

Yeo Sing San v Sanmugam Murali and another
[2016] SGHC 14

Case Number : Originating Summons 40 of 2014
Decision Date : 02 February 2016
Tribunal/Court : High Court
Coram : Aedit Abdullah JC
Counsel Name(s) : Alfred Dodwell, Chong Jia Hao & Tay Chie Chiang (Dodwell & Co LLC) for the plaintiff; Sarbjit Singh Chopra & Cheryl Monteiro (Selvam LLC) for the first defendant; The second defendant is unrepresented.
Parties : Yeo Sing San — Sanmugam Murali — AYS Building Contractors Pte Ltd

Companies – Derivative action – Whether applicant acted in good faith – Whether prima facie in the company’s interests

2 February 2016

Aedit Abdullah JC:

Introduction

1 This is an appeal against my decision to grant the plaintiff leave to bring a derivative action in the name and on behalf of the second defendant, AYS Building Contractors Pte Ltd (“AYS”), under s 216A of the Companies Act (Cap 50, 2006 Rev Ed) (“the Act”).

Background

2 The plaintiff and first defendant are equal shareholders and the only directors of AYS, which as the name indicates, is involved in building and construction. AYS was incorporated in 2006, two years after the plaintiff and first defendant came to work together. From 2006 to 2009, the plaintiff was in charge of the management and administration of the company. By late 2009, AYS was managed and controlled by the first defendant. The precise circumstances that led to this was in dispute between the parties, but was not germane to the present proceedings.

3 Subsequently, disagreement arose between the plaintiff and first defendant. Notice to the directors had been given on 9 December 2013, requesting action to be taken in respect of:

- (a) Cash withdrawals and payments to a company controlled by the first defendant, CLD Construction Pte Ltd (“CLD”);
- (b) Unknown loans taken without proper approval;
- (c) Payments made to subcontractors without supporting documents;
- (d) Kickbacks received by the first defendant;
- (e) Payments made to CLD for work done by AYS; and

(f) Payments to staff, including for overtime work without provision for CPF contributions and income tax and for claims without supporting documents.

4 On 15 January 2014, the plaintiff commenced the present application seeking leave to bring an action in the name of AYS against the first defendant for breaches of directors' duties on the basis of various allegations.

5 Eventually, in September 2014, the plaintiff appointed an accountant to examine AYS's finances. The accountant, who subsequently deposed an affidavit as the plaintiff's expert, indicated that there was a series of misstatements in the accounts which required adjustments to be made to AYS's book value. The first defendant obtained the services of his own expert, whose report sought to rebut the adjustments indicated by the plaintiff's expert.

6 At the hearing, an issue also arose as to whether certain correspondence between the plaintiff and first defendant were covered by settlement privilege, preventing reference to them.

The plaintiff's case

7 The plaintiff contended that the requirements under s 216A of the Act were met. Notice to the directors of AYS was given, but no action was taken.

8 The plaintiff was also acting in good faith. It was *prima facie* in the interests of the company that the action be commenced. The plaintiff's objective for the proposed derivative action was to ensure that AYS was not exploited by the first defendant. An obvious connection existed between the plaintiff's purpose and the interests of the company: *Ang Thiam Swee v Low Hian Chor* [2013] 2 SLR 340 ("*Ang Thiam Swee*") at [16]. The breakdown of the relationship between the plaintiff and the first defendant did not show lack of good faith as personal animosity is not sufficient to preclude a s 216A application: *Wong Kai Wah v Wong Kai Yuan and another* [2014] SGHC 147 at [77]. No personal vendetta or desire to destroy the company existed in the present case.

9 There were various matters of concern, which gave rise to a legitimate and arguable claim by AYS:

- (a) Withdrawals and payments were made to CLD for materials and work supplied by AYS;
- (b) Loans were obtained without proper approval;
- (c) Payments were made without proper supporting documents;
- (d) Improper payments were received by the first defendant from Kingz Enterprise Pte Ltd for materials supplied and work done by AYS;
- (e) Payments were made by Accenture Projects Pte Ltd, in which the first defendant was a director and shareholder, to CLD for work done by AYS;
- (f) Payments to staff were made for overtime work for which no provision was made for CPF contributions and income tax, and for claims without supporting documents.

10 Overall, there was about \$1.3m that was unaccounted for; that sum would be for the benefit of AYS if it made out its claims against the first defendant.

