EC-Asia International Ltd (in liquidation) *v* PricewaterhouseCoopers [2010] SGHC 372

Case Number	: Originating Summons No 1032 of 2009/N (Registrar's Appeal No 433 of 2009)
Decision Date	: 29 December 2010
Tribunal/Court	: High Court
Coram	: Kan Ting Chiu J
Counsel Name(s)	: Anthony Lee and Gan Kam Yuin (Bih Li & Lee) for the appellant; Aurill Kam and Douglas Chi (Rajah & Tann LLP) for the respondent.
Parties	: EC-Asia International Ltd (in liquidation) — PricewaterhouseCoopers

Civil Procedure – Discovery of documents – Pre-action discovery – ex turpi causa

29 December 2010

Kan Ting Chiu J:

Introduction

1 The plaintiff, EC-Asia International Ltd ("the company"), made an application for pre-action discovery under Order 24 Rule 6 of the Rules of Court (Cap 322, R 5, 2006 Rev Ed) from the defendant, PricewaterhouseCoopers. The application was dismissed by an Assistant Registrar ("AR"). The company appealed against the dismissal, and I allowed the appeal and granted the application. The defendant now appeals against my decision.

2 The plaintiff was a company registered under the Companies Act (Cap 50, 2006 Rev Ed) in 1993. Ang Ah Peng (also known as Kelvin Ang) ("Kelvin Ang") was the founder and managing director of the plaintiff. The defendant was the statutory auditor of the company from the Financial Year ended 30 June 2000 to the Financial Year ended 30 June 2005.

3 In the initial years the company appeared to be doing well. In 2004, it was listed on the Australian Stock Exchange ("the ASX") but its fortunes changed. Subsequently it went into voluntary liquidation and was delisted from the ASX. On 18 May 2007, Neo Ban Chuan ("the Liquidator") was appointed with two others as liquidators, but his co-liquidators subsequently left, and he continued as the sole liquidator. He issued his report (the "Liquidator's Report") on 29 July 2008 which set out the facts leading up to the collapse of the company.

The declared activities of the company

4 The stated business of the company was the recycling of memory chips that do not meet the data specification of major memory chip manufacturers ("rejected chips"). These chips were recycled by the company, re-branded with its brand names, and sold to other companies to be used in their products.

5 The company ostensibly carried on its business by:

(a) purchasing rejected chips from chip manufacturers upon immediate payment of the purchase

price;

(b) paying for the purchases by drawing on trade financing facilities granted to it by banks;

(c) recycling, rebranding and selling the recycled chips to third party purchasers on credit terms; and

(d) factoring the accounts receivable from its purchasers and using the monies obtained from the factoring to repay the banks and fund operations.

The investigations

6 In 2006/2007, the company experienced financial difficulties and one creditor bank issued a letter of demand. On 6 March 2007, the board of directors of the company appointed KPMG Business Advisory Pte Ltd ("KPMG") to undertake an independent financial review of the company with a view to making proposals to the company's creditors to restructure the company's debts.

7 KMPG conducted a stock check of the company's inventories in Singapore and Hong Kong and discovered that the company purchased a substantial proportion of its rejected chips from three Hong Kong companies, namely Landwide Tech Ltd ("Landwide"), Tec-Hill Semiconductor Ltd ("Tec-Hill") and Max Luck International Trading Ltd.

8 KPMG further discovered that a substantial portion of the company's sales of reprocessed and recycled chips was made to Landwide, Tec-Hill and another company, Chi Tat Enterprise Company ("Chi Tat"). KPMG concluded that the sales and purchases of the company's stocks were not genuine transactions and that much of the company's operations consisted actually of passing the same stocks between Singapore and Hong Kong with the associated paper trail but without any actual re-processing.

9 When KPMG presented its findings to the company's creditors on 13 April 2007, Kelvin Ang admitted that the company's accounts receivables of which over 90% were attributed to Landwide, Tec-Hill and Chi Tat were not in fact collectable and that the stocks reflected in its books had little or no value. He further admitted that he had for seven years been falsifying invoices to create the appearance of genuine sales and purchases in order to deceive the company's creditors and obtain credit facilities from them. Kelvin Ang was eventually charged and convicted for his fraudulent activities in respect of these sham transactions: see *Public Prosecutor v Ang Ah Peng* [2009] SGDC 94.

