FAMILY-OWNED FIRMS IN SINGAPORE

Legal Strategies for Constraining Self-dealing in Concentrated Ownership Structures

Ownership in Singapore's family-owned companies is highly concentrated, giving rise to the agency problem of expropriation of minority shareholders by the controlling shareholders. The problem can be significant as self-dealing transactions in these family-owned companies reached approximately S$1.8bn in 2009/2010. This article analyses specific local cases of expropriation of minority shareholders to expose the doctrinal problem arising therein and also undertakes an evaluation of the governance strategies used by the Singapore Exchange's Listing Rules to police self-dealing transactions. An economic analysis of the relevant legal rules in terms of "property rules" and "liability rules" highlights the problem areas which are in need of reform.

TAN Lay Hong*
LLB (National University of Singapore), LLM (University of London, King's College), Ph D candidate (National University of Singapore); Associate Professor, Nanyang Business School, Singapore.

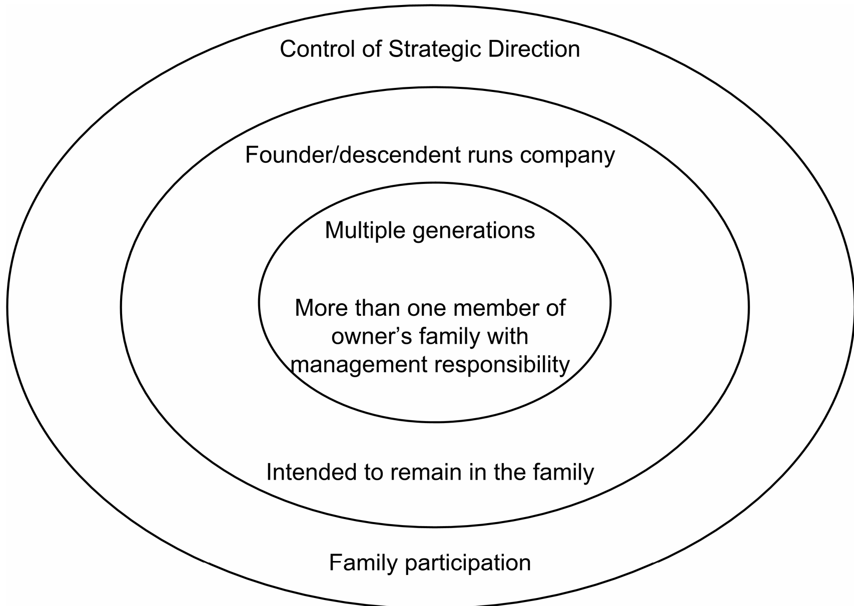
I. Family-owned businesses in Singapore

1 Generally speaking, firms in Singapore are of two main types: either they are owned by the State, *ie*, government-linked companies, or they are owned by families or groups of families in partnership with varying amounts of involvement by private equity, hedge funds and venture capitalists. Amongst the 100 largest firms, 69 are family-owned firms. Assuming that the control block is held by a family or groups of families, the mean percentage of shares held by a control block and a blockholder (*ie*, a family member) are 69.52% and 16.22% respectively. The median for a control block and a blockholder is 51.14% and 6.18% respectively.

2 There is no singular definition of a family business, although experts in the field have used many different criteria to distinguish such

* The author would like to thank Professor Tan Cheng Han, Dean, Faculty of Law, National University of Singapore, for his comments on an earlier draft of this article. All errors remain the author's alone.

businesses, such as percentage of ownership, strategic control, involvement of many generations and the intention for the business to remain within the family. Astrachan and Shanker have created a pictorial representation of the family business as follows:



Source: Handbook of Research on Family Business[1]

3 A family business thus could be any of these definitions. At the broadest, the outer-circle of the "bull's eye", a family business exists where there is some family participation in the business in terms of setting strategic direction. At the middle layer, the business owner intends the business to remain in the family and the founder or his descendant plays a key role in running the business. At the centre ring, which is the narrowest definition, multi-generations are running the business with the parent/founder as chairman, two or three siblings at top management, one sibling with ownership but no day-to-day responsibility and younger cousins at entry-level positions.[2]

4 Essentially, family businesses can be categorised into different classes depending on the extent of direct involvement in the business by family members. In order not to adopt too inclusive a definition or be

1 Joseph H Astrachan & Melissa Carey Shanker, "Family Businesses' Contribution to the US Economy: A Closer Look" in *Handbook of Research on Family Business* (Panikkos Zata Poutziouris, *et al* eds) (Edward Elgar Publishing Ltd, 2006).

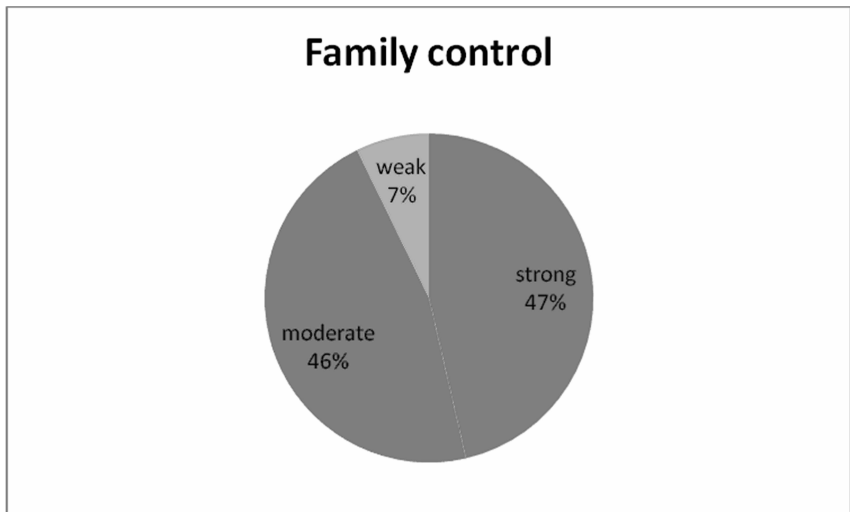
2 Joseph H Astrachan & Melissa Carey Shanker, "Family Businesses' Contribution to the US Economy: A Closer Look" in *Handbook of Research on Family Business* (Panikkos Zata Poutziouris, *et al* eds) (Edward Elgar Publishing Ltd, 2006) at pp 56 and 57.

unnecessarily exclusive, it is proposed to classify family businesses into three categories as follows:[3]

Types of Family Control	Criteria
Strong family control	(a) Family owns majority stake and holds key executive positions such as CEO or CFO (b) Family owns majority stake and holds executive positions
Moderate family control	(a) Family owns majority stake and holds non-executive positions or no board seats (b) Family owns a minority stake of between 30% and 50% and holds board seats (c) Family owns a minority stake of between 10% to 29% but holds key executive positions such as CEO or CFO
Weak family control	(a) Family owns a minority stake of between 10% and 29% and holds non-executive positions (b) Family owns a minority stake of between 10% and 29% with no board seats

5 Out of 74 non-government linked companies, 69 are family-owned. The sample of 69 companies is categorised according to the criteria set out in the above table. The data is obtained from the annual reports of these companies in the year 2007/8. It is found that out of 69 family-owned firms, 32 are under strong family control, 32 under moderate family control and five under weak family control. Hence, 93% of family-owned firms in Singapore are under moderate to strong family control. The concentration of shares in these firms is high at an average of 69.52%!

3 Adapted from Henry Wai-chung Yeung's classification in *Chinese Capitalism in a Global Era: Towards Hybrid Capitalism* (Routledge, 2004) at pp 195–196. Family members are identified through a common surname as well as from affiliations with substantial shareholders, who are often the founders or their descendents holding stakes in the company.



II. Characteristics of Singapore's family-owned businesses

A. *Family monopoly on strategy-making*

6 A stark feature that emerged in studying Chinese business firms is the Chinese entrepreneur's urge to control. Sociologically, this urge to control could have arisen from mistrust, a sense of threat arising from the political turmoil of the last century in China, and the Chinese tradition of perpetuating the family name. A few anecdotes gathered from Redding's interviews with Hong Kong entrepreneurs would serve to highlight the almost instinctive culture of retaining control within the Chinese business firm:[4]

> **Hu**: 'I think the Chinese are rather obsessed with power, personal power, and the Chinese managers and owners are very afraid to let go and lose control.'
>
> **Hoi**: 'I think it has something to do with the family tradition. In the Western world, family is not a coherent factor, so companies are not handed down; for various reasons, conglomerates take place easier. But then particularly for the southern Chinese, the independent spirit of owning a company is somehow very strong. Conglomerates will not take place in Hong Kong because somebody will have to give up control.'
>
> **Hsia**: 'I have this idea of building a large corporation and to hand it over to my child. I just cannot accept the idea of having a professional man to take care of the company which I have started. I don't know why. I may even think of getting a son just for this purpose.'

4 S Gordon Redding, *The Spirit of Chinese Capitalism* (Walter de Gruyter, 1990) at pp 44–46.

7 Whilst the late Kwek Hong Png was still alive, control of the Hong Leong empire rested within a small group of family members who handled business associates and clients. Professional managers were employed for middle level management posts but family members were put in charge of the subsidiaries. Decision-making, particularly on financial matters, remained centralised.[5] As one of the sons put it:[6]

> My father just says 'go there' and we go. He will decide who to transfer, who to go where. He is the head of the family. Though I am given charge of an outlet, I still refer to my father and uncle for direction and instructions. My father and uncle visit each of the branches once or twice every week. At the end of the month, the family meets to report on sales and other matters.

8 Even after the company became a listed entity, one company director noted:[7]

> The board of directors made decisions only in name. My father (owner and chairman) made most of the decisions: he only consulted the directors on technical matters …. It is slightly dictatorial; and even if he asks you, you may say something, but he will still go ahead with what he wants anyway.

9 Kwek Hong Png's successor, Kwek Leng Beng, was inducted into the family business for more than 30 years, and it was only when his father died that Leng Beng had the chance to prove his worth as a world-class deal-maker in acquiring hotels at bargain prices. As *Fortune* magazine described it: "Leng Beng was kept on a tight leash. It's gone now."[8] Even today, the Hong Leong group is controlled by senior family members working from a central management committee.[9]

III. Tunnelling

10 As outlined above, 93% of family-owned businesses in Singapore are under moderate to strong family control. The landscape of the Chinese family-owned businesses is littered with subsidiaries and

---

5 Tong Chee Kiong, "Centripetal Authority, Differentiated Networks: The Social Organization of Chinese Firms in Singapore" in *Asian Business Networks* (Gary G Hamilton ed) (Walter de Gruyter, 1996) at p 144.

6 Tong Chee Kiong, "Centripetal Authority, Differentiated Networks: The Social Organization of Chinese Firms in Singapore" in *Asian Business Networks* (Gary G Hamilton ed) (Walter de Gruyter, 1996) at p 144.

7 Tong Chee Kiong, "Centripetal Authority, Differentiated Networks: The Social Organization of Chinese Firms in Singapore" in *Asian Business Networks* (Gary G Hamilton ed) (Walter de Gruyter, 1996) at p 144 at p 145.

8 Fock Siew Tong, *Dynamics of Family Business: The Chinese Way* (Cengage Learning, 2009) at p 135.

9 Fock Siew Tong, *Dynamics of Family Business: The Chinese Way* (Cengage Learning, 2009) at p 145.

related companies spanning the length and breadth of South-east Asia but controlled tightly by core family members. It is inevitable that the family patriarch treats all his companies and subsidiaries as one big family corporation, and overwhelming control is exerted by the patriarch or core family members. Related-party transactions including self-dealing transactions are commonplace in these family corporate structures. A survey of interested-person transactions reported by the 69 family-owned companies in their 2010 and/or 2009 annual reports revealed that such transactions which were carried out without shareholders' mandate amounted to S$960,374,117[10] and those carried out with shareholders' mandate amounted to S$957,106,457.[11] Though these figures amounted to a small percentage of the total revenue of $305bn, in absolute terms they can be considered to be significant as they approached the $1bn mark.

