8. COMPANY LAW

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Lifting the corporate veil

8.1 In *Singapore Tourism Board v Children's Media Ltd* [2008] 3 SLR 981, the plaintiff entered into a series of agreements with the first defendant that related to a musical event known as "Listen Live" which was to be staged in Singapore. The purpose of the event was to raise funds for disadvantaged children. In reality, the first defendant was merely the conduit to receive the sponsorship sums. It was made to bear all the expenses and liabilities of the second defendant, which was a shareholder of the first defendant, as well as those of third parties, but it obtained none of the benefits for being the organiser of "Listen Live". Instead, where liabilities were to be incurred, the contract was entered into by the first defendant. In relation to income, such contracts were entered into by the second defendant. As between the first and second defendants, there were no internal procedures for the control of movement of funds, their bank accounts were effectively commingled, and there was a dearth of documents in relation to bank accounts, liabilities and obligations between them. Although it was said that there was a defined contractual relationship between the first and second defendants in relation to the staging of "Listen Live", there were no written documents to support this claim.

8.2 Control of the first defendant's bank account rested in the hands of the third defendant who was a director and the chief executive officer of the first and second defendants as well as the sole shareholder of the second defendant. The third defendant used the first defendant's bank account to make payments to himself, the second defendant, his friends and third parties. It could be said that the third defendant was essentially the controlling mind and the sole beneficiary of the profits of the second defendant, being the only person within the second defendant who decided to whom payments were to be made.

8.3 Although the plaintiff provided the first defendant with a sum of money as agreed under the first agreement with the first defendant, and several extensions of time to stage "Listen Live" were granted, the event was not eventually held as the third defendant claimed that the first defendant had not been able to fulfil its obligations under the first agreement. By this time, the first agreement had been superseded by a third agreement and a side letter. The latter provided that all prior agreements between the parties were deemed terminated; neither party had any further obligations arising from the prior agreements; and both parties waived their right to claims arising from the prior agreements.

8.4 The plaintiff claimed against the defendants for return of moneys paid to the first defendant and damages for breach of contract. Justice Lai Siu Chiu held that the third agreement and side letter should be rescinded because of fraudulent misrepresentations made to the plaintiff. That being the case, any claim against the first defendant for return of moneys and damages for contract would be straightforward as the first defendant had not fulfilled its contractual obligations. However, the facts rendered it likely that the first defendant would not be able to satisfy any judgment against it and thus the plaintiff sought to include the second and third defendants on the basis that the corporate veil should be lifted. This should only be done in exceptional circumstances, where there has been abuse of the corporate vehicle and the company has been used for an illegitimate purpose. (Generally, see Tan Cheng Han, "Piercing the Separate Personality of the Company: A Matter of Policy" (1999) Sing JLS 531.)

8.5 Lai Siu Chiu J listed some of the facts that the court would take into consideration in determining whether a company has been used for an illegitimate purpose: *Singapore Tourism Board v Children's Media Ltd* [2008] 3 SLR 981 at [98]. On the facts, the learned judge had no hesitation in lifting the corporate veil and equating the second and third defendants with the first defendant for the purposes of the claim against them: the separate existence that was claimed between the first and second defendants was compromised by the fact that their accounts were commingled and there did not appear to be a proper separation of affairs. It goes without saying that where a party seeks to rely on the separate personality of a company, this will be weakened where the facts show that the affairs of the said company have not been managed as if it was an entity in its own right. On this basis, the learned judge's decision cannot be impeached. However, in so far as she also felt that the veil could be lifted because the first defendant had been used by the third defendant as a means to evade his legal obligations (*Singapore Tourism Board v Children's Media Ltd* [2008] 3 SLR 981 at [154]–[155]), this may be debatable. It is not wrong for a company to be incorporated because the incorporators do not wish to assume personal liability; the right to distance oneself from a corporate vehicle's liability is the rationale for making incorporation widely available. What is impermissible is how the corporate vehicle is used in the pursuit of the business or other endeavour. Typically, where the veil is lifted because it has been used to evade a legal obligation, this obligation pre-dates the use of the corporate vehicle. A typical example arises where an owner of property enters into a binding contract to sell the said property but subsequently transfers it to a company to avoid having to specifically perform the contract of sale. The law will not allow such an existing obligation to be evaded simply through the use of a corporate vehicle (see, *eg*, *Jones v Lipman* [1962] 1 WLR 832).