The first defendant's case

11 The first defendant covered the various elements of an application under s 216A of the Act. While reference was made to the requirements of notice, no specific contentions were made in respect of the facts in the present case.

12 The first defendant contended that the plaintiff did not act in good faith. The commencement of the proceedings was made for self-interest and motivated by a vendetta, with the intention of damaging or destroying AYS. The plaintiff was also guilty of unreasonable delay and did not come with clean hands. In particular, he had knowledge of the irregularities since October 2012, yet in the meantime sought valuation of his shares and the re-audit of accounts, while threatening winding-up or other court proceedings. No allegation of impropriety was made at the time. There was a delay of two years before the present application was launched.

13 The application was not in the interests of AYS as there was no reasonable basis or a legitimate or arguable case against the first defendant, nor was it in the business interests of AYS for the matters to be pursued. The plaintiff was aware of the payments made to CLD, the loans made by the supposedly unknown creditor, one 'Ah Mak', and the payments made for housing, entertainment, subcontractors and suppliers were in accordance with the accounting and company procedures previously adopted by the plaintiff himself. These various allegations were thus frivolous and vexatious.

14 As no substantial adjustments need to be made to the accounts in view of the various transactions, it would not be in AYS's interests to proceed against the first defendant, who had ultimately managed the company in the same way as the plaintiff. In addition, the first defendant had contributed capital and exposed himself to personal liability to facilitate AYS's continued operations, and his assistance would be required for AYS to complete its projects.

The decision

15 I found that the plaintiff had met the requirements of s 216A of the Act. Sufficient notice to the board of directors was given. The application was also made in good faith. While there may have been a dispute between the plaintiff and first defendant as directors, this did not mean that the present application was not in good faith, as it was concerned with potential recovery by AYS of funds to which it was entitled. The application was not motivated solely by any vendetta or grudge. The fact that the plaintiff may have indicated his willingness to be bought out of the company did not show that there was any lack of *bona fides*. As the claims put forward in the application were legitimate and arguable, the proceedings contemplated were *prima facie* in the interests of the company. The low threshold required by the law was crossed by the matters raised, which were essentially about the possible misuse of funds.

16 In the course of the hearing, I also determined that settlement privilege applied to a letter between the plaintiff and the first defendant, the contents of which the first defendant sought to refer to; that privilege was not waived by the plaintiff though he had referred to a part of it in his affidavit.

Analysis

Notice

17 No issue was taken with sufficiency of the notice at the hearing. On examination, the requirements of s 216A were met — the notice specified the grounds for the allegation of breach by

the first defendant, giving the directors the information required for any deliberation. The fact that nothing was done was not surprising given that the only two directors were the plaintiff and the first defendant.

Good faith

18 Good faith was shown as the application and consequential proceedings would serve to recover funds for AYS which, if successful, would be for the company's benefit. While it may be that there were discussions where the plaintiff showed a desire to either be bought out or have the company wound up, these were not sufficient to establish lack of good faith.

19 What is required in terms of good faith was laid down in *Ang Thiam Swee* — the focus of the requirement of good faith is on the object of the proposed action, which must be connected or related to the company's interests. Thus a purely vindictive action, which would not bring any benefit to the company, would not be made in good faith. In addition, *Ang Thiam Swee* clarified at [29] that good faith would exist if there was an honest or reasonable belief that there was a good cause of action. It was not a requirement of good faith that the application had merits. While several local cases could be read as linking good faith to the merits of the application, the Court of Appeal in *Ang Thiam Swee* made it clear that this would not be correct. What mattered in assessing good faith was the belief that there was a good cause of action.

20 There was such a belief in the present case — there was nothing to show that the identification of the alleged breaches was motivated by anything other than a belief that there was a possible cause of action. The first defendant pointed to the fact that the plaintiff sought to be bought out. However, exploring the possibility of exit from the company would be expected in any negotiations between shareholders, especially in a context such as the present, where the shareholders in dispute are the only shareholders, and the situation is one of deadlock. The difficulties of the situation would be further compounded by the absence of any third-party investor who was ready and willing to come in — most, if not all, small private companies would face this hurdle. Against such a backdrop therefore, the mere fact that a claimant under s 216A happened to ask to be bought out or to have the company wound up would not disclose such a degree of disregard for the interests of the company so as to qualify as lack of good faith.

