9. COMPANY LAW

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Lifting the corporate veil

9.1 The objective of incorporation is well known and broadly accepted. By allowing companies to be incorporated through the mechanism of registration, the law arguably 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 can take place in a number of ways including by the shareholders being a co-contracting party to an agreement into which the company has entered. Shareholders can also enter into separate collateral contracts that mirror the company's obligations, such as where shareholders provide a guarantee to creditors for the company's debts. The advantage of recognising the company as a separate legal entity is that it has allowed individuals to invest in companies without any assumption of responsibility for such company's obligations. Accordingly, a shareholder is able to segregate his or her risk. This would not be possible in a world where shareholders and their companies were regarded as one and the same legal entity. In such a world – often regarded as a world without "limited liability" – even a small investment in a company would mean that the shareholder potentially risks his entire fortune should this company become insolvent, as all the shareholders will then be answerable to the company's creditors. This would limit the ability of companies to raise capital by the issue of shares and in turn limit the development and growth of stock exchanges. It may also dampen the entrepreneurial spirit. For such reasons, courts uphold the separate personality of companies unless there is a compelling reason not to do so, such as an abuse of the corporate form to commit fraud or engage in other wrongdoing.

9.2 A case that is illustrative of the courts' approach to the separate personality of companies is *NEC Asia Pte Ltd (now known as NEC Asia Pacific Pte Ltd) v Picket & Rail Asia Pacific Pte Ltd* [2011] 2 SLR 565. In this case, the plaintiff commenced an action against the first defendant for non-payment of a sum in relation to a contract to supply projectors. An alternative claim was made against the second defendant for payment on a dishonoured cheque. For the purposes of company law, it was the claim against the third defendant that is relevant as the claim against him was that he, being the sole shareholder of the first defendant, should be liable personally as the first defendant was only the *alter ego* for him in the transaction with the plaintiff. Accordingly, the plaintiff submitted that the third defendant was the true contracting party with the plaintiff.

9.3 Belinda Ang Saw Ean J did not accept this argument. She said that evidence of sole control and ownership of a company without more will not move the court to intervene. With respect, this must be correct. Whether there is one or many shareholders, it cannot be that if one or all the shareholders cause the company to act in a certain way, and this causes the company to incur liabilities, the sole shareholder or all the shareholders will bear personal liability. It is the very purpose of company law as it stands today that the corporation is seen as a conduit for shareholders to pursue an enterprise through a separate entity. Therefore, the mere pursuit of such enterprise should not lead a court to equate the company with the shareholders for purposes of rights or liabilities.

9.4 In any event, her Honour pointed out that, factually, the plaintiff's contention ran counter to its conduct throughout the entire course of events. The plaintiff had always regarded the first defendant, and not the third defendant, as its counterparty in the transaction. For example, the plaintiff had earlier rejected the third defendant's offer of interposing the second defendant in the commercial scheme as it was an inactive company. The plaintiff had also asked the third defendant to provide evidence of the first defendant's financial standing before agreeing to accept the latter as a suitable counterparty in the deal. There were also other occasions where the plaintiff pointed to the first defendant as its counterparty.

9.5 The only contention that the authors may have with her Honour is in her characterisation of the circumstances in which the court will ignore the separate personality of the company by lifting the corporate veil. However, this critique can be made of the approach of courts in other common law jurisdictions as well, as it has, at its root, the tendency of courts in this area to use metaphors such as the corporate veil being lifted because the corporation is a "sham" or "façade" or "mask" to take some well-known examples. The problem with such metaphors is that they provide catchphrases that sometimes allow judges – though not in the present case – to arrive at a conclusion without properly articulating in detail the reasons behind such a conclusion. The metaphors are therefore understandably vague.

9.6 In the present case, the learned judge said that the *alter ego* argument was different from the sham or façade exception to the doctrine of separate personality. Her Honour seemed to regard the latter as a basis for lifting the veil based on fraudulent acts by a company's controller. The *alter ego* doctrine, on the other hand, arose when the company was used to carry on the business of the controller. Although her Honour did say that this would essentially involve a question of fact, in one sense the issue as framed is correct and vague at the same time because in all cases it can be said that a corporate vehicle is used to carry on the business of its' controller(s). The question is always identifying the tipping point at which it becomes unacceptable as a manner of legal principle.

9.7 The authors suggest that, as fraud will typically be frowned upon, and cases involving fraud have been the classic cases where the corporate veil has been lifted, recourse to fraud as a basis for lifting the corporate veil should be recognised for what it is and reliance on metaphors is neither useful nor desirable. Where persons, whether shareholders or directors, have used a corporate vehicle as a conduit for fraudulent acts, the law should have no hesitation in looking beyond the corporate form as the company would have been used for an illegitimate purpose and this is an abuse of the privilege of incorporation. Public policy therefore leans in favour of an exception to corporate personality.

