

Shareholders vs Mismanagement by Directors: The power of a Statutory Derivative Action

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I. INTRODUCTION

Let's say you are a minority shareholder. The company is not doing well, and you believe the company's directors have committed financial mismanagement, or maybe committed fraud. To make matters worse, the other majority shareholders are in cahoots with these directors, so your concerns are dismissed quickly at every meeting.

Usually, a company would have a legal claim against such misbehaving directors.¹ However, the directors of a company are the ones who decide when the company takes legal action.² When directors they obviously would not make the company take legal action against themselves. Does this mean the company is left helpless to claim for its losses from these directors?

Thankfully not. As a shareholder, although you are typically unable to cause the company to take legal action,³ the law provides an exception to this rule under Section 216A of the Companies Act. This is called the "statutory derivative action". Once certain requirements are met, shareholders can request for permission from courts to take legal action on behalf of the company against such directors.⁴ This article explains the requirements needed before shareholders can attain a statutory derivative action.

II. DISCUSSION

To bring a statutory derivative action, the following *three* requirements must be fulfilled:

- a) You must provide "*notice*" to the company that you intend to apply for a statutory derivative action;⁵

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¹ Companies Act (Cap 50, 2006 Rev Ed) ("*Companies Act*"), at s 157; See also *Ho Kang Peng v Scintronix* [2014] 3 SLR 329, at [35].

² *Agus Irawan v Toh Teck Chye* [2002] 1 SLR (R) 471 ("*Agus Irawan*"), at [8].

³ *Ibid.*

⁴ *Companies Act*, *supra* n 1, at s 216A(2).

⁵ *Id.*, at s 216A(3)(a).

- b) You must bring the action on behalf of the company in “good faith”;⁶ and
- c) The action must be in the “interests of the company”.⁷

A. Requirement one: “Notice”

Before heading to court, you must first give 14 days’ notice to the company that you intend to apply for a statutory derivative action.⁸ This is to give time for the company to reconsider its decision to take legal action.⁹ A problem then arises: what if, after receiving your notice, these directors realise their wrongs will be discovered, and take steps to destroy evidence of their wrongdoing?

The law acknowledges this problem, and there is a system whereby you can go straight to the court under Section 216A(4) of the Companies Act. To do this, you need to show the court that such notice would not be “practicable”.¹⁰

This happened in the case of *Fong Wai Lyn*. There, a shareholder, Ms. Fong, alleged that a director diverted business away from the company, thereby committing a wrong against the company.¹¹ Ms. Fong applied to court for a statutory derivative action, but notified the company too late.¹² Ms. Fong argued that she was afraid that the director would learn their wrongdoings would be discovered, and accordingly destroy all evidence.¹³

The court found for Ms. Fong,¹⁴ as the company’s directors did not take any action even after Ms. Fong’s (late) notice was given.¹⁵ So, even if Ms. Fong had notified the company on time, notice would have been pointless or impracticable.¹⁶ Accordingly, the court did not hold Ms. Fong’s failure to give notice on time against her.¹⁷

⁶ *Id.*, at s 216A(3)(b).

⁷ *Id.*, at s 216A(3)(c).

⁸ *Companies Act*, *supra* n 1, at s 216A(3)(a).

⁹ *Petroships Investment Pte Ltd v Wealthplus Pte Ltd* [2016] 2 SLR 1022, at [35].

¹⁰ *Fong Wai Lyn Carolyn v Airtrust (Singapore) Pte Ltd* [2011] 3 SLR 980 (“*Fong Wai Lyn*”), at [13].

¹¹ *Id.*, at [5].

¹² *Id.*, at [12].

¹³ *Id.*, at [15].

¹⁴ *Id.*, at [17].

¹⁵ *Id.*, at [18].

¹⁶ *Id.*, at [17] – [18].

¹⁷ *Id.*, at [18].