11 As these companies are listed on the local stock exchange, the emerging problem is the expropriation of the interests of minority shareholders by the controlling shareholders. The expropriation of the interests of minority shareholders in emerging countries has been termed "tunnelling" by La Porta *et al* to denote expropriation of such interests in the Czech Republic where assets were removed through underground tunnels. Specifically, "tunnelling" refers to the transfer of resources out of a company to its controlling shareholder, who is often also a top manager. Such transfers may take the form of outright theft or fraud, which is illegal, or more insidious forms as in asset sales or transfer pricing on advantageous terms to the controlling shareholder, excessive executive remuneration, loan guarantees and the usurpation of corporate opportunities. In addition, controlling shareholders may expropriate value by insider trading, diluting minority positions through dilutive share issuance and minority freeze-outs.[12]

IV. The economics of self-dealing

12 Bernard Black has ably explained the pernicious effects of self-dealing on stock markets. The potential for self-dealing creates a "market for lemons" or an adverse selection problem.[13] Investors do not know which insiders are honest and will not expropriate assets or interests of minority shareholders, and which are dishonest, and so they

---

10 Singapore Exchange Listing Rules r 905 where the value of the transaction(s) amounted to 3% or more of the latest audited net tangible asset of the company.

11 Singapore Exchange Listing Rules r 906 where the value of the transaction(s) amounted to 5% or more of the latest audited net tangible asset of the company.

12 Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, "Tunneling" (2000) 90(2) *The American Economic Review* 22 at 22–23.

13 Bernard Black, "The Core Institutions that Support Strong Securities Markets" (2000) 55 *Business Lawyer* 1565.

will discount the price they will offer for the shares of a company. This creates a dilemma for honest insiders who would not divert assets to themselves. Discounted prices will discourage honest insiders from seeking financing from the capital markets. However, discounted prices will not deter dishonest insiders from entering the market because the prospect of receiving a discounted price even for discounted or worthless paper is attractive to dishonest insiders.[14]

13 This adverse selection by issuers in which high-quality issuers leave the market because they cannot obtain a fair price for their shares, while low-quality issuers remain, lowers the average quality of issuers. Investors rationally react by discounting even further the prices they would offer, thus leading to a "death spiral" where high-quality issuers are kept out while low-quality issuers thrive, and this can drive share prices to zero, save for a few large issuers who can rely on their substantial reputation to prop up their share prices.[15]

14 Self-dealing also creates a moral hazard problem because once a company has floated its shares, insiders have an incentive to renege in order to capture more of the company's value for themselves than investors expected. This incentive is only partially held in check by the issuer's desire for future offering of shares for additional finance. A hypothetical example will illustrate the problem of why insiders feel entitled to appropriate value to themselves. Suppose a company has a value of $100 and 50 outstanding shares, all held by insiders. These shares are worth $2 each. But outside investors may only be willing to pay a discounted price of $0.50 per share, so that if the company issues an additional 50 shares, the total value of all the shares is only $125. If the insiders behave honestly and keep 50% of the company as they are entitled, their shares are worth $62.50 while the outside investors' shares will be worth $62.50 – two and half times what they had paid for them ($25). The insider's rational response is then to appropriate at least 80% of the firm's value, ie, $100 out of $125.[16]

15 On the other hand, self-dealing transactions may be beneficial as, often times, the company may only be able to deal with directors and controlling shareholders because outsiders cannot evaluate their prospects or companies may not want to reveal trade secrets and confidential information to outsiders when they deal with them. Self-dealing transactions with insiders may also be transacted at lower costs

14 Bernard Black, "The Core Institutions that Support Strong Securities Markets" (2000) 55 *Business Lawyer* 1565 at 1584.

15 Bernard Black, "The Core Institutions that Support Strong Securities Markets" (2000) 55 *Business Lawyer* 1565 at 1585.

16 Bernard Black, "The Core Institutions that Support Strong Securities Markets" (2000) 55 *Business Lawyer* 1565 at 1585.

because insiders know about the risks involved and have proprietary knowledge about the company. In any case, prohibiting certain self-dealing transactions such as executive remuneration contracts and executives dealing in company's shares is simply out of the question because nobody would work for free, and managers cannot be prohibited from investing in the companies they manage just as controlling shareholders cannot be prevented from disposing of their shareholdings.

16 As such, legal constraints are often put in place to control self-dealing transactions to minimise the pernicious effects of self-dealing, *ie*, the expropriation of minority shareholders' interests.

V. Strategies for self-dealing transactions

17 In *The Anatomy of Corporate Law: A Comparative and Functional Approach*, Reiner Kraackman *et al* suggested two main types of strategies to deal with self-dealing transactions, amongst others; "regulatory strategies" and "governance strategies". Firstly, regulatory strategies are prescriptive, containing substantive terms to constrain the agent's behaviour directly; and secondly, governance strategies seek to facilitate the principal's control over the agent's behaviour.[17]

A. Regulatory strategies

18 Regulators may seek to constrain the agent's behaviour directly through rules or standards. Bright line rules are often instituted *ex ante* to prevent expropriation relating to creditors, such as the capital maintenance rules, dividends payable out of profits only and so on. But rules are hardly used to control an agent's behaviour in intra-corporate relations, for instance, self-dealing transactions with controlling shareholders and directors. In these situations, standards are more often used to guard against expropriation of minority shareholders' interests. Situations of self-dealing are presumably too complex to be regulated with rigid prohibitions and exemptions but more conducive to regulation by open standards that leave discretion to be exercised by adjudicators *ex post facto* as to whether violation has occurred. Thus, standards instituted for approving related-party transactions often require directors to act in "good faith" or mandate self-dealing transactions to be "entirely fair".[18]

17 Reiner Kraakman, *et al*, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 2009) at p 38.

18 Reiner Kraakman, *et al*, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 2009) at pp 39–40.

19 The second regulatory strategy is the use of affiliation terms with which the principal contracts with the agent. The law can dictate terms of entry, by requiring the agent to disclose information about the quality of his performance before contracting with the principal, or alternatively, the law can provide exit opportunities for principals such as appraisal rights or rights of transfer.[19] As regards terms of entry, laws often provide for mandatory disclosure of ownership interests to signal to investors the right price to pay for the shares. In this regard, in firms with concentrated ownership and controlling shareholders, the controlling shareholder has a strong incentive to monitor management and so reduce agency costs. But blockholders could be a source of new agency costs, notably the extraction of private benefits of control. There is also the risk of over-monitoring which may discourage management from showing initiative. The behaviour of the blockholders depend on their genre, *ie*, whether they are private investors, family owners or institutional investors. If investors expect the costs of a particular ownership structure to outweigh the benefits, they may discount the shares, and *vice versa*. Because of this trade-off, the impact of ownership structure is likely to be different for each firm. The function of ownership disclosure is to enable investors to make an informed assessment as to how they should price the shares. This is why most securities laws mandate ownership disclosure in the prospectus. In addition, firms with concentrated ownership or multiple voting rights are less susceptible to a control contest. The probability of a control contest will also likely impact upon the valuation of the shares.[20]

20 The exit strategies allow principals to escape opportunistic agents. For example, the right of withdrawal of one's investments, commonly called appraisal rights, is a technique used in some jurisdictions such as Canada to enable minority shareholders who disagree with major transactions such as mergers to be bought out by the majority and hence preserve the value that their shares had prior to the disputed transaction. The second exit strategy, which is the right of transfer by public shareholders, permits the replacement of current shareholders with new ones who may be more effective in controlling the agent. The right of transfer or the threat of it may be an effective tool to discipline the agent.[21]

---

19 Reiner Kraakman, *et al*, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 2009) at p 40.

20 Michael C Schouten, "The Case for Mandatory Ownership Disclosure" (2009) 15 *Stanford Journal of Law, Business and Finance* 128 at 135–137.

21 Reiner Kraakman, *et al*, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 2009) at pp 41–42.

B. *Governance strategies*

21 There are four governance strategies that may be used to facilitate the principal's control over the agent. Firstly, there is the appointment right, *ie*, the right to select or remove directors. Minority shareholders may protect their positions by cumulative voting to reserve seats on the boards for minority shareholders or by limiting the voting rights of controlling shareholders. Secondly, corporate law may provide that principals ratify the decisions of their agents. Considering that management powers are often ceded to the board, such rules or articles of association are unlikely, save for the most fundamental corporate decisions such as a merger or amendment of the articles of association or substantial disposal of a company's undertaking.[22]

22 Thirdly, the trusteeship and reward strategies are incentive strategies which seek to reward agents for advancing their principal's interests. For example, the sharing rule mandates that majority shareholders share equally dividends distribution on a *pro rata* basis. Lastly, the trusteeship strategy uses independent actors such as independent directors and auditors to monitor agents based on the ground that these actors will respond to low-powered incentives of conscience, pride and reputation.[23]

23 It is expedient at this juncture to set out the ambits of this article. Paragraphs 24–76 will evaluate Singapore's legal strategies for monitoring self-dealing transactions under the Singapore Exchange Listing Rules ch 9 ("SGX Listing Rules'), the Companies Act[24] and the common law. Paragraphs 77–99 will provide an economic analysis of the legal strategies and evaluate their suitability in a concentrated ownership structure.

VI. Singapore's legal strategies for self-dealing transactions

A. *Specific rules*

(1) SGX Listing Rules

24 First, we shall deal with the specific rules on self-dealing transactions. Under ch 9 of the SGX Listing Rules, a self-dealing transaction (which is called an "interested person transaction" under the

---

22 Reiner Kraakman, *et al*, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 2009) at p 42.

23 Reiner Kraakman, *et al*, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 2009) at p 43.

24 Cap 50, 2006 Rev Ed.

Rules) has to be *immediately announced* on SGXNET if the value of the transaction or the aggregate value of all the transactions during the same financial year amounts to 3% or more of the group's latest audited net tangible assets.[25] Where the value of the self-dealing transaction or the aggregate value of all self-dealing transactions during the same financial year amounts to 5% or more of the group's latest audited net tangible assets, the company must obtain *ex ante* the *shareholders' approval*.[26]

25 The SGX Listing Rules define "interested persons" as a director, chief executive officer or controlling shareholder of a company and their associates. The types of self-dealing transactions include the following:[27]

(a) the provision or receipt of financial assistance;

(b) the acquisition, disposal or leasing of assets;

(c) the provision or receipt of services;

(d) the issuance or subscription of securities;

(e) the granting of or being granted options; and

(f) the establishment of joint ventures or joint investments.