8.6 Similarly, if the corporate vehicle has been incorporated because the shareholders intend for it to be used to perpetrate a fraud on third parties and wish to insulate themselves from such fraudulent activity, this provides the classic example of where the veil will be lifted as this is clearly an instance of a company being used for an illegitimate purpose. The "fraud exception" to the recognition of the company's separate personality is a well-known one. On the facts, it could be said that at some point (if not right from the outset) the first defendant became an instrument to perpetrate a fraud on the plaintiff and the use of a company for a fraudulent or dishonest purpose cannot absolve the persons behind the company from the legal consequences of such acts. It is suggested that the learned judge undoubtedly had this in mind in arriving at her decision.

8.7 The defendants' appeal was dismissed by the Court of Appeal in *Children's Media Ltd v Singapore Tourism Board* [2009] 1 SLR 524. On the corporate veil point, stress was laid on the failure to treat the entities as separate. Judge of Appeal V K Rajah said (at [9]) that the "first and second [defendants] were no more than corporate puppets compliantly dancing to the tune of the third [defendant]. He treated their assets as his own. Their liabilities arising from the failure to stage ['Listen Live'] should now also be his."

Breach of fiduciary duty

8.8 Despite the strict attitude of the law against employees or agents taking advantage of their position to appropriate for themselves opportunities that should belong to their employers or principals, it is not uncommon for employees or agents to attempt to do so. *Viking Airtech Pte Ltd v Foo Teow Keng* [2008] 1 SLR 225 is one of such cases. The plaintiff company was in the business of providing heating, ventilation and air-conditioning ("HVAC") systems for marine vessels. The first defendant was a director and general manager of the plaintiff. A contract was entered into between the plaintiff and an Indonesian shipyard to provide a HVAC system for a tugboat. The first defendant signed the contract on the plaintiff's behalf but resigned several months later. Before his resignation, the second defendant was incorporated by the first defendant's friends. It carried out the same business as the plaintiff. After incorporation, the second defendant entered into contracts with two Indonesian shipyards that were the plaintiff's customers. The first defendant signed those contracts on behalf of the second defendant. He and his wife subsequently took over the second defendant without paying for the transfer of shares to them. After the first defendant's resignation, the plaintiff discovered the HVAC system intended for the aforementioned tugboat in its warehouse. It then found out that the second defendant had already separately delivered the HVAC system for the said tugboat and received payment via a letter of credit. The plaintiff claimed against the first defendant for acting in breach of his fiduciary duty by diverting business from the plaintiff to the second defendant *vis-à-vis* the two contracts with the Indonesian shipyards and the aforementioned tugboat contract. The plaintiff also sued the defendants for conversion of equipment in the plaintiff's Shanghai office.

8.9 On the basis of the above facts, Justice Judith Prakash unsurprisingly found that the first defendant was in breach of his fiduciary duty as a director and senior employee of the plaintiff. In relation to the tugboat contract, it was clear that there was a diversion of the benefit of the contract to the second defendant as a letter of credit had been issued in its favour by the other party to the contract. As for the contracts with the two Indonesian shipyards, he had been negotiating for them on behalf of the plaintiff between April and August 2003. Accordingly, the level of negotiations was such that the two contracts were ripening or maturing business opportunities for the plaintiff which the first defendant diverted to the second defendant. As a fiduciary, the first defendant had to act in the best interests of the plaintiff and he did not so act when he acted unilaterally to pass on the contracts to the second defendant.

