9. COMPANY LAW

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Lifting the corporate veil

9.1 The objective of incorporation is well known. Allowing companies to be incorporated through the mechanism of registration has helped to facilitate the entrepreneurial spirit that has underpinned market economies. Through incorporation, companies are regarded as legal entities in their own right and therefore distinct from their incorporators and shareholders (or members). They can enter into contracts and incur rights and liabilities. These rights and liabilities are not shared with their shareholders, unless the latter choose to assume them personally. This allows individuals to invest their spare capital in companies without any assumption of responsibility for the investee company's obligations. Accordingly, the investing shareholder is able to segregate his or her risk. Without this ability to partition risk, even a small investment in a company will mean that the shareholder potentially risks his entire fortune as all the shareholder's assets can be claimed by the company's creditors should the company's assets be insufficient to repay its debts. This in turn will limit the ability of companies to raise capital by the issue of shares and also have the consequence of retarding the development and growth of stock exchanges. For such reasons, courts tend to uphold the separate personality of companies.

9.2 There are occasions, though, where the courts have equated the shareholders or directors of a company with the company for limited purposes. This does not mean that the company is not a separate person. It means that because of extraordinary circumstances, certain acts, debts or obligations of the company are also treated as those of some or all of the shareholders or directors of such a company. This is commonly referred to as lifting or piercing the corporate veil and the courts often justify this by saying that the company was a sham or façade. It has been suggested by the authors in previous editions that the use of such metaphors is unhelpful in explaining why the separate personality of a company is not given effect to. The authors have suggested that when the corporate veil is lifted, the courts do so either because the company has been used for an illegitimate purpose, thereby abusing the privilege of incorporation, or the company was never intended to be the real party to the act or transaction in question, *eg*, where the company was interposed merely as a matter of convenience and was never intended to play a real or substantive role. In the latter situation, the company is sometimes referred to as a mere corporate name: see *Asteroid Maritime Co Ltd v The owners of the ship or vessel Saudi al Jubail* [1987] SGHC 71. It is also suggested that the courts are expressing this idea when they say that the corporate veil should be lifted because the company is the *alter ego* of a shareholder or director.

9.3 From this perspective, the decision of Stephen Chong J in *Tjong Very Sumito v Chan Sing En* [2012] 3 SLR 953 is to be welcomed as stating clearly the grounds on which the company's personality will be pierced. His Honour said that there are, in general, two justifications for the corporate veil to be pierced under common law: that the evidence showed that the company was not in fact a separate entity, and where the corporate form has been abused to further an improper purpose. An example of the former would arise where the controller of a company used the company as an extension of himself and made no distinction between the company's business and his own. In such circumstances, the controller could be regarded as the *alter ego* of the company. Being the controller *per se* is not sufficient, however, as persons are entitled to create companies even where the companies are effectively one man companies.

Breach of fiduciary duty

9.4 A company's directors and other senior management owe fiduciary duties to the company because a company, not being a true person, is in a vulnerable position *vis-à-vis* its directors and senior management. Should there be any wrongdoing against the company by its directors and senior management, the company itself is not in any position to protest. Wrongdoing against the company also ultimately affects its shareholders. As a result of the vulnerability of companies, and by extension shareholders, the law places a potentially onerous positive obligation on directors and senior management to act in the best interests of the company. By extension, this positive obligation also imposes obligations not to do certain things, *eg*, not to enter into a transaction where there may be a conflict of interest between duty to the company and the self-interest of the director or senior manager. Such obligations, known as fiduciary obligations, are imposed to discourage the fiduciary from taking undue advantage of another person who is in a vulnerable position *vis-à-vis* the fiduciary. The fiduciary must prefer the other person's interests over his or her own which is a departure from the general rule that in commercial matters a person is entitled to be self-interested as long as there is no fraud or illegality involved.

9.5 In *Panweld Trading Pte Ltd v Yong Kheng Leong* [2012] 2 SLR 672, Stephen Chong J held that a director, who was also a 20% shareholder of the company, was in breach of his fiduciary duty to the company when he procured the company to pay a salary to his wife when she was not an employee of the company. His Honour did not accept that the only other shareholder knew and approved of this arrangement. As such, the principle in *Re Duomatic Ltd* [1969] 2 Ch 365 did not apply. On appeal, the Court of Appeal upheld Chong J's finding of fact and dismissed the appeal: see *Yong Kheng Leong v Panweld Trading Pte Ltd* [2013] 1 SLR 173.