26 "Financial assistance" includes "the lending or borrowing of money, the guaranteeing or providing of security for a debt incurred or the indemnifying of a guarantor for guaranteeing or providing security" and "the forgiving of a debt, the releasing of or neglect in enforcing an obligation or the assuming of the obligation of another".[28]

27 One of the important details to be included in the announcement comprises a statement as to whether the audit committee is of the view that the transaction is on normal commercial terms and is not prejudicial to the interests of the company and its minority shareholders; or a statement that the audit committee is obtaining an opinion from an independent financial adviser before forming its view which will be announced later.[29] In a meeting to obtain shareholders' approval, the interested persons and any of their associates shall not vote in the resolution.[30] The circular to shareholders to obtain approval must contain, *inter alia*, an opinion from an independent financial adviser who is acceptable to the Exchange stating whether the transaction(s) is on normal commercial terms and is not prejudicial to

25 Singapore Exchange Listing Rules r 905.
26 Singapore Exchange Listing Rules r 906.
27 Singapore Exchange Listing Rules r 904(6).
28 Singapore Exchange Listing Rules r 904(3).
29 Singapore Exchange Listing Rules r 917(4).
30 Singapore Exchange Listing Rules r 919.

the interests of the company and its minority shareholders.[31] If the audit committee takes a different view from the independent financial adviser, an opinion from the audit committee on similar terms is required.[32]

28 A company with local property projects has to announce a sale or proposed sale of any units in the project to an interested person of the company or a relative of a director, chief executive officer or controlling shareholder within two weeks of the sale or proposed sale.[33] A company with non-local property projects has to comply with r 905 with respect to the sale or proposed sale of any units of the projects to an interested person.[34] In other words, the value of these sales or proposed sales must amount to 3% of the company's latest audited net tangible assets with respect to non-local property projects. In deciding any such sale, the board of directors must be satisfied that the terms of the sale are not prejudicial to the interests of the company and its minority shareholders. In addition, the audit committee must also review and approve the sale and satisfy itself that the number and terms of the sale(s) are fair and reasonable and are not prejudicial to the interests of the company and its minority shareholders.[35]

(2) Companies Act

29 Section 162 prohibits a company, other than an exempt private company, from making a loan to a director of the company or of a related company. In addition, s 163(1) of the Companies Act prohibits company A from making a loan to company B or entering into any guarantee or providing any security in connection to a loan made to company B if a director or directors of company A are interested in 20% or more of the equity shares of company B.[36] In this regard, an interest of a member of a director's family shall be treated as the director's and members of a director's family shall include his spouse, son, adopted son, step-son, daughter, adopted daughter and step-daughter.[37] This rule does not apply to exempt private companies.

30 Prior to 1998, section 160A of the Companies Act prohibited a director of a company or its holding company, or a person connected with such a director, from acquiring non-cash assets of the requisite value from the company and *vice versa* unless the arrangement was first approved by a resolution of the company in general meeting. A "non-cash asset of the requisite value" meant an arrangement of a

31 Singapore Exchange Listing Rules r 921(4).
32 Singapore Exchange Listing Rules r 921(5).
33 Singapore Exchange Listing Rules r 910(1).
34 Singapore Exchange Listing Rules r 910(2).
35 Singapore Exchange Listing Rules r 912.
36 Companies Act (Cap 50, 2006 Rev Ed) s 163(1).
37 Companies Act (Cap 50, 2006 Rev Ed) s 163(5).

value of not less than $5,000 but exceeds $100,000.[38] Section 160D defined a person connected to a director of a company as that director's spouse, child, step-child; or a body corporate with which the director is associated; or a person acting in his capacity as a trustee for a trust the beneficiaries of which are the director, his spouse or any of his children or step-children or body corporate of which he was associated; or a partner of the director. Sections 160A–160D have been repealed since 1998.

31 Section 163 and the previous ss 160A–160D are bright line rules that prohibit specific types of self-dealing transactions. Because the opportunity for self-aggrandisement is so great, s 163 prohibits outright loans to directors and director-controlled companies. In contrast, the previous ss 160A–160D utilised disclosure and shareholders' approval to "whitewash" self-dealing transactions.

32 Lastly, s 156 uses affiliation terms to mandate that directors disclose to the board their interest in any transactions with the company or proposed transactions with the company, as well as the holding of any office or possession of any property that could create any conflicts of interest. The law thus stops short and does not provide clearly how the conflict can be resolved. Would the board's approval or shareholders' approval be required to absolve the directors' conflict? This question will be answered below.[39]

B. General rules at common law

(1) Diversion of corporate opportunity

33 Apart from the specific types of self-dealing transactions enumerated in ch 9 of the SGX Listing Rules and s 163 of the Companies Act, another common type of self-dealing transaction conducted by controlling shareholders is the diversion of corporate opportunities to companies they are interested in. In the Singapore context of family-owned firms, the controlling shareholder is often the top executive in the company.

34 In such a scenario, it is unlikely that ch 9 of the SGX Listing Rules would apply even though r 904(6) does not use an exhaustive definition of self-dealing transactions. It is more likely that s 157 of the Companies Act together with the common law on fiduciary duty to avoid conflicts of interest would be applied to resolve the outcome.

---

38 Companies Act (Cap 50, 2006 Rev Ed) s 160A(2).
39 See paras 45–52 of this article.

35 Section 157(1) provides that "a director shall act *honestly* and use reasonable diligence in the discharge of the duties of his office" [emphasis added]. The word "honestly" should import notions of good faith and a prophylactic no-conflict rule. Furthermore, s 157(2) provides that a director "shall not make improper use of any information acquired by virtue of his position as director of the company to gain, directly or indirectly, an advantage for himself or for any other person or to cause detriment to the company". Taken together, these two subsections should govern to constrain a diversion of corporate opportunity by directors who are controlling shareholders.

36 The common law on fiduciary duty to avoid conflicts of interest was settled by Lord Cranworth in *Aberdeen Railway Co v Blaikie Brothers* as follows:[40]

> [I]t is a rule of universal application that no one, having [fiduciary] duties to discharge, shall be allowed to enter into engagements in which he has or can have a personal interest conflicting or which possibly may conflict with the interests of those whom he is bound to protect.

37 *Cook v Deeks*[41] exemplifies the prohibition of the diversion of corporate opportunities belonging to the company to one or more of the directors. In this classic case, three directors of the Toronto Construction Company resolved to break their business relationship with the fourth director, Cook. Each of the directors had successfully negotiated contracts with the Canadian Pacific Railway Company, and the last of these contracts, called the Shore Line contract, was secretly diverted to the three directors. A shareholders' resolution which was comprised of the three directors' votes was passed to ratify that the company claimed no interest in the contract. Cook sued the three directors. The Privy Council opined:[42]

> [I]t appears quite certain that directors holding a majority of votes would not be permitted to make a present to themselves. This would be to allow the majority to oppress the minority. To such circumstances the cases of *North-West Transportation Company v Beatty* and *Burland v Earle* have no application. In the same way, if directors have acquired for themselves property or rights which they must be regarded as holding on behalf of the company, a resolution that the rights of the company should be disregarded in the matter would amount to forfeiting the interest and property of the minority of shareholders in favour of the majority, and that by the votes of those who are interested in securing the property for themselves. Such use of voting power has never been sanctioned by the Courts ….

40 [1843–60] All ER 249 at 252.
41 [1916] 1 AC 554.
42 *Cook v Deeks* [1916] 1 AC 554 at 564.

38 In such scenarios, the directors hold the corporate opportunity in trust for the company and are liable to hold all profits made thereon in trust for the company.

39 On the issue of whether the shareholders may ratify a diversion of corporate opportunity such that the directors are not liable for a breach of fiduciary duty, the English case of *Regal (Hastings) Ltd v Gulliver*[43] ("*Regal (Hastings)*") held that directors could, if they wished, protect themselves from breaches of the no-conflict rule through a shareholders' resolution at general meeting. *Regal (Hastings)* could, of course, be distinguished from *Cook v Deeks* by the fact that the directors in *Regal (Hastings)* were totally honest and above board in their self-dealing transactions with the company.

40 The local courts have similarly frowned upon a director (who is also a joint venture partner) diverting an existing contract belonging to the joint venture company to his own company. In *Chew Kong Huat v Ricwil (Singapore) Pte Ltd*,[44] Chew entered into a joint venture agreement with Ricwil (Malaysia) Sdn Bhd to set up the joint venture company called Ricwil (Singapore) Pte Ltd ("Ricwil"). Chew was a shareholder and the managing director of Ricwil and his wife was the director in charge of the accounts of Ricwil. Chew and his wife also owned and controlled two companies called Sintalow and Thermosel. Ricwil, Sintalow and Thermosel occupied the same premises until mid-June 1996 when Ricwil moved out of the premises. Disputes arose between the other shareholders of Ricwil and Chew and his wife. Ricwil had contracts with Speed-Air for the manufacture of ducts for the latter. These contracts were entered into on Ricwil's stationery and order forms, and Ricwil had performed the contracts using its materials and goods. After the ducts were manufactured, Chew and his wife caused the contracts to be cancelled and transferred to Thermosel and issued Thermosel's delivery orders to deliver the ducts and caused Thermosel to reap the profits from the transactions. In addition, Ricwil submitted a quotation to Kwang Wah for the delivery of pre-insulation carrier pipes for the Suntec City project. Kwang Wah requested a 30% discount; Ricwil agreed to a discount of 22.5% provided Ricwil would also supply Nippon steel pipes to Kwang Wah for two other projects. However, it subsequently transpired that the steel pipes were supplied by Sintalow and not Ricwil. The Court of Appeal held that Chew and his wife had breached their duty to act in the best interest of Ricwil and also s 157 of the Companies Act.[45] In the words of the learned judge: "Mr Chew had

43 [1942] 1 All ER 378.
44 [1999] 3 SLR(R) 1167.
45 Cap 50, 1994 Rev Ed.

purloined the business opportunity that belonged to Ricwil and allowed Sintalow to reap the benefit of this opportunity."[46]

41 At this juncture it is important to note that company law proscribed the diversion of corporate opportunity by a director from the *company* to himself or his nominees. The company must have existed and operated as a separate legal entity. It does not prevent a director (who is also an equal shareholder) from diverting corporate opportunities to herself to the exclusion of two other equal shareholders when the company has never operated as a separate legal entity but was in actuality "three self-seeking groups plying their wares, sheltering nominally under a single corporate tent, but with scant regard for any corporate discipline or mutual regard".[47]

42 In *Tokuhon (Pte) Ltd v Seow Kang Hong*,[48] three families, operating Nan Tat & Co, Continental Trading Co and Wee Seng Heng Medical Hall, were originally the distributors of a Japanese brand of medicinal plasters called "Tokuhon". Under the prodding of the Japanese manufacturers, the three families formed the plaintiff company to distribute the plasters in Singapore and Malaysia. Each family's interest of an equal one-third share was represented by a director on the board of the plaintiff company. The founders of Nan Tat and Continental having passed away, their respective sons took over the helm of the family companies and sat on the board of the plaintiff company. When the plasters were imported into Singapore and Malaysia, their distribution was undertaken separately by the three families instead of through a centralised agency of the plaintiff. Shareholder disputes broke out amongst the three families over a long period of time and Seow Kang Hong and his wife, who were the descendants of the owner of Continental Trading Co, sold their shares to the other two families. Meanwhile, the shareholders' disputes came to the manufacturer's main Hong Kong distributor's attention and they terminated the distributorship agreement in May 2000. Six months later, the Hong Kong distributor awarded the distributorship agreement to Seow Kang Hong and his wife. The owners of Nan Tat and Wee Seng Heng brought an action for breach of directors' duties against Seow and his wife in the name of the plaintiff company. Justice Rubin held that the real plaintiffs in the action were the Nan Tat and Wee Seng Heng family members, and the "court in exercising its powers to grant discretionary relief, would be well justified to lift the veil of incorporation and scrutinize the real

46 *Chew Kong Huat v Ricwil (Singapore) Pte Ltd* [1999] 3 SLR(R) 1167 at [32].
47 *Tokuhon (Pte) Ltd v Seow Kang Hong* [2003] SGHC 65 at [94].
48 [2003] SGHC 65.

motives of those who might be hiding behind the corporate veil".[49] The learned judge decided as follows:[50]

> The three groups in the case before me, had been, consistently over the years, conducting themselves as though they were three separate units and the incorporation of the plaintiffs was nothing but a vehicle of convenience. In my view, the issue concerning the breach or otherwise of any fiduciary duty, … would have to be approached in reference to what should be considered fair between the contending factions of directors ….

43 The court thus applied the principle in *Mills v Mills*[51] and decided that all was fair game when the three contending families had all along vied to outdo one another to secure the distributorship of the plasters for themselves. In addition, the court held that the plaintiffs had not come with "clean hands" and were themselves guilty of the same charges which they hurled at the defendants.