9.8 The "sham" or "façade" ground should be understood in a sense analogous to that of "sham contracts". A contract is a sham where the parties entering into it do not intend the contract to embody the true agreement between them. As Diplock LJ put it in *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786 at 802, the pejorative word "sham" means acts done, or documents executed, by the parties to the sham which are intended by them to give to third parties, or to the court, the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intended to create. Similarly, the company is a sham or façade if it was never the intention of the shareholder(s) that the company should be the real contracting party and this may exist independently of whether there is fraud or not. A good example of such a sham company, though one where the court felt that the motive of the controller was dubious, is the case of *Asteroid Maritime Co Ltd v The Owners of the Ship or Vessel Saudi al Jubail* [1987] SGHC 71 ("*Saudi al Jubail*") where the late Lai Kew Chai J found that the companies in question were being used as mere corporate names as a cover for the controller's own trading and ship owning activities.

9.9 The authors suggest that the *alter ego* ground is really another means of expressing the idea that the interposition of the corporate vehicle was merely a sham and the company was not intended to be the true contracting party with the counterparty. The *ratio* for *Smith Stone and Knight Ltd v Lord Mayor Alderman and Citizens of the City of Birmingham* [1939] 4 All ER 116 cited by Ang J is a good example of this and one which did not involve any fraud or dubious practice. The parent company had purchased a waste business from a partnership. The parent company subsequently incorporated a subsidiary company and purported to use the subsidiary company to carry on the waste business. However, the said business was never transferred to the subsidiary. The subsidiary had no staff, the books and accounts were kept by the parent and the subsidiary had none of its own and the profit made was allocated to the parent and treated by the parent as having been made by it rather than through the subsidiary by the payment of a dividend from the subsidiary to the parent. Therefore, the court decided that the subsidiary was merely an agent and the waste business belonged to the parent. An alternative explanation is that the actions of the parent company demonstrated that it did not recognise its subsidiary company as being engaged in the waste business. As such, there was no proper segregation of the subsidiary's profits and it did not even notionally have its own staff or governance processes. It was therefore, to quote *Saudi al Jubail*, a "mere corporate name" or sham.

Breach of fiduciary duty

9.10 It is clear that a company's directors and other senior management owe fiduciary duties to the company. This is 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. Having said this, in essence any wrongdoing towards the company will also affect its shareholders. While there may be shareholder remedies to which shareholders can have recourse, as many shareholders are not involved in day to day management, they may not be able to prevent wrongdoing from taking place. 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.

9.11 The case of *Mona Computer Systems (S) Pte Ltd v Chandran Meenakumari* [2011] 1 SLR 310 provides a fairly typical instance of a breach of fiduciary duty on the part of a senior executive of a company. The plaintiff company, which was family owned, brought a claim against a director and her husband, an executive of the company, for breach of their fiduciary duty to the plaintiff. Essentially, the two defendants had incorporated another company to engage in the same business as the plaintiff. This was done while they were still a non-executive director and executive respectively of the plaintiff. The complaint against the first defendant was limited to this. As against the second defendant, the claim was that he also diverted business from the plaintiff and indeed, he admitted that while he was an executive of the plaintiff he did so to the new company that he and the first defendant had incorporated.

9.12 Counsel for the defendants accepted that the second defendant was a fiduciary to the plaintiff company. Belinda Ang Saw Ean J agreed. The second defendant was the only employee of the company and after the death of the managing director and majority shareholder at the time (who held all the shares except for one share in his mother's name), the second defendant's job scope included that of sales manager. In this capacity the second defendant was expected to get contracts for the plaintiff. Accordingly, Ang J said that he was under a duty to act in good faith, and not to act so as to place himself in a position of conflict between his personal interests and those of the plaintiff. In particular, he was under a duty not to use or cause to be used any opportunity available to him by reason of his employment and his position as a fiduciary for any purpose other than furthering the interests of the plaintiff. His defence was that the present majority shareholder and managing director, who was the wife of the deceased former majority shareholder, had consented to him securing contracts for the new company. Ang J found this unlikely as this would have had an impact on the new majority shareholder's livelihood. In the absence of any informed consent on her part, the second defendant could only bring his fiduciary obligations to an end by resigning from the plaintiff's employment. This he did not do until 20 February 2009 and he was therefore liable for any breaches prior to such date for the diversion of business opportunities to the new company. Accordingly, he had to account to the plaintiff for profits made from the contracts diverted to the new company.

