Hengwell Development Pte Ltd v Thing Chiang Ching and Others
[2002] SGHC 146

Case Number : OS 601182/2001

Decision Date : 15 July 2002

Tribunal/Court : High Court

Coram : Lai Kew Chai J

Counsel Name(s) : Hee Theng Fong, Tay Wee Chong and Yu Siew Fun (Hee Theng Fong & Co) for the plaintiffs; Patrick Ang and Andrew Ang (Rajah & Tann) for the defendants

Parties : Hengwell Development Pte Ltd — Thing Chiang Ching

Companies – Members – Representative action – Application by plaintiffs for court's leave to commence action on behalf of company – Whether action in good faith – Whether action prima facie in company's interests – Whether to grant application – s 216A Companies Act (Cap 50, 1994 Ed)

Companies – Members – Shareholder action – Company suffering loss as a result of breach of fiduciary duties owing to it – Plaintiffs' loss reflective of company's loss – Whether plaintiffs can recover such loss

Judgment

Cur Adv Vult

GROUNDS OF DECISION

By this Originating Summons the plaintiffs are seeking under s 216A of the Companies Act (Cap. 50) ("the Act") leave of the court to bring an action ("the action") in the name of and on behalf of the 4th defendant, Far East-Hengwell Pte Limited ("the Joint Venture Company"). The proposed action will seek to recover funds misappropriated by a substantial corporate shareholder of the Joint Venture Company, namely Far East Packaging Industrial Pte Limited ("Far East Packaging") and certain directors and officers appointed by Far East Packaging to manage and run the wholly owned subsidiary known as Quanzhou Hengwei Colour Printing & Exquisite Sack Co Ltd ("Quanzhou Hengwei") of the Joint Venture Company in the People's Republic of China ("PRC"). The claims will include damages for breaches of contractual and/or fiduciary duties and for misrepresentation by the defendants and others and for reliefs against them as dishonest recipients.

2 The proposed defendants have denied that there was a misappropriation of the alleged sum of RMB 5,700,000 and the other claims asserted by the plaintiffs against them on behalf of the Joint Venture Company. They stress in rebuttal that the allegations are entirely without basis. The first three defendants further assert that even the allegations made by the plaintiffs were taken as made out for present purposes, the application under s 216A of the Act is misconceived for the following reason. They say that the Joint Venture Company has no locus standi and is not the appropriate party to commence the proposed action. Initially, they further contend that even if the Joint Venture Company is the party to bring any action the Liquidator of the Joint Venture Company would be the best person to have conduct of the proposed action. But this line of argument was not relied on. I now turn to describe the parties and set out the material background and the applicable law.

3 The plaintiffs and Far East Packaging are joint venture partners. They formed the Joint Venture Company on 26 March 1996. The sole business activity of the Joint Venture Company is its wholly owned subsidiary which I have referred to as Quanzhou Hengwei. The purpose of the Joint Venture Company was to acquire all the shares of Quanzhou Hengwei. The plaintiffs own 2,550,000 shares of $1 each in the Joint Venture Company and Far East Packaging owns 2,450,000 shares; they therefore own 51% and 49% of

the shares respectively. However, day to day management of factory operations of Quanzhou Hengwei was reserved under the joint venture to Far East Packaging. By clause 6.2 of the Joint Venture Agreement dated 27 March 1996 it was agreed that the day to day management of Quanzhou Hengwei would be carried out by the executive director and/or managers appointed by Far East and they shall be directed by Mr Thing Chiang Ching ("Mr CC Thing"), the first defendant. In the event, Far East Packaging appointed and authorised Mr CC Thing, one Mr Lim Seng Kwee ("Mr Lim") and one Mr Wu Yu Qin ("Mr Wu") to manage the factory and business operations of Quanzhou Hengwei. The three executives were said to have been directed by Mr CC Thing.

The background

4 On 31 May 2001 Far East Packaging commenced winding up proceedings to wind up the Joint Venture Company on a judgment debt which it had obtained. The plaintiffs looked into the matters and came to the conclusion that the Joint Venture Company had substantial cross claims against Far East Packaging which would overtop the judgment debt.

