

7. COMPANY LAW

TAN Cheng Han SC

LLB (Hons) (National University of Singapore), LLM (Cambridge);

Advocate and Solicitor (Singapore);

Professor and Dean, Faculty of Law, National University of Singapore.

Separate personality and limited liability

7.1 In *Vita Health Laboratories Pte Ltd v Pang Seng Meng* [2004] 4 SLR 162 (also discussed below at paras 7.21–7.32), V K Rajah JC (as he then was) made some useful observations on the separate personality of a company. His Honour said that a company provided a vehicle for limited liability and facilitated the assumption and distribution of commercial risk. Corporate law and economics scholars would certainly agree with this observation. Scholars in this mould would say that one advantage of limited liability is that it facilitates the mobilisation of capital and savings. People with excess money can invest in a company secure in the knowledge that, should the company succeed, the investment will be well rewarded. Should the company fail, the investor is not financially ruined because it is excess capital that was invested and the creditors of the company cannot claim against the other assets of the investor. It allows the investor to segregate the assets he is prepared to invest from the rest of his assets. This in turn allows the investor to spread his investments among many different companies to achieve a “balanced” portfolio of share investments in a spread of companies, some of which may be more risky but offer potentially higher returns, and others which may be more conservative.

7.2 In this sense, limited liability potentially reduces the cost of capital as well as broadens a company’s access to funds. Without limited liability, people will only invest in companies if the return to them is so high that it offsets the risk of the rest of their assets being seized should the company fail to repay its debts. Alternatively, the company will have to rely more on borrowings which could sometimes be less optimal as debt requires regular interest payments and can generally be called back or must be repaid within a period of time or even “on demand”. In addition, lenders may price in the likelihood of failure of the business which could lead to high interest costs that will further increase the danger of failure: see Richard A Posner, *Economic Analysis of Law* (Little, Brown and Company, 4th Ed, 1992) at pp 392–397. At the same time, new and riskier companies can potentially attract equity investors since such investors can spread their investments over a range of companies with different risk profiles.

7.3 Limited liability also reduces the costs of monitoring management and other shareholders. If liability were unlimited, shareholders would have to spend more time and money monitoring those who manage the company since the consequences of the company becoming insolvent could be disastrous on shareholders. Shareholders would also have to monitor other shareholders to ensure that such shareholders do not unfairly dispose of their assets to others thereby placing a greater burden on the other shareholders in the event of the corporation's insolvency: see F H Easterbrook and D R Fischel, "Limited Liability and the Corporation" (1985) 52 U Chicago L Rev 89 at 94–95.

7.4 Rajah JC *Vita Health Laboratories Pte Ltd v Pang Seng Meng* (*supra* para 7.1) also said that limited liability immunity could not be divorced from legal responsibility imposed on directors in their dealings with third parties and their conduct while exercising corporate powers. Rights go hand in hand with responsibilities. Ordinary norms of commercial morality must be observed. In appropriate cases, the cloak of corporate immunity would be readily lifted by the court. This expresses very nicely the balance between the need to protect and encourage entrepreneurial activities on the one hand, and the need to restrain improper use of a corporate vehicle. It has been argued elsewhere by this author that at the heart of the cases where the corporate veil has been lifted, the courts have felt that the corporate form has been abused to further an improper purpose and not for a *bona fide* commercial transaction: see Tan Cheng Han, "Piercing the Separate Personality of the Company: A Matter of Policy?" [1999] SJLS 531.

7.5 In *TV Media Pte Ltd v De Cruz Andrea Heidi* [2004] 3 SLR 543, it was held that a company had acted negligently in distributing slimming pills that were consumed by the plaintiff/respondent. It was further held that a director of the company, who was characterised as the controlling mind and spirit of the company, was liable for the company's negligent acts. The Court of Appeal expressed the view that a court could only find a director personally liable for authorising, directing or procuring a company's tort if it had first lifted the company's corporate veil which otherwise protected a director from being found liable for the said tortious acts. The court then held that, on the facts, the corporate veil should be lifted in view of the extent of the director's involvement in authorising, directing and/or procuring the company's negligent acts.

7.6 In arriving at its decision, the Court of Appeal said that it recognised that the issue of a director's personal liability for his company's torts involved the consideration of difficult policy questions. On the one hand, there was

the principle that a company was separate and distinct in law from its shareholders and directors, and that there was a commercial interest in allowing companies to enjoy the benefits of limited liability which were offered by incorporation. On the other hand, directors of companies should not be allowed to escape personal liability to third parties for torts that they personally committed merely because they committed the torts in the course of carrying out their duties as directors of the company. Previous courts had weighed these considerations in the balance and arrived at the conclusion that whether or not a director was personally liable for a tort committed by his company depended on the factual situation at hand. The court must look at the level of his involvement in the company in order to determine the extent to which he was the company's alter ego.

7.7 The Court of Appeal accepted that on the totality of the evidence, it was clear that the director, and he alone, had absolute control of the company. It stood to reason that the director was the person who directed its negligent acts or omissions. The court found no reason to overturn the trial judge's finding that nothing was done without the director's knowledge and that his involvement in the negligence of the company was not merely very great, but was total. As such, the corporate veil should be lifted so as to make the director personally liable for the company's torts.