10 There were also other matters of interest relating to the affairs of the company:

(i) ***Conflict of Interests of Lo Tak Fu***

Lo Tak Fu ("Lo") was a director of the company and also the majority shareholder of Landwide. The Liquidator stated in the Liquidator's Report that it was reasonable to assume that the defendant knew or ought to have known of Lo's majority interest in Landwide and that knowledge would indicate an increased audit risk which warranted more intensive audit procedures in relation to obtaining audit evidence for the company's dealings with Landwide.

(ii) ***The Poison Pen Letter***

In 2003, the company had applied to be listed on the Singapore Stock Exchange ("SGX"). On the last day of the period offer for its listing on the SGX, the Monetary Authority of Singapore ("MAS") issued an interim stop order after the SGX and MAS received a letter on 22 May 2003 ("the Poison Pen Letter") from a "former staff" of the company which alleged that:

(a) two named former employees who had both been convicted of dealing in stolen goods, were the real directing minds of the company;

(b) the company had violated intellectual property rights by purchasing unbranded blank chips and selling them under branded names like "Samsung", "Hynix" or "Infineon"; and

(c) the company was inflating in the accounts of profits from a customer in Hong Kong declaring higher buying price.

The directors of the company had instructed a law corporation to conduct an investigation. The investigation which was confined to the first allegation but not the second and third allegations concluded that neither of the two named persons was in control of the company. No independent investigation was conducted into the second and third allegations. The independent directors stated in the prospectus for the subsequent listing on the ASX that, at the time of the failed attempt of listing on SGX, they had made their own enquiries into each of the allegations contained in the Poison Pen Letter and had found that there were no basis for the allegations.

11 The Liquidator was of the view that if the second and third allegations in the Poison Pen Letter were true, the company would have engaged in fraudulent practices in deceiving its customers and the users of the chips and that the defendant, which was on the distribution list of the Poison Pen Letter should be cautious that fraud could be involved, and plan its audit procedures accordingly.

12 The Liquidator further stated the defendant may be liable for conducting its audit of the company negligently, thereby allowing the perpetration of the fraud by Kelvin Ang, and he intended to continue investigating the defendant's conduct of the audit during the period of their engagement.

Correspondence leading to the pre-action discovery application

13 On 1 February 2008, the company, through their solicitors at that time, Shook Lin & Bok LLP ("SL&B"), wrote two letters to the defendant, an open letter and a "Without Prejudice" letter. Only the open letter was produced during the application, and it read:

We act for the Liquidator of the Company, ...

We understand that you were the statutory auditors for the Company for Financial Years ended 30 June 2001 to 30 June 2005.

As you may be aware, on 10 May 2007, the Liquidator of the Company commenced an action in the High Court against the former Managing Director of the Company, Mr Kelvin Ang Ah Peng ("Kelvin Ang") for, *inter alia*, breach of fiduciary and statutory duty on the basis of Mr Kelvin Ang's fraudulent conduct which resulted in losses to the Company.

On 21 June 2007, the Company obtained interlocutory judgment against Mr Kelvin Ang with damages to be assessed. Final judgment was entered against Mr Kelvin Ang on 19 December 2007

for the sum of US$25,981,338 on the basis of admissions made in his letter to the Liquidator dated 10 December 2007 wherein Mr Kelvin Ang admitted, *inter alia*, that his fraudulent conduct had caused loss and damage to the Company.

Our client's investigations into the affairs of the Company have shown that *the Company has a potential claim against you* in respect of, inter alia, your failure to exercise reasonable skill, care and diligence as statutory auditors which resulted in the fraudulent conduct of Mr Kelvin Ang going undetected.

For the avoidance of doubt, all our client's rights and the rights of the Company are expressly reserved.

[emphasis added]

The "Without Prejudice" letter was not produced at the hearing of the application, but was produced during the appeal hearing before me and I will refer to it later on.

14 On 21 August 2008, SL&B wrote to the defendant to request for:

(a) all letters and other documents setting out the terms of engagement governing the defendant's engagement as the statutory auditors of the company;

(b) the company's documents, notes, memoranda, correspondence and/or copies thereof which were supplied to the defendant in the course of their engagement for the purposes of preparing the accounts of the company;

(c) the audit and other working papers produced and/or generated by the defendant in the course of and/or as a result of their engagement as statutory auditors to the company; and

(d) other documents in the possession, custody or power of the defendant concerning the trade dealings and affairs or property of the company.

In response to the request, the defendant furnished the requested documents with the exception of the audit papers and working papers.