5 First, the plaintiffs assert that Far East Packaging had dishonestly assisted Mr Wu and Mr Lim in the latters' breaches of their fiduciary duties and/or breaches of trusts. These two executives had misrepresented to Quanzhou Hengwei and the Joint Venture Company that various trade debtors of Quanzhou Hengwei amounting to the total value RMB5.7 million had not paid those debts, when in truth and in fact these debts had been paid to Quanzhou Hengwei. The plaintiffs further claim that Far East Packaging had knowingly received RMB1,244,108.45 as constructive trustee of the Joint Venture Company and/or Quanzhou Hengwei. In this connection, the plaintiffs allege that Far East Packaging and Mr CC Thing had through their representatives Mr Wu and Mr Lim fraudulently misrepresented to the Joint Venture Company and Quanzhou Hengwei that Quanzhou Hengwei were liable in the said sum for "handling fees" and/or "general fees" when in fact all of them knew that the representations were false. They all knew that the said sum should not have been paid.

6 In amplifying the allegations, it is alleged that Far East Packaging had in connection with its management of Quanzhou Hengwei appointed one Mr Zhu Yi Qing ("Mr Zhu") as a sales manager of the factory. At that time, Mr CC Thing, Mr Wu and Mr Lim were authorised to run the day to day business of Quanzhou Hengwei. Accordingly, Mr Zhu owed the following fiduciary duties to Quanzhou Hengwei, namely: (1) to collect debts from the trade debtors of Quanzhou Hengwei and hand them to the accounts department; (2) to act in good faith and in the best interests of the company; (3) not to place himself in a position in which his personal interests did or might conflict with the interests of the company; and (4) to hold whatever monies and property collected from the trade debtors on trust for Quanzhou Hengwei. In addition, Far East Packaging and Mr CC Thing, according to the plaintiffs also owed the last three named fiduciary duties to the Joint Venture Company and Quanzhou Hengwei.

7 Mr Zhu had in a statement in Chinese disclosed what had transpired. He said that he was appointed as manager of the business department of Quanzhou Hengwei in March 1996. He was responsible for marketing and for the collection of debts from customers. Mr Lim as representative of Far East Packaging was appointed executive director and general manager of Quanzhou Hengwei. Mr Wu assisted Mr Lim in the management of Quanzhou Hengwei. Mr Zhu alleges that in 1998 Mr CC Thing, one Mr Teng Chiang Keow, Mr Wu and Mr Lim had conspired with him (Mr Zhu) to hatch a plan. Under it, it was agreed that monies collected from trade debtors would be paid into their individual personal accounts and the proceeds would be used to incorporate and fund a new company to be set up to compete with the business of Quanzhou Hengwei. Mr CC Thing promised that Mr Zhu and Mr Wu would be allotted 10% of the shareholdings of the new company. Mr CC Thing promised that he would incorporate the company in Singapore which would be used, in turn, to form a company in Quanzhou, PRC. The company formed in Singapore was, in the event, Sin Quan Packaging Pte Ltd which was incorporated on 18 May 1998. In fact,

according to the plaintiffs, at a manager's meeting at the end of 1999 Mr Zhu admitted in the presence of Mr CC Thing, Mr Wu and the representatives of the plaintiffs, one Mr Dai Zhi Xin, a sales representative of Quanzhou Hengwei and Mr Go Twan Heng (" Mr Go") that Far East Packaging had instructed him to divert funds from Quanzhou Hengwei to Far East Packaging. The total amount diverted was approximately RMB2.4 million. At that meeting, Mr CC Thing told Mr Go that Mr Wu had "taken" RMB2.4 million from the trade debtors and that Far East Packaging would repay this sum. According to Mr Go, Mr CC Thing had at the same time promised that he (Mr CC Thing) would be personally liable for the RMB2.4 million.

8 In the statement, Mr Zhu also referred to various payments from his personal account into which the funds collected from the trade debtors of Quanzhou Hengwei had been deposited. He had on Mr Wu's instructions paid RMB20,000 to one Cheng Xiang, the driver of Mr CC Thing. According to Mr Zhu, Mr Wu had said that the money was meant for the girlfriend of Mr CC Thing. On another occasion, Mr Zhu had paid Mr Wu RMB20,000 at the latter's request.

9 Mr Zhu in the statement further alleged that he had handed over to Mr Wu the sum of RMB350,000 which Mr Wu had paid over to the Shanghainese girlfriend of Mr Teng. He further alleged that Mr Wu had instructed one Mr Li Po and one Mr Lin Lian Fang to collect monies from the trade debtors of Quanzhou Hengwei and that Mr Wu had received about RMB300,000 to RMB400,000 from these collectors.

10 Mr Go in his affidavit in support of the plaintiffs' application herein asserts that Mr Zhu and Mr Wu had collected from trade debtors of Quanzhou Hengwei the approximate sum of RMB5.7 million. In several sub-paragraphs under para 19 of his affidavit Mr Go listed the breakdown.

