CORPORATE LAW

SUMMARY

LAWSKOOL.SG

LAWSKOOL SINGAPORE

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Cases

1. Common Law Derivative Action

1.1 Decision to Sue: *Who can sue on behalf of the company?*

Qn: 'Which person or body of persons is the company for the purpose of authorizing the litigation?'

(1) Reference to the Articles of Association:

- If the articles specify that a certain person or body may authorize litigation on the company's behalf, that person is the company for the purpose of suing and defending. However, usually nothing of this sort is stated in the articles.

(2) Board of Directors:

- Since, such a power is never expressly written down, the power to manage is usually vested with the board of directors. It is arguable that the managing director has the implied authority to commence legal proceedings in the name of the company. It is impossible to require the board or general meeting of a company to meet and specifically authorize the managing director to commence litigation for recovery of a debt.

- However, every suit brought by the Managing director has to be exercised in the interests of the company. The managing director may not commence litigation in order to further his own personal interests. If the lawsuit is not in the company's best interest or it is being brought to further the director's own personal interest, it should not be authorized. This is because a managing director has only the implied authority to do things that are in the company's interest.

Avel Consultants Sdn Bhd v Mohd Zain Yusof [VC George] held that 'in the absence of express limitation to the contrary, the managing director of a company has the implied authority to commence legal proceedings in the name of the company'.

United Investment & Finance v Tee Chin Yong [Chua J] held that the managing director did not have the power to authorize the proceedings unless that power had been vested in him by the board.

Woon on Company Law opines that the decision in *Avel Consultants* is correct for it is inefficient to require the board or general meeting to convene just so to authorize the managing directors to commence litigation. Also, the solicitor demanding a board resolution before commencing every single routine debt collection and litigation would be inefficient and ridiculous. Thus, the position should be that the managing directors have the implied authority to commence legal proceedings in the name of the company. The power to institute and defend legal actions is a subset of the power of management and since the managing director has the power to manage, he necessarily has such powers (start and stop suit).

1.2 Is it possible to over-ride the board's decision?

Shaw v Shaw [1935] 2 KB 113

Facts:

Defendants who were directors and were indebted to the plaintiff company had agreed to a Settlement term that the 1st respondent would resign as governing directors and together with the other 2 defendants, be ordinary directors. The company's articles were altered so as to provide the defendants with no control over their debts. Later a special resolution was passed that provided the ordinary directors with no right in respect of the company's financial affairs and other businesses which they only held rights of voting and control which was conferred upon them by the permanent directors.

Holding:

" I think the judge was also right in refusing to give effect to the resolution of the meeting of the shareholders requiring the chairman to instruct the company's solicitors not to proceed further with the action. A company is an entity distinct alike from its shareholders and its directors. S*ome of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in the directors, they and they alone can exercise these powers*.

The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in the directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove.

They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of shareholders. The law on this subject is, I think, accurately stated in Buckley on Companies as the effect of the decisions there mentioned: see 11th ed., p. 723"

1.3 When there is a disagreement between the board and the members?

- Usually, the courts would not interfere with the decision of the directors is they had been exercised in *bona fide* in the interest of the company. Factors such as cost of proceedings outweighing the damages recoverable; defendant may have been a long time customer or supplier of the company which would be damaging to the business relationship; adverse publicity are all taken into consideration.

John Shaw v Shaw: Members cannot over-ride the director's decision.

Credit Development Pte. Ltd v IMO Pte. Ltd: Previous form of article vesting management powers in the board does allow the members to give instructions to the board under certain circumstances.

Powers of directors

157A. —(1) The business of a company shall be managed by or under the direction of the directors.

(2) The directors may exercise all the powers of a company except any power that this Act or the memorandum and articles of the company require the company to exercise in general meeting.

- *S 157 A:* Its instatement does confirm that the business of the company shall be managed by the directors and the directors may exercise all the powers of a company except any power that the CA or MA expressly reserved by the company. Thus, the general meeting cannot by passing a resolution instruct the directors what to do without first amending the articles or the MA.

1.4. Common Law-'Proper Plaintiff Rule'

*Usually invoked to prevent members suing to enforce corporate rights.

Foss v Harbottle:

Richard Foss and Edward Starkie Turton were two minority shareholders in the "Victoria Park Company". The company had been set up in September 1835 to buy 180 acres of land near Manchester .This became Victoria Park, Manchester. The claimants alleged that property of the company had been misapplied and wasted and various mortgages were given improperly over the company's property. They asked that the guilty parties be held accountable to the company and that a receiver be appointed.

Holding:

The Vice-Chancellor held that the conduct with which the defendants were charged was not an injury to the plaintiffs exclusively; it was an injury to the corporation as a whole. The corporation and the members are not the same thing. Accordingly, the action could not be maintain by the plaintiffs.