44 At first glance, the decision appears irreconcilable with the established doctrine that directors shall not divert corporate opportunities to themselves or their nominees. There was a breach of fiduciary duty but no remedy was given because of the reasons aforesaid. It is submitted that the lifting of the corporate veil is but the first step in the analysis. The court should have proceeded further and decided that given three contending families as equal shareholders in a shell company, no fiduciary duty is owed by each shareholder towards the other. Such a holding will sit better with established doctrines and is amply supported by the courts and academics alike.[52] To decide the case upon the ground that the plaintiffs did not come to court with "clean hands" would seem to "make two wrongs become one right", which is patently incorrect.

(2) Ratification of self-dealing transactions and derivative actions

45 Ratification has a variety of meanings in different contexts. If a director enters into a contract with the company in which he has an

49 *Tokuhon (Pte) Ltd v Seow Kang Hong* [2003] SGHC 65 at [120].
50 *Tokuhon (Pte) Ltd v Seow Kang Hong* [2003] SGHC 65 at [122].
51 (1937–38) 60 CLR 150.
52 Robert Flannigan, "Fiduciary Duties of Shareholders and Directors" [2004] *Journal of Business Law* 277 at 285–286. Because the joint stock company was a partnership, the stockholders were originally fiduciaries to each other. But when the joint stock company assumed corporate status, the new corporation became the principal or owners of the business instead of the stockholders. The stockholders are no longer principals in relation to the business. Two consequences flow from the act of incorporation: first, the corporation contracts as principal and assumes vicarious liability for the torts of its workers; and secondly, the stockholders' previous fiduciary obligations owed to each other as partners are erased (at 280).

interest, the contract is voidable and liable to be avoided by the company. But the company may choose to ratify the contract, and so, ratification in this sense means an affirmation of the contract. This act of ratification will bind the company but does it also operate as a release of the director's breach of duty? More specifically, where directors have committed a breach of duty, they often seek forgiveness and condonation of their wrongdoing, and this too has been termed ratification. The questions arise as to firstly, which breaches of director's duty are ratifiable and which are not. Secondly, which organ of the company should exercise the right of ratification? Is it the board or the general meeting? Thirdly, are there any limitations on the voting power of the board or general meeting? Fourthly, is ratification by the company binding on its successors when there is a change in control? Fifthly, how does ratification of a breach of duty affect the right of a shareholder to bring a derivative action against the errant director? This article will try to answer these questions.

46 Though an academic has argued that ratification which operates as a release of a director's personal liability for breach of duty has to be supported by consideration,[53] the preponderance of authority favours the rule that a director (like a trustee) could be absolved from liability if his principal/beneficiary (*ie*, the company) consents to or concurs in a breach of duty or subsequently confirms it or grants a release to the director or even acquiesces to it.[54] The consent of the company must, however, be a fully informed consent where the director fully discloses to the board or general meeting his wrongdoing.[55] This was confirmed by the celebrated case of *Regal (Hastings)*, where the House of Lords said of directors who had made a secret profit that "they could, had they wished, have protected themselves by a resolution (either antecedent or subsequent) of the Regal shareholders in general meeting".[56] Furthermore, in voting to ratify a breach of duty, a controlling shareholder may use his votes to ratify his own breach of duty as a director.[57]

53 R J C Patridge, "Ratification and the Release of Directors from Personal Liability" (1987) 46(1) CLJ 122.

54 Philip H Pettit, *Equity and The Law of Trust* (Oxford University Press, 11th Ed, 2009) at p 525 and Pearce & Stevens, *The Law of Trusts and Equitable Obligations* (Oxford University Press, 4th Ed, 2010) at p 756.

55 Philip H Pettit, *Equity and The Law of Trust* (Oxford University Press, 11th Ed, 2009) at p 525; Pearce & Stevens, *The Law of Trusts and Equitable Obligations* (Oxford University Press, 4th Ed, 2010) at p 756; John Mcghee, *Snell's Equity* (Sweet & Maxwell, 13th Ed, 2000) at p 331; and J E Penner, *The Law of Trust* (Oxford University Press, 6th Ed, 2008) at p 324.

56 *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 at 389.

57 *North-West Transportation Co Ltd v Beatty* (1887) 12 App Cas 589 (Privy Council). This is based on the rule that votes are proprietary rights which the holder may exercise in his own selfish interests even if these are opposed to those of the

(*cont'd on the next page*)

47 *Regal (Hastings)* has often been contrasted with *Cook v Deeks*. In *Cook v Deeks*, directors in breach of fiduciary duty diverted a contract (*ie*, a corporate opportunity) to themselves and purported to ratify the act by a shareholders' resolution which carried their own votes. The Privy Council held that the directors could not retain the benefit of the contract as it belonged in equity to the company, and that the directors holding a majority of votes "would not be permitted to make a present to themselves".[58] These two irreconciliable cases have spawned a sea of debate and academic opinion, of which the most important are as follows:

(a) The distinction lies between misappropriating money, property or advantages which belong to the company or in which other shareholders are entitled to participate, and the mere making of an incidental profit for which directors are liable to account to the company.[59] The act in *Cook v Deeks* fell within the first category and was non-ratifiable whilst that in *Regal (Hastings)* fell into the latter category and was ratifiable. The first type of case is of a fraudulent character whilst the latter type is not. Some academics have disputed this distinction on the ground that "locating the indicia of fraud in the conduct that gives rise to the breach of duty can be a matter of intractable difficulty".[60] Some kinds of misconduct such as bribe-taking may admit of both personal accountability and a proprietary claim. Furthermore, the distinction falls on its own head in one of the two cases where the Privy Council in *Cook v Deeks* declared that the directors were to account for the profits they had made out of the contract which in equity belonged to the company.[61]

(b) Professor Gower distinguished *Cook v Deeks* from *Regal (Hastings)* on the ground that the directors in *Cook v Deeks* were guilty of bad faith whilst the *Regal (Hastings)* directors acted in good faith throughout the transaction.[62] But *mala fides* as a doctrine admits of no clear boundaries and in *Bamford v*

---

company, see Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (Sweet & Maxwell, 7th Ed, 2003) at p 438.

58 *Cook v Deeks* [1916] 1 AC 554 at 564.

59 Paul L Davies, *Gower and Davies' Principles of Modern Company Law* (Sweet & Maxwell, 7th Ed, 2003) at p 439; K W Wedderburn, "Derivative Actions and *Foss v Harbottle*" (1981) 44 MLR 202 at 206.

60 G R Sullivan, "Restating the Scope of the Derivative Action" (1985) 44(2) CLJ 236 at 240.

61 G R Sullivan, "Restating the Scope of the Derivative Action" (1985) 44(2) CLJ 236 at 241.

62 Gower, *Principles of Modern Company Law* (Oxford University Press, 4th Ed, 1979) at p 593.

Bamford[63] was held to even include an improper exercise of power by the directors. The Court of Appeal in *Bamford* held that a shareholders' meeting could ratify an improper allotment of shares which were issued primarily to forestall a takeover bid.

(c) Brenda Hannigan drew a wider distinction and sought to reconcile the cases of *Daniels v Daniels*[64] (negligent sale of land to a director at a gross undervalue), *Alexandra v Automatic Telegraph Co*[65] (where directors called up uncalled capital except that unpaid by three of the directors who owned 75% of the shares), *Menier v Hoper's Telegraph Works*[66] (where the majority shareholders settled an action on terms favourable to themselves that had the effect of dividing the company's assets between themselves to the exclusion of the minority) and *Estmanco (Kilner House) Ltd v Greater London Council*[67] (where the Council had used its majority power to bring an advantage to itself in breach of contract and to the exclusion of the minority) on the ground that "the essential point, that is the substance of the act or transaction, as objectively considered by the court, was damaging to the company (in the sense of the *loss* of an asset, advantage or opportunity) *and* to the personal *benefit* of the wrongdoers"[68] [emphasis added]. It is submitted that this is an attractive distinction which is supported by Vinelott J in *Prudential v Newman Industries (No 2)*.[69]

(d) To Vinelott J in *Prudential v Newman Industries (No 2)*, "there is no obvious limit to the power of the majority to authorise or ratify any act or transaction *whatever its character* provided it is not ultra vires or unlawful and that the majority does not have an interest which conflicts with that of the company"[70] [emphasis added]. Thus, *all* acts and transactions that are not *ultra vies* or unlawful are ratifiable provided that those in breach of duty *qua* director cannot use their votes *qua* shareholder to condone their own wrongs.[71] Such use of the voting power by a director to prevent an action being taken against them amounts to a "fraud on the minority" under the exception to the rule in *Foss v Harbottle*.[72] A derivative action

---

63 [1970] Ch 212.
64 [1978] Ch 406, [1978] 2 All ER 89.
65 [1900] 2 Ch 56.
66 (1874) 9 Ch App 350.
67 [1982] 1 WLR 2, [1982] 1 All ER 437.
68 Brenda Hannigan, "Limitations on a Shareholder's Right to Vote-Effective Ratification Revisited" (2000) *Journal of Business Law* 493 at 502.
69 [1980] 2 All ER 841 at 866–869.
70 *Prudential v Newman Industries (No 2)* [1980] 2 All ER 841 at 862.
71 *Prudential v Newman Industries (No 2)* [1980] 2 All ER 841 at 862.
72 (1843) 2 Hare 461, 67 ER 189.

> can follow. In other words, a majority of disinterested directors or shareholders should ratify the breach of duty. One problem with this approach is that it may be difficult to vest the power to ratify a breach of duty in disinterested directors as this raises obvious issues of partiality.[73] Similarly, finding the disinterested shareholders may be "illusory" and such shareholders may be "non-existent", not to mention the elementary considerations of democracy that decision-making should be taken out of the hands of those who have the most at stake in the company.[74]

48 It would appear from the cases that some breaches of duty by directors are not ratifiable, or if they are ratifiable, the ratification should not be carried by the votes of interested directors and shareholders. The above authorities cited also held that the proper organ to ratify a breach of duty is the general meeting.[75] In all likelihood, ratification would operate as a release of the director's personal liability for a breach of duty, and based on the expediency of the "internal management rule" laid down in *Edwards v Halliwell*,[76] no derivative action will lie. As a practical matter, however, directors who want to be fully protected should insist on a formal release, as an equitable release may be effected by an instrument under hand, orally or even by conduct.[77] This is particularly so if a change of control is imminent.

49 Though it might be argued that the task of ratification could be left to the board as part of its management powers, for reasons of the practical difficulty of obtaining an "unbiased voice and advice of every director" and the policy consideration of *nemo debit esse judex in propria causa*, it is unlikely that judges in Singapore would hold the board to be the responsible organ for ratification. However, where ratification means an affirmation of a voidable contract, or rejection of a corporate opportunity, it might be possible for a disinterested board to be the appropriate organ to make the decision on grounds that it involved the

73 Pearlie Koh, "Disclosing Conflicts of Interests" (2005) 17 SAcLJ 465 at 472.

74 L S Sealy, "*Foss v Harbottle* – A Marathon Where Nobody Wins" [1981] CLJ 29 at 32 and K W Wedderburn, "Derivative Actions and *Foss v Harbottle*" (1981) 44 MLR 202 at 208.

75 *Gwembe Valley Development Co Ltd v Koshy* [2004] 1 BCLC 131 at 151.

76 [1950] 2 All ER 1064 at 1066. But Belinda Ang J in *Dayco Products Singapore Pte Ltd v Ong Cheng Aik* [2004] 4 SLR(R) 318 appears to take the view that disclosure to the board by the director of the conflict of interest and abstaining from voting therefrom will render the transaction unimpaired. See further the case note on this case by Pearlie Koh, "Disclosing Conflicts of Interests" (2005) 17 SAcLJ 465.