11 Another head of claim is in relation to the sum of RMB1,244,108.45 which were paid out by Quanzhou Hengwei for "handling fees" or "general fees" which the plaintiffs assert were not genuine liabilities at all. They were paid out against 9 vouchers issued in 1997. In 1997 the total import of paper to Quanzhou Hengwei was 1089.66 metric tons. According to the customs documents the import and export of the paper was tax exempted. There could not have been such substantial, extraordinary and apparently unexplained liabilities. The plaintiffs assert that Far East Packaging caused these payments to be made by Mr Lim and Mr Wu to themselves or to third parties when there was no justification for such payments.

12 By a letter of 22 June 2001 a director of the Joint Venture Company appointed by the plaintiffs under the Joint Venture Agreement called for the convening of the Directors' Meeting and an Extraordinary General Meeting of the Joint Venture Company to consider the commencement of legal proceedings to claim against Far East Packaging and Mr CC Thing for the recovery of monies of Quanzhou Hengwei which were dishonestly retained or diverted by them. In July 2001 the directors of the Joint Venture Company who were appointed by Far East Packaging replied to the effect that they were abstaining to vote. Those directors did not turn up at the scheduled meetings. They also failed to attend the adjourned meetings. As clause 4.5 of the Joint Venture Agreement dated 27 March 1996 stipulated that the quorum for any directors' meeting shall be at least one director of the Joint Venture Company appointed by the plaintiffs and one director appointed by Far East Packaging, no valid meeting was convened and there was no corporate approval to commence the legal proceedings. The plaintiffs contend that Far East Package had unreasonably refused to attend the directors' meeting and authorised the commencement of the legal proceedings.

13 In response to the contention of the first three defendants that Quanzhou Hengwei, and not its parent (the Joint Venture Company), has the locus standi to commence legal proceedings against Far East Packaging, Mr CC Thing and others, the plaintiffs through their solicitors sought the opinion on Chinese law in relation to three questions. The first question is whether there is any equivalent of s 216A of the Act in Chinese Company law that gives a shareholder of a company the right to sue in the name of the company. The second question is whether, under the law of China concerning enterprises with Sole Foreign

Investment and Detailed Rules for the implementation of the Law of China on Sole Foreign Investment Enterprises, there are equivalent provisions similar to s 216A of the Act. The third question is this: if there is a deadlock between the shareholders of a company in not being able to procure or cause the company to sue the debtors, how would the Courts in China deal with the situation. In December 2001 Mr Wan Hailong, a licensed practising lawyer in the PRC, of 9 years' standing gave his opinion on the 3 legal questions. He opined that under the Companies Act and the Foreign Capital Enterprises Act and their relevant rules and regulations, there is nothing that is similar to those of section 216A of the Act. He further stated in his opinion that if there are two camps of shareholders with conflicting views resulting in a situation where the company cannot pass a resolution to sue in the name of the company, then the Court will not deal with the company's claims against its debtors. These views were not challenged by the first three defendants and no contrary opinions on the relevant Chinese laws were proffered. Accordingly, the conclusion is that in a stalemate, such as the one in this instant case, Quanzhou Hengwei will have no recourse and will be unable to enforce its rights against Far East Packaging and its appointed directors in the Joint Venture Company and Quanzhou Hengwei would not approve of any such legal action. In those circumstances, it seems to me that there must be very compelling reasons why the Joint Venture Company should be refused any leave to commence legal proceedings against the wrongdoers and allegedly bad fiduciaries.

Section 216A of the Act

14 Ordinarily, a company by its majority members or its Board should decide whether to prosecute or defend a claim. Occasionally, it is not possible to obtain Board's approval because the potential defendant's approval is required and it is withheld. That is to be expected because a person would not ordinarily authorise its company to sue him. A member of the company, if he has a legitimate claim, may apply for leave to bring an action in the name and on behalf of the company. Under subsection 216A(3) of the Act, however, it must be shown that the complainant is acting in good faith and that it appears to be prima facie in the interest of the company that the action be brought.

15 In this case, the first three defendants contend that the ability of the Joint Venture Company to bring action to recover reflective losses had been authoritatively restated by the House of Lords in *Johnson v Gore Wood & Co (a firm)* [2001] 2 WLR 72. Counsel for the first three defendants points out that the alleged losses and damages suffered by the Joint Venture Company were essentially (if proven) a reduction in the value of its shareholdings in Quanzhou Hengwei. Such reduction in the value of the shares is a reflection of the loss suffered by Quanzhou Hengwei. If Quanzhou Hengwei sues and successfully recovers the losses and damages, then the Joint Venture Company will be fully compensated and the value of its shares will remain intact. The House of Lords decided that as a matter of policy a shareholder should be precluded from recovering a reflective loss. As Lord Millet explained, disallowing a corporate claim would prejudice the company's creditors if the company becomes insolvent as a result of the wrongdoing. The interests of other shareholders would also be adversely affected. In addition, the House of Lords disapproved of Johnson challenging 'in one capacity the adequacy of the terms he had agreed in the other'.

