Tam Tak Chuen *v* Eden Aesthetics Private Limited and another
[2010] SGHC 24

Case Number : Originating Summons No 658 of 2009

Decision Date : 20 January 2010

Tribunal/Court : High Court

Coram : Judith Prakash J

Counsel Name(s) : Ang Cheng Hock SC and Tham Wei Chern (Allen & Geldhill LLP) for the plaintiff; See Chern Yang and Chan Kin Yew (Premier Law LLC) for the non-parties.

Parties : Tam Tak Chuen — Eden Aesthetics Private Limited and another

Companies

20 January 2010

Judith Prakash J:

Introduction

1 This matter came before me as an application ("OS 658") by the plaintiff ("Dr Tam") for leave to commence derivative proceedings on behalf of the defendants (namely Eden Aesthetics Private Limited ("EA") and Eden Healthcare Pte Ltd ("EH")) against one Dr Khairul Bin Abdul Rahman ("Dr Khairul") and a company owned by Dr Khairul, KAR Pte Ltd ("KAR"), in respect of the alleged breach by Dr Khairul of his director's duties owed to EA and EH. In response to this application, Dr Khairul applied to wind up EA (by CWU 112 of 2009) ("CWU 112") and EH (by CWU 111 of 2009) ("CWU 111") on the ground that it was just and equitable to do so. After hearing the parties' submissions, I allowed Dr Tam's application and stayed the two winding up applications. Dr Khairul has since appealed.

Factual Background

2 The facts were not in dispute. From 1998, Dr Tam and Dr Khairul were in medical practice together. Initially, they practised in partnership under the style of "Eden Family Clinic" but subsequently, they incorporated EA and EH to own their medical practice. Most of the business income of Eden Family Clinic was booked under EH. The rest of Eden Family Clinic's business was booked under EA. In 2005 and 2006, the Eden Family Clinic business earned more than $1m annually. Dr Tam and Dr Khairul were the directors of both EA and EH and were equal shareholders in those companies.

3 All was well until sometime in 2004 when cracks in their relationship began to appear. The full details of the breakdown of the relationship and the consequences of the same are contained in my judgment in *Tam Tak Chuen v Khairul bin Abdul Rahman and Others* [2009] 2 SLR (R) 240 ("*Tam Tak Chuen*"). Briefly, Dr Khairul suspected Dr Tam of having an illicit affair with one of the nurses working in the clinic and did not believe Dr Tam's repeated denials. In October 2006, Dr Khairul installed a closed circuit camera in the clinic for the sole purpose of obtaining evidence of Dr Tam's activities. He obtained such evidence in December 2006.

4 In the meantime, on 14 November 2006, Dr Khairul incorporated KAR with himself as its sole

shareholder and director. KAR's main activities comprised "clinic and general medical services" and "specialised medical and surgical services" which were the same categories of business that EA and EH were involved in.

5 On 4 March 2007, Dr Khairul confronted Dr Tam with the video footage and threatened him with public disclosure. He then demanded that Dr Tam's shares in both EA and EH be sold to him at a gross undervalue ("the share transfers"). Dr Tam acceded to this demand and executed share transfers of his shares in EA and EH in favour of Dr Khairul that same night. Shortly thereafter, however, Dr Tam changed his mind and decided to rescind the transactions. On 6 March 2007, Dr Tam made a police report against Dr Khairul for extortion, blackmail and criminal intimidation, and also informed Dr Khairul that he regarded the share transfers and his resignation as director as invalid. On 26 November 2007, Dr Tam commenced an action against, *inter alia*, Dr Khairul to set aside the share transfers and his removal as director. In the result, Dr Tam prevailed (see *Tam Tak Chuen*).

6 Following the judgment, Dr Tam obtained a court order to compel Dr Khairul to provide him with a copy of the financial documents of EA and EH by 31 March 2009. Upon receiving these documents, Dr Tam discovered that in April 2007, Dr Khairul had transferred the business of Eden Family Clinic from EH and EA to KAR. As a result of the transfer, KAR received $1,109,129 and $1,492,864 in revenue in 2007 and 2008 respectively, while Dr Khairul was paid $540,000 in directors' fees (excluding directors' salary) in 2008. EH's and EA's combined revenue which had been $1,796,104 in 2005 and $1,415,908 in 2006 dropped to $71,695 in 2007. Of this $71,695 only $2,930.25 came from consultant fees. The rest came from a one-off sale of closing stocks.

