8. COMPANY LAW

TAN Cheng Han SC
LLB (National University of Singapore), LLM (Cambridge);
Advocate and Solicitor (Singapore);
Professor and Dean, Faculty of Law, National University of Singapore.

Shares

8.1 In *HSBC (Malaysia) Trustee Bhd v Soon Cheong Pte Ltd* [2007] 1 SLR 65, Justice Judith Prakash reiterated the well-known principle that the power given to directors to refuse to register a transfer of shares to a person that the directors do not approve of was open to review by the courts. However, when the court reviews the sufficiency of the reasons given for the refusal, it will only seek to ascertain if they are legitimate or not, and whether the directors have proceeded on proper principles. If the reasons assigned are legitimate, the court will not interfere with the decision on the ground that it would have come to a different conclusion. A court should be slow to question the directors' exercise of their discretion where they have acted *bona fide* in what they consider to be in the best interests of the company.

8.2 In the present case, her Honour accepted that the director in question had exercised his discretion properly in refusing to register the transfers of the 175 shares to the second to seventh plaintiffs who were the beneficiaries of the estate of one Chua Chai Wu, the existing registered owner of the shares. The said director did not allow the registration of the transfers to the beneficiaries as he was concerned that this would cause the defendant company to eventually have more than 50 members and to thus lose its status as a private company. Justice Prakash said that this concern was not fanciful but *bona fide* and legitimate. There were other trustee shareholders and elderly living shareholders who might scramble to submit similar applications for fear that the 50-member limit might be breached if the plaintiffs' application was allowed. In addition, while the director had refused to register the transfers of the 175 shares to all six of the beneficiaries, he was prepared to approve and register the transfers to a maximum of two of them. He was thus not seeking to deny the entitlement of the beneficiaries to the shares in the defendant company. He was only requesting that they consolidate their share entitlement such that only two of them would hold the shares on trust for the others. In this manner, the beneficiaries would, through their trustees, still be able to exercise their rights as shareholders of the defendant and still be entitled to dividends of the defendant. The plaintiffs' concern that they would not be involved in the defendant as individual shareholders and protect their rights as

shareholders against any abuse or mismanagement was therefore unfounded.

Power to grant relief

8.3 Section 391 of the Companies Act (Cap 50, 2006 Rev Ed) is a well-known provision that allows the court to relieve certain persons either wholly or partly from their liability for negligence, default, breach of duty or breach of trust where such persons have acted honestly and reasonably, and ought in all the circumstances of the case to be fairly excused for the negligence, default or breach. This provision applies, inter alia, to auditors of a company and in *JSI Shipping (S) Pte Ltd v Teofoongwonglcloong* [2007] 4 SLR 460, the question before the Court of Appeal was whether the auditors of the appellant company could be excused partially from liability for negligence under s 391(1) of the Companies Act where the company's directors had contributed to the non-discovery of the fraud perpetrated on the company but where the defence of contributory negligence had not been pleaded.

8.4 The Court of Appeal answered this question in the affirmative and held the auditors liable for 50% of the company's losses. The court observed that a similar provision in England had been considered in *Barings plc v Coopers & Lybrand* [2003] Lloyd's Rep IR 566 and that the observations in that case on such a provision were helpful in elucidating the scope, thrust and rationale of the provision. The court stressed that relief from liability must be underpinned by the presence of the three elements of honesty, reasonableness and fairness. The auditors had been honest but were guilty of an error of judgment by reason of their failure to follow up on an inquiry due to a misguided reliance on the alleged oversight and control exercised by the parent company. As for reasonableness, auditors could be held to have acted reasonably for the purposes of the section notwithstanding that they were found to be negligent. The consideration of fault attribution would justifiably affect the degree to which the auditors could be said to have acted reasonably by relying on the oversight, review and control exercised by the directors. The determination of reasonableness for the purpose of the section was also not to be limited by the specific breach, but could encompass wider considerations such as the nature of the audit and other relevant circumstances.

8.5 The court also said that while the provision does appear to provide an alternative platform for the court to partially excuse the respondent and to attribute liability in a manner somewhat akin to a plea of contributory negligence, it must be highlighted that s 391 requires the respondent's conduct to be both honest and reasonable, requirements which are clearly not prerequisites to a plea of

contributory negligence. If the respondent fails to satisfy these mandatory statutory prerequisites, the court would be powerless to partially excuse the respondent under the section, notwithstanding any culpability attributable to the directors or to management. In view of the different and higher threshold requirements mandated by s 391, it would clearly be prudent, as a matter of practice, to plead both contributory negligence as well as s 391.