9.6 By virtue of the fiduciary obligations imposed on a director or senior manager, they may not obtain a profit in connection with their position without the informed consent of the company. Where a director or senior manager has placed himself in a position where his duty to the company may conflict with his personal interests and has made a profit in the process, the company may seek disgorgement of such profit from the director or senior manager. However, as the obligation is owed to the company, the company can release the director or senior manager from such obligation. The release can be prospective or retrospective, provided the decision to release is a fully informed one. It therefore behooves the fiduciary to disclose his interest fully to the company when seeking its consent to take advantage of an opportunity (or to forgive an earlier breach of duty) that has come to the fiduciary's attention as a result of the fiduciary's position. In *Lim Suat Hua v Singapore HealthPartners Pte Ltd* [2012] 2 SLR 805, Andrew Ang J held that the company and shareholders had released the plaintiff director from her inadequate disclosure of two contracts that she had an interest in. There was no release, however, for a third contract as this contract was not referred to in the settlement agreement to which all the shareholders were parties.

Meetings and procedural irregularities

9.7 In *Tang Kin Fei v Chang Benety* [2011] 1 SLR 568, a series of board meetings was convened to pass various resolutions. The company in question had two corporate shareholders, Sembcorp Marine Ltd and PPL Holdings Pte Ltd. At the board meetings referred to above, the three directors appointed by PPL Holdings Pte Ltd declined to attend as a defensive tactic, with the consequence that there was no quorum for the said meetings as the articles of association of the company provided that at least one director nominated by PPL

Holdings Pte Ltd had to be present for the meeting to have a quorum. Sembcorp Marine Ltd's nominees on the board nevertheless went ahead to pass the resolutions and brought an application to validate the said resolutions under s 392(2) of the Companies Act (Cap 50, 2006 Rev Ed) ("the Act"). At first instance, the High Court validated the resolutions relating to the appointment of a law firm to advise the company in relation to a suit brought by the Sembcorp Marine Ltd nominee directors against the PPL Holdings Pte Ltd nominee directors for breach of the latter's duties to the company by allegedly disclosing confidential information to a third party.

9.8 The trial judge had concluded that the absence of a quorum was a procedural irregularity and this was upheld by the Court of Appeal. The Court of Appeal also agreed that a quorum requirement of the type in question which ensured that each party could prevent the company from making a decision which would prejudice them, was one that, if breached, would *prima facie* cause substantial injustice to the party that had attempted to exercise its deadlock rights. However, the Court of Appeal disagreed with the trial judge's conclusion that the Sembcorp Marine Ltd nominee directors had adequately displaced the *prima facie* position that substantial injustice had been caused. This was because the Sembcorp Marine Ltd nominee directors had attempted, through the resolutions, to expand the role of the law firm beyond what had earlier been agreed between the two groups of nominee directors. The validation of the resolutions would have had the effect of overriding this agreement and constituted, without more, a substantial injustice to the appellants as they were deprived of the bargain which they had struck. In addition, the Court of Appeal felt that the resolutions were such as to give the Sembcorp Marine Ltd nominee directors a significant advantage over the other group of nominee directors as the resolutions allowed the chairman of the company, who belonged to the former group of directors, to give and receive instructions from the appointed law firm.

Pre-emption rights

9.9 In *Khoh Chen Yeh Shane v Seng Realty & Development Pte Ltd* [2012] 3 SLR 1, Judith Prakash J held that the pre-emption clauses in the articles of association of a company, National Aerated Water Company Pte Ltd ("the Company"), were triggered when a bare trustee sought to return shares in the Company to the beneficiary. The issue is ultimately one relating to the proper interpretation of the relevant clauses in a company's articles of association. For example, some pre-emption clauses could apply only in the context of a situation where the transfer has come about as the result of a sale. Such a pre-emption clause would not apply to the instant case but Prakash J held that the

Company's pre-emption clauses were wider and intended to apply to any form of transfer. The issue also has to be seen in the context of an article that is typically found in most companies' constitutions, namely, that a company is not bound by any trust over its shares and is entitled to recognise the registered owner as the party fully entitled to such shares.

