CASE UPDATE

Court of Appeal provides clarification on the concept of Reserve Management Powers of Shareholders

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Introduction

If the board of a company is unable or unwilling to act, do the shareholders have any residual power to act in management matters? Or must the shareholders either reconstitute the board or commence legal proceedings to compel the directors to act?

In *Chan Siew Lee v TYC Investment Pte Ltd and others and another appeal* [2015] SGCA 40 (the "TYC Case"), the Court of Appeal was presented with the opportunity to consider the above questions.

In the TYC Case, pursuant to an agreement to amend a deed of settlement entered into between Dr Tay and Ms Chan, the two shareholders (and directors) of a company, it was agreed that neither Dr Tay nor Ms Chan will sign a cheque on the company's bank accounts unless the other has signed a voucher approving (the "Payment Clause"). Ms Chan invoked the Payment Clause to refuse to approve payments by the company for advisory services provided by KPMG Services Pte Ltd ("KPMG Fees") and for costs, outgoings and taxes incurred in relation to certain properties ("Property-related expenses"). Dr Tay made the payments himself and sought reimbursement. Ms Chan did not approve the reimbursements and an extraordinary general meeting ("EGM") was called by Dr Tay to approve the reimbursements.

At the EGM, resolutions were approved by Dr Tay and his son to authorise Dr Tay to unilaterally sign cheques and vouchers to effect the reimbursement. Resolutions were also passed to authorise Dr Tay to take all steps and actions on the company's behalf as may be necessary or desirable to secure the reimbursement of the Property-related expenses and the KPMG Fees from Ms Chan. Legal counsel was appointed to represent to the company and the legal fees incurred were not approved by Ms Chan ("Legal Fees"). Corporate secretarial charges for the EGM and subsequent meetings held were also not approved by Ms Chan ("Corporate Secretarial Fees"). At the appeal, only the KPMG Fees, the Legal Fees and Corporate Secretarial Fees remained unpaid and outstanding.

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Decision

1. The Court of Appeal held that the question as to whether there is a reserve power of management vested in shareholders in general meeting must be one that is analysed in the context of "implied terms".
2. In this case, the division of powers between the board and the shareholders was found in the constitution of the company which was a contract between the company and shareholders, and shareholders, *inter se*: Section 39 of the Companies Act.
3. The Court will generally preserve this division not only because it has no power to rewrite the contract for shareholders, save for limited grounds, and also because directors are constrained by their fiduciary duties whereas shareholders are not.
4. The Court may intervene to imply a term in exceptional circumstances where there is "necessity". This means that there are 2 conditions to be satisfied: (1) the board must be deadlocked and is unable or unwilling to act and (2) the implication is limited to what is *necessary* to break the deadlock.
5. A disagreement by shareholders with a *bona fide* board decision will not be sufficient. A deadlock that can be broken in some other way under the company's constitution (such as by reconstituting the board) will also be insufficient. Although there is no general proposition governing the scope of reserve management powers of shareholders, a convenient test of whether such powers should be implied is whether it is "reasonably necessary".
6. A reserve power to the shareholders must be limited and based on 2 cumulative requirements: (a) the dispute must relate to the performance of a *bona fide* obligation owed by the company to a third party; and (b) there is no material suggesting that it will not be in the company's best interest to honour those obligations.
7. In such a situation, the court in effect is trying to strike a balance among the competing factions *within* the company which threaten to paralyse the company and the prejudice to innocent third parties *outside* it. The need to invoke the limited reserve powers will not arise if there is either (a) no deadlock or (b) the deadlock can be broken by appointing and removing directors in general meeting.
8. Similarly, if the *impasse* can be resolved by a derivative action under Section 216A of the Companies Act, the court will not imply a term reserving management powers to shareholders.
9. However, that is also not to say that the very presence of Section 216A of the Companies Act allowing shareholders to bring a derivative action against the directors will prohibit the court in implying reserved powers to shareholders in all cases. The availability of Section 216A will in certain cases be a relevant factor to be considered in deciding whether a reserved power of management should be implied and the scope and extent of such a power. A distinction should be drawn between disputes that concern holding directors accountable and disputes that do not. Section 216A is more appropriate where a claim is directed against directors for breach of fiduciary duties.
10. Further, the fact that the agreement between shareholders distinctly contemplates a deadlock does not necessarily restrict the court's ability to imply a term to reserve powers to the shareholders. In such a case, the deadlock contemplated may only exist at board level and not amongst shareholders (who are then in a position to break the *impasse*).

11. On the facts, reconstitution of the board was not possible as the constitution of the company entrenched the nominees from Dr Tay and Ms Chan and prevented new directors being appointed without their approval.
12. The Court of Appeal held that the implication of a reserve power to make payment is not inconsistent with the Payment Clause, as the Payment Clause was merely a structure of checks and balances so that no single director can act unilaterally and was predicated on the basis that the board will be able to come to a decision. It did not prevent the legitimately authorised liability of the company being met once the shareholders pursuant to and within the limits of a reverse power had determined that it should be met.
13. The Court allowed the payment of the KPMG Fees as a matter of necessity as the company was given advice on accounting and tax issues. The Corporate Secretarial Fees were also approved by the Court on the basis that the conditions in paragraph 4 above were met. The Legal Fees were also approved to the extent that legal advice was sought as to whether reserve powers of shareholders could be invoked but disallowed to the extent that such legal advice related to the bringing of legal proceedings against directors for an alleged breach of duty, which were more appropriately pursued under Section 216A of the Companies Act.

Conclusion

In this case, although the Court of Appeal implied the reservation of management powers to shareholders, it is clear that this is done in very limited situations and is fact sensitive, dependent on the facts in each case.

Clear drafting in shareholders' agreement or the articles of association will be necessary to either clearly entrench the deadlock between directors/shareholders (if this is desired) or to reserve management powers to shareholders. Third parties supplying services to companies in which shareholders are in dispute should take heed that there may be no certainty of voluntary payment by the creditor company, where the board is deadlocked.

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