77 Ross Cranston, "Limiting Directors' Liability: Ratification, Exemption and Indemnification" (1992) *Journal of Business Law* 197 at 200 and Meagher, Heydon & Leeming, *Equity: Doctrines and Remedies* (Butterworths LexisNexis, 4th Ed, 2002) at p 1029.

management of the company.[78] Arguably, forgiving or condoning a breach of director's duty cannot be said to be part of the ordinary business of management of the company.[79]

50 As alluded to above, Vinelott J decided that the majority cannot use its voting power to prevent a derivative action against the errant directors for this would amount to a "fraud on the minority" and would give rise to a derivative action. Thus, this presents a limitation on the power of the general meeting to ratify a breach of duty. Lastly, we come to the quagmire of the impact of ratification on the right of a minority shareholder to maintain a derivative action for which there is no direct authority.

51 On first principles, it depends on the scope of the ratification. If the ratification constitutes a forgiveness and condonation of the director's breach of duty, and the votes of the majority of disinterested shareholders are obtained on such a motion, then the rule in *Foss v Harbottle* would apply and no derivative action can be instituted by a disgruntled minority shareholder.[80] If the ratification comprises the affirmation of a voidable contract, there is authority that the director will not be made liable to account for the profits he makes for that would be to write a new contract between the parties.[81] There would be no loss for the company to sue in any action, let alone a derivative action. On the other hand, if the ratification comprises a rejection of corporate opportunity, estoppel might arise in favour of the director who has committed a breach of duty. Hence, in all probability, ratification would block an action by the company, whether derivatively or otherwise.

52 In addition to the common law derivative action, s 216A of the Companies Act provides for a statutory derivative action. To qualify, the applicant, who may be a member or any proper person, must apply to the court for leave to bring an action in the name of the company. In granting leave, the court must be satisfied that 14 days' notice had been given to the directors to allow the directors of the company to bring the action; the applicant acted in good faith and it is *prima facie* in the interests of the company to bring the action.[82] The statutory derivative action does not apply to a listed company.[83]

---

78 *Peso Silver Mines Ltd v Cropper* (1966) 58 DLR (2d) 1 and *QueenslandMines v Hudson* (1978) 18 ALR 1.

79 Ross Cranston, "Limiting Directors' Liability: Ratification, Exemption and Indemnification" (1992) *Journal of Business Law* 197 at 202.

80 *Smith v Croft (No 2)* [1988] Ch 114.

81 *Tracy v Mandalay Pty Ltd* (1953) 88 CLR 215.

82 Companies Act (Cap 50, 2006 Rev Ed) s 216A(3).

83 Companies Act (Cap 50, 2006 Rev Ed) s 216A(1).

(3) Extracting private benefits of control

53 Another notable case which shows that tunnelling is tolerated to a greater extent in this part of the world than elsewhere is *Raffles Town Club Pte Ltd v Lim Eng Hock Peter*[84] ("*Raffles Town Club*"). The defendants were investors who set up the plaintiff as a proprietary club in 1996, first as a public limited company and one year later as an exempt private company. They were also owners of a club known as Europa Country Club and Resort through Europa Holdings Pte Ltd ("EH"). In 1996, EH tendered a $100m bid for a site to build a private recreational club which later turned out to be the "Raffles Town Club". It transpired that the sum tendered for the site was too high and the first defendant, Peter Lim, was roped in as an investor at a sum of $20m. The club was built and marketed to members of the public at a founder member's price of $28,000 *per* membership. A total of 19,000 club memberships were sold; this precipitated a lawsuit by the club members on grounds of misrepresentation that the club was exclusive and prestigious when in fact there was overcrowding and poor amenities. On 12 May 2001, the defendants sold their shares in the Raffles Town Club to the present owners of the plaintiff. The plaintiff then brought the action against the defendants who were former directors of the plaintiff, for breach of fiduciary duties. There were, *inter alia*, three grounds for the action: firstly, a breach of fiduciary duties by the defendants arising from the wrongful payment of $78m in management fees to EH between 11 May 1997 and mid-August 1999; secondly, payment of $13m in purported directors' remuneration and expenses which were, in effect, a "dressed up payment of dividends out of capital", an unlawful payment because there were no profits with which to pay the dividends; and thirdly, conspiracy and misapplication of Raffles Town Club's funds in the form of a $33m loan to an offshore banking account in the name of Raffles Town Club (International) Ltd.

54 As regards the payment of $78m in management fees to EH, the High Court held that the management agreement between Raffles Town Club and EH was not a sham and that EH was entitled to be remunerated for work done in respect of the sales, marketing and promotional services rendered to the plaintiff for launching the Raffles Town Club. It was found that the plaintiff was set up by EH as a special purpose vehicle to hold the site, and that the plaintiff was simply a shell company with no assets, no expertise, no staff nor branding. It was EH's goodwill and reputation that successfully launched the club. All expertise had come from EH and, hence, the 15% marketing commission was not extortionate. Even though experts had tendered evidence that EH's work be valued at 1%–3%, the court decided that EH was entitled to more because it had undertaken the risk of the project

84 [2010] SGHC 163.

and the defendants had even personally guaranteed a $60m loan from Hong Leong Bank to kick start the project.[85]

55 As far as directors' remuneration was concerned, the court refrained from interfering with the quantum of remuneration for directors, preferring to hold that "this is a commercial decision best left to be worked out under the relevant provisions in the company's articles of association".[86] It was "not a case in which payments were made to directors of a company in the absence of *any work* or oversight on the part of the directors"[87] [emphasis in original]. The plaintiff further argued that the defendants had claimed certain expenses from the plaintiff under their "private accounts" with the plaintiff that were unauthorised. On this score, the court opined that "it is trite law that the defendants, as directors, owe a duty as fiduciaries to the company to act honestly and in the best interests of the company", but in answer to the rhetorical question "whose interests are the company's interests?", the court answered that "in a capitalist environment which encourages entrepreneurship such as ours, one should not view every transaction which does not positively result in profitable returns to the company as a *commercial entity* with suspicion". Relying on the old case of *Greenhalgh v Ardene Cinemas Ltd*,[88] the court decided that the "'company as a whole' does not mean the company as a commercial entity, distinct from the corporators; it means the corporators as a general body".[89] Thus, the court decided that as the plaintiff was solvent at all material times, the plaintiff's interests should be equated with the interests of its shareholders.[90] The court further found that the defendants had every intention for the plaintiff to prosper, not to systematically strip it of its assets. As such, the court did not think the transactions were disguised attempts to distribute dividends ahead of profits being earned.

56 As regards the third ground, the court found that the $33m had been repaid to the plaintiff, and in any case, the Raffles Town Club (International) Ltd was a subsidiary of the plaintiff and hence s 163 of the Companies Act was not infringed.

57 Two issues arise in this case. Firstly, the management agreement between the plaintiff and EH was a conflicted transaction which would require disclosure and approval by independent shareholders or directors. But on this score, the defendants' actions were unassailable

85 *Raffles Town Club Pte Ltd v Lim Eng Hock Peter* [2010] SGHC 163 at [133]–[137].
86 *Raffles Town Club Pte Ltd v Lim Eng Hock Peter* [2010] SGHC 163 at [149].
87 *Raffles Town Club Pte Ltd v Lim Eng Hock Peter* [2010] SGHC 163 at [154].
88 [1951] 1 Ch 286.
89 *Raffles Town Club Pte Ltd v Lim Eng Hock Peter* [2010] SGHC 163 at [161]–[164].
90 *Raffles Town Club Pte Ltd v Lim Eng Hock Peter* [2010] SGHC 163 at [164].

because as promoters they were not obliged to form an independent board for the plaintiff and, since the days of *Salomon v A Saloman and Co Ltd*,[91] disclosure to existing members in a private company have been held to be equally effective, which was the case in *Raffles Town Club*. When the present owners bought over the club in 2001, their due diligence exercise should have disclosed these payments and an appropriate discount should have been made.

58 The second issue is more contentious and admits of no easy answer. To whom are the fiduciary duties of a director owed? The conventional view says it is to the company, but who is the company? The High Court in *Raffles Town Club* decided that the company is the general body of corporators. But this fails to take into account the heterogeneity of the body of shareholders. According to Schwarcz, there are short-term and long-term investors with different goals. Short-term investors may prefer immediate profits whilst long-term investors prefer continuing profits and long term firm value.[92] But these are all *current* investors with long or short-term goals of investment. In contrast, there are future investors who have yet to buy into the firm. These *future* investors would favour the disclosure of risks affecting the company so that they may buy at a discounted price whilst *current* investors would disfavour the disclosure of risks affecting the company so that they can maintain their share value. Similarly, *current* investors disfavour the downgrade of a firm's bond rating whilst *future* investors will favour it.[93]

59 Corporation law as it stands suggests that directors owe their fiduciary duty to the *current* investors. Yet, in the case of publicly held corporations, securities law takes into account *future* investors because disclosure of material information and risks in prospectuses during the issuance of securities and periodic reporting thereafter are clearly for the protection of *future* investors. Professor Schwarcz termed the conflict between long and short-term *current* investors the "static-investor conflict", and the conflict between *current* and *future* investors, the "temporal conflict".

60 Corporation law as it stands does not provide the answer as to how to resolve these conflicts. It simply mandates that the directors chart a course that is in the best interests of the company without regard to a fixed investment (time) horizon. That course is left to the business judgment of the directors, and depending on the circumstances,

91 [1897] 1 AC 22.
92 Steven L Schwarcz, "Temporal Perspectives: Resolving the Conflict between Current and Future Investors" (2004–2005) 89 *Minnesota Law Review* 1044.
93 Steven L Schwarcz, "Temporal Perspectives: Resolving the Conflict between Current and Future Investors" (2004–2005) 89 *Minnesota Law Review* 1044 at 1046–1057.

directors may sacrifice short-term gains for the long-term corporate interests and *vice versa*.[94] A firm's directors would thus side with long-term shareholders in a takeover context such as was seen in the *Time/Paramount* litigation.[95] In March 1989, Warner Communications ("Warner") and Time Inc ("Time") announced that they would merge in a cash-for-free exchange of stock. On 7 June, shortly before the shareholders voted on the deal, Paramount Communications ("Paramount") tendered a bid to purchase all of the outstanding shares of Time at $175 *per* share in an all-cash offer. Concerned that shareholders of Time would not see the long-term benefits of a Warmer-Time merger, Time's board recast the Warner agreement in a manner that would not require shareholder approval. On 23 June, Paramount raised its offer to $200 *per* share but Time's board rejected the offer on grounds that unlike Paramount, Warner was not a threat to Time's survival and its "Time Culture" of journalistic independence. Paramount and some dissident Time shareholders sued to enjoin Time's deal with Warner.[96]

61 An investment banker who advised Time's board gave evidence that the likely short-term price following the Warner merger would be around $150. The trading range for the year 1990 would be $106 to $188. In the longer term, however, Time's advisers predicted a trading range of $159 to $247 for 1991, $230 to $332 for 1992 and $208 to $402 for 1993.[97] Time's board was clearly denying Time's shareholders an immediate gain of their investment, preferring to realise the firm's long-term share value. On 14 July 1989, Chancellor Allen refused to enjoin Time's board's decision to merge with Warner.

62 A few matters were decided by the court. Firstly, Chancellor Allen noted that it was not the function of the court to evaluate whether the Time-Warner deal was a good deal for Time shareholders or a poor one. What was important was the crucial issue of the scope of directors' duties owed to Time Inc in the circumstances. In this analysis, Chancellor Allen equated the interests of Time Inc with its shareholders but drew a distinction between managing for current value maximisation and managing for longer term creation.[98] However, he

---

94 Steven L Schwarcz, "Temporal Perspectives: Resolving the Conflict between Current and Future Investors" (2004–2005) 89 *Minnesota Law Review* 1044 at 1064.

95 Henry T C Hu, "Risk, Time and Fiduciary Principles in Corporate Investment" (1990-1991) 38 UCLA L Rev 277.

96 *In re Time Inc Shareholder Litigation, Paramount Communications Inc v Time Inc* (1989) Federal Securities Law Reports 1344.

97 *In re Time Inc Shareholder Litigation, Paramount Communications Inc v Time Inc* (1989) Federal Securities Law Reports 1344 at 1348.