7 On 9 June 2009, Dr Tam filed this application and two months later, on 7 August 2009, Dr Khairul filed CWU 111 and CWU 112. The action that Dr Tam wanted to commence against Dr Khairul and KAR was for the purpose of recovering damages for any losses suffered by EA and EH as a result of the diversion of their businesses and also an account of profits made by Dr Khairul and KAR arising out of the transfer of the Eden Family Clinic business to KAR.

8 All the applications came on for hearing before me at the same time. In respect of this application, the nominal defendants, EA and EH, were not represented and took no part in the argument. Dr Khairul, however, had filed an affidavit to oppose the application and he and KAR obtained permission to appear as "Non-Parties" in order to resist it.

The derivative action

9 Section 216A(3) of the Companies Act (Cap 50, 2006 Rev Ed) ("the Act") sets out three requirements which must be fulfilled before a shareholder can be granted leave to pursue an action on behalf of the company:

> (3) No action may be brought and no intervention in an action may be made under subsection (2) unless the Court is satisfied that —
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> (a) the complainant has given 14 days' notice to the directors of the company of his intention to apply to the Court under subsection (2) if the directors of the company do not bring, diligently prosecute or defend or discontinue the action;
>
> (b) the complainant is acting in good faith; and
>
> (c) it appears to be prima facie in the interests of the company that the action be brought, prosecuted, defended or discontinued.

I found that all three requirements had been met.

Sufficient notice

10 All the parties before me agreed that Dr Tam had in fact provided notice (pursuant to s 216A(3)(a)) to the directors of EA and EH of his intention to commence derivative proceedings against the Non-Parties. Initially, Dr Khairul raised the objection that Dr Tam had not allowed EA and EH to seek independent legal advice so that they could consider whether to commence proceedings against him. At the hearing, however, this objection was not proceeded with. That was a correct decision since such an objection is not supported by the language of s 216A(3)(a). Further, the rationale of s 216A is to confer authority on a complainant to commence an action on behalf of a company against a director of that company in circumstances when the directors do not wish to do so or when there is a deadlock which effectively prevents any action being taken by the company. The inability or refusal of the company to sue its director thus has nothing to do with obtaining independent legal advice.

Acting in good faith

11 Counsel for the Non-Parties argued vigorously that Dr Tam had not discharged the burden of establishing that he was acting in good faith by bringing this application.

12 In the Nova Scotia Court of Appeal case of *L & B Electric Limited v Oickle* [2006] NSCA 41, it was held that while the complainant had the onus of satisfying the court that he was acting in good faith in asking for leave to commence a derivative action on behalf of a company, that burden was not any higher than what the statute provided and would be satisfied by "a preponderance of evidence" (at [53]). This means that the usual burden of the balance of probabilities applies.

13 In *Pang Yong Hock and Another v PKS Contracts Services Pte Ltd* [2004] 3 SLR (R) 1 ("*Pang Yong Hock*"), the Court of Appeal gave guidance as to how good faith was to be established. It said (at [20]):

> 20 The best way of demonstrating good faith is to show a legitimate claim which the directors are unreasonably reluctant to pursue with the appropriate vigour or at all. Naturally, the parties opposing a s 216A application will seek to show that the application is motivated by an ulterior purpose, such as dislike, ill-feeling or other personal reasons, rather than by the applicant's concern for the company. Hostility between the factions involved is bound to be present in most of such applications. It is therefore generally insufficient evidence of lack of good faith on the part of the applicant. However, if the opposing parties are able to show that the applicant is so motivated by vendetta, perceived or real, that his judgment will be clouded by purely personal considerations, that may be sufficient for the court to find a lack of good faith on his part. An applicant's good faith would also be in doubt if he appears set on damaging or destroying the company out of sheer spite or worse, for the benefit of a competitor. It will also raise the question whether the intended action is going to be in the interests of the company at all. To this extent, there is an interplay of the requirements in s 216A(3)(b) and (c).