Fraudulent trading

9.10 Section 340(1) of the Act provides 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 may, on the application of the liquidator or any creditor or contributory of the company, 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. Section 340(5) provides further that in such a case, every person who was knowingly a party to the carrying on of the business with that intent or purpose shall be liable on conviction to a fine or a term of imprisonment or both.

9.11 In *Phang Wah v Public Prosecutor* [2012] 1 SLR 646, the appellants were charged and convicted under s 340(5) of the Act. They appealed against their conviction. In dismissing the appeal, Tay Yong Kwang J cited the decision of the District Judge that "fraudulent purpose" connoted an intention to go beyond the bounds of what ordinary decent people engaged in business would regard as honest, or involving real moral blame according to the current notions of fair trading among commercial men. His Honour was satisfied that the company was perpetrating a fraud on the participants of its multi-level marketing business as the business was an unsustainable one and that the accused both knew that they were perpetrating such a fraud.

Derivative actions

9.12 Two of the most basic principles in company law are that companies are separate legal persons and directors owe negligence and fiduciary duties to their company (and not to their company's individual shareholders). Therefore, when directors breach their duties, it is the company alone, as a separate legal person, that *prima facie* has the right to sue. As companies are fictitious legal persons, however, they cannot decide to sue on their own and can only take action based on the decisions of human beings. Thus, when there is a breach of directors' duties, the question that naturally arises is: Who has the power to decide whether the company, as a separate legal person, will sue?

9.13 Under normal circumstances, this question is answered easily through the regular corporate decision-making process. Ordinarily, company law vests the board of directors with the power to make management decisions for the company (see s 157A and Art 73 in Table A of the Act). As the decision to sue is a management decision, the board normally has the power to decide whether the company should sue the directors for breaching their duties. This makes sense because the board normally has the best available information about the company's potential lawsuit and board members are bound by their directors' duties to decide in the interest of the company whether the lawsuit should be pursued.

9.14 An obvious problem arises, however, when the same directors who breached their duties are the ones who have the power to decide whether the company should sue. In such a case, the normal corporate decision-making process produces an acute conflict of interest as it vests the wrongdoing directors with the power to decide whether the company should, in effect, sue themselves. This acute conflict of interest becomes intractable when the wrongdoing directors are also the controlling shareholders as they can then entrench themselves and effectively foreclose the company from suing them for breaching their directors' duties.

9.15 From the time of *Foss v Harbottle* (1843) 67 ER 189, common law courts have grappled with this intractable problem. Their solution has been to allow individual shareholders, in circumstances where such acute conflicts of interest arise, to pursue an action for and on behalf of the company against the wrongdoing directors, essentially circumventing the normal corporate decision-making process. These shareholder-driven corporate actions have come to be known as "derivative actions" because the shareholders driving them do not seek to enforce their own personal rights but rather the company's rights (*ie*, rights "derived" from the company).

9.16 In this light, it is clear that the derivative action is an essential mechanism for good corporate governance. Indeed, without it, directors' duties would essentially be rendered nugatory for all controlling shareholder directors. It is, however, equally clear that the derivative action presents serious corporate governance risks as it allows a single shareholder to thrust an entire company into potentially harmful litigation. These risks are heightened by the fact that individual shareholders normally do not owe any duties to the company, may lack critical information about the company's potential lawsuit and may be using the derivative action to serve their own interests which may diverge from the company's. It is in this context that common law courts have grappled with developing an effective filter that both weeds out abusive wealth-reducing derivative actions and at the same time allows legitimate wealth-maximising ones to proceed.