15 No further action was taken for a while, till 28 May 2009 when the company's new solicitors, Bih Li & Lee wrote to the solicitors for the defendant, Rajah & Tann LLP ("R&T") and renewed its request for the audit papers and working papers. This request was again rejected. In its reply dated 2 July 2009 R&T stated, *inter alia*:

6. We wish to draw the Liquidator's attention to the English Court of Appeal case of *Moore Stephens (a firm) v Stone & Rolls Limited (in liquidation)* [2008] EWCA Civ 644, where on very similar facts, the court had held that the company in question was precluded from suing its auditors in negligence for failing to detect the on-going fraud of its managing director.

7. Our clients are of the view that on the basis of the facts in the present case, the contemplated claim against our clients is not a viable one, and that pre-action discovery would neither save time nor costs for the Liquidator. We are instructed to request that the Liquidator reconsider the necessity of its request.

The decision referred to in the letter was the decision of the English Court of Appeal which is reported

as *Stone & Rolls Ltd (in liquidation) v Moore Stephens (a firm) and another* [2008] 3 WLR 1146. The decision had been affirmed in a majority decision in the House of Lords in *Stone & Rolls Limited (in liquidation) v Moore Stephens* [2009] 3 WLR 455. (Both decisions will be referred to as "*Stone & Rolls*".)

16 The plaintiff applied on 8 September 2009 for an order under O 24 r 6 of the Rules of Court for the pre-action discovery of the audit papers and working papers. In support of the application, the Liquidator filed an affidavit in which he explained that pre-trial discovery of the defendant's working papers was required because:

> 12. After reviewing the documents which the Defendants provided in December 2008 and after further consideration, I am of the view that *the Defendants' audit procedures need to be scrutinized carefully* and, although *I have not come to a firm conclusion* on this, that the Defendants are *likely to be a party to future proceedings* ...
>
> 13. From the [Liquidator's] Report, it can be seen that the Company's inventories and accounts receivable were two (2) main areas in which fraud was perpetrated. As auditors, audit programmes on stocks (also referred to as inventories) and accounts receivable need to achieve six (6) objectives, namely, completeness, existence, accuracy, valuation, ownership and presentation. In particular, *if fraud is assessed to be a risk factor*, additional audit procedures are usually conducted. ... One of the areas that will have to be considered is *whether the usual requisite audit procedures were complied with, whether additional audit procedures* arising from fraud risk assessment were or should *have been complied with*, and *how the fraud remained undetected*. The working papers and audit papers will be needed for such a review to be fair and comprehensive.
>
> [emphasis added]

17 The defendant raised three objections to the application [note: 1] :

> (a) the plaintiff had already formed a view that it has a viable claim against the defendant and did not need the audit papers and working papers ("the Necessity issue");
>
> (b) the plaintiff's potential claim was not viable in law ("the *ex turpi causa* issue"); and
>
> (c) the request for audit papers and working papers for the financial year ended June 2000 to the financial year ended June 2003 was ill-founded as any claim founded on the papers would be time-barred ("the Time Limitation issue").

18 The Necessity issue arose from O 24 r 7 that:

> On the hearing of an application for an order under Rule 1, 5 or 6, the Court may, if satisfied that discovery is not necessary, or not necessary at that stage of the cause or matter, dismiss or, as the case may be, adjourn the application and shall in any case refuse to make such an order if and so far as it is of opinion that discovery is not necessary either for disposing fairly of the cause or matter or for saving costs.

The defendant made three points: firstly, that the plaintiff by its own conduct had already taken a view that it had a viable claim; secondly, that the plaintiff was able to initiate a case without the desired information, and thirdly, that the plaintiff had not shown that the audit papers and working papers were necessary. [note: 2]

19 On *ex turpi causa* the defendant referred to the law as set out and applied by the Court of Appeal and the House of Lords in *Stone & Rolls* and argued that the defence was also available to the defendant on the facts of the present case.

20 On the Time Limitation issue, the defendant submitted that even taking the date of the filing of the application, 8 September 2009 as the point of reference, the statutory accounts and financial statements for the periods preceding 30 June 2003 (which counsel referred to as the "Pre 2004 Audits") any action for negligent audit in respect of the Pre 2004 Audits would be outside the six-year limitation period prescribed by s 6 of the Limitation Act (Cap 163, 1996 Rev Ed).