9.13 Although the plaintiff succeeded against the second defendant, the claim against the first defendant was dismissed. This was because the learned judge found that the first defendant had told her mother of the defendants' intention to incorporate a separate company that would be involved in the same business. The mother who was the holder of one share was also a director and Ang J accepted that the mother had given her consent to this. Ang J noted that, ideally, the first defendant should have informed the new majority shareholder, but she accepted that the family circumstances were complicated and that the first defendant and the new majority shareholder were not on speaking terms. The latter also knew, from the second defendant, of the incorporation of the new company as early as December 2007. This was before the new company commenced business. Furthermore, the first defendant was not involved in the business of the new company; she had little formal education and was primarily a homemaker. It is respectfully suggested that Ang J's very practical approach towards the first defendant is to be welcomed. It is difficult to see what real harm she had caused to the plaintiff even though any disclosure on her part was somewhat informal and not in accordance with good corporate practices and procedures.

Meetings

9.14 In *Tang Kin Fei v Chang Benety* [2011] 1 SLR 568, a series of board meetings were 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, 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). This is the well-known provision that states that procedural irregularities do not of themselves invalidate an act of the company unless the irregularity has caused substantial injustice. It is a useful provision because it prevents acts from being invalidated due to procedural irregularities that may have taken place as a result of ignorance or mistake and which have not led to any real harm being done. In fact, to invalidate any transaction or act because of any procedural irregularity, however minor, could lead to substantial cost and inconvenience to the company and other third parties.

9.15 It was submitted for the three defendants that the very fact that they were deprived of the defensive tactic that they were entitled to adopt meant that the court did not have any power under s 392(2) of the Companies Act to validate resolutions or that there would necessarily be substantial injustice which would never be cured under s 392(2), unless the resolutions were passed inadvertently without knowledge of a lack of quorum. Woo Bih Li J did not agree with this submission. His Honour said that the principle that the procedural irregularity must have caused the injustice and not the resolutions themselves did not mean that the substance of the resolutions was to be totally disregarded. The absence of a quorum was, by statute, only a procedural irregularity. What the principle meant was that both the procedural irregularity and the substance of the resolutions must be considered as part of the holistic approach, and not only the substance of the resolutions themselves. If the defendants' submission was correct, the efficacy of s 392(2) of the Companies Act would be reduced substantially, as in effect, it would mean, in the context of meetings that proceeded without a quorum, that such meetings could only be validated if the party proceeding with the meeting did so inadvertently, thinking that there was a valid quorum. The authors respectfully agree with Woo J's reasoning and would only add that the existence of an honest mistake does not mean that there would be an absence of substantial injustice. It is the practical effect of the procedural irregularity that is important in ascertaining substantial injustice and any distinction between inadvertence and deliberateness is unlikely to make a significant difference in many cases.

9.16 Woo J went on to state that he was of the view that the starting point should be that, where there is a provision which allows one party to engage in the defensive tactic mentioned above, he is, *prima facie*, entitled to do so. Where there is a deadlock in the sense that no quorum could be formed for a board meeting, his Honour was of the view that to allow one party to push ahead with his agenda in the absence of the other party was *prima facie* a substantial injustice because he was denying the other party the right to stop the proposing party from proceeding with his agenda; a right which the parties had agreed to beforehand. It would then be for the party wishing to proceed with the resolutions to persuade the court why the resolutions should be validated.

9.17 Applying these principles, Woo J was of the view that most of the resolutions should be validated. This was because those resolutions were intended to ensure that the company had the benefit of legal advice over the dispute between the shareholders as to the beneficial ownership of certain shares in the company. They were also to ensure that, in relation to a separate action that had been commenced by Sembcorp Marine Ltd against PPL Holdings Pte Ltd, the company's solicitors had authority to appear on behalf of the company to ensure that its interests were protected. Again the authors respectfully agree. The key ultimately to a dispute of this nature, *ie*, where a shareholder has a "deadlock" right, must be the best interests of the company. In this vein, Woo J did not allow two of the resolutions as he felt that they were not neutral and more importantly, that it was not clear if those two resolutions were in the best interests of the company because the true motive behind those resolutions had not yet been established.

Directors' right to inspect accounting and other records

9.18 Section 199(3) of the Companies Act provides that the accounting and other records of a company shall at all times be open to inspection by the directors of such company. The language used in s 199(3) is very broad. However, as with many powers and rights accorded to directors, it is implicit that they exist to facilitate the interests of the company, or at least that they should not be used in a manner detrimental to the company. This was recognised by the Court of Appeal in *Wuu Khek Chiang George v ECRC Land Pte Ltd* [1999] 2 SLR(R) 352. This *caveat*, on what is otherwise a broad right accorded to directors, is sometimes the object of dispute when a company seeks to deny a director access to the accounting or other records of the company. The two Singapore cases in 2011 on s 199(3) of the Companies Act provide good illustrations.