98 *In re Time Inc Shareholder Litigation, Paramount Communications Inc v Time Inc* (1989) Federal Securities Law Reports 1344 at 1348.

observed that such a distinction may be a false one because in a large, active, informed market for the shares of the company, the market functions to discount to a present value the future financial prospects of the firm. Be that as it may, he opined that "as a matter of law, in normal circumstances, directors when acting deliberately, in an informed way, and in good faith pursuit of corporate interests, may follow a course designed to achieve long-term value even at the cost of immediate value maximization".[99] On 24 July 1989, the Delaware Supreme Court affirmed Chancellor Allen's judgment and held that the question of long-term versus short-term corporate strategy is largely irrelevant because directors, generally, are obliged to chart a course for a corporation which is in its best interests without regard to a fixed investment horizon. Thus, the Supreme Court sidestepped the question of how directors should act in deciding what is in the best interests of the company. The court felt that this is best left to the business judgment of the directors. Thus, directors could take long-term or short-term value maximisation for the firm unless there are special circumstances such as a change to the "Revlon mode" when directors are obliged, where the sale of the company has become inevitable, to exercise their power in the good faith pursuit of *immediate* maximisation of share value.[100]

63 In addition, there is a stark contrast between three conceptions of the corporation: the classic entity-oriented model, the "pure" shareholder wealth maximisation model, and the "blissful" shareholder wealth maximisation model.[101] The first means the maximisation of profits for the good of the entity; the second means the maximisation by the managers of the *actual* price of shares; and the third means the maximisation of the price that shares would command in an omniscient and fully rational stock market.[102]

64 Tying all things together, the question is "whose benefits and interests should the directors of Raffles Town Club maximise?" Is it the corporation's as an entity or the *current* shareholders' or *future* investors'? Admittedly, the court found that at face value, there was asset-stripping by the defendant directors, but upon consideration, the

99 *In re Time Inc Shareholder Litigation, Paramount Communications Inc v Time Inc* (1989) Federal Securities Law Reports 1344 at 1348.

100 *In re Time Inc Shareholder Litigation, Paramount Communications Inc v Time Inc* (1989) Federal Securities Law Reports 1344 at 1348. The "Revlon mode" refers to the duty of the board of directors to exercise its powers to realise an immediate value maximisation when the board decides to enter into a change in control transaction.

101 Henry T C Hu, "New Financial Products, the Modern Process of Financial Innovation, and the Puzzle of Shareholder Welfare" (1991) 69 *Texas Law Review* 1273 at 1277.

102 Henry T C Hu, "New Financial Products, the Modern Process of Financial Innovation, and the Puzzle of Shareholder Welfare" (1991) 69 *Texas Law Review* 1273 at 1288.

court decided that as the defendants were the only shareholders of the plaintiff and they collectively represented the interests of the company, they were entitled under their business judgment to vote themselves generous remuneration, expenses and management fees to companies owned and controlled by themselves.[103] The court took the traditional route and held that the company is the general body of shareholders and where all the shareholders have agreed, the company's assets and funds can be expropriated for the shareholders' benefits, ignoring all other constituencies such as *future* investors and creditors, present and future.[104] In other words, there is no obligation on the part of directors to achieve long-term sustainability of the business for posterity. There is a legal conundrum: "For whose interests should the directors maximise the value of the firm"?

65 It is submitted that the court should have looked at the interests of the company as a whole, including its *future* shareholders, creditors and employees.[105] The learned judge could have found support for the proposition that future shareholders' interests are to be considered by directors in the exercise of their powers in the authority of *Provident International Corp v International Leasing Corp*.[106] Helsham J of the Supreme Court of New South Wales in deciding how directors should exercise their power to issue shares opined as follows:[107]

> Firstly, I am quite satisfied that in taking the action they did the directors did not consider the interest of the company as including the general body of shareholders, at all either those who were such before the resolution of 7 February 1962, or *those three creditor shareholders who would become such as a result of its adoption*. [emphasis added]

66 In that case, the resolution to issue shares was adopted on 7 February 1962 wherein shares were, *inter alia*, issued to persons who would become shareholders of the company via the resolution, *ie*, *future* shareholders. Therefore, it is submitted that the directors of Raffles Town Club in the exercise of their powers to make payment of the managing fees to EH, and the voting of generous remuneration to themselves, should have paid regard to the interests of *future* shareholders who would certainly be prejudiced by such payments. That US managers suffer from "short-termism" is legend, and it is precisely

103 Even the presence of conflicts of interest on the part of the defendants in the making of the management agreement between EH and the plaintiff for the payment of the management fees would be absolved as all shareholders were appraised of the conflict but had agreed to the payment.

104 *Raffles Town Club Pte Ltd v Lim Eng Hock Peter* [2010] SGHC 163 at [184]–[186].

105 Companies Act (Cap 50, 2006 Rev Ed) s 159.

106 [1969] 1 NSWR 424.

107 *Provident International Corp v International Leasing Corp* [1969] 1 NSWR 424 at 437.

this kind of judicial attitude that will foster myopic and short-term behaviour by managers in Singapore.

67 In the final analysis, the decisive point in *Raffles Town Club* that tilted the balance in favour of the defendants was probably the absence of minority shareholders whose interests had been prejudiced by the asset-stripping. Thus, where there are no minority interests and in an entrepreneurial society such as Singapore's, the courts apparently pay heed to the desire of entrepreneurs to realise their investments through the extraction of private benefits of control.

C. Oppression remedies under s 216

68 Section 216 of the Companies Act provides a remedy for minority shareholders to be bought out by the majority or in extreme cases for the winding up of the company where the affairs of the company are being conducted or the powers of the directors are being exercised in a manner *oppressive* to one or more of the members or in *disregard* of his interest as a member; or that some act of the company has been done or threatened or that some resolution of the members is passed or is proposed which *unfairly discriminates* against or is otherwise *prejudicial* to one or more of the members.[108] Such actions are often called oppression actions.

69 A huge body of case law in the UK, Australia and other parts of the Commonwealth including Singapore has expounded the width and depth of s 216. Suffice it to say that the main idea behind s 216 is to examine whether the majority shareholders have departed from the "proper standard of commercial fairness and the standards of fair dealing and conditions of fair play".[109] Other descriptive compendiums of s 216 include "an awareness of the minority interest and an evident decision to override it or brush it aside"[110] and "the directors have acted unscrupulously, unfairly or with any lack of probity".[111]

70 The question arises as to whether directors who are also the majority shareholders and who have entered into self-dealing transactions with the company could be found guilty of oppressive conduct under s 216. Two local cases have determined that the making of self-dealing transactions by directors in breach of their fiduciary duty could amount to an infringement of s 216. The first is *Kumagai Gumai Co Ltd v Zenecon Pte Ltd*[112] where Low through his company Zenecon

108 Companies Act (Cap 50, 2006 Rev Ed) s 216(1)(*a*) and 216(1)(*b*).
109 *Re Kong Thai Sawmill (Miri) Sdn Bhd* [1978] 2 MLJ 227 at 229.
110 *Re Kong Thai Sawmill (Miri) Sdn Bhd* [1978] 2 MLJ 227 at 229, *per* Lord Wilberforce.
111 *In re Five Minute Car Wash Service Ltd* [1966] 1 WLR 745 at 752.
112 [1995] 2 SLR(R) 304.

Pte Ltd formed a joint venture called Kumagai-Zenecon Construction Pte Ltd ("KZ") with a Japanese company Kumagai for the purpose of engaging in the business of building contractors and property development. KZ had a subsidiary called Kumagai Property Marking Pte Ltd ("KPM") which was to be the marketing arm of KZ. With Kumagai's approval, the original subscribers of KPM were Low, his wife Teo and one Low Woon Hock. Subsequently, KZ was allotted 9,000 shares in KPM and Low's brother-in-law, Lim Thye San, was allotted 1,000 shares.

71 In early 1991, Kumagai told Low not to tender for any new projects but Low nevertheless submitted tenders on behalf of KZ and used KPM's funds to pay for the tender deposits. In May 1991, KPM bought 7.321m shares in Pacific Can Investment Holdings Ltd through a company called Kumagai Investment Pte Ltd. The objects clause of KPM was later altered to enable KPM to invest in shares as part of its business. KPM also invested in KZ Investments Pte Ltd, a company which was wholly-owned by Zenecon Pte Ltd. In June 1991, KPM, without the knowledge of Kumagai, paid for and took up $1.3m worth of shares in KZ Investments Pte Ltd. In September 1991, KZ Investments Pte Ltd acquired 3.117m shares in a Malaysian company called Aokam Tin Bhd. Low also bought 2.011m shares in Aokam Tin Bhd. All these acts were done without Kumagai's knowledge and approval. On 17 September 1991, Zenecon requisitioned an extraordinary general meeting to remove a Kumagai nominee, Okazaki, from the board of KZ and appoint Lim Thye San in his place. This move was later abandoned by Low. From December 1991 onwards, Zenecon nominated directors did not attend meetings convened by Kumagai nominated directors to discuss company matters. In January 1992, Low instructed KZ's solicitors to deny Kumagai nominated directors access to files relating to certain projects. On 11 February 1992, Kumagai obtained a court order appointing provisional liquidators for KZ. It was found that much of KZ's documents and records had been removed and were missing. On 29 January 1992, Kumagai filed a petition under s 216 seeking the winding up of KZ and KPM.

72 The court found that Low had run KZ and KPM as though they were his own without regard to Kumagai's interest as a shareholder. In particular, KPM's investment in KZ Investments Pte Ltd through Kumagai Investment Pte Ltd had the effect of locking up $1.3m of KPM's funds in a company which was practically inactive. As a minority shareholder in KZ Investments Pte Ltd, KPM would have great difficulty in recovering the investment and the deal made no commercial sense for KPM. The only reason why KPM took up these shares was to help Zenecon gain a 51% voting power in KZ Investments Pte Ltd. This was done solely for Low's own purpose and ultimately prejudicial to Kumagai. The same went for the "Pacific Can Investment Holdings Ltd" investment. In answer to the defence that the oppression, if any, took

place at KPM level and not at KZ level, the Court of Appeal decided as follows:[113]

> Reverting to the facts in the instant case, Low represented KZ in KPM and was the nominee director of KZ on the board of KPM. It was certainly in the interests of KZ that Low should discharge his duties as directors of KPM properly … When he and his co-directors of KPM carried on the business of KPM, which served only the interest of Low and/or Zenecon and in disregard of the interest of KZ, he acted in breach of his duty to KZ, and such conduct on his part was also conduct in the affairs of KZ and oppressive to Kumagai as a shareholder of KZ.

73 In the event, the Court of Appeal ordered the winding up of KZ and KPM. The second case is *Lim Swee Khiang v Borden Co (Pte) Ltd*[114] where the plaintiff, Lim, was a minority shareholder in a company called Borden Co Pte Ltd ("Borden"). Borden was originally set up in 1960 by six families to manufacture and distribute medicinal and pharmaceutical products. Its most successful product was the "Eagle Brand" medicated oil. Borden was the registered owner of the "Eagle Brand" trademark in many countries such as Malaysia, Australia, Canada, the US, Taiwan, Hong Kong, the Philippines and Vietnam. Each family was represented on the board of Borden by a family member. In 1975, Borden granted a licence to PT Eagle to manufacture and distribute the "Eagle Brand" medicated oil in Indonesia. PT Eagle was a company set up by Madam Halim, a shareholder and director of Borden, and her son, Edy Chew. Madam Halim was named as a commissioner and her son a director of PT Eagle under Indonesian law. PT Eagle paid royalties of $60,000 annually to Borden from 1986 to 1995. Thereafter, the directors of Borden neglected to collect royalties from PT Eagle. PT Eagle was aggressively expanding its business empire in Malaysia, Vietnam and the United Arab Emirates, and registering itself as the owner of the "Eagle Brand" trade marks in these countries.