The AR's decision

21 The AR only dealt with the Necessity issue. In his brief grounds of decision he referred to the main decisions from our courts on pre-action discovery, namely *Bayerische Hypo-und Vereinsbank AG v Asia Pacific Breweries (Singapore) Pte Ltd* [2004] 4 SLR(R) 39 and *Kuah Koh Kim v Ernst & Young* [1996] 3 SLR(R) 485, and noted that they affirmed that discovery would not be ordered if an applicant already knew that he had a viable claim and was able to plead his case.

22 Applying the law to the facts, the AR found that the Open Letter "*taken in isolation*, would probably be insufficient for the court to conclude that the plaintiffs thought that it had a viable claim" because a potential claim was quite different from a good or viable claim. However, he found that there were "several other factors which tipped the balance." He identified three factors:

(i) that the Open Letter did not request for documents, and had alluded to investigations being carried out;

(ii) that a "Without Prejudice" letter was issued simultaneously with the Open Letter. While the contents of the "Without Prejudice" letter were not revealed to him, he presumed from the fact of "Without Prejudice" communications that:

> ... parties did enter into negotiations in an attempt to settle the matter. This carries with it an inference (albeit not a very strong one) that the plaintiff knew it has a viable cause of action against the defendant.

and

(iii) that neither did the plaintiff state on affidavit nor did counsel submit that the plaintiff was not able to plead its case without disclosure of the information sought.

Review of the decision

23 The AR was correct that when SL&B stated in the Open Letter that the plaintiff had a potential claim against the defendant, that was not a statement of the plaintiff's conclusion that it already had a viable claim against the defendant.

24 Against this background, careful consideration must be given to the factors which were found to tip the balance against the plaintiff. I found that:

(i) on the first factor, the AR had drawn wrong inferences that the plaintiff did not request for documents in the Open Letter because it already concluded that it had a viable claim against the defendant. That was inconsistent with the express use of the words "potential claim". I have

often seen counsel's unjustified confidence in his or her cases, but seldom the converse. If the writer had felt that there was a claim against the defendant, there was no reason for him not to state that in plain terms without qualification.

(ii) on the second factor, it was unsafe for the AR to draw any inferences without knowledge of the contents of the contemporaneous "Without Prejudice" letter. Privilege over the "Without Prejudice" letter and the correspondence that followed was waived during the hearing of the appeal before me and the letters were produced during the appeal. The "Without Prejudice" letter read:

> We refer to the above matter and our open letter of the same date.
>
> Notwithstanding the contents of our open letter, our client now invites you to make a proposal for an amicable resolution of this matter.
>
> Please let us have your response and/or proposal within seven (7) days of the date hereof.
>
> All our client's rights are expressly reserved.

It was evident by the letter that SL&B was hoping to secure an amicable settlement of the "potential claim", and the writer had not asserted that it had determined that the plaintiff had a claim against the defendant or indicated the basis of the claim. With the unveiling of the "Without Prejudice" letter, the AR's inference that "the plaintiff knew that it has a viable cause of action against the defendant" was unfounded; and

(iii) on the third factor, the AR's treatment of the fact that the plaintiff or counsel did not state that the plaintiff was not able to plead its case without the documents sought as a tipping factor was difficult to understand. The Liquidator had deposed in the affidavit in support of the application that "the Defendants' audit procedures need to be scrutinized carefully" and, "although I have not come to a firm conclusion on this, the Defendants are likely to be a party to future proceedings". On a fair and careful reading of the Liquidator's affidavit, it was clear that the plaintiff was not ready or able to plead a cause of action without reviewing the requested papers.

25 On the conclusion of the review of the grounds of decision, I found that the AR had drawn wrong inferences in arriving at the three tipping factors. I also found little substance in the points the defendant raised. The Liquidator had explained in his affidavit that he needed the audit papers and working papers to come to an informed decision whether the plaintiff had a viable cause of action. Unless he was dishonest or wrong in his affidavit, his professional conclusion should be accorded due weight, and there was nothing to suggest that he was being disingenuous or was mistaken. It was evident that before he decided to sue he would need to know whether the defendant was aware of the Poison Pen Letter, whether the defendant was aware of Lo's conflict of interests, whether the defendant had issued proper instructions to address the risks of fraud, and whether the defendant's staff had complied with instructions when they carried out the audits.

26 The AR did not address the *ex turpi causa* issue and the time limitation issue. He probably thought that it was not necessary for them to be dealt with as the application had failed on the necessity requirement. As I disagreed with his finding on that issue, I will address the two other issues.