16 The facts in *Johnson v Gore Wood & Co* may be stated briefly. Gore Wood, a firm of solicitors, had acted for Johnson's company, in which he held all but two shares. It was alleged that the solicitors had acted negligently and had failed to exercise an option to purchase the land for Johnson's company. The company sued the solicitors and it was settled by the payment of a large sum to that company. After the payment, Johnson also claimed damages for negligence on the ground that the solicitors had also assumed certain duties towards him as the substantial shareholder. As some of the losses claimed by Johnson were also losses which his company had suffered and which had been settled, the solicitors applied to strike out those claims on the ground that they were reflective losses and Johnson was not entitled personally to recover them. The House of Lords struck out those claims which were reflective losses but allowed the others to go to trial.

17 The issue raised in this case has implications both in principle and in terms of policy. The principles of corporate identity and autonomy are established in *Salomon v Salomon* [1896] AC 22 and *Foss v Harbottle* (1843) 2 Hare 461 which decided respectively the cardinal principles that a duly incorporated company is separate in law from its members and that the majority of members is entitled to exercise its powers and control its operations generally. The notable exception to the last named principle is that the majority cannot by those powers and control commit a fraud on the minority nor oppress it by the exercise of those powers and control. The question is under what circumstances it is right to make an exception and effectively lift the corporate veil with the effect that interests of shareholders are identified with those of the company. The New Zealand Court of Appeal in *Christensen v Scott* [1996] 1 NZLR 273 and the English Court of Appeal in *Barings plc v Coopers & Lybrand* [1997] 1 BCLC 427 had made exceptions to those principles of keeping separate a company from its shareholders. In those cases, it was respectively decided, inter alia, that a loss suffered by a company could also be suffered by an individual shareholder and that a reflective loss may be recoverable by a shareholder. But the House of Lords in *Johnson v Gore Wood & Co* has decided only a company can maintain an action to recover reflective losses and that a shareholder is precluded from doing so.

18 Lord Bingham in his leading Speech considered *Prudential Assurance Co Ltd v Newman Industries Ltd* [1982] 1 All ER 354**,** *Barings plc v Coopers & Lybrand and Christensen v Scott* and stated at pp 94E-95B:

"These authorities support the following propositions. (1) Where a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss. No action lies at the suit of a shareholder suing in that capacity and no other to make good a diminution in the value of the shareholder's shareholding where that merely reflects the loss suffered by the company. A claim will not lie by a shareholder to make good a loss which would be made good if the company's assets were replenished through action against the party responsible for the loss, even if the company, acting through its constitutions organs, has declined or failed to make good that loss. So much is clear from *Prudential Assurance Co Ltd v. Newman Industries Ltd (No. 2)* [1982] Ch 204, particularly at pp 222–223, *Heron International*, particularly at pp 261-262, *George Fischer, particularly at pp 266 and 270-271, Gerber and Stein v Blake*, particularly at pp 726-729. (2) Where a company suffers loss but has no cause of action to sue to recover that loss, the shareholder in the company may sue in respect of it (if the shareholder has a cause of action to do so), even though the loss is a diminution in the value of the shareholding. This is supported by *Lee v Sheard* [1956] 1 QB 192, 195-196, *George Fischer and Gerber.* (3) Where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by breach of a duty independently owed to the shareholder, each may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to that other. I take this to be the effect of *Lee v Sheard,* at pp 195-196, *Heron International,* particularly at p 262, *R P Howard,* particularly at p 123, *Gerber and Stein v Blake,* particularly at p 726. I do not think the observations of Leggatt LJ in *Barings* at p 435 and of the Court of Appeal of New Zealand in *Christensen v Scott* at p 280, lines 25-35, can be reconciled with this statement of principle."

