not merely to negate it after foreseeability of harm was proved to exist.

In *Leigh & Silavan Ltd v Aliakmon Shipping Co Ltd* [1986] AC 785, the question before the House of Lords was whether the Plaintiff, who only had a contractual right to certain consigned goods, were owed a tortious duty, which would sound in damages, where goods were damaged in transit at sea. In rejecting the Plaintiff’s claim, the House of Lords held that the *Anns* two-staged test did not provide *“a universally applicable test of the existence and scope of a duty of care in the law of negligence”*, and that the same approach should not be *“adopted to the existence of a duty of care in a factual situation in which the existence of such a duty had repeatedly been held not to exist”*. (at page 815, per Lord Brandon)

The decisive case in the counter-revolution against *Anns* two staged test was probably the Privy Council decision in **Yuen Kuey-yeu v A.G. Hong Kong** [1988] AC 175. The question for the Privy Council was whether a duty of care was owed by the Hong Kong Commissioner of Deposit-taking Companies to investors who had lost money deposited in a company registered under the Deposit-taking Companies Ordinance. The defendant had supervisory powers under this Ordinance. The Privy Council found that, although it was reasonably foreseeable by the defendant that harm could occur if an uncreditworthy company was allowed to remain on the books, this was not sufficient to establish a duty of care. As there was no special relationship between the plaintiff and defendant analogous to that in the *Hedley Byrne* case, the Privy Council found there was no duty of care owed.

*Continue on next page*

## RECOVERING PURE ECONOMIC LOSS IN NEGLIGENCE

## (CONT.)

Lord Keith in delivering his judgment said that the Anns test had been “elevated to a degree of importance greater than its merits, and perhaps greater than its author intended”. Lord Keith also said that “in view of the direction in which the law has since been developing, their Lordships consider that for the future it should be recognised that the two-staged test in *Anns* is not to be regarded as in all circumstances a suitable guide to the existence of a duty of care”.

Shortly before expressly over-ruling *Anns*, the House of Lords decided in **Caparo Industries plc v Dickman** [1990] 2 AC 605 that it was impossible to use a single general principle in determining the duty of care issue in all cases. They favoured the traditional approach, and cited with approval Brennan J.’s dicta in the High Court of Australia in *Sutherland Shire Council v Heyman*, where his Lordship stated “that the law should develop novel categories of negligence incrementally and by analogy with established categories, rather than by a massive extension of a prima facie duty of care restrained only by indefinable ‘considerations which ought to negative, or to reduce or limit the scope of the duty or class of person to whom it is owed.’”

In place of the *Anns* two-staged test, Lord Bridge expounded the following formula:

“..., in addition to the foreseeability of damage, necessary ingredients in any situation giving rise to a duty of care are that there should exist between the party owing the duty and the party to whom it is owed a relationship characterised by the law as one of ‘proximity’ or ‘neighbourhood’ and that the situation should be one in which the court considers it fair, just and reasonable that the law should impose a duty of a given scope on one party for the benefit of another.” (at page 617, per Lord Bridge)

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The current English law in respect of recovery of pure economic loss in negligence is clear: the existence of reasonable foreseeability of damage alone is insufficient. Something more is required: the plaintiff must show that there was between himself and the defendant a “special relationship”.

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#### THE DEMOLITION OF THE ANNS TWO-STAGED TEST: MURPHY V BRENTWOOD DC

In 1990, *Anns* was expressly overruled by the House of Lords in **Murphy v Brentwood District Council** [1991] 1 AC 398. This case concerned a council’s building department which had negligently approved the design on the foundation of a house which was later found to be faulty. Serious cracks appeared in the house a year after it was bought by the plaintiff. The estimated cost of repair was GBP 45,000. The plaintiff could not afford this, and instead sold the house,

value of the house in an undamaged condition. The plaintiff sued the council for this sum on grounds that it had negligently passed the plans for the foundations. Unlike in *Anns*, the House of Lords regarded the damage as purely economic in nature, and so rejected the Plaintiff’s claim. In place of the *Anns* two-staged test, the House of Lords reaffirmed the traditional position that, in the absence of a special relationship between the parties, pure economic loss is not recoverable in negligence.

The thrust behind the rejection of the *Anns* test was the concern that it was too broad, too undisciplined, an approach in negligence law, and it did not provide any mechanism for avoiding the risk of unlimited liability. Lord Keith (at page 468 – 469) said:

“The existence of a duty of that nature [where pure economic loss had been sustained], should not, in my opinion, be affirmed without a careful examination of the implications of such affirmation. To start with, if such a duty is incumbent upon the local authority, a similar duty must necessarily be incumbent also upon the builder of the house. If the builder of the house is to be so subject, there can be no grounds in logic or in principle for not extending liability upon like grounds to the manufacturer of a chattel. That would open up an exceedingly wide field of claims, involving the introduction of something in the nature of a transmissible warranty of quality.”

15 years after *Murphy* was decided, it remains good law in England. The current English law in respect of recovery of pure economic loss in negligence is clear: the existence of reasonable foreseeability alone is insufficient. Something more is required: the plaintiff must show that there was between himself and the defendant a “special relationship”, such as existed in *Hedley Byrne & Co Ltd v Heller & Partners Ltd*. (at page 492 – 493, per Lord Oliver of Aylmerton) *Junior Books’* decision was not overruled by *Murphy* as it was regarded as being an application of the *Hedley Byrne* principle (at page 466, per Lord Keith; at page 481, per Lord Bridge), and not as authority for any extension to that principle. As such, *Junior Books* has effectively been confined to its own facts.