8.10 Although the first defendant argued that there was no breach of duty with respect to the two shipyards since the plaintiff could not have availed itself of the opportunity, the learned judge said that he should not have made the decision unilaterally. Rather he should have brought this to the attention of the other directors of the plaintiff to allow the board to make a fully informed decision. With respect, there is no doubt that Judith Prakash J was correct here. There are numerous cases where judges have cautioned fiduciaries against temptation and therefore adopted a strict approach. In a much-cited passage from the old case of *Keech v Sandford* (1726) Sel Cas T King 61, Lord King LC said (at 62): "if a trustee on refusal to renew might have a lease to himself, few trust estates would be renewed to the *cestui que use*". In any event, the circumstances strongly indicated that the second defendant was not an independent third party but a vehicle for the first defendant to divert business to. Accordingly, the first defendant was liable in damages for breach of duty and the second defendant was liable for abetting such breach of duty.

Member's remedies

8.11 In *Re Lee Tung Co (Pte) Ltd* [2008] 1 SLR 800 and *Chow Kwok Chuen v Chow Kwok Chi* [2008] 4 SLR 362, the High Court and Court of Appeal respectively dealt with "family" companies where the relationship between the three directors of the companies, who were also collectively the major shareholders, had deteriorated to a point where they were unable to agree on how to manage the companies. One of the brothers, the respondent, accordingly, brought an action to wind up the companies on the "just and equitable" ground in s 254(1)(*i*) of the Companies Act (Cap 50, 2006 Rev Ed), which the other two brothers opposed. In the High Court, Justice Judith Prakash ordered that the companies be wound up on the basis that the poor relationship between the parties made it fairer for the parties to be allowed to go their separate ways. It did not make sense for the courts to allow the situation between the brothers to deteriorate further. In family companies such as the present where there were only a few members and directors holding completely divergent objectives and where it was not feasible for members to exit at will simply by selling their shares to any willing purchaser, a winding-up order was inevitable even if it was admittedly not the perfect solution.

8.12 The Court of Appeal upheld Judith Prakash J's decision. Delivering the judgment of the court, Judge of Appeal Chao Hick Tin began with a salutary caution. While the "just and equitable" ground gave the courts a wide discretion – and could be available even if the company was profitable and there was no lack of probity or unfairness in the way it was managed – it should not be readily available to a minority shareholder on the ground that he did not see eye to eye with the majority. The memorandum and articles of association of a company provide the framework within which the shareholders and directors should operate. Caution must, therefore, be exercised before a winding-up order is made. In each instance where a winding-up order is sought, there must be sufficient grounds before the court makes the order, as that would have the effect of dispensing the petitioner from complying with the scheme of things provided in the memorandum and articles of association.

8.13 In assessing whether a company should be wound up on the "just and equitable" ground, one factor that is relevant is whether there is a deadlock in the management of the company as this would reduce the effectiveness of the company as a business vehicle. The court expressed the view that "deadlock" was to be understood in a general rather than a technical sense, and that the phrase "just and equitable" need not and should not be confined to situations of true or absolute deadlock where there was an even number of shareholders who were equally split. In the present case, the court was of the view that no decision could be made because any proposal by one brother would be shot down by the other two. This was a case of a three-way impasse. The companies were limping along with the three employees managing the daily affairs with no leadership provided from the board of directors. Accordingly, the court agreed with Justice Judith Prakash that there had been a case of real deadlock amongst the three directors. The management of the companies was at a stalemate.

8.14 Where there is a stalemate, and the company is essentially a "quasi-partnership", the fact of the stalemate has long been regarded as a basis on which it is just and equitable to wind up the company. This is because a partnership may be dissolved where trust and confidence has broken down amongst partners and this principle has been extended to companies that are incorporated with many features of a partnership. Some such companies may well have been partnerships previously with the then partners incorporating a company with themselves as directors and shareholders. Where a company is not a quasi-partnership, the authorities indicate that the fact of a stalemate may not be relied upon as a ground of winding up. The companies in question were not quasi-partnerships because they were set up by the late patriarch of the family who, during his lifetime, managed the companies in the manner he thought best. The Court of Appeal, however, said that while in most instances the obligations common to partnership relations will not arise outside incorporated partnerships, it did not see why there could not be situations analogous to incorporated partnerships where such obligations could also arise. One such analogous situation could be the case where a patriarch set up a company for himself and his children.