74 On 24 October 2001, Madam Halim moved an extraordinary general meeting to remove Lim as an executive director of Borden. Some months later, a board resolution appointed Christopher Yeo (belonging to the Yeo family) as managing director and Rachel Chew (Madam Halim's daughter) as assistant managing director. After Lim was stripped of his executive directorship, he was powerless to stop PT Eagle from encroaching on Borden's commercial interests.

75 On appeal, the Court of Appeal found that Madam Halim and her co-directors had acted in disregard of Borden's interest (and hence Lim's interest) in not keeping a lid on PT Eagle's aggressive actions as a

113 *Kumagai Gumai Co Ltd v Zenecon Pte Ltd* [1995] 2 SLR(R) 304 at [57].
114 [2006] 4 SLR(R) 745.

competitor; in particular they had settled an action with PT Eagle in Malaysia for US$900,000 when Borden had the upper hand in the litigation and the settlement was a total rip-off for Borden. The court further found that Madam Halim was in a position of conflict as regards the competition between PT Eagle and Borden. She was a shareholder and director of Borden and at the same time a shareholder of PT Eagle which was controlled by her son. She stripped Lim of his executive powers and prevented him from trying to halt PT Eagle's aggressive move into Malaysia, Vietnam and from registering the "Eagle Brand" trade mark in the United Arab Emirates. In this position of conflict, Madam Halim had preferred the interests of PT Eagle over that of Borden. As such, she had disregarded the interests of Lim as a minority shareholder. In effect, the court found Borden to be a quasi-partnership and applied the principles in *Ebrahimi v Westbourne Galleries Ltd*.[115]

76 More importantly, the Court of Appeal cited *O'Neill v Phillips*[116] with approval and held that Parliament has chosen the criterion of fairness by which the court must decide whether to grant relief. The notion of "fairness" has to be decided against the context and background of the action. Thus, conduct which may be perfectly fair between competing businessmen may not be fair between members of a family. Company law which has developed seamlessly from the law of partnership would therefore restrain the exercise of strict legal rights in certain relationships when it considers that this would be contrary to good faith.[117]

VII. Economic analysis of legal strategies for constraining self-dealing transactions

A. Specific rules under SGX Listing Rules

77 In this regard, Singapore uses a combination of regulatory and governance strategies. Rules 905 and 906 are bright line rules that mandate disclosure and shareholder approval of self-dealing transactions respectively. In the mandatory disclosure provision, r 917 uses the trusteeship strategy to repose authority for approving a self-dealing transaction in a group of independent actors, in this case the audit committee. Under the Code of Corporate Governance 2005, the audit committee shall comprise at least three directors, all non-executive, the majority of whom, including the chairman, should be independent.[118] With respect to obtaining shareholders' approval, r 921

115 [1973] AC 360.
116 [1999] 1 WLR 1092.
117 *O'Neill v Phillips* [1999] 1 WLR 1092 at 1089–1099.
118 Code of Corporate Governance 2005 Principle 11.

requires an opinion from an independent financial adviser judging the "fairness" of the transaction. Again, this is a form of trusteeship strategy, interlaid with standards of fairness, the adjudication of which is reposed in independent actors. In approving the self-dealing transaction at a shareholders' meeting, r 919 stipulates approval from a majority of the disinterested minority because interested persons and their associates shall not vote on the resolution. This is a type of decision rights strategy. Such techniques of constraining self-dealing transactions are comparable to the US standard of "entire fairness" decided by disinterested directors or a majority of minority shareholders.[119]

78 As regards the trusteeship strategy of disclosure to the audit committee housed with the majority of independent directors, it is submitted that this rule misses the point because it is the disinterestedness of the directors with respect to the conflicted transaction that is crucial rather than the label of "independence" on these directors. The SGX Listing Rules presume that independent directors would be disinterested in all matters, which is patently wrong. In fact, the answer can be found in Art 81 of Table A of the Companies Act which provides that directors who have an interest in any contract or proposed contract should not vote on the matter. It is therefore proposed that the SGX Listing Rules be changed to provide for approval or ratification of self-dealing transactions by *disinterested* directors who will be regarded as disinterested in respect to the self-dealing transaction if they were neither directly nor indirectly involved in the alleged wrongdoing, are not under the influence of the alleged wrongdoers so that their impartiality is compromised, and do not stand to gain improperly from the ratification.[120] The main problem, however, with this strategy is, of course, the availability of credible, adequately qualified and disinterested independent directors in view of the "mutual back-scratching" and the tendency to form "old boys clubs" on the boards of listed companies.[121]

---

119 Jens Dammann, "Corporate Ostracism: Freezing Out Controlling Shareholders" (2008) 33(3) *Journal of Corporation Law* 681 at 688.

120 Hans C Hirt, "The Company's Decision to Litigate against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest" (2005) *Journal of Business Law* 159 at 178.

121 Hans C Hirt, "The Company's Decision to Litigate against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest" (2005) *Journal of Business Law* 159 at 179. See further Richard Nolan's recommendation for using the independent non-executive director as a monitor of conflicted transactions in Richard C Nolan, "The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report" [2005] 6 *Theoretical Inquiries in Law* 413 at 443–449. But see Tan Cheng Han, "Corporate Governance and Independent Directors" (2003) 15 SAcLJ 355 at 369–371 for a contrary view where the learned author expressed doubts as to the independence of independent directors in Singapore.

79 As regards the strategy of approval by a majority of disinterested minority shareholders, it is submitted that though it may be fraught with the "collective action" problem amongst the public shareholders who are in the minority, it is the least of all evils in the circumstances. Firstly, it solves the "wrongdoer control" problem in our concentrated ownership structure where the controlling shareholder is likely to be in the majority and the wrongdoer as well. It takes the decision for ratifying a self-dealing transaction by the director (who is often also the controlling shareholder) out of his hands and places it in the hands of the minority. Depending on who comprises the "minority", different sets of problems arise. If the minority comprises public shareholders, then we are faced with the "collective action" problem. The "collective action" problem arises from "rational apathy" and the "free rider problem" of individual shareholders. If an individual shareholder is but one of a great number in a large company, it may not be worth his while to invest time, effort and resources to understand the company's affairs (including the implications of the self-dealing transaction) and vote accordingly. The shareholder's costs of informed voting may exceed his benefits, which will only be a *pro rata* accretion in the value of his shares. Thus, individual shareholders may understandably be "rationally apathetic". Moreover, no shareholder expects his vote to be decisive. With little or no incentive to invest time and effort to vote intelligently, the shareholder would rather rely on others to vote and get the benefit from them. Thus, we have the "free rider problem". Not to mention the costs of organising a general meeting, it may be difficult practically to obtain a vote from the majority of the disinterested minority, if the latter comprises public shareholders.

80 On the other hand, if the "minority" comprises other substantial shareholders such as institutional investors or families, it may be easier to obtain their disinterested votes. The only possible problem is that of collusion between the controlling shareholder and these minority shareholders. In any case, if there is collusion, then it would not be a *disinterested* minority decision. Though this may conflict with notions of democracy and majority rule, yet where a self-dealing transaction is concerned, it is right on principle and authority that the majority should not be a judge in their own cause. Moreover, the need for an expert opinion from an independent financial adviser judging the "fairness" of the transaction (an external trusteeship strategy) would add an extra layer of protection to the shareholders.

(1) Transaction costs for self-dealing

81 Legal protection rules for governing self-dealing transactions can be classified either as "property rules" or "liability rules".[122] An entitlement is said to be protected by a property rule when someone who wishes to remove the entitlement from its holder must buy it from him in a voluntary transaction in which the value of the entitlement is agreed upon by the seller. On the other hand, where a person is willing to pay an objectively valued price to destroy the entitlement, the entitlement is protected by a liability rule.[123] Thus, a rule which reposes authority in an impartial body such as the Judiciary to determine a fair price to enable the self-dealing transaction to proceed is a liability rule whilst a rule which allows a majority of the minority of disinterested shareholders to approve a self-dealing transaction is a property rule.

82 SGX Listing Rules r 917 which reposes authority in the audit committee to approve the self-dealing transaction is akin to a liability rule. The audit committee has the responsibility of determining the "objective" value of the self-dealing transaction, which is not an exact science. Necessarily, the independent directors sitting on the audit committee would try to protect themselves against any allegations of negligence by relying on value assessments made by professionals. These value assessments are subject to tendentiousness, not to mention that the rendered opinion may be slanted to meet the demands of the party who has commissioned it (who is likely to be the controlling shareholder), or there may be opposing opinions tendered by the parties in order to fix the "correct" value of the transaction. Where there is no market price for the asset, the "objective" value necessarily is the result of subjective ascertainment. If the parties are not satisfied with the decision of the audit committee, actions of appeal can be taken to the courts, thus incurring more costs. These costs are called adjudication costs. Furthermore, the company is often made to bear these costs for the benefit of the controlling shareholder who is interested to see the transaction approved.[124]

83 With respect to obtaining the approval of the majority of the disinterested minority shareholders, it is a property rule. This rule uses the voting mechanism to determine the group's consent, and by disallowing interested shareholders from voting, it thus reflects the group's preference, especially where the minority forms a large group.

122 Zohar Goshen, "The Efficiency of Controlling Corporate Self-dealing: Theory Meets Reality" (2003) 91 *California Law Review* 393 at 398.

123 Guido Calabresi & A Douglas Melamed, "Property Rules, Liability Rules and Inalienability: One View of the Cathedral" (1971–1972) 85 *Harvard Law Review* 1089 at 1092.

124 Zohar Goshen, "The Efficiency of Controlling Corporate Self-dealing: Theory Meets Reality" (2003) 91 *California Law Review* 393 at 403.

There will be costs arising from the negotiation process because the minority has to expend money and resources to understand the information given to them. Such costs are likely to be high in view of the professional opinions obtained from experts to justify or oppose the transaction (in fact SGX Listing Rules r 921 requires such an opinion). In the voting process, the non-participation of some voters will lower the quality of the decision-making. Whilst the presence of institutional investors amongst the minority would improve the decision-making, these investors may, however, collude with the controlling shareholders. Where the minority is able to coalesce and "hold-out" in order to extract a higher "payout" for approving the self-dealing transaction, efficient transactions may be lost. As the majority of the disinterested minority shareholders' approval needs to be obtained for all self-dealing transactions, negotiation costs will substantially increase.[125] Regardless of this shortcoming, this strategy empowers the minority to look after its own interests and strive to obtain the maximum price it can achieve.[126]

84 Whether the transaction will take place depends on how the opposing parties divide up the surplus. Where X values an asset at $100 while the asset is worth $200 to Y, the $100 difference between their valuations will constitute the surplus. Any transaction that takes place at a price between $100 and $200 will be efficient. If the price is set at $101, X receives $1 and Y $99 of the surplus, whereas if the price is set at $199, X will receive $99 while Y $1. In either case, the transaction will be efficient and will be "fair" because both parties consented to it. Thus, a property rule such as majority of minority disinterested shareholders' approval will allow the minority to demand a larger portion of the surplus. Yet, abusive holding out by the minority may lead to the loss of worthwhile transactions.[127]

85 On the other hand, the liability rule under r 917 which empowers the audit committee to make an "objective" evaluation will not have the problem of holding out by minority shareholders looking to extract a large portion of the surplus. The "fairness" test thus reduces the minority's profit on each transaction and ensures the maximum number of transactions.[128] However, it has its drawbacks. There are possibilities of serious errors in valuations made by the audit committee and/or wrong decisions made by the courts so that inefficient

125 Zohar Goshen, "The Efficiency of Controlling Corporate Self-dealing: Theory Meets Reality" (2003) 91 *California Law Review* 393 at 417.

126 Zohar Goshen, "The Efficiency of Controlling Corporate Self-dealing: Theory Meets Reality" (2003) 91 *California Law Review* 393 at 402.