14 Counsel for the Non-Parties contended that Dr Tam was not acting in good faith because:

> (a) he bore severe personal animosity towards Dr Khairul because the latter had exposed the truth as regards Dr Tam's illicit sexual relationship and this animosity was shown by:
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> > (i) the fact that Dr Tam's police report of 6 March 2007 was only made after he knew that his wife had been told about the relationship;

(ii) Dr Tam had always lied to Dr Khairul about the relationship;

(iii) Dr Tam commenced OS 252 of 2009 to enforce his rights as a director and shareholder of EA and EH even though Dr Khairul had already confirmed in writing that he would comply with Dr Tam's request;

(iv) Dr Tam did not deny that there had been a breakdown in the relationship of trust and confidence between him and Dr Khairul; and

(v) Dr Tam refused to allow independent legal counsel to advise the companies on his allegations and also refused to allow the appointment of an independent advisor in the form of a liquidator to consider and assess Dr Tam's allegations;

(b) the claim which Dr Tam wanted to pursue was not a legitimate claim in that he was furthering his own interests which were not aligned with the interests of EH and EA; and

(c) Dr Tam had not set out the story in full from the beginning.

15 I did not find there to be any substance in the allegation that Dr Tam's good faith had been adversely affected by his personal feelings about Dr Khairul. As the Court of Appeal pointed out in *Pang Yong Hock*, there is bound to be hostility between the factions involved in all cases of this nature. If the relationship of trust and confidence between the two parties had not broken down, none of the events that led to *Tam Tak Chuen* and thereafter to this application and the winding up applications would have occurred. That the events have engendered anger and dislike of each other in the parties did not mean that Dr Tam's actions were motivated by spite or a personal vendetta. It was clear from the facts that the main motivation was financial, not personal, and the beneficiaries of the action would be EA and EH and their shareholders who included Dr Khairul himself (*ie* he would benefit in his capacity as a shareholder of the companies although he might lose the case in his personal capacity).

16 Further, none of the matters listed in [14] above indicated that Dr Tam's actions in relation to this application were unreasonable or did not have a logical basis connected with a legitimate claim. The actions of Dr Khairul subsequent to March 2004 in relation to the transfer of business from EA and EH to KAR were actions that could be legitimately questioned as they had a serious financial impact on the two companies and Dr Tam's desire to challenge these actions could not be ascribed only to personal considerations.

17 The Non-Parties argued that Dr Tam was merely furthering his own interests which were not aligned with the interests of the companies because when he succeeded in his action against Dr Khairul, he did not press the claim for damages. Instead, he elected as his primary remedy that the share transfers should be set aside. Further, Dr Khairul's view was that EA and EH had not suffered any loss by reason of the transfer of their business because they had at all times operated the clinic on the premise that the profits earned would be paid out to the directors as remuneration. As the two companies did not gain any profit from the clinic's activities, they did not lose out when those activities were transferred to KAR. Dr Tam was pursuing this action for his own benefit rather than for the benefit of the two companies. Finally, this application was filed after Dr Khairul had informed Dr Tam that he intended to wind up the companies on the basis of the just and equitable rule. Contrary to Dr Tam's allegation that the winding up was filed by Dr Khairul as a response and means to thwart Dr Tam's attempts to ventilate the allegation of breach of directors' duties, the application by Dr Tam was an afterthought and was his means of stopping the liquidation of the companies or alternatively, his means of negotiating a buyout price which would be more advantageous for him.

18 The fact that Dr Tam decided on rescission rather than damages as his primary remedy did not affect the *bona fides* of the present claim. Dr Tam was entitled to choose whether he wanted to regain his position as a shareholder of the companies rather than make a claim for damages at that time. Such a decision was based on the circumstances as they then existed and could not prevent him from claiming that the companies were entitled to seek recourse against Dr Khairul for breach of fiduciary duty in respect of matters which took place after Dr Tam was ousted and of which Dr Tam was not aware until after he obtained judgment in *Tam Tak Chuen*.

19 Having considered the circumstances of the case, I was in no doubt that it was *prima facie* in the companies' interests to commence the action as the transfer of the Eden Family Clinic business from them to KAR without apparent or sufficient consideration adversely affected their income. The fact that Dr Khairul and Dr Tam had, when running the companies, paid out most of the income as remuneration so that the companies were not profitable, did not mean that it was not beneficial to the companies to have such income. Private companies are entitled to deal with their income in all lawful ways and if they decide to spend most of their income on remuneration of their directors, that is between them and the directors and their shareholders. Indubitably, a loss of income is not beneficial to a company and if that loss arises from a breach of fiduciary duty on the part of a director, it would be in the interests of the company to take steps to recover such income.