9.17 The filter developed in Singapore and throughout the Commonwealth has been to require potential shareholder-plaintiffs to convince the court in a preliminary leave application that they should be granted the right to pursue a derivative action. Historically, in order to do this, potential shareholder-plaintiffs have had to establish that the wrongdoing director committed "fraud on the minority" – a concept which has been vexed with ambiguity. To this day, the law in Singapore remains unsettled on the precise criteria that must be proven in order to establish "fraud on the minority" (see *Sinwa SS (HK) Co Ltd v Morten Innhaug* [2010] 4 SLR 1 ("*Sinwa SS (HK) Co Ltd*") at [54]–[55]). This ambiguity, combined with other critiques of the fraud on the minority test, inspired Singapore's Parliament in 1993 to create a new statutory procedure in ss 216A and 216B of the Act for shareholders to pursue a derivative action. In the last decade, the UK and most other leading common law (and many civil law) countries have followed Singapore's lead and similarly provided for a statutory derivative action in their Companies Acts (for more details, see, *Derivative Actions in Asia: A Comparative and Functional Approach* (Dan W Puchniak, Harald Baum, Michael Ewing-Chow eds) (Cambridge University Press, 2012) at p 2).

9.18 Singapore's statutory derivative action, however, is somewhat idiosyncratic in that it does not currently apply to foreign-incorporated companies or companies listed on a Singapore exchange. Hence, the common law derivative action – and, in turn, the much criticised fraud on the minority test – still remains very much alive in Singapore (see, *eg*, *Sinwa SS (HK) Co Ltd*; *Ting Sing Ning v Ting Chek Swee* [2008] 1 SLR(R) 197 ("*Ting Sing Ning*")). This idiosyncrasy, however, will soon be significantly reduced as the Ministry of Finance has recently announced that the Act will be amended to extend the statutory derivative action to cover all *Singapore-incorporated* companies whether they are listed or unlisted (*Review of the Singapore Companies Act, Ministry of Finance's Responses to the Report of the Steering Committee for Review of the Companies Act* (3 October 2012) at pp 37–38).

9.19 Unfortunately, however, the proposed amendment does not appear to extend s 216A to foreign-incorporated companies. As such, even after the Act is amended, it appears that the common law derivative action – and, in turn, the much criticised fraud on the minority test – will still have some relevance as it will be the only avenue for shareholders in foreign-incorporated companies to pursue a derivative action in Singapore. It is noteworthy that the possibility of shareholders in foreign-incorporated companies wanting to pursue a derivative action is far from remote. In fact, Singapore's two leading cases on the common law derivative action were both brought by shareholders in foreign-incorporated companies (see, *eg*, *Sinwa SS (HK) Co Ltd*; *Ting Sing Ning*). The authors agree with the Ministry of Finance's recommendation to expand s 216A to all Singapore-incorporated companies as s 216A provides a much better filter than the fraud on the minority test. We, however, would suggest that further expanding s 216A to cover all Singapore and foreign-incorporated companies would be desirable as it would put to rest the much criticised fraud on the minority test and allow the courts to focus on fine-tuning the s 216A filter.

9.20 Specifically, s 216A requires shareholders to satisfy three elements before the court will grant them leave to pursue a statutory derivative action: (a) the complainant has given 14 days' notice to the company's directors of his intention to bring the derivative action before commencing the application for leave; (b) the shareholder pursing the derivative action is acting in good faith; and (c) that it appears to be *prima facie* in the interests of the company that the derivative action be brought. Although these three elements are much clearer than the fraud on the minority test, courts must still fine-tune these broad principles to create an effective filter that both weeds out abusive wealth-reducing derivative actions and at the same time allows legitimate wealth-maximising ones to proceed.

9.21 In *Ang Thiam Swee v Low Hian Chor* [2013] 2 SLR 340, the appellant and respondent were the only remaining directors and minority shareholders in a company ("the Company") whose majority shareholder director had recently been imprisoned and disqualified as a director for making fraudulent tax claims related to the Company. Following these events, an independent audit of the Company's accounts revealed that the majority shareholder, who was by then a former director, had also misappropriated over $5m from the Company. The respondent alleged that the independent audit further revealed that the appellant, in his capacity as a director and co-signatory of the Company's accounts, had also breached his director's duties by misappropriating funds from the Company. Based on these allegations, the respondent succeeded in having the High Court grant him leave under s 216A to pursue a derivative action in the name of the Company against the appellant.