8.6 A different conclusion was arrived at in *W & P Piling Pte Ltd v Chew Yin What* [2007] 4 SLR 218. In that case, Justice Lai Siu Chiu said that the defendant directors in question had neither acted honestly or reasonably in transferring five machines from the plaintiff company to a related company when the plaintiff company was already insolvent. This was not a case where the directors had made *bona fide* commercial decisions which later turned out to be against the company's interests.

Corporate governance

8.7 In *Firstlink Energy Pte Ltd v Creanovate Pte Ltd* [2007] 4 SLR 780, the Court of Appeal upheld the trial judge's finding that there had been a breach of fiduciary duty on the part of the defendant directors as funds advanced by the respondent company to another company for a coal mining investment had been diverted by the directors for their personal use. One of the directors was also the controlling shareholder of the company that the advances had been made to. The court also expressed the view that the directors' conduct fell within s 157 of the Companies Act which enjoins directors to act honestly and diligently in the discharge of their duties and they could have been held liable under this provision.

8.8 The Court of Appeal also considered ss 162 and 163 of the Companies Act which generally prohibit companies (other than exempt private companies) from making loans to their directors. The trial judge had found that the advances made by the respondent company to the other company were effectively loans made in breach of ss 162 and 163 of the Companies Act. In doing so, his Honour felt that both sections intended the word "loan" to have a meaning beyond its conventional sense, *ie*, a contract where one person lends money to another in consideration of a promise to repay whether on demand or otherwise and whether with interest or not. In the present case, the monies had been advanced to another company and not to the directors themselves.

8.9 The Court of Appeal was of the view that notwithstanding the attractiveness of the trial judge's view, the word "loan" in ss 162 and 163 of the Companies Act should mean loan in a conventional sense. In arriving at this conclusion, the court exhaustively considered the origin

of the provisions as well as developments in other jurisdictions. The court also felt that in a criminal provision of this nature, the word "loan" should be restrictively interpreted and given its ordinary meaning.

8.10 It not infrequently happens that a person is appointed to the board of several companies and may therefore find himself in a potential position of conflict should there be any issue or dispute between the companies that he is a director of. Where the companies that he is a director of are the parent company and its wholly-owned subsidiary, there would normally be a considerable coincidence of interests as the Court of Appeal pointed out in *Townsing Henry George v Jenton Overseas Investment Pte Ltd* [2007] 2 SLR 597. Accordingly, there should not be a rigid compartmentalisation of a director's conduct *vis-à-vis* a subsidiary and a parent company. Thus the appellant, who was a director of the parent company and its subsidiary, was liable for breach of fiduciary duty to the parent when he authorised the payment of a substantial sum by the subsidiary to a third party against the interests of the parent company which was the sole shareholder and creditor of the subsidiary.

8.11 In *dicta*, the court also endorsed the principle of "reflective loss" that was first accepted as good law in Singapore by Justice Lai Kew Chai in *Hengwell Development Pte Ltd v Thing Chiang Ching* [2002] 4 SLR 902. The court opined that from a doctrinal point of view, the "no reflective loss" rule may be seen as a variant of the "proper plaintiff" rule which seeks to ensure that wrongs against a company are efficiently and fairly disposed of by regulating the category of persons who can recover what was effectively the company's loss. The need to regulate such claims is an unavoidable consequence of the corporate venture which a company represents. The various and diverse interest groups that are potentially affected when a wrong is suffered by a company creates the need to ensure that those losses are remedied in an orderly manner through the company as the claimant. However, this principle could not be considered in the instant case as the issue had not been canvassed in the court below and it was too late given the circumstances for the issue to be dealt with in the Court of Appeal.

8.12 *W&P Piling Pte Ltd v Chew Yin What* [2007] 4 SLR 218 ("*W&P Piling Pte Ltd*") was another case involving persons who held concurrent directorships in related companies. Justice Lai Siu Chiu found that they had breached their fiduciary duties to the plaintiff company when they transferred five machines to the plaintiff's immediate holding company without a proper valuation or a call for tenders, and the plaintiff failed to receive payment from any of the sales of the said machines.

8.13 In addition, the transfers of the five machines took place when the plaintiff company was insolvent. As such, the interests of the

plaintiff's creditors became paramount and the defendant directors had to take those interests into account when discharging their fiduciary duties. This they had not done.