9.19 In *Ng Joo Soon v Dovechem Holdings Pte Ltd* [2011] 1 SLR 1155, it was argued that the company was justified in not permitting a director to inspect the financial records as the director had persistently failed, refused and/or neglected to divulge his real reason, or for that matter, any reason at all, for wanting to have access to the financial records of the company. It was also averred that, this request to inspect the company's records, was part of the director's self-serving scheme to have his present 24% shareholding increased to 34% and then to split the Dovechem Group of Companies accordingly, so that he could eventually end up with 34% of the split entity. Philip Pillai J rejected these arguments on the basis that a director was not obliged to provide reasons for the request. The onus was on the company to establish any *mala fides* on the part of the requesting director. There was no evidence to show that the request for inspection was or would be detrimental to the interests of the company.

9.20 In *Hau Tau Khang v Sanur Indonesian Restaurant Pte Ltd* [2011] 3 SLR 1128, it had been held by the assistant registrar that this right to inspect was restricted to enabling a director to carry out his duties. As the intention behind the appellant director's request to inspect was to enable him to obtain evidence against a potential derivative action against him, the assistant registrar dismissed the appellant's application to exercise his purported rights under s 199(3) of the Companies Act.

9.21 One of the submissions made by the respondent was that s 199(3) of the Companies Act exists strictly to enable a director to fulfil his statutory duties in relation to the company's accounts as the provision is placed within Part VI of the Companies Act entitled "Accounts and Audit". This argument was rejected by Steven Chong J who was of the view that inspection was intended to enable a director to discharge *all* his statutory duties, including, but not limited to, those in relation to accounts. His Honour said that it was quite foreseeable that a director might, for example, need to check the company's accounts so as to discharge his duties of reasonable care and diligence pursuant to s 157(1) of the Companies Act. A director may also need to have access to the accounts of a company to determine how best to exercise his discretion to act in the interests of the company.

9.22 The respondent's second submission was that s 199(3) of the Companies Act required the right to be exercised in relation to a director's present and future duties, and not to justify past conduct. Chong J did not accept this and agreed with the appellant's argument that it would be in the interest of companies to allow a director to inspect the accounts, because if the accounts proved that a director had not breached his fiduciary duties, the company's limited resources would not be squandered on futile litigation.

9.23 The third submission made by the respondent was that the right should not be exercised for a purpose not connected with the discharge of a director's duties and any such purpose was improper. In addressing this submission, Chong J expressed the view that the existing authorities did not confine the circumstances under which a court would refuse inspection, to situations where the exercise of the right would injure the company. The court could also refuse inspection if it was established that inspection was sought for some other improper purpose not connected to the discharge of the duties that a director may have towards his company, even if this would not be injurious to the company. However, the burden is on the party asserting that a director should not be entitled to inspect to establish this and the burden is a high one, since the default position is that the director is entitled as of right to inspect the company's accounting and other records.

9.24 In the present case, the appellant's rationale in making this application now, instead of waiting to address the matters at a future trial, was to nip the problem in the bud. Parties would therefore save on time, costs and resources, in so far as the allegations relating to financial irregularities were concerned. Chong J saw no real issue to this and felt that the inspection had a sufficient nexus to the appellant's duties as a director. It would be too narrow to construe the right as limited to duties in relation to accounts or for the performance of present and future duties only, a view which he had already rejected. Accordingly, he held that the right to inspect the accounts was related to the appellant's discharge of his director's duties, even if he did so with a view to prove that he had not acted in breach of such duties.

9.25 The authors respectfully agree with Chong J's analysis and result. There was clearly no harm that could be caused to the company from the appellant's application, and one should be wary of unduly circumscribing the right of directors to inspect a company's accounting and other records. Given that another director of the respondent company had gained access to the company's accounts and through this obtained information that allegedly showed a breach of fiduciary duty on the part of the appellant, it would have been strange to prohibit the appellant from inspecting the company's accounts for the purpose of better assessing the accuracy of the allegation, given that the allegation related to the appellant's discharge of his fiduciary duties, albeit in the past.

Informal resolutions and articles of association

9.26 *Ng Joo Soon v Dovechem Holdings Pte Ltd* [2011] 1 SLR 1155 ("*Dovechem*") also raised the issue of the *Duomatic* principle. This is derived from the case of *Re Duomatic Ltd* [1969] 2 Ch 365 ("*Re Duomatic Ltd*"), where the court upheld the payment of salaries to directors that had not been approved in a general meeting. The basis for the decision was that a general meeting could have sanctioned such payment, and since all the shareholders who had the right to attend the meeting had assented to this payment, the assent was held to be as binding as a resolution passed at a general meeting. This issue arose in *Dovechem* because all the shareholders had allegedly approved a remuneration plan several years ago where it was agreed that directors reaching the age of 70 would retire. This was used as another basis for the refusal to allow the director in question access to the company's accounting and other records, as it was argued that the director was no longer a director when he turned 70.