19 Lord Bingham summarised the reasoning at p 95C as follows:

"On the one hand the court must respect the principle of company automony, ensure that the company's creditors are not prejudiced by the action of individual shareholders and ensure that a party does not recover compensation for a loss which another party has suffered. On the other, the court must be astute to ensure that the party who has in fact suffered loss is not arbitrarily denied fair compensation. The problem can be resolved only by close scrutiny of the pleadings at the strike-out stage and all the proven facts at the trial stage: the object is to ascertain whether the loss claimed appears to be or is one which would be made good if the company had enforced its full rights against the party responsible, and whether (to use the language of *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204, 223) the loss claimed is "*merely a reflection of the loss suffered by the company".* In some cases the answer will be clear, as where the shareholder claims the loss of dividend or a diminution in the value of a shareholding attributable solely to depletion of the company's assets, or a loss unrelated to the business of the company. In other cases, inevitably, a finer judgment will be called for. At the strike-out stage any reasonable doubt must be resolved in favour of the claimant."

20 The principle in *Johnson v Gore Wood & Co* was applied recently in *Shaker v Mohammed Al-Bedrawi* [2001] EWHC Ch 159. Mr Justice Lawrence Collins said at paras 28 and 29:

> "In *Johnson v Gore Wood* the House of Lords disapproved the approach of the New Zealand Court of Appeal in *Christensen v Scott* [1996] 1 NZLR 273 (applied by the Court of Appeal in *Barings plc v Coopers & Lybrand* [1997] 1 BCLC 427) in allowing a personal claim for diminution in the value of shares allegedly caused by the negligence of accountants and solicitors in advising on the company taking a lease of farm land ... These decisions are disapproved in *Johnson v Gore Wood* by all the members of the House (except Lord Cooke of Thorndon), although it is apparent that Lord Hutton did so with some reluctance."

21 The same issue arose for consideration in *Eric Terence Day v James Thomas Gregory Cook* [2001] EWCA Viv 592. The question in that case was whether Day could recover damages against his solicitor, Cook, for the loss in value of his shareholding in his principal trading company caused by his solicitor's breach of duty. Lady Justice Arden referred to Lord Bingham's speech in *Johnson* and said at para 36:

> "Lord Goff gave a concurring speech, and agreed with Lord Millett's analysis (below) of the earlier case law. Lord Cooke of Thornden concurred in the result, but considered in some cases it was possible that the shareholder would suffer additional loss. He cited the case of *Christensen v Scott* [1996] 1 NZLR 273, where a shareholder was permitted to pursue a claim for reflective loss after the company's claim had been settled. Lord Hutton agreed with the result, holding that the approach in *Prudential Assurance v Newman* should be preferred to that in *Christensen v Scott* as it had stood for almost 20 years."

Lady Justice Arden continued at paras 38 to 40 as follows:

> "It will thus be seen from the speeches in *Johnson v Gore Wood* that where there is a breach of duty to both the shareholder and the company and the loss which the shareholder suffers is merely a reflection of the company's loss there is now a clear rule that the shareholder cannot recover. That follows from the graphic example of the shareholder who is led to part with the key to the company's money box and the theft of the company's money from that box. It is not simply the case that double recovery will not be allowed, so that, for instance if the company's claim is not pursued or there is some defence to the company's claim, the shareholder can pursue his claim. The company's claim, if it exists, will always trump that of the

> shareholder. Accordingly the court has no discretion. The claim cannot be entertained. The English rule is therefore different from the position in New Zealand: see *Christiansen (sic) v Scott,* above. Even in the case of owner-managed companies, there is no discretion."

22 Counsel for the plaintiffs submitted, in rebuttal, that the facts of the instant case fall within propositions (2) and (3) of Lord Bingham's summary in *Johnson v Gore Wood & Co*. He relies on the fact that Quanzhou Hengwei has no cause of action or is unable to enforce its full rights, for which he relies on the evidence of the expert on Chinese law. I find considerable force behind these submissions, which I accept. The facts in the instant case falls within propositions (2) and (3) of Lord Bingham. A litigant is not to be lightly turned away from bringing a genuine cause before our Courts. A fortiori, if there is no risk of double recovery and there is no prejudice to the creditors or shareholders of the company, which has no remedy in any event under Chinese law, the policy reasons behind the decision in *Johnson v Gore Wood & Co* do not apply. Accordingly, the Joint Venture Company as the sole shareholder of Quanzhou Hengwei has the right and title to bring the action to recover the claims. Whether it succeeds or not depends on the evidence it can gather and present to Court. There is a prima facie case. The application is allowed. There will be an order in terms of prayers 1, 2, 3 and 5 set out in the Originating Summons. Other prayers regarding the future conduct and costs of the proceedings are adjourned for further consideration. Parties are also directed to settle the draft orders of Court for my approval.

Sgd:

Lai Kew Chai

Judge