20 In relation to the third point, I considered that there was no substance in the allegation that Dr Tam had omitted material points in relation to the application and the companies. I do not need to deal in detail with this matter.

Prima facie in the interests of the companies

21 The final requirement that the applicant, Dr Tam, has to satisfy is that the application must appear to be *prima facie* in the interests of the companies. What this means is that the application must be in the interest of the shareholders and cannot appear to be frivolous or vexatious. Further, the court must also be satisfied that there is some reasonable basis for the underlying cause of action and that the application is a legitimate one which could reasonably succeed.

22 The Non-Parties submitted that it would not be in the interests of the companies if leave was granted to Dr Tam to commence action against them. First, Dr Tam had not shown that the companies had suffered loss as a result of Dr Khairul's alleged acts. This was a repetition of the point that I have dealt with above that EA and EH were not profit-making companies and therefore no loss was caused to them by Dr Khairul's alleged acts. For the reasons given above, this argument had to be rejected.

23 They also argued that there were genuine commercial considerations why leave should not be granted to Dr Tam. Dr Tam had not denied the breakdown of the relationship of trust and confidence between him and Dr Khairul. It was the breakdown that was the basis of the winding up petitions against EA, EH and the third company in the group, Eden Family Clinic Pte Ltd ("EFC"). Dr Tam was consenting to the winding up of EFC on that ground which showed his recognition of the substance of the ground. Therefore, the only reason why he was objecting to the winding up of EA and EH was that he wanted to use the derivative action as a means to further his own interests without regard to the interests of EA and EH. This point related to the issue of whether it is proper to authorise a derivative action when winding up is an available alternative.

24 First of all, it should be noted that the Court of Appeal made it clear in *Ting Sing Ning v Ting Chek Swee and others* [2008] 1 SLR (R) 197 ("*Ting Sing Ning*") that *Pang Yong Hock* was not authority for the proposition that, as long as the alternative of winding up the company was available,

leave would be refused, however meritorious the proposed claim may be. It would be noted that one of the grounds on which the application in *Pang Yong Hock* was rejected was that the Court of Appeal had there held that the more appropriate remedy was to wind up the company.

25 In *Ting Sing Ning*, however, the Court of Appeal confined the holding in *Pang Yong Hock* to the specific facts of that case. Neither of the applicants in *Pang Yong Hock* had made out a *prima facie* case against the proposed defendants. On the other hand, the special-accountant's report had indicated that a case could be made out against all the shareholder-directors. If leave to commence derivative proceedings were granted, this would likely result in multiple derivative actions driven by the various factions of shareholder-directors against each other. It was therefore a more sensible solution in *Pang Yong Hock* to wind up the company concerned.

26 What I had to determine was whether in this particular case the remedy of winding up was more beneficial to EA and EH than the commencement of derivative proceedings against the Non-Parties would be. I decided that winding up would, in all the circumstances of this case, be the less appropriate course.

27 Here, EA and EH had, *prima facie*, a meritorious claim against Dr Khairul for breach of his duties as a director in that he diverted business from them to KAR. Secondly, in view of the fact that KAR had made substantial revenues after the diversion, a successful claim against it would be of monetary value to EA and EH and not result in only a paper judgment. Thirdly, additional costs would be incurred by EA and EH if the companies were wound up as they would have to pay both the liquidator's costs and the costs of solicitors to be instructed by the liquidator if the liquidator decided to sue Dr Khairul and KAR. There would also be some delay in prosecuting the claim if the companies were wound up because first the liquidator would have to study the general records of the company and secondly, the liquidator and his solicitors would have to study the records of the case in order to determine whether it would be worthwhile to pursue it and would also have to look for funding. Dr Tam already had the necessary information and was prepared to fund the litigation on behalf of the companies.

Conclusion

28 I was satisfied that the requirements of s 216A(3) of the Act had been satisfied in this case. I therefore granted Dr Tam leave to commence derivative proceedings against the Non-Parties on behalf of EA and EH for Dr Khairul's breach of directors' duties. As regards the winding up applications, these could not proceed until the derivative actions had been completed. I therefore issued orders staying those proceedings. As regards costs, my order was that the costs of this application should be reserved to the court determining the outcome of the derivative action.