21 The first defendant also argued that there was unreasonable delay in the present proceedings. However, I did not find that there was anything untoward or sinister in the present proceedings, such that the lapse of time would show lack of good faith. Time may be needed for the complaining party to examine the issues, discuss matters and go through the records. Good faith may be excluded if the discussions were dragged out without reason, or if there was some other indication that there was an ulterior motive. Nothing of that sort was indicated here — there were lengthy discussions, including possible exit, but nothing to show that matters were being dragged out just to delay or to force AYS to a conclusion.

Action prima facie in the interests of the company

22 The action that was proposed was in the interests of the company — firstly, the action would be arguable and legitimate; and secondly, the action would lead to practical benefit to AYS.

Arguable and legitimate claim

23 An action is *prima facie* in the interests of the company if the claim to be made is legitimate and arguable. The threshold is low, with only clearly unmeritorious claims excluded: see *Ang Thiam*

Swee. In that case, the Court of Appeal emphasised the interlocutory nature of the application at [55]:

It is plain that at this interlocutory stage, the standard of proof required is low, and only the most obviously unmeritorious claims will be culled. Of particular relevance to the present appeal is that illegitimate actions, whether due to the element of frivolity or vexation, will not be considered to be *prima facie* in the interests of the company. There is an obvious overlap here with the requirement of good faith, in that an applicant with a frivolous or vexatious claim will also typically be unable to demonstrate an honest belief in the merits of the proposed statutory derivative action or the absence of a collateral purpose amounting to an abuse of process. As such, the same considerations which militated against [the applicant]'s *bona fides* will also undermine the legitimacy of the Application.

The weighing of the claim and response of each side would take place at the actual proceedings by the company. The application for leave is only to provide a form of filtering, and it is clear that such filtering can only be at a broad level at this stage.

24 The present case did not fail to cross that threshold. The proposed claim, which was founded on various matters relied upon by the plaintiff (as set out at [9] above), was sufficient to meet the threshold. For these various allegations, there was a total of about \$1.3m in doubt. Furthermore, the upshot of these matters raised was that adjustments would be needed for proper accounting. The circumstances surrounding the payments, including the destination of the payments or payees, would also need to be looked into. Here, the allegations by the plaintiff went beyond mere suspicion of wrongdoing. As the issues were founded on the accounts and financial records, and were supported by accounting analysis, there would be a basis for these matters to be looked at fully at trial, and it could not be said that the company's claim would be defeated right at the start.

25 How the specific claims or wrongdoing affected the first defendant's duty as a director was not argued in detail, but it is clear that if made out, the plaintiff's allegations would establish breach of a directors' duty — the proper use of funds would be within the core meaning of the duties imposed upon a director of a company.

Knowledge of the plaintiff

26 The first defendant's main retort to the plaintiff's claims was that the plaintiff knew or was well aware of what was happening; the plaintiff had even signed off on some of the documents. Examples were given by the first defendant in respect of payment vouchers relating to a company, SKI Building Services, and subcontracting work at the Science Park, in which CLD was involved.

27 The plaintiff argued that he had only signed off on some of the documents, and that some of the payments were actually made under protest by him or without his full knowledge. In his affidavit, he maintained that the vouchers were prepared by persons acting for the first defendant, and the plaintiff himself had indeed questioned the basis of the payments though he ultimately signed just to assist the company, which he was told, was facing cash flow problems. While signing on documents would usually be a strong indicator of knowledge as well as approval, in some circumstances it may indeed be done without full appreciation of all the circumstances and consequences. Knowledge however would not be sufficient generally — it had to be shown that there was not merely awareness, but also consent or approval. The fact that documents were signed would not, without more, be sufficient to nip an arguable case — a person may sign payment without full knowledge of all the circumstances, such as the overall amount paid by such means or the details of the transactions concerned. The first defendant did not raise anything sufficient to preclude an argument of lack of

knowledge or signing without consent, such as a duly recorded approval at a board meeting or the like. Again, it may be that if the proceedings went on the first defendant would be able to fend off the allegations, but at this time the allegations made by the plaintiff were at least arguable, and that was all that he needed to show.

28 It may also be, as alleged by the first defendant, that the plaintiff was the one who instituted the practices in question, or had similar practices previously, but what mattered for the present application was whether the issues with the accounting and the concerns about improper reporting of transactions gave rise to a possible legitimate claim by AYS against the first defendant. What was adduced in evidence was sufficient to be at least arguable — the evidence of wrongdoing remained even if the procedures were those put in place by the plaintiff originally. It is one thing to be wanting in proper processes; it is another to make use of it to potentially cause harm to the company.