Overall, the court will consider the facts of each case in deciding whether failing to give notice on time affects your application.¹⁸ At the end of the day, however, it may be best to give notice. Compliance with the notice requirement is strict, and notice *must* be given (even if late).¹⁹ So be mindful to notify the company even if you are worried evidence may be destroyed – a failure to do so may be fatal to your application.²⁰

B. Requirement two: “Good faith”

Next, you must apply for a statutory derivative action in “good faith”.²¹ This is proven in two ways.²² First, you must honestly or reasonably believe the company has a legal claim,²³ and second, you cannot bring the application for some ulterior purpose.²⁴

(1) Honest or reasonable belief

First, you must prove that you honestly or reasonably believe that the company has a legal claim.²⁵ In other words, not only must you honestly believe that the company has a legal claim, but you must also show that any other person, in your shoes, would believe the company has a legal claim to pursue as well.²⁶

An example of the latter can be found in *Tiong Sze Yin Serene v HC Surgical Specialists Ltd*.²⁷ There, a shareholder, Ms. Tiong, alleged that one of the company’s directors had mishandled an acquisition of shares, thereby committing a wrong against the company.²⁸ Ms. Tiong then applied for a statutory derivative action.²⁹

¹⁸ *Id.*, at [17].

¹⁹ *Lee Seng Eder v Wee Kim Chwee* [2014] 2 SLR 56, at [9].

²⁰ *Id.*, at [8] – [10].

²¹ *Companies Act*, *supra* n 1, at s 216A(3)(b).

²² *Jian Li Investments Holdings Pte Ltd v Healthstats International Pte Ltd* [2019] 4 SLR 825 (“*Jian Li*”), at [42].

²³ *Ibid.*

²⁴ *Id.*, at [44].

²⁵ *Id.*, at [42].

²⁶ *Id.*, at [42] – [43].

²⁷ *Tiong Sze Yin Serene v HC Surgical Specialists Ltd* [2021] 3 SLR 1269.

²⁸ *Id.*, at [40].

²⁹ *Id.*, at [47].

As it turned out, the evidence clearly indicated that the board of directors had properly considered the acquisition of shares,³⁰ and that they had weighed its benefits and costs thoroughly.³¹ Ms. Tiong was aware of this, and yet “persistently ignored” this fact throughout proceedings.³² This led the court to find that no reasonable person, in her shoes, would believe that the company had a legal claim.³³ Thus, Ms. Tiong lacked good faith, and her application for a statutory derivative action was denied.³⁴

(2) *No ulterior purpose*

Second, you cannot apply for a statutory derivative action for some ulterior purpose.³⁵ Since the statutory derivative action is meant to assist the company,³⁶ you cannot apply for one to serve your own needs, instead of helping the company.³⁷

*Ang Thiam Swee v Low Hian Chor*³⁸ is a good example of this. There, a shareholder, Mr. Low, alleged that a director misappropriated funds from the company, thereby resulting in a legal wrong against the company.³⁹

The court found that Mr. Low lacked good faith because his application was for an ulterior purpose.⁴⁰ This was because Mr. Low shared a rocky relationship with this director,⁴¹ and stood to gain from the statutory derivative action:⁴² his shareholdings would have increased in value,⁴³ and he would have assumed control over the entire company.⁴⁴ Overall, these reasons

³⁰ *Id.*, at [57].

³¹ *Id.*, at [59].

³² *Id.*, at [72].

³³ *Ibid.*

³⁴ *Id.*, at [78].

³⁵ *Jian Li*, *supra* n 22, at [44].

³⁶ *Ibid.*

³⁷ *Ibid.*

³⁸ *Ang Thiam Swee v Low Hian Chor* [2013] 2 SLR 340 (“*Ang Thiam Swee*”).

³⁹ *Id.*, at [6].

⁴⁰ *Id.*, at [46].

⁴¹ *Id.*, at [32] & [46].

⁴² *Id.*, at [45].