#### CONCLUSION

In effect, the *Junior Books* case was the high water mark of claims for pure economic loss in the United Kingdom. Since then, a series of decisions at the highest level have marked points along the long retreat to the present position (as set out in the *Murphy* case) along the way relegating to the sphere of legal history the *Anns* two-stage test. In effect, the House of Lords, presumably terrified by the spectre of “liability in an indeterminate amount for an indeterminate time to an indeterminate class” (*Ultramares Corp. v Touche Niven & Co* (1931) 255 NY 170, per Cardozo J) has shut the floodgates and wedged them into place, where they have remained for the past 15 years. If the law of England applied to Malaysia, this discussion would end there, and study of the law of pure economic loss could be effectively confined to a reading of the *Murphy* case. However, the English approach has not found universal favour in the rest of the Commonwealth nations, including Malaysia. The next and concluding part of this article will consider the recovery of pure economic loss in other common-law jurisdictions, with particular attention to the Malaysian position.

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# HOUSE OF LORDS SETS CRITERIA FOR FIXED CHARGES OVER BOOK DEBTS

## National Westminster Bank plc v. Spectrum Plus Limited and Ors [2005] UKHL 41

### BACKGROUND

Spectrum (Borrower) created a debenture to secure its indebtedness to National Westminster Bank plc (Bank) in respect of an overdraft facility.

The debenture included a specific charge of all book debts and other debts now and from time to time owing to the Borrower.

Under the terms of the debenture, the Borrower was prohibited from disposing of or charging the uncollected book debts but was permitted to deal with the debtors and collect the debts. Payments received from debtors were paid into a designated current account with the Bank. The Borrower was permitted to draw freely on this account for its business purposes provided that the overdraft limit was not exceeded.

The High Court had in **Siebe Gorman & Co Ltd v Barclay's Bank Ltd** [1979] 2 Lloyd's Rep 142, the leading case to date, held that the charge over book debts created under a debenture containing substantially the same terms as that in the present case was a fixed charge.

### ISSUE

The question that arose for decision by the House of Lords was whether the charge created over book debts upon the terms set out above is in law a fixed charge or a floating charge.

### DECISION

The House of Lords after an extensive review of the leading cases on charges of book debts and the underlying principles of fixed and floating charges laid down the following principles:-

- 1) it is permissible to create a fixed charge over book debts (decision of the House of Lords in **Tailby v Official Receiver** (1888) 13 App Cas 523 affirmed);
- 2) the essential characteristic that distinguishes a floating charge from a fixed charge is that the asset subject to charge is not finally appropriated as security until the occurrence of some future event that crystallises the charge. In the meantime the chargor is free to deal with the charged asset and to remove it from the security (decision of the Privy Council in **Agnew v Commissioners of Inland Revenue (Brumark Investments Ltd)** [2001] 2 AC 710 applied);
- 3) a charge should in principle be categorised as a floating charge if the chargor remained free to remove an asset from the scope of the security;
- 4) it is not possible to create a charge which remains fixed when the book debt remains uncollected but becomes a floating charge once collected (decision of Court of Appeal in **Re New Bullas Trading Ltd** (1994) BCC 36 overruled).

Lord Scott observed that the minimal restrictions imposed on the Borrower's right to deal with its uncollected book debts went very little way to support the contention that the charge is a fixed one. According to his Lordship, what is important are the restrictions imposed on the Borrower's right to use the payments received in respect of such debts.

Although the debenture required the Borrower to deposit all payments of book debts into a current account with the Bank, the Borrower was thereupon entitled to withdraw a corresponding amount for its normal business purposes irrespective whether the account was in credit or in debit. Further, the account could be drawn on by the Borrower at will without any requirement for the Bank's consent.

In the circumstances, his Lordship concluded that the debenture, although expressed to grant a fixed charge, in law created only a floating charge over the Borrower's book debts. He further added that the label placed on the charge by the parties could not alter the true character of the security created.

In arriving at this conclusion, the Court expressly overruled **Siebe Gorman & Co Ltd v Barclay's Bank Ltd** as having been wrongly decided.

### SIGNIFICANCE

The House of Lords decision in the Spectrum Plus Case is significant in several respects.

First, when a chargee requires a fixed charge to be created over book debts, appropriate mechanisms, such as establishing a blocked account, must be put into place both in the security document and in practice to control or restrict the chargor's right to use the proceeds. Merely describing the charge as a fixed charge is insufficient as the Court may look beyond that description to determine whether the charge is in substance a fixed charge or a floating charge.

Secondly, the efficacy of a floating charge is limited by specific provisions of the Companies Act, 1965 in the event of the insolvency of the chargor. Under sec. 292(4), where the assets of a company available for payment of general creditors, the preferential debts specified in sections 292(1)(b), (d) and (e) and any amounts advanced under sec. 292(3) (all of which pertain primarily to remuneration and statutory contributions for employees) shall have priority over claims of debenture holders under any floating charge created by the company and shall be paid out of property which is subject to such floating charge.

Further sec. 294 provides that any floating charge created by a company within six months of the commencement of its winding-up shall be invalid except to the extent of any cash paid to the company at the time of or subsequent to the creation of and in consideration of the charge together with interest at 5% per annum unless it is proved that the company was solvent at the time of the creation of the charge,

Although the Spectrum Plus Case is not binding on the Malaysian Courts, the principles laid down by the House of Lords will undoubtedly provide invaluable guidance to local judges in cases where similar legal issues have to be determined.

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