9.27 Philip Pillai J rejected this contention. His Honour said that even if the remuneration plan evinced the assent of all directors and shareholders of the company at that time that the director in question was to retire in future upon reaching 70, a further step would necessarily be required to activate such assent as far as the company and all external persons were concerned. To do so, the director would have had, pursuant to the company's articles of association, to tender a notice of resignation. No such letter of resignation was tendered. Neither was there any formal board resolution recording any such retirement or resignation. This did not appear on the evidence to have been an oversight of a mere formality. The director continued to attend corporate meetings as before with no questions being raised as to his continued attendance or the capacity in which he was in attendance. Alternatively, activation could have been made by the parties proceeding to amend the articles of association of the company to insert a new provision that a director would automatically be retired on reaching 70 or that his directorship would automatically become vacant upon reaching this age. No such amendment of the company's articles was made.

9.28 Accordingly, Pillai J was doubtful whether the *Duomatic* principle came into play in this case. There was no action taken either by anyone when the director in question turned 70 to confirm the previous assent, and on the contrary, the conduct of all parties at this time was inconsistent with such assent. In the absence of confirming actions by the director in question and/or all the other directors and shareholders, whose unanimous agreement was being relied upon, and in the absence of any amendment of the articles of association to provide for the automatic retirement of all directors, his Honour said he would be hesitant, without more information, to extend the *Duomatic* principle to this case.

9.29 In any event, his Honour found that nothing in the remuneration plan by its express content provided that the director in question had to retire as a non-executive director upon reaching 70. For all these reasons, he continued to be a director and was entitled to inspect the company's accounting and other records.

9.30 The Court of Appeal in *Dovechem Holdings Pte Ltd (in liquidation) v Ng Joo Soon* [2011] 4 SLR 345 upheld Pillai J's judgment. The Court of Appeal felt that there was nothing in the company's memorandum of association which dispensed with the need for a special resolution where amendment of its articles was concerned. Therefore, the remuneration plan could not be read as overriding the articles so as to require the director in question to retire as a director upon turning 70. Under article 71 of the company's articles of association, an ordinary resolution was required to remove a director. The court added that the absence of a special resolution amending this article could not be cured by applying the *Duomatic* principle. The facts of the present case were far removed from those in *Re Duomatic Ltd*, where the irregularity to which the *Duomatic* principle was applied was relatively minor. What the appellants were attempting to do, in the present case, was to rely on the *Duomatic* principle to enforce an alleged agreement relating to directors' retirement which was contrary to the express provisions of the company's articles.

9.31 The reasoning of the Court of Appeal is interesting as it may signal a difference from that adopted in the UK. In *Cane v Jones* [1980]

1 WLR 1451 (and see also *Re Bailey Hay & Co Ltd* [1971] 1 WLR 1357), it was held that the *Duomatic* principle could be applied to effect an amendment to the company's articles of association so as to deprive the chairman of the casting vote that had been provided for in the said articles. There is certainly merit in the view taken by the Court of Appeal that, in so far as constitutional amendments are concerned, there must be some compliance with the procedures set out in the memorandum or articles of association. Yet, if shareholders have consistently and unanimously acted in a manner different from that set out in the company's constitutional documents, there might be unfairness if this was departed from subsequently, simply because the procedures for amendment were not invoked. Perhaps one solution might be to place reliance on the doctrine of estoppel as a means to prevent unfairness where appropriate, whilst, at the same time, recognising that the corporate constitution has not been formally amended. In such a case, the court would acknowledge that the constitution had not been amended but this could not be relied upon by dissenting shareholders as they would be estopped by their previous conduct. This should be done where it would otherwise be unfair to the majority, to allow the minority, to rely on the strict terms of the constitution given the past conduct of all the shareholders. The extent of the estoppel will depend on the facts of the case.

Disqualification of directors

9.32 In *Ong Chow Hong v Public Prosecutor* [2011] 3 SLR 1093, the appellant was disqualified from taking part in the management of a company for 12 months upon his plea of guilty to an offence under s 157(1) of the Companies Act for failing to exercise reasonable diligence as a director. Essentially, the appellant could not be present at a meeting to prepare a reply to a query from the Singapore Exchange and told the company secretary that he would agree to any announcement issued by the company if another director, who was a lawyer approved of it. The appellant therefore did not see the announcement before it was released.

