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## Singapore High Court declines leave to bring common law derivative action

*Sinwa SS (HK) Co Ltd v Morten Innhaug* [2010] SGHC 157

The case of *Sinwa SS (HK) Co Ltd v Morten Innhaug* [2010] SGHC 157 considered both procedural and substantive issues in connection with bringing a common law derivative action in Singapore on behalf of a non-Singaporean company against a director of the company for breach of the director's fiduciary duties.

The shareholders of a joint venture BVI company, Nordic International Limited (the "**Company**"), were Sinwa Limited and Morten Innhaug (the "**Defendant**"), each holding 50% of the shares in the Company. Sinwa SS (HK) Co Ltd (the "**Plaintiff**") was novated Sinwa Limited's rights under a shareholders' agreement with the Defendant (the "**Shareholders' Agreement**"). Disputes arose between the Plaintiff and the Defendant as regards the way the joint venture was being conducted. The directors of the Company appointed by the Plaintiff supported a request by the Plaintiff to take legal action against the Defendant for alleged breach of his directors' duties, but the directors of the Company appointed by the Defendant refused to support the Plaintiff's request.

The Plaintiff therefore applied to the Singapore court for leave to commence a derivative action on behalf of the Company against the Defendant. As the Company was a foreign company, and not a Singapore incorporated company, the Plaintiff could not apply for leave under section 216A of the Companies Act to bring a derivative action on behalf of the Company. The Plaintiff had to rely on the common law derivative action.

The Singapore High Court declined to grant leave on three grounds, namely the Plaintiff's failure to (a) follow the proper court procedure, (b) exhaust alternative remedies, and (c) bring the action in good faith.

### Procedure

The court found that the Plaintiff had adopted the wrong court procedure in:

- beginning an action by way of originating summons (which would have been correct if the action was a statutory derivative action under section 216A of the Companies Act) instead of by writ of summons (which is required for common law derivative actions); and
- failing to join the Company as a party to the action; and
- failing to reflect in the title in action that the action was being brought in a representative capacity.

In this regard, the court was persuaded that the procedural error was made *bona fide* and noted that the Defendant, as far as the court could tell, did not suffer any prejudice as a result. The court was therefore able to exercise its discretion to cure the procedural errors. However, as the court came to the

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view that for other reasons, the application would fail in any case, the court declined to exercise its discretion to cure the procedural irregularity.

The key reason that persuaded the court not to grant leave to the Plaintiff to bring the common law derivative action was the fact that it was an equitable remedy, and the court came to the view that the Plaintiff was not entitled to this equitable remedy because it had not yet exhausted all alternative remedies, or convinced the court that its action was made *bona fides* (in good faith).

#### **Alternative remedies**

The court noted that if an alternative remedy existed, an equitable remedy such as a common law derivative action should generally not be allowed. This is because a derivative action as a procedural device is only necessary if justice could not be done by other means. In the present case, the Shareholders' Agreement provided for arbitration as a forum for the resolution of disputes between the Plaintiff and Defendant. Although such a provision was irrelevant in the context of whether the Defendant was in breach of his duties to the Company, the court held that by virtue of the arbitration provision, the issue as to who may decide to bring an action by the Company against the Defendant should have been decided first by arbitration. Should the arbitration subsequently find that the assent of the Defendant's appointed directors would be required, whether solely, or as forming a required majority or unanimous vote, and such is withheld without good reason, an application to commence a derivative action would be appropriate. Till then, the court considered the Plaintiff's application premature.

#### **Bona fides**

Secondly, the court considered the "clean hands" doctrine and whether the Plaintiff in seeking to pursue a common law derivative action was doing so in the best interests of the Company and without any ulterior purposes. On the evidence before the court, it held that the Plaintiff might not have disclosed its real motive for bringing a derivative action in the name of the Company. The Plaintiff was clearly unhappy with the assignment of a time charter to a company controlled by the Defendant, nonetheless, the court found it difficult to imagine why, as long as the charter hire was paid. Furthermore, the Plaintiff's conduct in flatly refusing to negotiate the lowering of charter hire rates which a counterparty was entitled to under the time charter with the Company, suggested that the Plaintiff might not have been acting in the best interests of the Company. The court did not take it upon itself to speculate on the real motive behind the Plaintiff's actions, but was of the view that the application was not *bona fide* in the interests of the Company.

In light of the above, the court dismissed the Plaintiff's application.

#### **Prerequisites of a common law derivative action**

For completeness, the court also considered several prerequisites of a common law derivative action which it opined on, even though they were ultimately not determinative of the application.

A prerequisite to allowing a common law derivative action was the demonstration that the Company would be entitled, *prima facie*, to the relief claimed. Another prerequisite to allowing a common law derivative action was the demonstration that the Plaintiff had *locus standi* to bring the action in the name of the Company. The traditional “fraud on the minority” exception to the rule in *Foss v Harbottle* was discussed by the court, and in particular, the meaning of “fraud” and the test that should be used - the orthodox test of an unratifiable wrong or a looser test based on breach of director’s duties and an attempt to stifle action by the company in respect of such breach. Without coming to a conclusion as to which test should prevail, the court took the view that “fraud” had been made out on the facts of the case as the Defendant had *prima facie* prevented legal action from being taken out against the time charter counterparty for the recovery of charter hire in order to protect his own interests in another company that he controlled and owned.

The court also considered the prerequisite of showing that the Defendant had control of the Company. In this context, the court framed the issue as whether the Defendant was able to prevent an action from being brought against him. In this case, the court could not determine on the evidence before it whether the Defendant could control the Company’s decision to take action against him as it was uncertain as to who in the Company had the authority to decide the matter.

### **Conclusion**

This case once more emphasises the high threshold that has to be surmounted to commence a common law derivative action based on the “fraud on the minority” exception to the rule in *Foss v Harbottle*. From the perspective of litigation strategy, it is critical to take all the necessary steps to ensure that the court is apprised of any injustice and inequity to the Plaintiff if it is not allowed to pursue a common law derivative action, such as ensuring that alternative remedies are exhausted, and that the Plaintiff’s actions were taken out in good faith in the best interests of the Company.

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If you would like to discuss the impact of this case on your business, please contact:

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