8.15 Justice Chao then went on to say (*Chow Kwok Chuen v Chow Kwok Chi* [2008] 4 SLR 362 at [31]) that the reason an incorporated partnership is treated somewhat differently is because the express or implicit understanding among the partners before incorporation as to how the new company is to be managed means that equity will not allow a person who is a party to that understanding to renege on that understanding. In the case of a company formed by a patriarch for the family, it would likewise be the expectation of the patriarch that the children would co-operate, work the company and make it grow for the common good of themselves and their descendants. When a child receives shares in such a company from the patriarch, either during the latter's lifetime or under his will, the child is not really entering into the company of his or her own free will. This is unlike most companies where the corporate constitution was intended to regulate the relationship of the members. Co-operation and mutual trust among sibling shareholders or directors are central to family companies and their absence is as critical as in a quasi-partnership, and would, accordingly, warrant its winding up. Where such a company is at a deadlock because the siblings cannot see eye to eye, it is difficult to perceive why resort to the just and equitable jurisdiction of the court to order a winding up should not be available. Ultimately, whether equity should intervene in such a situation must necessarily depend on the justice of the case. In a situation like the present, the unfairness came in the sense that it would be unfair to insist that the siblings remain together in the company instead of allowing them to go their separate ways.

8.16 Although the companies were not quasi-partnerships, it was clear that mutual trust and confidence among the brothers was the cornerstone of the entire set-up. The court agreed with Justice Judith Prakash that the companies and their directors' relationships shared certain characteristics with quasi-partnerships: not only were the shares of the companies closely held and not easily transferable to outside parties, and not only did the directors hold their positions due to ties of blood rather than to business acumen or commercial considerations, but the parties really had not on their own accord voluntarily entered into legal relations with one another to promote some common business interest. Instead, they inherited or were endowed their shares and directorships by their parents, based on the latter's understanding or aspiration of furthering the family's interests cohesively. What was in issue now was whether the stalemate so frustrated the basis of a family company that it justified a winding-up order. It was clear that mutual trust and confidence were inherently essential to the late patriarch's objective in incorporating the companies. Upon the breakdown of such mutual trust and confidence, the entire purpose of the companies was destroyed, notwithstanding that the companies' properties continued to yield rental income.

8.17 It is respectfully suggested that the decision was rightly arrived at. Although the companies were not strictly speaking incorporated partnerships, it could be said that the brothers were thrust into a quasi-partnership situation upon the death of their father. Accordingly, this was a situation very analogous to that of a quasi-partnership as the court observed.

8.18 The only variation that the Court of Appeal made to Justice Prakash's order was to suspend the winding-up order for one month to allow the parties to arrive at an amicable solution if one was possible. This would allow one or more of the brothers to preserve the legacy of their late father.

8.19 In addition to the winding-up proceedings discussed above, one of the brothers had also commenced an action under s 216 of the Companies Act (Cap 50, 2006 Rev Ed) alleging that the other two brothers had conducted the affairs of the companies in a manner which oppressed him or otherwise disregarded his interests. Justice Judith

Prakash found in *Chow Kwok Ching v Chow Kwok Chi* [2008] 4 SLR 577 that the complaint was made out, particularly in relation to the other two brothers' use of company funds without the knowledge of the complaining brother. Although the late patriarch had borrowed money from the companies and sometimes dispensed with resolutions, and there was no intention to misappropriate the said funds, this was a practice that should not have been continued by the two brothers particularly in the light of protests by the complainant. The other two brothers should also have done more to allow the complainant to participate in the management of the companies. Accordingly, if a winding-up order under s 254(1)(*i*) of the Companies Act had not already been made, her Honour would have ordered the companies wound up under s 216 of the Act. Nevertheless, although the complainant succeeded, many of his allegations were unfounded, and in his closing submissions he had raised points that had been conceded earlier or were not pleaded. All these added to the length of the trial and thus he was only allowed 65% of his costs.