Accounting concerns

29 The various contentions made by the plaintiff concern issues about dubious payments and loans. The examination by the plaintiff's expert threw up concerns indicating possible misuse of funds, which go beyond mere suspicion. These concerns raised by the plaintiff were not explained away. The first defendant's evidence and arguments did not rebut or sufficiently attenuate the plaintiff's allegations. In particular, there were unauthorised loans and payments to CLD which, at the very least, called for further examination. Against that backdrop, a claim by AYS founded on such loans and payments would at least be arguable.

Unsupported invoices and payments

30 The plaintiff contended that the invoices were suspect for a number of reasons:

- (a) Various invoices paid by AYS, such as those to a company, Wireka Sdn Bhd, were actually issued to CLD;
- (b) Duplicate payments appeared to have been made for housing for foreign workers;
- (c) Payments for entertainment expenses and other claims were without supporting documentation;
- (d) GST claims were apparently made for personal expense;
- (e) Cash payment was made to a subcontractor without any documentation;
- (f) Payments were made to suppliers without supporting documents; and
- (g) Dubious payments were made to various suppliers, such as one Maxtop M&E Pte Ltd and one Guna, in suspect circumstances, such as before work contracts were even signed, or for amounts larger than those received by AYS for the entire project.

Implicit in this was that the payments were thus improper.

31 The first defendant's stand was that, aside from the plaintiff's knowledge of what was happening, there was no actual wrongdoing. For instance, while some payments were made for matters invoiced to CLD, this was part of the arrangements in place, and all payments to AYS were in fact accounted for. CLD and another entity belonging to the plaintiff, Yeo Sing San Construction ("YSS"), often transacted with each other and with AYS as a way to manage AYS's cash flow for its

business transactions. As for the absence of supporting documents, it was the practice within AYS for payments to be made without full recording of particulars or supporting documents. This practice started from the time the plaintiff was in charge of the accounts within AYS. As for one set of payments to undisclosed subcontractors, this was actually a mistaken record and the money was actually used for staff bonuses in 2011. All expenses in question were indeed incurred by AYS in the course of its business activities.

32 While I noted the first defendant's explanations (including the knowledge and possible consent of the plaintiff), the very fact that payments were made on invoices not addressed to AYS or that payments were made without or ahead of invoices or relevant paperwork go beyond mere suspicion of wrongdoing. These aspects would generally be a red flag. Especially in this day and age, sufficient paperwork in a company would be expected for most, if not all, services provided on a commercial basis. That being so, it cannot be accepted that the claim by AYS would be obviously unmeritorious. At the end of the day, the first defendant may yet be vindicated, but this mere possibility does not mean that the plaintiff's application should be refused at this stage.

Loans taken out

33 A number of loans were also questioned by the plaintiff. The first defendant argued that these were legitimate and were generally taken out because of low funds. The plaintiff however pointed out that these loans were not supported by any documents. Tellingly, argued the plaintiff, these loans were taken from one 'Ah Mak', whose identity remains unknown and who did not comply with usual moneylending practices in issuing the loans. This gave rise to the inference that they were from an unlicensed moneylender. The first defendant, for his part, relied on the signing of payment vouchers by the plaintiff to show the plaintiff's knowledge and highlight his untruthfulness or lack of good faith, as well as to indicate that the loans were in fact used for AYS's business.

34 The circumstances around the loans raised concerns which were not so weak that the allegations should be dismissed out of hand. Again, supporting papers would be expected, though not essential. Sufficient basis was made out for investigation of this issue by the company at trial.

High interest payments

35 An issue arose in the proceedings on the rates of interest which was paid on loans given by various parties. The plaintiff contended that they were very high, some as high as 608% per annum, which made the loans highly suspect, and thus the allegation made against the first defendant was legitimate and arguable.

36 The first defendant took issue with the calculations employed by the plaintiff. In respect of loans from the one 'Ah Mak', the first defendant's response was that the interest rate when calculated on a simple interest basis was 12.39%, in contrast to the calculation of 18.75% by the plaintiff's expert.

37 At the end of the day, even if the loans were not charged interest as high as the plaintiff alleged, the rates were significantly higher than what one would expect where the transactions were all at arm's length. It may be that ultimately, the amounts charged as interest would not be shown to be unfounded, particularly given the financial circumstances of AYS. But that is a separate matter — the question at the application before me was whether there was an arguable or legitimate claim arising out of the interest charged. The plaintiff established that the interest charged at least raised an arguable case against the first defendant in respect of his duties in AYS.