The court dismissed their claim and held that when its directors wrong a company it is only the company that has standing to sue. In effect the court established two rules:

First, the *"proper plaintiff rule*".

The Court stated as such: *First, the proper plaintiff in an action in respect of a wrong alleged done to a company ... is prima facie the company itself.*

Second, the "*majority rule principle"*: It states that if the alleged wrong can be confirmed or ratified by a simple majority of members in a general meeting, then the court will not interfere.

Secondly, where the alleged wrong is a transaction which might be made binding on the company ... on all its members by a simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that if a mere majority of the members of the company ... is in favour of what has been done then cadit question the matter admits of no further argument.

1.5 Justification for 'proper plaintiff rule'

(1) Possibility of a multiplicity of suits by individual shareholders on the same subject, matter may be avoided.
(2) It avoids the situation whereby the alleged wrongdoing may be ratified by the majority subsequently by passing a resolution and therefore resulting in the suit being brought in vain.
(3) It prevents vexatious actions begun by one or two minority shareholders trying to blackmail the company.

1.6 Actions to which the 'Proper Plaintiff' rule does not apply

- This is when the minority member sues in his own to name to enforce the company's rights. The member is not suing to enforce his own rights but rather that of the company.

- However, the action could be struck out by the Courts if it is argued that the company's cause of action is not vested in a member. This could be avoided if the plaintiff can show that the case falls within one of the exceptions to the rule in *Foss v Harbottle.*

- It is contentious whether the rules stated below can even be considered rules. *Woon* at para 9.26 stated that below are the situations when the rule is not applicable. Calling them exceptions is misleading as for something is an exception only when the rule is applicable and they are waived for particular reasons. Also, personal rights exception is not an exception but falls out of the ambit of the *Foss v Harbottle* rule. The member is seeking to enforce his own rights and cannot be subjected to the rule in *Foss*. The 'justice of the case exception' was doubted in the *Prudential Assurance v Newmann Industrial* case.

Below are the following exceptions which can be gleamed from case law:

1. *Ultra Vires acts*
2. *Fraud on the minority*
3. *Special majorities*
4. *Personal rights*
5. *Where the justice of the case requires it*

1.6.1 Personal Rights:

- This is not an exception *per se* but rather it falls outside the ambit of the rule in *Foss v Harbottle.*

- Also, personal rights exception isn't an exception but falls out of the ambit of the *Foss v Harbottle* rule. The member is seeking to enforce his own rights and cannot be subjected to the rule in *Foss*.

  Where the harm suffered could support both a corporate action and a personal action

- Though the courts could not stop a member from pursuing his own personal action, this is now subject to the rule laid down by the HOL in *Johnson v Gore Wood* [2002] 2 AC 1, that a shareholder cannot recover a loss which is simply reflective of the company's loss, even though the shareholder's cause of action is independent of the company's.

- **Reflective loss principle:** It is justified on the grounds of preventing the wrongdoer having to compensate twice for essentially the same loss, since a diminution of share value is merely a natural result of a depletion of the company's assets. The basis is to prevent an abuse of the process and to avoid a windfall to the shareholder, since the loss can be made good by replenishing the company's assets through an action by the company against the wrong doer.

Also, the HOL went on to add that the rule shall bar a shareholder from taking a personal action 'even if the company, acting through its constitutional organs has declined or failed to make good that loss'. Thus, if the shareholders decided to settle for a lesser remedy or not follow with the litigation, the shareholders only have a right to sue the board for negligence and not the wrong doer.

Unless of course it can be proven that: [situation whereby the principle is not applicable]

(1) Where a company suffers a loss but has no cause of action to sue to recover that loss, the shareholder may sue in respect of it.
(2) Where the shareholder suffers a loss that is separate and distinct from that suffered by the company caused by a breach of duty independently owed to the shareholder, the shareholder, then, may sue to recover his loss.

1.6.2 Special Majorities:

- It is a subset of the personal right discussion. Where the Articles specifies 80% majority is required and if this requirement is ignored than any member may complain to court.

1.6.3 Ultra Vires

- If the majority members contravene the MA and are threatening to do an act or enter into a transaction that is ultra vires, a member may sure to restrain it. It is an action to which the rule of *Foss v Harbottle* does not apply. The minority members may sue to restrain the company on the basis that the M&A is a contract among the members *inter se*: S 39 (1).

- At common law the rule in *Foss v Harbottle* has no application where act complained of is wholly *ultra vires*. This is because an *ultra vires* act cannot be ratified at common law and thus a member would be allowed to recover the company's property from a 3rd party to whom it had been transferred to under the *ultra vires* agreement.

- In Singapore, an *ultra vires* exception is not void because of the application of s 25(1).Thus, the question of recovering the property from a party to the *ultra vires* agreement will never arise. Secondly, the action to restrain the *ultra vires* act will not be prevented by the rule in *Foss v Harbottle* as the member would be suing to enforce his own personal rights.

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