Financial assistance

8.20 In *Wu Yang Construction Group Ltd v Mao Yong Hui* [2008] 2 SLR 350, the Court of Appeal had to consider issues relating to financial assistance under s 76 of the Companies Act (Cap 50, 2006 Rev Ed). The appellant ("Wu Yang") and Zhejiang Jinyi Group Co Ltd ("ZJL") were Chinese companies which had business dealings with each other. ZJL's managing director and controlling shareholder was Chen Jinyi ("CJY") who was also the sole shareholder of Kingsea Ltd, a British Virgin Islands company. Between 1 June and 18 November 2003, ZJL borrowed a total sum of RMB30m from Wu Yang. This transaction was documented in nine agreements. Under the fifth agreement dated 12 July 2004, CJY indicated his willingness to "pledge" 134,700,000 shares in VGO Corporation Ltd ("VGO") to Wu Yang. On 12 August 2004, CJY confirmed to Wu Yang that Kingsea Ltd held 31,764,784 shares in VGO, and that all those shares would be pledged to Wu Yang "as irrevocable joint liability guarantee for the repayment of the amount owed by [ZJL] to Wu Yang". ZJL and CJY later confirmed (via an agreement dated 10 October 2004) that the value of those 31,764,784 shares was not less than S$3,176,478.40.

8.21 Kingsea Ltd acquired its shares in VGO as a result of VGO's decision to acquire Spring Wave Ltd ("Spring Wave"), a wholly-owned subsidiary of Kingsea Ltd. The purchase consideration was agreed at RMB55m and was to be satisfied by the allotment of new VGO shares of S$0.01 each, credited as fully paid, at an issue price of S$0.085 per share. The initial understanding was that the completion of this transaction was subject to the consolidated net asset value ("NAV") of Spring Wave being confirmed at RMB55m. Kingsea Ltd also provided several warranties and agreed to deposit 81,175,347 of the new VGO shares (with a market value of about RMB33.14m) with VGO as security for the performance of its obligations. Under the agreement, VGO had the right to sell as many of the new VGO shares held in escrow as would be necessary to satisfy the liabilities of Kingsea Ltd in the event of the latter breaching any of its obligations. As a result of Kingsea Ltd not being able to fulfil all the warranties, and a shortfall in the NAV, more new VGO shares were deposited in escrow. Eventually, 59,339,238 shares in VGO were sold to the respondent, Mao Yong Hui ("Mao"), when Kingsea Ltd was not able to meet its obligations.

8.22 This state of affairs, therefore, gave rise to competing claims over shares in VGO between Wu Yang and Mao. VGO's interest in the escrow shares as equitable mortgagee was prior in time to that of Wu Yang's, and, when Mao purchased those shares from VGO, he was entitled to the same priority. On 23 March 2005, one day after VGO had sold the escrow shares to Mao, Wu Yang filed OS 343, naming ZJL, CJY and Kingsea Ltd as defendants and seeking orders that, *inter alia*, they be restrained from dealing with the VGO issued shares and that those shares be transferred to Wu Yang. The title of OS 343 recited that it was filed in support of an intended arbitration between Wu Yang as claimant and ZJL and CJY as respondents. On the same day, Wu Yang obtained the freezing order, which was served on VGO the next day, whereupon VGO notified Wu Yang of the sale of the escrow shares to Mao. On 6 April 2005, Wu Yang filed a notice of arbitration addressed to ZJL, CJY and Kingsea Ltd pursuant to the International Arbitration Act (Cap 143A, 2002 Rev Ed) ("IAA") and the rules of the Singapore International Arbitration Centre.

8.23 On their part, VGO and Mao applied to court on 15 and 25 April 2005, respectively, to intervene in the action and to vary the freezing order by excluding the escrow shares from that order. They relied on the ground that VGO had sold the said shares to Mao, who had priority to the shares over Wu Yang.