Ex turpi causa

27 The defendant relied on the *Stone & Rolls* decisions of the Court of Appeal and the House of Lords and argued that the courts had, "on very similar facts ... held that the company in question was precluded from suing its auditors in negligence for failing to detect the on-going fraud of its managing director".

28 It is useful to set out the material facts in *Stone & Rolls*. The plaintiff in that case was the liquidators of a company, Stone & Rolls Ltd ("S&R"), and the defendants were the company's auditors. A pivotal figure, one Stojevic, stood out in the decisions. In the lead judgment of Rimer LJ in the Court of Appeal, Stojevic was found to be the "sole directing mind and will" of the company, and that he "owned, controlled and managed the company", that "the company was his company and that it was for practical purposes, a one man company", and that he was the company's "controlling mind and will". In the judgments of the House of Lords, Stojevic was described as "the persona of S&R", "its directing mind and will", "the very ego and centre of the personality of the corporation" and "the embodiment of S&R for all purposes", and S&R was described as "even on the most exacting definition of the term, a one-man company". Through Stojevic's manipulation, S&R defrauded banks by deceiving them into believing that they were financing S&R in commercial transactions. When the fraud came to light, a bank sued and obtained judgment against S&R and Stojevic. S&R was unable to pay the judgment and was put into liquidation, and the liquidators of the company sued the company's auditors for negligence for failing to detect the fraud when they audited the company's accounts, and the auditors applied to strike out the claim.

29 The Court of Appeal and the House of Lords applied the *ex turpi causa* principle and struck out the claim. The principle was explained by Lord Mansfield CJ in *Holman v Johnson* (1775) 1 Cowp 341 at 343 that:

> No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise ex turpi causa, or the transgression of a positive law of this country, there the court says he has no right to be assisted. It is upon that ground the court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff.

The courts held that since Stojevic was the beneficial owner and the directing mind and will of S&R, the company was to be imputed with awareness of the fraud perpetrated against the bank, the auditors could invoke the *ex turpi causa* defence to the company's claim.

30 The relationship between Kelvin Ang and the plaintiff company was materially different from the relationship between Stojevic and S&R. Kelvin Ang did not control the company as Stojevic controlled S&R. The company was a public company limited by shares registered in Singapore under the Companies Act and was also listed on the ASX. As Kelvin Ang held 37% of the company's shares through his personal shareholding and deemed interest (and therefore other parties held the remaining 63% of the shares of the company), he did not own the company. While he was the managing director and sole executive director of the company and was involved in the administration and day-to-day operations of the company, he had to report to the board of directors of the company, he was not the embodiment of the company.

31 Although the company had alleged that Kelvin Ang was its controlling mind and will, [note: 3] the company was manifestly not a one-man company that S&R was. Stojevic's absolute control and domination over S&R was vital to finding by the Court of Appeal and the House of Lords that the defence of *ex turpi causa* was available to S&R's auditors, but in the present case the plaintiff could not be identified with Kelvin Ang in the manner that S&R was identified with Stojevic. The facts did not support the contention that the company could not claim against the defendant.

Time Limitation

32 The defendant's basis for applying the six-year limitation period to the plaintiff's right of discovery was unduly narrow. The plaintiff was seeking pre-action discovery to ascertain if it had a viable claim in negligence against the defendant. The defendant's conduct throughout the period of its engagement as the company's auditor was relevant to show whether it was negligent. If the Pre 2004 Audits audit papers and working papers revealed that the defendant was aware of risks of fraud by the company, or that instructions which had been issued by the defendant to its staff in connection with the audits were not followed, the information would be relevant to the determination of the defendant's conduct within the limitation period. A six year cut-off period could not be applied to the plaintiff's application on the basis put forward by the defendant.

Conclusion

33 I found that the application was made in good faith by the Liquidator after he had explained the information that he had, and had identified the papers that he had to examine to make a reasoned decision whether there was a case of negligence against the defendant. Implicit in the application was his awareness that if he obtained the additional information and found that they did not help to establish a case, the plaintiff would not sue the defendant, unless other evidence was available.

34 In these circumstances, the application was necessary for disposing fairly of the matter and it could save not only costs, but time and anxiety for both the plaintiff and the defendant. I therefore allowed the appeal and granted the plaintiff's application.

[note: 1] Defendant's Brief Points of Argument, para 1

[note: 2] Defendant's Brief Points of Argument, paras 3 & 4

[note: 3] Suit No 297 of 2007, Statement of Claim, para 4