7.8 On the basis that the director in question had authorised, directed or procured the tortious acts of the company, there is ample authority to support the conclusion that the director should be made personally liable for the company's acts. It was probably not necessary, though, to lift the corporate veil to reach such a result, although the effect is the same. A director who specifically authorises, directs or procures his company to perform a tortious act is a joint tortfeasor regardless of whether he knew that the acts were of a tortious nature or not. The corporate veil does not need to be lifted to make such a director a joint tortfeasor. One policy reason for holding directors personally liable in such circumstances is because a subordinate officer of a company who performs the tortious act is probably liable for it and the director, who occupies a more senior position and who has authorised, directed or procured the act, should not be in a better position. Another possible reason is that such a position at law will increase the probability that directors will be more conscious of their actions and, in particular, what amounts to civil wrongdoing when exercising their management responsibilities.

Directors

7.9 In the current year under review, there were a number of cases dealing with the duties of directors. Some of these cases are also discussed in an insightful article by Assoc Prof Hans Tjio, “The Rationalisation of Directors’ Duties in Singapore” (2005) 17 SAclJ 52.

7.10 In *ECRC Land Pte Ltd v Ho Wing On Christopher* [2004] 1 SLR 105, the plaintiff was incorporated in 1994 as the vehicle for an intended joint venture to redevelop the East Coast Recreation Centre (“the centre”) into an amusement theme park. One of the joint venture parties was Grande Leisure Management Pte Ltd, which, together with the fifth to tenth defendants, was part of the Grande group of companies (“Grande”). The first to fourth defendants were variously directors of the plaintiff and the fifth to tenth defendants at the material times.

7.11 The plaintiff took over management of the centre in 1995. The plaintiff’s day-to-day management was left to Grande. The joint venture encountered various difficulties, and the plaintiff was eventually ordered to be wound up in 1999. The plaintiff’s claims against the defendants were based on fraud, breaches of fiduciary duty, constructive trust and conspiracy. The plaintiff alleged that there had been wrongful draw-downs or use of the plaintiff’s banking facilities for interior renovation and/or fitting out works of others; that wrongful charges had been borne by the plaintiff for miscellaneous expenses including interest expenses, consultancy fees, operating/administrative expenses; and that there had been wrongful transactions relating to the plaintiff’s business operations and/or tenancies. It was also alleged that Grande treated the plaintiff as if it were one of its subsidiaries.

7.12 In view of the difficulties encountered in the development of the centre, Tay Yong Kwang J felt that the defendants had acted reasonably and properly. In his Honour’s view, the court should be slow to interfere with commercial decisions taken by directors. It should not, with the advantage of hindsight, substitute its own decisions in place of those made by directors in the honest and reasonable belief that they were for the best interests of the company, even if those decisions turned out subsequently to be money-losing ones.

7.13 On the facts presented in the action, Tay J saw no dishonesty or unreasonable actions on the part of the first to the fourth defendants. He disagreed with the plaintiff’s contention that Grande, and in particular the

first to fourth defendants, took deliberate and concerted steps throughout the four-year joint venture period in question to blatantly misuse and/or misapply the plaintiff's funds and assets for their own benefit. Similarly, there was no unjust enrichment, conversion or conspiracy in respect of the other defendants. The plaintiff's action was therefore dismissed save for some payments to the fifth and sixth defendants that his Honour said ought not to have been paid.

7.14 In *Chip Thye Enterprises Pte Ltd v Phay Gi Mo* [2004] 1 SLR 434, the plaintiff ("the company") was a family-owned company, which had since gone into liquidation. The first defendant and second defendant ("D1" and "D2" respectively) were directors and shareholders in the company. The third defendant ("D3") was, prior to her death, a shareholder of the company. The fourth defendant ("D4") was a shareholder of the company.

7.15 The liquidator of the company brought an action against all four defendants alleging six improper transactions in the period from 1999 to 2001 ("the relevant years"), whilst the company was insolvent. The relevant transactions were:

- (a) a write-off of a sum owed by D2;
- (b) the write-off of sums owed by parties related to the defendants;
- (c) payments made to D1 and D2;
- (d) the investment of a sum into a foreign partnership;
- (e) the payment of dividends for the financial years ending 1999 to 2001; and
- (f) allowing liability for a debt owed to the company from D4 to be transferred to a subsidiary company ("CT"), a company known to be insolvent.

7.16 The liquidator alleged that these transactions amounted to a breach of the defendants' fiduciary duties to the company. The defendants contended that the transactions were carried out when the company was solvent, and that in any case, there was nothing improper about the transactions.

7.17 Belinda Ang Saw Ean J allowed the claims against D1 and D2 but dismissed the claims against D3 and D4. Her Honour accepted that where a

company is insolvent, directors owe duties principally to the creditors of the company. This is because where a company is insolvent the creditors are entitled to invoke the liquidation process under which their claims to the corporate assets take priority over the interests of shareholders.