9.33 V K Rajah JA dismissed the appeal and allowed the Prosecution's cross-appeal to enhance the period of disqualification, by imposing a 24 months disqualification period. Rajah JA pointed out that an analysis of the statutory structure behind the disqualification regime in Singapore showed that its objective was predominantly protective in nature, and not intended to be essentially punitive. The statutory policy appeared to be that disqualification orders ought to be generally imposed to protect the public from individuals who were shown to be unworthy of being privileged with the protective shield of corporate autonomy. In other words, the disqualification regime served to protect the public from abuses of the privilege of limited liability.

9.34 Although the main purpose was protection, his Honour said that in Singapore the case law has tended to focus only on what he characterised as the "thin" definition of protection. By this, Rajah JA, meant the protection of the public from an individual who has failed to fulfil his obligations *qua* director. There was also the "thick" definition of protection to be borne in mind. By this, Rajah JA, meant the need to generally protect the public from all errant directors by an uncompromising reaffirmation of the expected exemplary standards of corporate governance so as to preserve investor confidence in Singapore's capital markets. Given the disclosure-based regulatory framework adopted by Singapore, there was a need for the courts to ensure the accuracy of market disclosures to the public. This form of protection of the public is expressed through the appropriate calibration of disqualification orders assessed to be sufficient to deter serious lapses in corporate behaviour. In his Honour's view, these two notions, of specific and general protection, were not mutually exclusive and are often intertwined. Accordingly, precedents on disqualification orders of directors that do not acknowledge these dual considerations of protection ought to be viewed warily.

9.35 Given his views, Rajah JA stated that the district judge erred as a matter of law when he proceeded on the wrong footing, that the disqualification scheme was essentially punitive and failed to consider the wider public interests that ought to be taken into account. Consequently, he had given undue consideration to the standing of the appellant since, in the context of the protective objective of the disqualification regime, the appellant's good standing had only a penumbral significance.

9.36 In the present case, Rajah JA was of the view that the appellant consciously abdicated his responsibilities. He was quite content to delegate his responsibilities to another director, and was either indifferent to his responsibilities or failed to appreciate them. He had committed nothing short of a serious lapse in entirely abdicating his corporate responsibilities. Offering important observations that directors of public listed companies in Singapore will, henceforth, no doubt have to be aware of, Rajah JA said that such directors have to appreciate that the present disclosure-based regime requires accurate and prompt disclosure to function effectively. It would never be sufficient or acceptable for a director to say that he expected his co-directors to do what was right. Every director has to ensure that he discharges his responsibilities with due diligence in all pertinent matters. Therefore, any reliance on professionals, or any reliance placed on directors with special knowledge, must be balanced against the responsibility that the law placed upon every individual director to bring to bear their own judgment in evaluating the advice received. Directors cannot adopt a silo approach and invariably seek shelter behind other directors on the notion of reliance. Of course, how this responsibility ought to be discharged in any particular case would be a question of fact.

The derivative action

9.37 In most situations, the decision of whether a company should sue is easily resolved through the normal corporate decision-making process. As the decision to sue is generally a management decision, the board of directors is normally the corporate organ vested with the power to make such a decision. This makes sense. Directors are normally in a better position than shareholders to decide whether the company should sue as they have greater access to relevant information, can more efficiently make such a decision and are bound by fiduciary and negligence duties to properly make such a decision in the best interests of the company as a whole.

9.38 An obvious problem arises, however, when there is a breach of directors' duties and, in turn, the directors themselves become potential targets of corporate litigation. In such a case, according to the normal corporate decision-making process, the wrongdoing directors have the power to decide whether the company should, in effect, sue themselves. This obvious 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 on their breach. From the time of *Foss v Harbottle* (1843) 67 ER 189, common law courts have attempted to solve this problem by allowing individual shareholders, in certain circumstances, to pursue an action for and on behalf of the company against the wrongdoing directors; effectively circumventing the normal corporate decision-making process. These shareholder driven corporate actions have come to be known as "derivative actions" because the rights they seek to enforce are "derived" from the company.

9.39 Although the derivative action undoubtedly provides a useful mechanism for enforcing the duties of controlling directors, it also presents serious corporate governance risks. Allowing a single shareholder to thrust an entire company into potentially damaging litigation is clearly contrary to the foundational principle of majority rule and risks producing negative externalities. It also creates a potential mechanism for vexatious shareholders to launch strike suits, which may erode corporate value and make directors risk averse. Therefore, common law courts have been faced with the conundrum of developing a filter to weed out abusive, wealth-reducing, derivative actions while at the same time allowing legitimate, wealth-maximising, ones to proceed.

