# CASE UPDATE

## Statutory Derivative Actions Not Available When Company is in Liquidation

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### *Introduction*

**1.** Recently, the Singapore Court of Appeal ("**CA**") released its judgment of *Petroships Investment Pte Ltd v Wealthplus Pte Ltd and Ors* ("***Petroships Investment***"). [1] The CA decided that the statutory derivative action mechanism provided in the Companies Act ("the Act")[2] is not available when a company is in liquidation.

### *Facts*

2. The Claimant, Petroships Investment Pte Ltd ("**Petroships**"), was a minority shareholder in a joint venture investment vehicle, Wealthplus Pte Ltd ("**Wealthplus**") (the 1st Respondent). The 2nd and 3rd Respondents were majority shareholders of Wealthplus and subsidiaries of Koh Brothers Group Limited ("**Koh Brothers**").

3. The dispute involved an investment opportunity between Petroships and the 2nd and 3rd Respondents to exploit land use rights in China ("**the Chinese Investment**"). Wealthplus was created as the investment vehicle for the Chinese Investment.

4. Subsequently, the Chinese Investment did not conclude as planned. Following from this, Petroships demanded for the return of its share of the investment profits and its capital investments into the Chinese Investment.

5. In the meantime, disagreements arose between the directors of Koh Brothers and Petroships. This culminated in an application by Petroships to seek leave to commence a statutory derivative action against Wealthplus' directors, on the basis that certain transactions made in respect of the Chinese Investment were not in Wealthplus' best interests.

6. A week after Petroships sought leave to commence the derivation action, however, Wealthplus was placed in members' voluntary liquidation. Petroships' attempt to apply for an injunction to restrain the resolution to liquidate the company failed, and liquidators were eventually appointed.

[1] [2016] SGCA 17
[2] Cap. 50, 2006 Rev. Ed.

***The High Court's decision***

7. The High Court Judge ("**the Judge**") refused Petroships leave to commence the derivative action. The Judge found that Petroships had not satisfied two of the three pre-requisites (in particular, ss 216(3)(b) and (c) of the Act) to commence such an action.

8. First, in respect of the requirement in s 216A(3)(b) to act in good faith, the Judge found (among other things) that Petroships had an illegitimate collateral purpose in seeking the derivative action. Specifically, the purpose was to allow Petroships to recover its capital and profits from the Chinese Investment.

9. Second, in respect of the requirement in s 216A(3)(c) to ensure that the derivative action was in Wealthplus' interests, the Judge found that it was unnecessary for Petroships to commence litigation to bring a statutory derivative action. Given that Wealthplus was already in liquidation, Petroships could have simply proposed to Wealthplus' liquidators to commence the derivative action.

10. Further, even if Wealthplus' liquidators had refused to act (out of self-interest), Petroships could have applied to court for the liquidators to be replaced under s 302 of the Act, or brought an action against the liquidators for breach of duty. In short, there was no need for Petroships to have brought the s 216A action.

11. Dissatisfied with the Judge's decision, Petroships appealed.

***The CA's decision***

12. At the appeal, the bulk of the parties' submissions focused on whether Petroships had satisfied the pre-requisites in s 216A(3) of the Act to commence a statutory derivative action. The CA pointed out, however, that the real issue lay at a more preliminary level. To the CA, **the real question was the threshold of whether s 216A was applicable to a company in liquidation in the first place**.

13. Eventually, **the CA concluded that the statutory derivative action mechanism was not available to companies in liquidation** (even if it was because of a members' voluntary winding up), but only to companies that were still a going concern. In reaching this conclusion, the CA analysed three factors: (a) the statutory text; (b) the legislative history of statutory derivative actions; and (c) case law of statutory and common law derivative actions.

*The statutory text*

14. First, the CA noted that there were various references to "*directors of the* company" in the wording of s 216A(3) of the Act. These references indicated that statutory derivative actions were only meant for companies that were still going concerns. This was because such references presupposed that there would be directors in active management in the first place, who could authorize legal proceedings on behalf of the company.

15. Where a company was in liquidation, however, its board of directors would be *functus officio*. Hence, it would be up to the liquidator to decide whether to commence an action on behalf of the company. Given the fact that s 216A(3) of the Act also did not make reference to liquidators, the CA concluded

 

that there was an implicit recognition in the Act that statutory derivative actions applied only to companies that were still solvent.

*The legislative history of the statutory derivative action*

16. Second, the CA reviewed the legislative history and rationale of the implementation of statutory derivative action mechanisms in Singapore, Canada, and the UK. In this regard, the CA found no indication in all three jurisdictions that statutory derivative actions should be available as a remedy for shareholders of a company in liquidation.

17. The CA drew a similar conclusion from its review of the legislative history of Canada's and UK's statutory equivalents to Singapore's s 216A. For instance, the CA pointed out that in Ontario, Canada, statutory derivative actions were introduced as a more streamlined way to protect a company's minority shareholders against oppression by its majority shareholders.

18. From this, the CA reasoned that references to shareholders (rather than creditors) indicated that derivative actions in Ontario would also only be available to companies that were going concerns. After all, references to shareholders would be moot in the case of an insolvent company – the dominant consideration of in this situation would, instead, be the interests of its creditors.

*Case law of statutory and common law derivative actions*

19. In this section, the CA made the following points:

    (a) First, foreign case law on statutory derivative actions in the UK, New Zealand, and Australia have held that statutory derivation actions are not available for a company that is in liquidation. This is in line with the CA's earlier review on the statutory wording of s 216A of the Act.

    (b) Second, with regard to common law derivative actions, the position in Singapore is that once a company is in liquidation, common law derivative actions cannot be commenced.[3] This is because, in such a situation, it would be for the liquidator to bring an action on behalf of the company instead.

    (c) Third, locally, common law derivative actions have not been expressly abolished by the enactment of s 216A of the Act. Consequently, if statutory derivative actions could be commenced for companies in liquidation, this would result "*in an incongruous situation where in liquidation, one form of derivative action is available but not the other, even though both remedies are design to address similar mischief*".[4]

[3] *Walter Woon on Company Law*, paragraphs 9.6 and 9.7.
[4] [2016] SGCA 17, at [72].

20. For these reasons, the CA concluded that statutory derivative actions would not be available for companies in liquidation. Applying this to the facts, given that Wealthplus was now a company in liquidation, the CA held that Petroships' application to obtain leave to commence a statutory derivative action was a non-starter. Petroships' appeal was thus dismissed.

21. At the same time, however, the CA took pains to emphasise that Petroships (and minority shareholders in general) would not be left without remedy. For example, if it was suspected that the liquidator was not acting fairly, the CA pointed out an action for breach of duty could be brought against the liquidator.

*Conclusion*

22. The CA's decision clarifies that companies in liquidation would not be entitled to commence a statutory derivative action. The CA's decision also clarifies that even in liquidation, a minority shareholder will also not be left without remedy.

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