7.18 After examining the facts, Ang J concluded that the overall evidence established that the company was insolvent during the relevant period. The plaintiff could not pay its creditors without disposing of its assets. It did dispose of its assets, a property in Joo Chiat, but not to pay its unsecured creditors. The attitude of the directors was that they would not use their own money to pay their nominated subcontractors who had worked on the company's condominium and bungalow project at Tanglin Hill. The totality of the evidence showed that the plaintiff had been clearly insolvent since the financial year ended on 28 February 1999 and remained so until it was wound up on 23 March 2001. The six transactions that were the subject matter of this action happened during the time the company was insolvent.

7.19 Since the company was insolvent in the relevant years, D1 and D2 should not have approved transactions (a) to (d) above as these reduced the assets of the company, which should have been available for the discharge of its liabilities to its creditors. These four transactions were clearly not in the interests of the creditors and neither D1 nor D2 could satisfactorily explain these transactions. It followed that the company should not have declared an interim dividend of \$321,900 after 28 February 1999 because any dividend would further reduce the capital of the company that should have been available for the discharge of liabilities to its creditors. The dividend was clearly for the personal benefit of D1 to D4. D1 and D2 were liable for breaching their directors' duties in declaring the dividends. However, as regards D3 and D4, the company's pleadings did not support a cause of action against them as constructive trustees on the ground of knowing receipt of funds subject to a trust and therefore the claim against them in respect of the dividends received failed.

7.20 As for the final head of claim, Ang J said that the liquidator of the company had, in his restated balance sheets, acknowledged that CT rather than D4 owed the debt in its entirety. This amounted to an acceptance that the debt was never due at any time from D4. The liquidator could not now adopt an inconsistent position and, therefore, the company could not hold D4 liable for the said debt.

7.21 In *Vita Health Laboratories Pte Ltd v Pang Seng Meng* (*supra* para 7.1), the first plaintiff, Vita Health Laboratories Pte Ltd ("VHLS") and

the second plaintiff, Vita Health Laboratories (Hong Kong) Ltd (“VHLHK”) were wholly owned by the third plaintiff, Vita Corporation Pte Ltd (“VCL”). VCL was, in turn, wholly owned by the fourth plaintiff, Vita Life Sciences Limited (“VLS”), an Australian company listed on the Australian Stock Exchange (“ASX”) until 30 June 2003. The group, collectively referred to as the Vita Health Group of Companies (“VHGC”), carried on the business of import, export and distribution of medicinal and pharmaceutical products.

7.22 The defendant, Pang Seng Meng, was the operating and controlling mind of VHGC at the material times. Between 1997 and 1998, he procured substantial investments in VCL from two large investment companies. Under the investment agreements, it was mandatory for VHGC to be listed on a stock exchange by the end of 1999. To effect a backdoor listing on the ASX, the defendant arranged for VLS, which was already listed, to take over VHGC in exchange for shares in VLS. The arrangement was embodied in a share sale agreement (“SSA”).

7.23 After the defendant was forced to step down from all management positions in March 2002, the present proceedings were initiated and a special accountant appointed to inquire into VHGC’s operations. The plaintiffs claimed that the defendant had breached his fiduciary duties by, *inter alia*:

- (a) fraudulently creating false and unrecoverable receivables purportedly due from third party entities in Indonesia, the Philippines and Taiwan;
- (b) purchasing excessive stock, which it had no reasonable prospect of selling, from Sunkist Growers (“Sunkist”) and Nestlé Australia (“Nestlé”); and
- (c) making payments of company money to his brother and wife without proper authorisation.

In addition, VLS independently claimed:

- (a) the amounts due under specific warranties made by the defendant in the SSA;
- (b) damages for the defendant’s fraudulent misrepresentations of the receivables due from the entities in Indonesia, the Philippines and Taiwan; and

- (c) the return of all bonus shares issued to the defendant pursuant to the SSA.

7.24 V K Rajah JC (as he then was) said that every director of a company, regardless of whether he had an executive or non-executive designation, had fiduciary duties and legal responsibilities to his company. In scrutinising and analysing a director's conduct, particular attention would be directed to the director's belief in adopting a particular course of conduct and the purposes for which he exercised a particular power. Corporate powers ought to be exercised *bona fide* solely for the purpose for which they were granted and for the general benefit of the company. The common law duties were neatly encapsulated in s 157(1) of the Companies Act (Cap 50, 1994 Rev Ed) ("the Act") which required the application of honesty and discharge of reasonable diligence by directors. Incompetence was not *ipso facto* considered a breach of fiduciary duty even though it might attract other heads of liability.

7.25 The learned judicial commissioner also endorsed Tay Yong Kwang J's observation in *ECRC Land Pte Ltd v Ho Wing On Christopher* (*supra* para 7.10) that the court should be slow to interfere with commercial decisions taken by directors. It should not, with the advantage of hindsight, substitute its own decisions in place of those made by directors in the honest and reasonable belief that they were for the best interests of the company, even if those decisions turned out subsequently to be money-losing ones. According to Rajah JC, this judicial endorsement of the sanctity of business judgment was underpinned by strong policy considerations. It was the role of the marketplace and not the function of the court to punish and censure directors who had, in good faith, made incorrect commercial decisions. Directors should not be coerced into exercising defensive commercial judgment, motivated largely by anxiety over legal accountability and consequences. *Bona fide* entrepreneurs and honest commercial men should not fear that business failure entails legal liability. A company provides a vehicle for limited liability and facilitates the assumption and distribution of commercial risk. Undue legal interference would dampen, if not stifle, the appetite for commercial risk and entrepreneurship.