8.14 Justice Lai Siu Chiu also said that while the third defendant-director played a more limited role in the wrongful disposal of the plaintiff's machines, and was a nominee director (as he described himself), he owed the same duties to the company as did the other directors. He should have been more vigilant in how the plaintiff company dealt with its assets when he knew that the company was in financial difficulties. However, to the extent that he was less culpable, her Honour held that he was entitled to 75% contribution from the other two defendants pursuant to his third party notice.

8.15 It should be said that while it is surely correct that all directors owe the same duties to their companies, it does not necessarily follow that in the discharge of their duties all directors are necessarily regarded similarly. It is common practice for companies, particularly listed companies, to have non-executive independent directors to exercise broad oversight on management. Such non-executive independent directors are of course expected to discharge their duties responsibly and honestly but it would be going too far to expect them, in doing so, to have the same degree of understanding or information about the company's day to day business as the executive directors or other senior management may have. The law must make reasonable allowances for such disparities. In *W&P Piling Pte Ltd*, the third defendant took no part in the decision to sell the first machine but was present at the meetings where discussions on the transfers of the other machines took place. Accordingly, Justice Lai felt that he should and could have been more vigilant in how his co-directors dealt with the plaintiff's assets when he knew that the company was in financial difficulties. Alternatively, the third defendant should have refrained from participating in the board decisions to sell four of the five machines. It can be seen therefore that the third defendant was apprised of the transfers and did not act sufficiently to discharge his fiduciary obligations.

8.16 In *Rabiah Bee bte Mohamed Ibrahim v Salem Ibrahim* [2007] 2 SLR 655, Justice Judith Prakash reiterated that under Singapore law, a director is in a fiduciary relationship *qua* the company and not *qua* the members. This is because, as a consequence of the doctrine of separate legal personality, the company is a separate legal entity from the members and the director is its officer and not the members' officer. Also, if a director breaches his duty, it is the company that directly suffers the loss. In addition, her Honour said that the case was not brought as a derivative action which meant that, under the proper plaintiff rule, the plaintiff, who was a member of the company, was

precluded from claiming in respect of the fiduciary duties owed to the companies.

Minority protection

8.17 The well-known "proper plaintiff" rule in company law sets out the general principle that when a wrong is done to a company, the company rather than individual shareholders is the proper party to bring a claim in respect of the wrong. If the directors of a company choose not to bring such a claim, it is open to shareholders to remove the board and install new directors who think otherwise. If, however, the majority of shareholders do not wish to remove the existing board, minority shareholders who would have wanted the company to bring a claim will have to abide by the decision of the majority.

8.18 One important exception at common law to this general proposition is the "fraud on the minority" principle that essentially provides that where the majority members within a company have abused their power to benefit themselves at the expense of the company, the courts will allow a minority shareholder to bring an action on behalf of the company to remedy the said abuse of power.

8.19 Common law derivative actions have been rare in Singapore and since the enactment of s 216A of the Companies Act, which introduced a statutory derivative action, the common law derivative action was regarded as a somewhat endangered species. Most minority shareholders who today feel aggrieved by an abuse of majority power that they feel has damaged the company will prefer to rely on the "minority oppression" remedy in s 216 of the Companies Act or, if they wish to procure the company to sue the majority members, the statutory derivative action which has a number of advantages over the common law action, *eg* the ability on the part of the court at the initial stage to order that the company pays reasonable legal fees and disbursements incurred by the complainant.

8.20 In *Ting Sing Ning v Ting Chek Swee* [2008] 1 SLR 197, recourse could not be had to the statutory derivative action as the company in question was incorporated in Hong Kong and therefore s 216A was inapplicable. As such, the complainant relied on the common law derivative action. The main issue was whether the sister of one of the alleged wrongdoers should be regarded as part of the majority. Aside from the family relationship, she was also the largest shareholder of another company, Merit Concord Holdings ("Merit") because of shares her brother had given her. It was alleged that the defendant directors of the subject company had used its funds to finance Merit. The Court of Appeal felt that in view of these factors, it was highly probable that she

would vote in favour of her brother's group to prevent any claim being brought against the defendant directors and Merit. The court acknowledged that it could not conclude without any doubt that because of consanguinity alone, the sister would vote in favour of her brother's position, but thought that in respect of an Asian family which still tended to be rather clan-like, the influence of such a relationship on business decisions could not be discounted. It was, of course, impossible to tell precisely the degree of influence that the brother had over his sister, but given all the factors it was probable that she would be in his camp.