127 Zohar Goshen, "The Efficiency of Controlling Corporate Self-dealing: Theory Meets Reality" (2003) 91 *California Law Review* 393 at 411 and 413.

128 Zohar Goshen, "The Efficiency of Controlling Corporate Self-dealing: Theory Meets Reality" (2003) 91 *California Law Review* 393 at 414.

transactions are ratified and efficient ones banned. Such indirect adjudication costs may inflict a serious blow to efficient transactions. Investors may be unwilling to invest as minorities in a company and the majorities are saddled with the task of creating reliable and cost-effective mechanisms to secure potential investors.[129]

86 In the final analysis, the SGX Listing Rules utilise both the "property" and "liability" rules for approving self-dealing transactions. Neither rule is superior to the other as each comes with its attendant costs and benefits that will apply according to the different situations outlined above. So long as parties bargain within the surplus created by the different valuations put forth by the opposing parties or the "objective" value is capable of ascertainment, efficient transactions will take place under either rule.

B. Common law derivative action

87 As discussed above, the common law respects majority rule and, hence, lays down the rule in *Foss v Harbottle*. Most self-dealing transactions would come under the "fraud on the minority" exception and this would entitle an individual shareholder to bring a derivative action. But the common law derivative action is not the optimal solution because of the "collective action" and "wrongdoer control" problem, not to mention that any damages recovered belong to the company while the litigant bears the costs of prosecution of the action until such time as the court orders an indemnity. Moreover, Knox J in *Smith v Croft (No 2)*[130] decided that a minority action should not proceed if the majority of members, who are independent of the defendant, are not in favour of litigation. Because of the aforesaid, it is not easy for an individual shareholder to bring a derivative action.

88 At this juncture, it is pertinent to note that the right to bring a derivative action depends on the *ratifiability* of the self-dealing act(s) as opposed to the *ratification* of the self-dealing act(s).[131] *Ratifiability* of a self-dealing act(s) depends on an *ex post facto* decision by the courts and thus much uncertainty exists at present under the common law derivative action (*ie*, the doctrinal problem).

89 Regardless of the doctrinal problem mentioned, most controlling shareholders would try to pre-empt a derivative action by

129 Zohar Goshen, "The Efficiency of Controlling Corporate Self-dealing: Theory Meets Reality" (2003) 91 *California Law Review* 393 at 420.

130 [1988] Ch 114.

131 Hans C Hirt, "The Company's Decision to Litigate against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest" (2005) *Journal of Business Law* 159 at 193.

procuring a ratification of the self-dealing act(s) by the general meeting which they control. In this regard, it is submitted that the rules on ratification by the general meeting do not work well in the concentrated ownership structure found in most family-owned firms in Singapore. The controlling shareholders who own the majority of shares would certainly vote to approve any self-dealing transaction, and the position is made worse by the principle in *North-West Transportation Co Ltd v Beatty*.[132] Thus, "wrongdoer control" would not ensure a fair result. However, we see some light at the end of the tunnel in the decision of *Smith v Croft (No 2)*. Knox J decided that a minority action should not proceed if the majority of members, who are independent of the defendant, are not in favour of litigation. By analogical reasoning, ratification of self-dealing transactions should be carried out by a majority of the disinterested minority. This would prevent "wrongdoer control" and ensures a fair result. But note that problems of "collective action" may occur depending on who comprises the "minority"; and secondly, this decision rights strategy of reposing authority in a subset of shareholders to decide whether to ratify a self-dealing transaction may provide disgruntled shareholders with opportunities to bring unmeritorious claims and for a collateral purpose such as extracting some sort of "payment" or benefit from the settlement of the action.[133]

90 Thus, at common law, doctrinal problems surrounding the *ratifiability* of self-dealing act(s) which *in limine* decides whether a derivative action can proceed presents a formidable barrier to a minority bringing a wrongdoing majority to task. In addition, the current rules on ratification by the general meeting tilt the balance too much in favour of the controlling majority.

(1) Transaction costs for self-dealing

91 As alluded to above, there is little protection of minority interests against self-dealing under the common law derivative regime. Under such a scenario, investors may simply opt out of the market altogether unless corporate groups as shareholders voluntarily insert protective devices in the corporate charter to include explicit protection, based either on the "fairness" test or majority of the minority requirement. In order to price a security properly, investors would have to incur information costs to ascertain the effectiveness of the protection, and he/she has to repeat the process for each security he/she

132 (1887) 12 App Cas 589.

133 Hans C Hirt, "The Company's Decision to Litigate against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest" (2005) *Journal of Business Law* 159 at 174.

wants to purchase so that prohibitively high information costs may be incurred for a diversified portfolio of shares.[134]

92 Even if the investor opts for estimating the probability of any company providing protection against self-dealing, so that the price that the investor would pay would then be some average based on the investor's probability estimate, there would be free-rider problems. Companies that do not offer protection would derive undeserved premiums and companies that gave a higher than average protection would not be fairly recompensed. Thus, companies with better protection will cancel their protection to enjoy the average premium. This will cause the investor to lower the premium he/she is willing to pay, leading to a zero defence point. To prevent this situation, companies may publicise the protection they offer and internalise the costs of keeping investors informed. But this does not reduce the information costs that investors have to bear because they now have to evaluate the information given to them.

93 The present common law derivative regime is therefore unsatisfactory from the economic viewpoint and is in need of reform.

C. Statutory derivative action

94 Section 216A of the Companies Act reposes wide discretion in the courts to determine if a derivative action should proceed. This is an external trusteeship strategy. The advantage of this regime lies in doing away with the doctrinal problems of *ratifiable* wrongs explained above. However, there are a few difficulties with this approach:

(a) Judicial discretion is unlikely to be exercised in a vacuum. Judges may be hamstrung by the common law cases on derivative actions and impose as exacting a standard as that required under common law.

(b) Shifting the decision-making power as to whether the derivative action is "in the best interests of the company" from shareholders and directors to the court as trustee may not be sensible as the decision whether to litigate is arguably a commercial and management decision entailing a balancing of risks and expenses against perceived benefits. As in *Smith v Croft (No 2)*, a majority of disinterested minority shareholders may perceive litigation to be a waste of the company's time and resources and inimical to the company's reputation.

---

134 Zohar Goshen, "The Efficiency of Controlling Corporate Self-dealing: Theory Meets Reality" (2003) 91 *California Law Review* 393 at 405.

(c) Procedural problems may arise during the application for leave as there is always the balance to be maintained against unearthing the whole truth and holding a mini-trial on the one hand, and assuming the plaintiff's pleadings to be factually correct on the other. If the balance is tilted in favour of the former, we will see the likes of *Prudential v Newman Industries (No 2)* where ten learned counsel argued for 70 days in a preliminary hearing.[135]

95 Despite the above misgivings, the courts in Singapore have shown their level-headedness in deciding s 216A actions.

D. *Oppression action under s 216*

96 The oppression remedy combines the trusteeship strategy with the standards strategy and provides an exit remedy. The trustee in this case is the court who will review the conduct of the controlling shareholder and decide whether he has breached the standards of "fairness", and if not, the court will generally order the majority to buy out the minority at fair value. In egregious cases, the court may order a winding up of the company.

(1) Transaction costs for self-dealing

97 Both the statutory derivative action and the oppression regime adopt the "liability rule" to decide if the self-dealing transaction should be approved. Apart from the adjudication costs incurred to resolve the dispute, the parties may also incur negotiation costs if they bargain in the "shadow of the rule". As the Singapore courts have shown themselves competent to decide sections 216 and 216A actions in a fair and just manner, any indirect adjudication costs are minimised.

E. *Adopting the American Law Institute's approach to self-dealing transactions?*

98 The American Law Institute's ("ALI") formula for self-dealing transactions by directors can be briefly stated as follows:[136]

(a) the transaction is upheld if the conflict disclosure is made and the transaction is fair;

---

135 L S Sealy, "*Foss v Harbottle* – A Marathon Where Nobody Wins" [1981] CLJ 29 at 29.

136 Norwood P Beveridge Jr, "The Corporate Directors' Fiduciary Duty of Loyalty: Understanding the Self-Interested Director Transaction" (1991–1992) 41 *DePaul Law Review* 655 at 679.

(b) the transaction is authorised in advance by disinterested directors and they could reasonably have concluded it was fair; or

(c) the transaction is authorised or ratified by disinterested shareholders and does not constitute waste.

99 Under the ALI principles, the absolving body is either the disinterested directors or shareholders. It is submitted that apart from ratification by the majority of disinterested minority shareholders as embodied under r 906 of the SGX Listing Rules, the common law rules can take a leaf from rr 905 and 917 and the ALI principles to mandate that self-dealing transactions be approved by a majority of disinterested directors, or a special committee of the board which could be the audit committee or some special committee set up *ad hoc* to approve such transactions. Support for this can be found in the UK Company Law Review Steering Group's Recommendations which proposed that disinterested members of the board should also have the power to take the decision not to sue.[137] In addition, Richard Nolan has also made a forceful argument that independent non-executive directors are equal to the task of approving self-dealing transactions by interested directors.[138] Apart from problems of perceived bias by disinterested directors, ratification by a disinterested board or special committee of the board would save negotiation costs necessitated by procuring approval from the majority of disinterested minority shareholders. But of course, advocating a "liability rule" would bring about the sticky problem of "objective" valuation of the asset, especially where there is no market price.

VIII. Conclusion

100 In summary, Singapore's legal strategies for monitoring self-dealing transactions by directors have to be considered in the light of its ownership structures. The SGX Listing Rules have utilised mandatory disclosure as a policing tool together with the trusteeship and decision rights strategies to monitor self-dealing transactions. Where ownership structures are highly concentrated as in Singapore, the agency problems between the majority shareholder and the minority shareholder can be acute as illustrated by the cases discussed above. Thus, the Listing Rules' enlistment of an independent actor like the audit committee to approve self-dealing transactions is a step in the right direction. For bigger

137 Hans C Hirt, "The Company's Decision to Litigate against its Directors: Legal Strategies to Deal with the Board of Directors' Conflict of Interest" (2005) *Journal of Business Law* 159 at 197.

138 Richard C Nolan, "The Legal Control of Directors' Conflicts of Interest in the United Kingdom: Non-Executive Directors Following the Higgs Report" [2005] 6 *Theoretical Inquiries in Law* 413 at 443.

transactions, a shareholder's mandate is needed and, in this regard, a vote from a majority of the disinterested minority shareholders is needed. Despite problems of "collective action" and "free riders", this strategy works out well in a concentrated ownership structure as it addresses the "wrongdoer control" problem.

101 The above rules have been classified as either "property rules" or "liability rules". Each type of rule has its attendant costs and benefits as discussed above. The SGX Listing Rules on self-dealing are certainly better than the common law derivative action regime. The lack of protection for minority interests against self-dealing will drive investors out of the market, and thus the common law is in urgent need of reform.

102 In addition, it is recommended that the statutory derivative action under s 216A should be made available to listed companies as well and the Steering Committee for the Review of the Companies Act has recommended a step in this direction, which is to be lauded. Both the statutory derivative actions (s 216A) and oppression actions (s 216) adopt the external trusteeship strategy and repose authority in the courts to decide the "fairness" of the transactions or acts involved. Our courts have shown themselves able and willing to decide disputes between controlling shareholders and minority shareholders in a fair manner and often in family tussles for control.

103 A final word on ratification of self-dealing transactions – at present, the common law states that the general meeting should decide on whether to ratify a self-dealing transaction. In concentrated ownership structures like our family-owned firms, it is submitted that Knox J's principle of ratification by a majority of disinterested minority shareholders would make more sense because it would address the problem of "wrongdoer control". It is suggested that the principle can be extended to include ratification by the majority of disinterested *directors* (functioning as the board or special committee of the board), as arguably ratification would forestall a derivative action and if the board can decide whether or not to pursue a legal action as part of its normal management powers, *in limine* it should be able decide whether to ratify a self-dealing transaction(s).