7.26 Limited liability immunity could not be divorced from legal responsibility imposed on directors in their dealings with third parties and their conduct while exercising corporate powers. Rights went hand in hand with responsibilities. Ordinary norms of commercial morality had to be observed. The lack of commercial probity would attract a variety of consequences, both civil and criminal. A director, who caused accounts to be misstated, flagrantly abused his position and breached his corporate duties.

Being in breach of his duties to the very company itself, he could not evade his responsibility by attempting to hide behind the cloak of corporate immunity. Apart from this, he might also face issues of liability or indemnities apropos his fellow directors, shareholders, auditors and third parties. In appropriate cases, the cloak of corporate immunity would be readily lifted by the court. Creative accounting of a deceitful nature ought to be severely denounced as it struck at the very heart of commercial intercourse which depended upon the integrity of company accounts and financial statements.

7.27 His Honour accepted the plaintiff's contentions that to create the illusion of a successful and profitable regional business, the defendant created and maintained false and unrecoverable receivables purportedly due from PT Vitaton Humanoria Lestari Indojoya ("Vitaton") in Indonesia and Vita Health Laboratories (Phils) Inc ("VHLP") in the Philippines. He represented that Vitaton and VHLP were independent third parties purchasing goods from VHLS when, in reality, they were run and managed as *de facto* subsidiaries of VHLS. The purported "sales" never existed as true sales. As for the plaintiffs' claims arising from business transactions in Taiwan with Weider Pharma (Taiwan) Co Ltd ("Weider"), the defendant conceded that Weider was a *de facto* subsidiary of VHLS. The difference between this arrangement and the ones in Indonesia and the Philippines was that no attempt was made to conceal Weider's origin and structure from VHGC or VLS.

7.28 The defendant did not breach his fiduciary duties by causing VHLS to purchase excessive amounts of Sunkist and Nestlé products. Many of the plaintiffs' assertions were inadequately pleaded. The evidence also precluded any finding of fraudulent conduct by the defendant on this issue. The defendant entered into the agreements with Sunkist and Nestlé based on proper business considerations, and the temptation to judge him with the benefit of hindsight for a commercial decision gone awry had to be resisted.

7.29 The defendant caused VHLS to remunerate his brother, Seng Hock, after August 2001, despite the fact that Seng Hock had ceased attending VHLS's offices. As the defendant made no proper disclosure of Seng Hock's alleged role in VHLS, and he did not take steps to adequately bring the matter to the attention of the other directors before sanctioning payment, he had to reimburse the amount paid. However, the plaintiffs' complaint against the amount paid to the defendant's wife, Michelle Nicholas, was unsubstantiated. The restoration of her pay after an earlier reduction was never concealed.

7.30 The SSA contained specific warranties made by the defendant that VCL's financial statements at the material dates presented "a true and fair view of the profit or loss of the company and the trade debts ... are *good* debts and will produce the *full* amount of the debts without deduction". The warranty was patently false given that the said debts did not exist.

7.31 Rajah JC concluded that crucial aspects of the defendant's corporate culture and conduct had revealed themselves in the proceedings to be flawed and alarming. The defendant had disconcertingly flouted conventional and essential norms of proper disclosure in order to attract outside investors. While this pattern of behaviour was largely arrested after VLS assumed control of VHGC, the earlier chicanery had already burrowed deeply into the accounts of VHGC. The defendant was clearly the principal author of these shabby deceptions. Between 1996 and 1998, he orchestrated a dizzying ascending spiral of impressive "sales" culminating in the entry of corresponding receivables from entities in the Philippines and Indonesia. The initial concealments led in turn to a smokescreen of creative accounting with corrosive results. The defendant's conduct in concealing material facts was, by any yardstick, inexcusable.

7.32 Accordingly, damages were awarded against the defendant for losses caused by virtue of his breach of fiduciary duties, and his misrepresentations and breaches of warranties given. In addition, the bonus shares granted to him were cancelled.

7.33 In *Dayco Products Singapore Pte Ltd v Ong Cheng Aik* [2004] 4 SLR 318, the defendant was the managing director of the plaintiff. The issues before the court were whether the defendant failed to disclose his personal interest in transactions whereby the plaintiff sold goods to companies controlled by the defendant, and if so, whether he was liable to account to the plaintiff for the unauthorised profits made by him. The alternative issue was whether the failure to disclose his interest rendered him liable to compensate the plaintiff in damages. The defendant claimed that there was no breach of fiduciary duty, as the person he reported directly to, John Purden, was aware of the defendant's interest in the purchasing companies and the circumstances for their incorporation and thus John Purden's knowledge and acquiescence could be imputed to the plaintiff.

7.34 Belinda Ang Saw Ean J held the defendant liable to account for the profits from the sales of goods to the companies controlled by him. Her Honour said that a director, being a fiduciary, could not exercise his powers for his own benefit or gain without clearly disclosing his interest and

obtaining the necessary consent. Separately, s 156(1) of the Act and sometimes the articles of a company, permitted a director who was interested in a proposed transaction to take the benefit of the transaction if he disclosed his interest to the board and took no part in the decision of the board on the transaction. If the director made that disclosure and abstained from taking part in the decision, the validity of the transaction was not impaired. A failure to adequately disclose his interest would render the director accountable to the company for the profits made from the transaction. The plaintiff must, on the facts, demonstrate a “real sensible possibility of conflict” (at [15], following *Queensland Mines Ltd v Hudson* (1978) 3 ACLR 176).