9.40 In Singapore, the UK and many other Commonwealth countries, the filter developed by the courts has been to require shareholders to seek leave as a precondition for pursuing a derivative action. Historically, for shareholders to succeed in such a leave application, they have been required to establish that the wrongdoing director committed "fraud on the minority". Despite its long history and importance, the precise criteria for establishing fraud on the minority remains an unsettled area of the law (see *Sinwa SS (HK) Co Ltd v Morten Innhaug* [2010] 4 SLR 1 at [54]–[55]). This ambiguity, combined with other wide ranging 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 Companies Act for shareholders to pursue a derivative action. Although Singapore was one of the first Commonwealth countries to implement a statutory derivative action, over the last decade the UK and most other leading Commonwealth (and civil law) countries have similarly provided for a derivative action procedure in their corporate statutes. For more details, see *Derivative Actions in Asia: A Comparative and Functional Approach* (Dan W Puchniak *et al* eds) (Cambridge University Press, forthcoming, 2012).

9.41 Singapore's statutory derivative action, however, is somewhat idiosyncratic as it applies only to companies that are Singapore-incorporated and not listed on a securities exchange in Singapore. As such, distinct from the UK and most other Commonwealth countries, the common law derivative action – and, in turn, the much criticised fraud on the minority test – still remain very much alive in Singapore (*eg*, see *Sinwa SS (HK) Co Ltd v Morten Innhaug* [2010] 4 SLR 1 and *Ting Sing Ning v Ting Chek Swee* [2008] 1 SLR 197). However, it appears that this idiosyncrasy may soon be substantially diminished as the Ministry of Finance's Steering Committee to Review the Companies Act has recently recommended that the statutory derivative action be extended to all Singapore-incorporated companies, regardless of whether or not they are listed on a securities exchange (see *Report of the Steering Committee to Review the Companies Act* June 2011, Recommendation 2.30). Similar to most other leading Commonwealth countries, this reform would make the statutory derivative action the principal means for shareholders in Singapore to pursue a derivative action; effectively side-lining the common law derivative action and fraud on the minority test.

9.42 Support for the statutory derivative action is based on the belief that s 216A of the Companies Act provides a better filter than the fraud on the minority test for weeding out abusive derivative actions, while at the same time facilitating legitimate ones. Specifically, s 216A requires shareholders to satisfy three elements before being granted leave to pursue a statutory derivative action: (a) to provide 14 days' notice to the company's directors before commencing an application for leave; (b) to establish that it is *prima facie* in the interests of the company that the derivative action be brought; and (c) to establish that the shareholder pursing the derivative action is acting in good faith. Although s 216A of the Companies Act is unquestionably more clearly defined than the fraud on the minority test, recent cases suggest that courts still face the difficult challenge of applying it in a manner that provides an effective filter; something which has vexed common law courts around the world for over a century.

9.43 In *Fong Wai Lyn Carolyn v Airtrust (Singapore) Pte Ltd* [2011] 3 SLR 980 (on appeal to the Court of Appeal), the plaintiff, a non-executive director and minority shareholder of a Singapore-incorporated private company ("Company"), brought an application under s 216A of the Companies Act, for leave to pursue a statutory derivative action against the Company's managing director ("Defendant"). The plaintiff claimed that the Defendant, in her capacity as the Company's managing director, breached her fiduciary duties by diverting several business opportunities from the Company to other companies in which she or her relatives had undisclosed interests and by causing the Company to engage in numerous transactions with such related companies. Based on these claims, the High Court granted the plaintiff leave to pursue a s 216A statutory derivative action.

9.44 A central argument advanced by the Defendant was that the leave application should be dismissed because the plaintiff provided notice of the leave application to the Company's directors seven days' *after* the application was filed; clearly violating the requirement under s 216A(3)(*a*) of the Companies Act that 14 days' *prior* notice must be provided. The High Court, relying on its discretion to dispense with notice under s 216A(4) of the Companies Act, rejected the Defendant's argument on the basis that it would have been "impracticable" for the plaintiff to have met the notice requirement. According to Judith Prakash J, the "key fact" supporting her finding of "impracticability" was that, even after notice was provided, the Company failed to make a "*bona fide* and determined effort to investigate [the plaintiff's] claim". This led her Honour to conclude that it would have been "futile" for the plaintiff to have provided 14 days prior notice as such notice would not likely have caused the directors to have considered whether the company should pursue the proposed action; rendering moot the central purpose of the notice requirement. As such, Prakash J held that it would be wrong to penalise the plaintiff for her failure to provide prior notice as such notice would have likely been "futile".