⁴³ *Ibid.*

⁴⁴ *Ibid.*

led the court to find that Mr. Low was applying to serve his own personal interests,⁴⁵ and not to assist the company.⁴⁶ Accordingly, his application was denied.⁴⁷

Thus, even if you believe the company's directors are up to no good, you still need to apply for a statutory derivative action in good faith. Where you apply for one without believing the company has a legal claim, or just to serve your own personal interests, the court will deny your application.

C. Requirement three: “In the interests of the company”

Finally, taking legal action must be in the company's interests.⁴⁸ To prove this, you must show that the company's claim has both “legal merit”⁴⁹ and “commercial merit”.⁵⁰

(1) Legal Merit

For legal merit, the company's claim must have some chance of being successful.⁵¹ This is because it could not possibly be in the company's interests to pursue a claim that is bound to be unsuccessful.⁵²

So, if you believe the company's directors have misappropriated funds or committed fraud, you need to show that there is *some* sense of merit to this claim.⁵³ But you do not need to show that the company's claim will be successful even after you get permission to commence legal action.⁵⁴

At this point, you may be concerned that you have little access to company documents to prove that the directors have committed a wrong against the company. However, courts acknowledge

⁴⁵ *Id.*, at [46].

⁴⁶ *Ibid.*

⁴⁷ *Id.*, at [59].

⁴⁸ *Companies Act, supra* n 1, at s 216A(3)(c).

⁴⁹ *Ang Thiam Swee, supra* n 38, at [58].

⁵⁰ *Id.*, at [57].

⁵¹ *Jian Li, supra* n 22, at [50].

⁵² *Id.*, at [49].

⁵³ *Id.*, at [50].

⁵⁴ *Ibid.*

this problem,⁵⁵ and take it into account when deciding if your claim has legal merit.⁵⁶ So far, courts have not made it difficult to satisfy legal merit,⁵⁷ and only the most fanciful or far-fetched claims that obviously have no chance of succeeding are denied.⁵⁸

(2) *Commercial merit*

As for commercial merit, the company must gain practically from taking legal action.⁵⁹ Essentially, the company must stand to gain substantially in money or in money's worth making it worthwhile to take legal action.⁶⁰

To illustrate, suppose a company has a legal claim worth \$100.⁶¹ Although the company can technically pursue this claim, it may not be commercially wise to do so.⁶² Damage to long-term profitable relationships, or bad publicity from litigation may outweigh any potential gains from taking legal action.⁶³ On the other hand, if a company's legal claim is worth millions of dollars,⁶⁴ that would be an obvious instance where the company stands to gain substantially from taking legal action.⁶⁵

Overall, courts will assess commercial merit on a case-by-case basis.⁶⁶ Just remember that litigation can span many years and be very expensive. So be sure to consider if it will be worthwhile for your company to take legal action, before applying for a statutory derivative action.

⁵⁵ *Ibid.*

⁵⁶ *Wong Lee Vui Willie v Li Qingyun* [2016] 1 SLR 696, at [51].

⁵⁷ *Jian Li*, *supra* n 22, at [50].

⁵⁸ *Ibid.*

⁵⁹ *Jian Li*, *supra* n 22, at [49].

⁶⁰ *Pang Yong Hock v PKS Contracts Services Pte Ltd* [2004] 3 SLR 1, at [21].

⁶¹ *Ibid.*

⁶² *Ibid.*

⁶³ *Ibid.*

⁶⁴ *Agus Irawan*, *supra* n 2, at [4] – [8].

⁶⁵ *Ibid.*

⁶⁶ *Id.*, at [8].

III. CONCLUSION

As a shareholder, you are entitled to apply to courts for permission to commence legal action on behalf of the company against errant directors. However, just remember that getting a statutory derivative action is only half the battle won. The statutory derivative action only grants you permission to *commence* legal action, and there is no guarantee that you will win the case that comes after.

One final word of caution: if your application is denied, be prepared for your working relationship with these directors to sour. After all, you *did* just accuse them of committing wrongs against the company, and that is unlikely to sit well in the boardroom. Accordingly, weigh your options. Sometimes, it may be best to settle the matter internally.