7.35 While her Honour was of the view that the defendant was unable to establish, on a balance of probabilities, that John Purden knew or was aware of, or even acquiesced in the sales, she also held that the law required disclosure to, and the consent of, a fully independent board under s 156(1) of the Act or the shareholders under general law before it would regard the fiduciary as absolved. As the essential fiduciary obligation was to avoid conflict between personal interest and duty to the plaintiff, it was necessary for the defendant to actually disclose that his companies were buying the plaintiff’s goods and to seek its approval for the sales. There was factually no disclosure, as such, in the present case, leading to informed consent, that would absolve a fiduciary from what would otherwise have been a breach of duty. It was never suggested that the defendant had formally informed the board of directors of the plaintiff or its shareholders or that they had given their consent to sell the respective stocks in question to the defendant’s companies.

7.36 In *Chong Hon Kuan Ivan v Levy Maurice* [2004] 4 SLR 801, the plaintiff’s employment with the company was terminated. In addition to a claim against the company for breach of the employment agreement, the plaintiff alleged that the directors of the company were guilty of a conspiracy to induce the company to terminate the said agreement. The defendant, who was one of the directors, applied to strike out the claim of conspiracy. *Woo Bih Li J* allowed the said claim to be struck out on the basis that if a servant who was acting *bona fide* within the scope of the servant’s authority procures or causes the breach of a contract between his employer and a third person, the servant does not thereby become liable to an action of tort at the suit of the person whose contract was thereby broken. This principle had two conjunctive qualifications: first, the servant must be acting *bona fide* and second, the servant must be acting within the scope of his or her authority.

7.37 Woo J went on to hold that the plaintiff's allegation that the three individual defendants had acted outside the scope of their office was not contained in the original Statement of Claim. The new allegations that certain conduct was outside the scope of the office of the individual defendants were mainly bare allegations, and the plaintiff's counsel did not meet the burden of persuading the court that the amendments should be allowed.

Financial assistance

7.38 In *Ei-Nets Ltd v Yeo Nai Meng* [2004] 1 SLR 153, it was alleged that there had been a breach of s 76 of the Act which prohibits a company from providing financial assistance in connection with an acquisition of shares in such a company. In that case, the respondent was an executive director of Plan-B Technologies Pte Ltd ("Plan-B") and the managing director of Plan-B Speed.com Pte Ltd ("Speed"), a company wholly owned by Plan-B. Speed owned 74% of the capital of Suntze Communications Engineering Pte Ltd ("Suntze").

7.39 Plan-B and Speed entered into a Sale, Purchase and Subscription Agreement ("SPS Agreement") with Strike Engineering Ltd ("Strike"), under which Plan-B and Strike would each own 4.6 million shares in Speed. The first appellant entered into a Share Exchange Agreement ("SE Agreement") with Plan-B and Strike. Upon completion of the SPS Agreement, Plan-B and Strike would transfer their shareholdings in Speed to the first appellant in exchange for shares in the first appellant.

7.40 The respondent also subsequently approved part-payment for the shares through the capitalising of inter-company loans owed by Speed and Suntze to Plan-B. The respondent was eventually employed by the first appellant. The second appellant was appointed as president and chief executive officer of the first appellant.

7.41 In May 2001, the second appellant commissioned two reports on Speed's accounts. It was alleged that the transfers of inter-company loans from Suntze to Plan-B were fictitious and fraudulent, and that the respondent had authorised the transfers to misappropriate the money, and had breached s 76 of the Act.

7.42 The second appellant placed both reports, together with an unsigned draft legal opinion before the first appellant's Audit Committee. The second appellant subsequently acted unilaterally to transfer the respondent back to

Plan-B. The respondent rejected the transfer and brought an action for breach of his employment contract, and another action for defamation. Both actions were successful, and the respondent was awarded damages for wrongful dismissal and defamation.

7.43 On appeal, the appellants again submitted that the transfers of the loans were fictitious, fraudulent, and breached s 76 of the Act. The appeal was dismissed and insofar as this issue was concerned, the Court of Appeal held that the fact of the matter was that Plan-B had been advancing funds, without formal agreements, for the activities of Speed and its subsidiary Suntze. The audited accounts of both Speed and Suntze recorded these loans as having no fixed terms of repayment. According to the view of one of the experts, whose evidence the trial judge accepted, a loan with no fixed terms of repayment would rightly be classified as a current liability as it would be construed as repayable on demand. This was in line with the Statements of Accounting Standard in Singapore which provided that an amount which did not have any fixed terms of repayment should be classified as a current liability and deemed repayable on demand. The firm of accountants appointed to look into the matter was also of the opinion that the capitalisation of loans was a cash injection to a company if the loans were short-term ones with no fixed terms of repayment. In the circumstances, the part-payment for the shares through the capitalisation of inter-company loans owed by Speed and Suntze to Plan-B was not in breach of s 76 of the Act.