8.21 In *Summit Co (S) Pte Ltd v Pacific Biosciences Pte Ltd* [2007] 1 SLR 46, a petition was presented to wind up the company under the "just and equitable" ground in s 254(1)(*i*) of the Companies Act. It was alleged that the relationship between the petitioner and the majority shareholder, Pasture Pharma Pte Ltd ("PPPL"), had irretrievably broken down. In the alternative, it was alleged that the entire substratum of the enterprise had disappeared. PPPL, in resisting the petition, argued that the petitioner was simply seeking to exit the enterprise at will and the petition was initiated to bring about an improper or collateral purpose, namely, to force the majority shareholder to buy over the petitioner's shareholding on the latter's terms. It was argued that this was an improper use of s 254(1)(*i*) of the Companies Act.

8.22 In dismissing the petition, Justice Belinda Ang said that if there was a breakdown at all in the relationship between the shareholders, the reason was because of the lack of consensus as to the terms on which they were to amicably sever their relationship. Such disagreement was not a matter concerning the conduct of the company, but rather a dispute as to the disposal and value of the shares. In her Honour's view, there was no jurisdiction to wind up the company on the just and equitable ground under s 254(1)(*i*) of the Companies Act merely because shareholders could not reach an agreement as to the terms on which they were to sever their relationship. She was satisfied that the winding up of the company was seen by the petitioner as a mechanism to exit the company at will. That was not an allowable basis under s 254(1)(*i*) of the Act.

8.23 This was also not a case where the company's operations had been crippled because of the disagreement between the parties. The apparent irreconcilable differences were not directed at the conduct of the affairs of the company and the day to day management and operations of the company were in the hands of PPPL. There was thus no deadlock that would prevent the company from functioning.

8.24 As for the argument that there had been a loss of substratum in the company's business, Justice Ang rejected it because there was no

impossibility in carrying on the business as at the date of the petition. There was in fact evidence that the company had a niche business relating to the importation of a number of drugs.

Fraudulent trading

8.25 In *Liquidator of Leong Seng Hin Piling Pte Ltd v Chan Ah Lek* [2007] 2 SLR 77, Justice Belinda Ang discussed the scope of s 340(1) of the Companies Act. This provision states that if, in the course of the winding up of a company or in any proceedings against a company, it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the court, on the application of the liquidator or any creditor or contributory of the company, may, if it thinks proper to do so, declare that any person who was knowingly a party to the carrying on of the business in that manner shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the court directs.

8.26 The applicability of this provision is premised on the existence of dishonesty on the part of the person carrying on the business. Her Honour said that honesty is not measured according to some private standard of a defendant, nor is the objective standard of the reasonable man a proper test. However, that objective standard might serve as a guide in the assessment of whether a defendant was dishonest. The subjective intention of the defendant that he had acted in good faith would constitute evidence which the court could evaluate and test against the weight of other objective facts available, including, if required, the objective standard of what an honest person would have done in the circumstances, in assessing the conduct of the defendant which was alleged to be dishonest.

8.27 Justice Belinda Ang found that on the facts there was no fraudulent trading. The question, in her view, is not whether there is a reasonable prospect of payment but whether the defendants were personally dishonest. Section 340(1) of the Companies Act should be invoked only where the business of the company has been carried on with intent to defraud. It is not applicable in every case where an individual creditor had been defrauded in the course of the carrying on of the business of the company. Equally, a company which had borrowed or bought goods on credit while insolvent did not *per se* offend the section. It is necessary to show that the creditor was deceived or misled and the director intended to gain an advantage. Neither would closing down a company by methods which disadvantaged creditors *per se* offend against s 340(1) of the Act.

8.28 On the facts, when examined in the actual setting in which the RC piles were purchased between April and July 2004 which were the transactions complained of, the fact that the company was in the red and its assets outstripped its liabilities was not determinative and could not constitute evidence of dishonest intention on the part of the defendants to carry on the business of the company to defraud the creditors. This was because the insolvency appeared on the face of the balance sheet and did not reside in an inability to pay debts as they fell due. It could not be said that there was no reasonable prospect of meeting the invoices for the supplies from April to July 2004. The claim that there was fraudulent trading accordingly failed.