8.24 At the hearing, counsel for Wu Yang argued that the new VGO shares had been allotted in breach of s 76 of the Companies Act (Cap 50, 2006 Rev Ed), in that VGO had provided financial assistance to Kingsea Ltd for the latter to acquire those shares. It was also submitted that Mao had conspired with VGO to keep the escrow shares out of the reach of Wu Yang and therefore his claim to the said shares should be postponed to that of Wu Yang's. The learned judge held that there was insufficient evidence of a conspiracy between VGO and Mao and that VGO had not provided financial assistance to Kingsea Ltd in breach of s 76 of the Companies Act. On the financial assistance issue, this was *prima facie* not surprising as the shares had been issued in consideration of the sale of Spring Wave to VGO. This was not a case of a company providing financial assistance to a person to purchase the company's shares but rather a company providing its shares as consideration for the purchase of an asset from another party. It is not uncommon for sale and purchase transactions to be structured in this manner and indeed payment for new shares issued can take place through cash or non-cash consideration. Accordingly, the Court of Appeal dismissed Wu Yang's appeal.

8.25 Delivering the judgment of the court, Chief Justice Chan Sek Keong said that Wu Yang did not have *locus standi* to invoke s 76 of the Companies Act (Cap 50, 2006 Rev Ed). Chan CJ said that s 76A(2) of the Companies Act provided that in the event of a breach of, *inter alia*, s 76(1)(*a*), the contract or transaction related to the breach shall be voidable at the option of the company. Additionally, s 76A(3) prescribed the parties who may apply to the court to have the contract set aside, namely: (a) a member of the company; (b) a holder of debentures of the company; (c) a trustee for the holders of debentures of the company; or (d) a director of the company. Whatever interest Wu Yang might have had in the escrow shares, it was not a prescribed person under s 76A(3). Therefore, it had no *locus standi* to invoke s 76 against VGO.

8.26 Although this disposed of the financial assistance issue, the court went on to address the financial assistance arguments in detail in view of the submissions of counsel. The court rejected the argument that the VGO shares were issued at a value exceeding the NAV of Spring Wave. This being the case, no financial assistance had been given because the allotment of the new VGO shares to Kingsea Ltd was merely the means to achieve VGO's commercial objective. VGO could have arranged to pay cash to Kingsea Ltd to enable the latter to subscribe for shares in VGO. Such a transaction would not have offended s 76 either, because the purpose of the payment to Kingsea Ltd would have remained unchanged. Section 76 was not intended to interfere with commercial decisions such as this taken in a *bona fide* fashion.

8.27 Chan Sek Keong CJ went on to clarify that if the elements of s 76 are present, the fact that the transaction was in the interests of the target company did not of itself mean that s 76 was not offended, if the main purpose or one of the purposes of the transaction was to provide financial assistance to the intended purchaser to enable the latter to acquire shares in the target company. Even if the target company had provided financial assistance to the intended purchaser to acquire shares in the target company believing this to be in the interests of the target company, this could not of itself lead to the conclusion that the transaction did not offend s 76 of the Companies Act. The element of commercial interest is only relevant in the context of examining the purpose for which the target company enters into a transaction. The purpose of the transaction could be the acquisition of a business or an asset; it might even be the acquisition of a commercial relationship in order to tap into the goodwill of another company. The purpose of the equity-business swap in the present case was certainly not the giving of financial assistance to Kingsea Ltd to enable the latter to acquire shares in VGO but the acquisition of Spring Wave's food and beverage business by VGO. Doubt was cast on the Court of Appeal's earlier decision of *Intraco Ltd v Multi-Pak Singapore Pte Ltd* [1995] 1 SLR 313 ("*Intraco*") in so far as the financial assistance point in that case was concerned. It was said that the Court of Appeal's views on the meaning and scope of s 76 of Companies Act (Cap 50, 2006 Rev Ed) in *Intraco* was in any event *obiter*.