7.44 Admittedly, there were no formal resolutions sanctioning the transfers. The Court of Appeal accepted that between related companies this was a common practice and it was not a requirement of law that such formalities must be fulfilled. The truth of the matter was that both Speed and Suntze owed money to Plan-B, and Speed also owed money to Suntze. There was no reason why, by mutual consent, such debts could not be offset. No company suffered a disadvantage or loss. Accordingly, once it was shown that the debt transfers were real and not fictitious, and that capitalisation of a current debt amounted to a cash injection, then the very foundation upon which the respondent was dismissed no longer existed.

Dividends

7.45 The case of *Chip Thye Enterprises Pte Ltd v Phay Gi Mo* has already been discussed earlier (*supra* paras 7.14–7.20). Belinda Ang J also made a number of observations regarding dividend payments. Her Honour said that it was trite law that directors were not allowed to pay dividends out of

capital. However, if there were realised or unrealised capital profits (because of an increase in the value of the company's capital assets as a result of a revaluation of the said assets made in good faith by competent valuers and the accretion in value is of a permanent nature rather than a short-term one) dividends could be paid out of such capital profits if the subscribed capital of the company is preserved and there has been an accretion to the capital of the company. However, in the present case it was irrelevant whether or not there were or could have been profits of a capital nature out of which dividends could have been paid. The dividends should not have been made when the company was insolvent. Her Honour also added that even if a company was not insolvent, if directors allowed a dividend to be paid where there were no profits, such an act would amount to a breach of fiduciary duty and the directors might be liable to replace the money wrongfully paid out. There would also be a breach of s 403 of the Act which would attract the consequences set out in the said section.

Derivative actions

7.46 In *Pang Yong Hock v PKS Contracts Services Pte Ltd* [2004] 3 SLR 1, there were four shareholders, all of whom were also directors, in the respondent company. They were divided into two factions with each holding 50% of the shares. The appellants, Pang Yong Hock ("Pang") and Lee Kim Swee ("Lee") comprised the first group while two others, Koh Hwee Meng ("Koh") and Tan Sok Khin ("Tan"), made up the other. The two groups owned the shares in equal proportions. There was no deadlock at the board of directors' level as Koh and Tan had the support of a fifth and remaining director.

7.47 Suspecting that Koh and Tan were abusing their powers as directors of the company, the appellants issued a notice under s 216A(3)(a) of the Act requiring the company's board of directors to commence an action against them for alleged breaches of their directors' duties. When the board took no steps in this regard, the appellants took out an application pursuant to s 216A of the Act for leave to commence proceedings in the name and on behalf of the company. The judge dismissed the application on the basis that, on the facts of the case, it would be more sensible and desirable to wind up the company. The appellants appealed, contending that the winding up of the company was not an appropriate alternative remedy given that there was no certainty that the liquidator would pursue the action against Koh and Tan.

7.48 The Court of Appeal said that the legislative intention behind s 216A was to provide a procedure for the protection of genuinely aggrieved

minority interests and for doing justice to a company while ensuring that the company's directors were not unduly hampered in their management decisions by loud but unreasonable dissidents attempting to drive the corporate vehicle from the back seat. Although the applicants were not minority shareholders as they held the same number of shares as the other shareholders, the applicants could be treated as being under the same disability as a minority shareholder in that it would not have been possible for them to set the company in motion to bring the action. As such, they could invoke the provisions of s 216A.

7.49 A person seeking leave under s 216A to bring an action on behalf of a company must act in good faith. The best way of demonstrating good faith was to show a legitimate claim which the directors were unreasonably reluctant to pursue with the appropriate vigour or at all. Naturally, the parties opposing a s 216A application would seek to show that the application was motivated by an ulterior purpose, such as dislike, ill-feeling or other personal reasons, rather than by the applicant's concern for the company. Hostility between the factions involved was bound to be present in most of such applications. It was, therefore, generally insufficient evidence of lack of good faith on the part of the applicant. However, if the opposing parties were able to show that the applicant was so motivated by vendetta, perceived or real, that his judgment would be clouded by purely personal considerations, that might be sufficient for the court to find a lack of good faith on his part. An applicant's good faith would also be in doubt if he appeared set on damaging or destroying the company out of sheer spite or worse, for the benefit of a competitor. It would also raise the question whether the intended action was going to be in the interests of the company at all. To this extent, there was an interplay of the requirements in ss 216A(3)(b) and (c).

7.50 Once the court had established that an applicant was acting in good faith and that a claim appeared genuine, the court must nevertheless weigh all the circumstances and decide whether the claim ought to be pursued. Whether the company stands to gain substantially in money or in money's worth relates more to the issue of whether it was in the interests of the company to pursue the claim rather than whether the claim was meritorious or not. The Court of Appeal said that a \$100 claim might be meritorious but it might not be expedient to commence an action for it. The company might also have genuine commercial considerations for not wanting to pursue certain claims. Perhaps it did not want to damage a good, long-term, profitable relationship. It could also be that it did not wish to generate bad publicity for itself because of some important negotiations which were

underway. In considering the requirement in s 216A(3)(c) that it must appear to be *prima facie* in the interests of the company that the action be brought, prosecuted, defended or discontinued, the court should also consider whether there was another adequate remedy available, such as the winding up of the company. Although the liquidator would have discretion whether to bring an action against directors who had acted wrongfully and therefore there was no certainty that such an action would be brought, this did not mean that winding up was not an alternative remedy.