9.45 We respectfully agree with Prakash J's general view that a plaintiff should not be penalised for failing to provide 14 days' prior notice when it is *clear* that even if such notice was provided, the directors would still not have made a *bona fide* effort to consider whether the company should pursue the plaintiff's proposed action (*ie*, when notice is clearly "futile"). We note, however, that such a "futility exception" to the notice requirement should be treated with extreme caution as its misapplication may undermine the important practical and commercial benefits of the notice requirement. In this vein, we respectfully caution that it should not be assumed that the directors' failure to act based upon inadequate notice is necessarily evidence that they would have similarly failed to act had proper notice been provided. This is particularly true when, as occurred in this case, notice was received after the leave application was filed and, in turn, after formal legal proceedings were commenced. Indeed, in our respectful opinion, it is possible (if not likely) that directors will respond differently to plaintiffs who meet the notice requirement and have not yet commenced legal proceedings than to plaintiffs who have neglected the notice requirement and have already rushed to the courthouse.

9.46 We respectfully would like to stress, however, that even if our caution is warranted, it does not necessarily undermine the High Court's decision in this particular case. It is still possible, based on the particular circumstances of this case, that the High Court could have reasonably concluded that prior notice would have indeed been futile. No doubt this will be one of the issues that will be raised before the Court of Appeal. Rather, our hope is that this caution will quell any attempt to extrapolate a general principle from this particular decision that the futility exception can be established based *solely* on evidence of the directors' failure to properly respond to inadequate notice. This being said, even in light of our caution, it should be acknowledged that a practical implication of Prakash J's decision is that directors will now likely be advised to always make a "*bona fide* and determined effort to investigate [the plaintiff's] claim", even if inadequate notice is provided. In our respectful opinion, this is unquestionably a positive corporate governance development, which can be maintained if the behaviour of directors who receive inadequate notice is one – but not the only – factor that the court considers when determining whether the futility exception to the notice requirement applies.

9.47 The recent case of *Urs Meisterhans v GIP Pte Ltd* [2011] 1 SLR 552 (on appeal to the Court of Appeal) further highlights the complexity of s 216A of the Companies Act leave applications and also suggests that local courts have implemented a number of pragmatic and effective solutions to respond to such complexity. In this case, the plaintiff, a shareholder and former director of a Singapore-incorporated private company ("Company"), sought leave under s 216A to pursue a derivative action against two of the Company's directors. The plaintiff's leave application was based primarily on three claims: (a) that he had been wrongfully removed from his position as a director of the

Company; (b) that the Company's directors and management had wrongfully withheld information from him and investors in the Company's business; and (c) that the Company's directors had mismanaged its business in a manner that damaged the Company.

9.48 The High Court dismissed the plaintiff's leave application on two grounds. First, Tay Yong Kwang J held that it would not have been *prima facie* in the interests of the Company to pursue the plaintiff's proposed action as his claims supporting the action "were all without merit". Second, his Honour found that the plaintiff had not brought the s 216A of the Companies Act leave application in good faith; evidenced by the fact that the plaintiff had sent unsubstantiated e-mails to investors and regulators which harmed the Company and had attempted to divert the Company's sole business to a company in which he was a director and shareholder.

9.49 In arriving at these findings, Tay J reiterated the well-established standard that plaintiffs must demonstrate *only* that "the intended action is a legitimate or arguable one" to satisfy the requirement under s 216A(3)(*c*) of the Companies Act that the proposed action must appear to be "*prima facie* in the interests of the company". Moreover, in line with existing authorities, his Honour noted that because applications under s 216A of the Companies Act are for leave, the court is not required to make an extensive inquiry into the merits of the claim and can rely solely on affidavit evidence. For at least three reasons, the authors respectfully agree with this facilitative approach to s 216A leave applications.

9.50 First, it would be impractical to require a s 216A Companies Act plaintiff in a leave application to establish more than a legitimate and arguable case based on affidavit evidence. Indeed, requiring anything more would essentially force the plaintiff to conduct a trial in the leave application in order to be granted leave to conduct yet another trial; clearly a redundant and inefficient result. Second, such a facilitative approach is justified in light of the significant economic and informational hurdles that s 216A plaintiffs face as a result of being in the unique position of a plaintiff which is saddled with the burden of funding and building a case on behalf of another (separate) legal person: the company. The court sometimes attempts to mitigate the uniquely disadvantageous position of s 216A plaintiffs by including indemnification for costs or corporate disclosure requirements in orders granting leave. However, such formal *ex post* remedies do nothing to level the playing field for inherently disadvantaged plaintiffs in the leave application itself. In this vein, the facilitative approach of only requiring the plaintiff to establish an arguable case based on affidavit evidence can be seen as a much needed *ex ante* attempt to level the playing field for s 216A plaintiffs in the leave application. Third, even though the arguable case based on affidavit evidence standard is clearly facilitative, it can nevertheless still provide an effective filter for weeding out abusive claims. As seen in this most recent case, if it is upheld by the Court of Appeal, even such a facilitative standard will rightfully scorn plaintiffs who try to thrust the company into a derivative action based on claims that are "without merit".