Benefit to the company

Benefit to the company

38 If leave were granted, AYS stood to benefit from the claim if it were made out.

39 The first defendant argued that ultimately no adjustments to AYS's books were needed, save for a GST claim that involved an erroneous entry and for an interest payment in respect of a private creditor loan. Even if this were so, the amounts in question were not negligible. The GST claim and the interest payment involve an adjustment of about \$36,000 and a possible \$30,000 respectively, though the issue was not fully canvassed in arguments. But in any event, should AYS pursue and succeed in its claim, there could be either a sum of several tens of thousands of dollars (on the first defendant's estimation) or a sum of about \$1.3m (on the plaintiff's calculations) which could accrue to AYS. It could not therefore be said that AYS had nothing to gain from pursuing the matter.

40 The first defendant argued that he had continued to manage the company following the same practices as the plaintiff, and that he had contributed capital to AYS, with a few more projects to finish up. Even if that were so, that would not be an answer to the argument that benefit would accrue to the company from the claim, which could amount to a not insignificant sum.

Conclusion on the interests of the company

41 Disputes between deadlocked shareholders, especially where there are only two of them, are often better resolved by means other than an action by the company against one or the other. However, where there are issues thrown up about the conduct of a director, and the allegations go beyond mere suspicion and are thus arguable or legitimate, it may be that proceedings by the company are appropriate. If a substantial claim for compensation can be made out, then that reinforces the appropriateness of such an order.

42 In the present case, as the allegations are arguable and legitimate, and a not insignificant amount is at stake, it would seem appropriate that proceedings should be permitted to go forward. It may be that even if an arguable case is shown, that the amount that may be recovered is unlikely to be significant, especially after the costs of legal proceedings are taken into account, such that leave may not be granted, but this is not such a case.

Other issues

Settlement privilege

43 At the hearing before me, an issue arose as to whether settlement privilege had been waived in respect of a "without prejudice" letter dated 26 November 2012. The contents of a number of other letters passing between the plaintiff and first defendant in 2013 were not in issue though they were referred to by the first defendant initially. After hearing oral arguments, I found the 26 November 2012 letter to be privileged so its contents could not be referred to by the first defendant in the proceedings. This issue was not brought within the appeal filed by the first defendant, and will thus only be addressed briefly.

44 The issue was whether reference by the plaintiff in his affidavit to the letter of 26 November 2012 (in a paragraph which mistakenly indicated the date as 26 September 2012) waived privilege as to the contents of that letter. The plaintiff in his affidavit deposed that in that letter, he asked for an independent auditor to be appointed and for the assets and shares of AYS to be valued. The letter itself went on to cover other matters connected to a proposed resolution. That would certainly be within the ambit of s 23 of the Evidence Act (Cap 97, 1997 Rev Ed) as a protected admission. The first defendant argued that there was waiver. The plaintiff responded that the letter attracted

privilege as it was the first communication which attempted to reach a compromise or settlement, and that there was no waiver.

45 I did not find that there was waiver. Such waiver has to be clear, and the plaintiff's reference in his affidavit to a part of the letter addressing a distinct area from what was sought to be protected by privilege was not, to my mind, waiver of the whole of the contents. The situation in the present case differed significantly from that in *Lim Tjoen Kong v A-B Chew Investments Pte Ltd* [1991] 2 SLR(R) 168 in which there was substantive detail disclosed to indicate waiver of privilege.

Credibility of the first defendant's expert

46 An issue was raised by the plaintiff about the credibility of the first defendant's expert, as that expert had qualified his opinion by stating that no warranty was given as to the accuracy of facts and information relied on in the report. Reference was made to *Tembusu Growth Fund Ltd v Actatek, Inc and others* [2013] SGHCR 2 ("*Tembusu Growth Fund Ltd*") in which the very same expert had produced a similar report subject to the same caveat. In *Tembusu Growth Fund Ltd*, the Assistant Registrar at [34] made the criticism that the caveat rendered the report 'unhelpful as it was based on unverified information'. Given the circumstances of how the report was prepared, in which the first defendant's expert was to review and comment on the report of the plaintiff's expert, such a qualification or disclaimer was not inappropriate, though perhaps it was unnecessary. I accordingly did not take issue with the report by the first defendant's expert on that score.

Conclusion

47 The grounds for the application were made out and the order sought by the plaintiff was accordingly granted. Costs of \$12,000 excluding disbursements were ordered in favour of the plaintiff.