7.51 Applying those principles, the court said that there was a lack of good faith on the part of the applicants as all four shareholder-directors appeared to have been implicated in some way in the special accountant's report. Furthermore, Koh and Tan, as contributories, had taken out a petition on 19 January 2004 to wind up the company. Koh and Tan had pleaded that it would be just and equitable to have the company wound up due to the inability of the two factions to co-exist and the resulting deadlock in the company. They also claimed that the company was unable to pay its debts when they fell due and had not filed its statutory accounts nor held the statutory meetings. Choo Han Teck J in the court below (see [2003] SGHC 195) and the Court of Appeal accepted that the company was not doing well. Accordingly, the Court of Appeal felt that it was eminently sensible for the parties to bring to an end a business relationship which had unfortunately evolved into a very unproductive and acrimonious one over the years, rather than make an order under s 216A.

Injunctions

7.52 Section 409A of the Act provides that where a person has engaged, is engaging or is proposing to engage in any conduct that constituted, constitutes or would constitute a contravention of the Act, the court may grant an injunction restraining such conduct. In *Tang Yoke Kheng v Lek Benedict* [2004] 3 SLR 12, Lai Kew Chai J had the opportunity to lay down some valuable general principles relating to the applicability of the said s 409A. His Honour said that a court had to exercise its discretionary powers under s 409A of the Companies Act justly and sensibly. The jurisdiction to issue statutory injunctions and make other orders under s 409A of the Act was conferred so that courts may, in exercising it, either deter contraventions of the provisions of the Act, such as trading with the intention of defrauding creditors, or prevent the furtherance of such infractions of provisions of the Act. It followed that courts could take into account in relation to s 409A of the Act wider issues than those which arose under traditional equitable

principles and, for present purposes, his Honour had to consider whether the statutory injunction would serve the purposes of the Act.

7.53 On the other hand, traditional equitable considerations of questions such as whether there was a serious question to be tried, the risk of dissipation of assets to defeat a judgment and where the balance of convenience lies, would not limit the scope of s 409A of the Act. At the same time, it seemed to his Honour an unassailable proposition that the interest of justice would always require those questions to be examined carefully when far-reaching and extensive injunctions, including mandatory injunctions, were sought before the entire case had been properly examined and adjudicated upon by the court at a trial.

7.54 In the present case, Lai J took the view that before any interim statutory injunction and the mandatory injunctions could be issued, there had to be established a *prima facie* case of contravention of a relevant provision of the Act and there was an appreciable, and not a fanciful, risk that without the issue of the injunctive and mandatory orders proper corporate compliance under the Companies Act would be frustrated. Equally, a judgment creditor, who had been frustrated after several proceedings to execute on the judgment and to publicly examine the officers of the corporate judgment debtor, must not resort to statutory injunctions and other mandatory orders without disclosing the commercial contexts in which the judgment debt was incurred. The provisions of s 409A of the Act were designed to achieve the purposes of the Act and not as a weapon of oppression by a frustrated judgment creditor.

7.55 Lai J said that he formed the view that the plaintiff ought to have disclosed all the prior enforcement action and the proceedings which had been taken but which were struck out. The impression was that this was a new action and that during the intervening period the defendants had been dissipating the assets of the company, which was quite untrue.

7.56 The defendants further contended, which Lai J accepted, that this new action was an attempt to go behind the judgment in a previous suit. In that action, the plaintiff's original claim was \$1,544,214.02. Before the hearing, judgment was obtained by the plaintiff for \$245,226.02, interest and costs. When the hearing of the action came up the parties were given an adjournment for settlement negotiations. A consent judgment was recorded eventually. In all the circumstances, his Honour concluded that the plaintiff had acted oppressively against all three defendants. She had obtained the

statutory injunctions and the mandatory injunctions by stealth by suppressing certain material facts.

Schemes of arrangement

7.57 In *Re Econ Corp Ltd* [2004] 1 SLR 273, Econ Corporation Limited (“the Company”) was a public company and a wholly-owned subsidiary of Econ International Limited (“EIL”), a public company listed on the Stock Exchange of Singapore Limited. The Company and EIL incurred significant losses and were unable to meet the demands of their creditors.

7.58 The Company convened a meeting of its unsecured creditors on 17 June 2003 pursuant to s 210 of the Act. The value of the admitted claims of those who voted in favour of the proposed scheme of arrangement (“the approved scheme”) exceeded the statutory requirement of 75%.

7.59 The Company then applied for sanction of the approved scheme under s 210(10) of the Act. The opposing creditors alleged that the Company’s conduct and the approved scheme lacked transparency and that the unsecured creditors should have been separately classed from certain other creditors at the meeting of 17 June 2003. Specifically, the opposing creditors alleged that there had been a lack of information on (a) losses incurred by EIL, (b) the transfer of the Company’s machinery to Tat Hong Heavy Equipment Pte Ltd (“Tat Hong”) and (c) the transfer of the Company’s machinery to any other creditors/third parties since 1 January 2003. The alleged lack of information hindered the opposing creditors’ ability to determine if the returns under the proposed scheme of arrangement were greater than what they would expect to receive in a liquidation.