9.22 In a watershed decision, the Court of Appeal overturned the High Court's ruling and denied the respondent leave to pursue a s 216A derivative action. In arriving at its decision, the court clarified three important points about the good faith requirement in s 216A. First, the court made it clear that in a s 216A application, the onus is on the complainant to establish that he is acting in good faith (*ie*, there is no presumption of good faith in favour of the complainant). The Court of Appeal based this finding on the clear language of s 216A (which states that the court must be "satisfied" that the "complainant is acting in good faith") and Canadian and Australian case law which also places the onus on the complainant to establish good faith. This clarification is important because earlier local case law suggested that the court was entitled to "assume that every party who [came] to Court with a reasonable and legitimate claim [was] acting in good faith" (*Agus Irawan v Toh Teck Chye* [2002] 1 SLR(R) 471 at [9] ("*Agus Irawan*"); see also several cases which cite this passage from *Agus Irawan* with approval: *Pang Yong Hock v PKS Contracts Services Pte Ltd* [2004] 3 SLR(R) 1 at [18]–[19]; *Poondy Radhakrishnan v Sivapiragasam s/o Veerasingam* [2009] SGHC 228 at [21]; *Fong Wai Lyn Carolyn v Airtrust (Singapore) Pte Ltd* [2011] 3 SLR 980 at [72]).

9.23 Second, the Court of Appeal clarified that the motivations of the complainant should be assessed in determining whether he has met the good faith requirement. In making this assessment, the court stressed the "crucial link" between the good faith and interests of the company requirements in s 216A. Specifically, it noted that a complainant's self-interested or questionable motives will only amount to bad faith if they are such that the company's interests would not be served by allowing the complainant to pursue a derivative action. In other words, the complainant's questionable motives *per se* would not amount to bad faith. Rather, such motives would only likely amount to bad faith if they prevent the derivative action from serving the company's interests. The court put a further gloss on evaluating whether a complainant's motives would amount to bad faith by suggesting that when the complainant's collateral purpose for bringing the derivative action is an abuse of s 216A, and in turn the company, it would amount to bad faith. On this basis, the court suggested that a useful test for determining bad faith may be found in the jurisprudence dealing with the grounds for striking out an action under O 18 r 19 of the Rules of Court (Cap 322, R 5, 2006 Rev Ed).

9.24 Third, the Court of Appeal clarified that an objective consideration of the legal merits of the proposed derivative action should not be seen as determinative of whether the complainant has met the good faith requirement. The court noted (at [29]) that it is possible for a complainant to "seek to bring a statutory derivative action in good faith even where there is no arguable or legitimate case to be advanced". Conversely, a legitimate case may lack good faith if the complainant "is so motivated by vendetta … that his judgment will be clouded by purely personal considerations" (at [12]). As such, the court stressed (at [29]) that the legal merits of a proposed derivative action alone should not be used to determine good faith. Rather, any determination of good faith must be linked "to an assessment of whether the applicant honestly or reasonably believes that there is a good cause of action."

9.25 The authors respectfully commend the Court of Appeal for significantly clarifying the good faith requirement in s 216A, thus making the filter for derivative actions in Singapore more effective. Even after the court's helpful clarifications, however, a real question still lingers about whether it makes sense for good faith to be listed in s 216A as a separate requirement. Indeed, it appears that all of the concerns articulated by the court above could have been mediated through the interests of the company requirement. In addition, the practice in Singapore leads to the conclusion that the interests of the company requirement functions as the primary filter for determining whether a s 216A derivative action will proceed. In fact, the authors are unaware of a single case in which the court has found that a proposed derivative action was in the interests of the company but failed to grant leave based on a lack of good faith. This is to the credit of the court as many leading scholars throughout the Commonwealth are of the view that "as long as the interests of the corporation are met, it should be of no consequence whether the complainant has good or bad intent" (Dennis Peterson & Matthew Cumming, *Shareholder Remedies in Canada* (LexisNexis, 2nd Ed loose-leaf, 2009) at para 16.39; see also Arad Reisberg, *Derivative Actions and Corporate Governance* (Oxford University Press, 2007) at pp 115–120). The authors fully support this view with the caveat that bad intent *should* be of consequence *if* (and only if) it interferes with the derivative action serving the interests of the company – reconfirming the futility of the good faith requirement.