7.60 Lai Siu Chiu J held that on the correspondence as well as all the affidavits filed, her Honour was of the view that the complaint of the opposing creditors that the Company’s conduct lacked transparency and that it withheld material information was not unfounded. First, the Company withheld information of EIL’s extensive losses and, had that been known at the meeting, the voting would have gone the other way. The opposing creditors were entitled to know the state of the Company’s finances as well as that of the parent company (EIL) before they decided whether the returns under the scheme of arrangement proposed were in fact greater than what they could expect to recover in a liquidation.

7.61 Second, her Honour said she could not fathom the Company’s rationale for disposing of its equipment to Tat Hong, leasing them back,

having those leases terminated for failing to pay the rent and entering into fresh leases at even higher rental which it could ill afford. It simply made no commercial sense. The machinery sold to Tat Hong under the agreement dated 20 May 2003 appeared to be at an undervalue of \$500,000 (based on Tat Hong's own insured value), while those sold under the agreement dated 31 May 2003 were at an undervalue of \$65,000.

7.62 Third, the set-off arrangements made by the company with various parties including Tat Hong of the prices of machinery sold by the Company against their outstanding claims were also highly questionable. Even if the reason for such preferred payments was that the Company was at the mercy of suppliers and subcontractors who demanded cash payment in exchange for current services or deliveries of materials there was no justification for the Company allowing Tat Hong to set off its purchase price for some machinery against rental due to another (albeit related) company Tat Hong Plant Leasing Pte Ltd ("THPL"). Indeed, the entire leasing arrangement with THPL smacked of an elaborate charade between the Company and Tat Hong to enable Tat Hong to recover as much of their outstanding claims as possible before they participated in the approved scheme. In the case of another company to which machinery was sold, the Company even allowed it to set off the entire purchase price for the machines it bought against the Company's total indebtedness (\$1,019,200) since February 2001.

7.63 Her Honour also accepted that certain creditors should have been classed separately, *eg* creditors whose claims were \$4,000 or less as those creditors had interests dissimilar to the others. They had priority and would be paid in full whereas in a winding up their claims would rank *pari passu* with those of other unsecured creditors. Similarly, Lai J expressed the view that contingent creditors should also have been separately classed for voting purposes. She disagreed with the contrary view of the Malaysian court in *Re Butterworth Products & Industries Sdn Bhd* [1992] 1 MLJ 429. The liabilities and rights of contingent creditors would not arise unless and until calls were made on the performance bonds they issued on the Company's behalf. Even then, they would not be creditors unless the Company defaulted on the indemnities it would have issued to those creditors in turn.

7.64 In the circumstances, her Honour dismissed the application. The Company had indicated that liquidation with a realisable return of 3% would be the only alternative to a scheme of arrangement, under which the return would be 65%. Lai J was sceptical of this in the light of her findings on the state of the Company's accounts. Also, liquidation might not be the only

alternative, since notice had been given that the opposing creditors intended to apply to court to place the company under judicial management.

Fraudulent trading

7.65 In *Tang Yoke Kheng v Lek Benedict (No 2)* [2004] 4 SLR 788, the plaintiff was a creditor of Amrae Benchuan Trading Pte Ltd (“the Company”), which was in liquidation, of which the first and second defendants were at all material times the directors and shareholders. The third defendant was an employee of the Company. The essence of the claim by the plaintiff was that the business of the Company had been carried on with intent to defraud creditors of the Company (in particular the plaintiff or Niklex) in breach of s 340(1) of the Act.

7.66 Andrew Ang JC (as he then was) said that in order to succeed under s 340(1) of the Act, the plaintiff would need to prove two elements, namely that the business of the Company had been carried on with intent to defraud the creditors of the Company or of any other person or for any fraudulent purpose; and that the defendants were knowingly parties to the carrying on of the business in that manner. The terms “defraud” and “fraudulent purpose” connoted actual dishonesty involving, according to current notions of fair trading among commercial men, real moral blame. The mere preference of one creditor over another (for which there was some evidence in the case) would not suffice.

7.67 On the facts, there was no evidence to suggest that at the time they obtained goods from the plaintiff, the first and second defendants had any intention that the plaintiff should not be paid or that they had no reasonable expectation of eventually being able to pay for the goods. Any suggestion of dishonesty was immediately and effectively met with the riposte that the first and second defendants had offered to cancel their last purchase order and to return to the plaintiff goods as yet unsold which they had previously bought from the plaintiff. Besides, over the years, they had paid the plaintiff more than \$5.2m for the goods they had purchased. Even after the parting of ways in February 2000, they had paid \$720,000 to the plaintiff by instalments stretching from April 2000 to July 2001. It also emerged that some of the money with which the Company paid the instalments came from loans made to the Company by the defendants. Whether or not one believed their reasons for discontinuing payment thereafter (and Ang JC said that he did not find the reasons convincing), the fact remained that there was no evidence to justify a finding of intent to defraud when the Company obtained goods from the plaintiff.