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Abstract

This paper analyses the statutory derivative action in Malaysia, and compares it with the law in the United Kingdom, Australia and Singapore. We argue that the statutory action is unlikely to overcome many of the uncertainties and difficulties of the common law derivative action.

Keywords

shareholders, statutory derivative action, minority shareholders, corporate governance, Malaysia, UK

THE STATUTORY DERIVATIVE ACTION IN MALAYSIA

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This paper analyses the statutory derivative action in Malaysia, and compares it with the law in the United Kingdom, Australia and Singapore. We argue that the statutory action is unlikely to overcome many of the uncertainties and difficulties of the common law derivative action.

I INTRODUCTION

A derivative action is an action brought by a shareholder or director of a company in the name of and on behalf of that company in respect of a wrong done to the company, rather than to its shareholders. It is 'derivative' as the party bringing the action does not have the right to sue, but such a right is 'derived' from that of the company. Normally, the authority to take legal action lies with the board as it has management responsibility. However, where the alleged wrongdoers are the directors themselves who control the company, the law gives shareholders the ability to commence action on the company's behalf.

Derivative action promotes managerial accountability and thus investor confidence. As a means of private enforcement, shareholder litigation supplements public enforcement, especially where public enforcement is weak. However, the common law is inadequate in many respects. Minority shareholders seeking to rely on the common law derivative action find themselves at a disadvantage on many fronts; the law is complex and corporate wrongdoing is extremely difficult to prove. There are issues of cost and the free-rider problem which also act as disincentives to minorities. Therefore, policy makers in many common law jurisdictions see the derivative action in its codified form as the solution. However, there is cognisance that vexatious and hostile minority shareholders acting to further their own narrow interests could be disruptive to management. The law must therefore strike a balance between facilitating shareholder litigation to enforce corporate rights and preventing needless and harmful litigation.

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It is well documented that this balance cannot be achieved through judge-made laws. Since the case of *Foss v Harbottle*, lawyers have had to sift through hundreds of cases spanning over a century and a half to find out the law. Principles of law often conflicted, hampering legal development. There are numerous hurdles imposed on the complainant and, more often than not, the courts concede to the wishes of the majority.

This balance can best be achieved through legislation, leading to the codification of the derivative action in many common law jurisdictions. In Malaysia, the statutory derivative action was introduced in 2007.¹ This comes shortly after the Malaysian Corporate Law Reform Committee ('CLRC')² made a recommendation for the same, following an earlier proposal by the High Level Finance Committee on Corporate Governance ('the Finance Committee').³ The Finance Committee recognised the importance of a codified derivative procedure to support private enforcement, but, fearing the spectre of 'massive litigation', considered an incremental approach by limiting the derivative action to certain types of companies.⁴ The CLRC, on the other hand, appears to have no such reservation.

This article is set out as follows. First, we briefly discuss the common law derivative action. We will then consider the salient aspects of the statutory action, focusing on Malaysia but making comparisons with the law in other common law countries. Here we use the laws in the United Kingdom (the 'UK'), Australia and Singapore as the benchmark for analysis. In our conclusion we consider whether the statutory derivative action in Malaysia has removed the weaknesses of the common law action and its potential in encouraging shareholder litigation.

II THE COMMON LAW DERIVATIVE ACTION

A *The Rule in Foss v Harbottle*

The common law position is based on two principles, the 'majority rule' and 'proper plaintiff rule', stated in the case of *Foss v Harbottle*.⁵ The 'majority rule' means simply that the wishes of the majority will prevail over those of the minority. The 'proper plaintiff rule' provides that if a wrong is committed against a company then the

¹ *Companies Act 1965* (Malaysia) s 181A-E.

² Corporate Law Reform Committee, *Members' Rights and Remedies*, A Consultative Document, (2007).

³ High Level Finance Committee on Corporate Governance, *Report on Corporate Governance*, (1999).

⁴ *Ibid* 190.

⁵ (1843) 2 Hare 461.

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company is the proper claimant in respect of that wrong.⁶ This principle is inter-related to the separate legal personality doctrine; that is, a company has a personality separate from that of its members and therefore a member of the company cannot sue to enforce rights that belong to the company.

The position in *Foss v Harbottle* was later expanded to also state that where the company is competent to settle the alleged wrong itself or the company is competent to ratify or condone an irregularity by its own internal procedure, then no individual member may bring an action in respect of it.

Apart from being doctrinally coherent, there are other advantages to the rule. It avoids multiple suits by shareholders, wasteful litigation and 'prevents vexatious actions by troublesome minorities seeking to harass the company'.⁷

Fortunately, the rule in *Foss v Harbottle* is not an absolute one. If it was, the wrongs committed by directors or the controlling shareholders would rarely be subject to litigation. Farrar and Hannigan put it as follows:

The company is the proper person to sue but a company can only act through its human agents, usually the board of directors, and the directors may well be the actual wrongdoers. They may therefore decide not to sue, a decision which may be approved by the company in general meeting where the wrongdoers may likewise control a majority of the votes. The net outcome would be that the wrongdoers would go unpunished and the minority shareholders would be at the mercy of the majority who could loot the company with impunity.⁸

Accordingly, in limited situations, the courts have allowed members to bring actions on the company's behalf. This is known as a 'derivative action' as the action is derived from a right belonging to the company.⁹ The action is brought in the name of the member on behalf of the company against the wrongdoers. The company will be joined as a co-defendant so that any judgment or order given by the court will bind the company.¹⁰

There are several exceptions to the rule in *Foss v Harbottle*,¹¹ but only one is universally accepted as a 'true' exception. That is, where a 'fraud on the minority' has been committed by those who control the company. Another exception based on the

⁶ *Edwards v Halliwell* [1950] 2 All ER 1064, 1066 (Jenkins LJ).

⁷ John Farrar and Brenda Hannigan, *Farrar's Company Law* (Butterworths, 4th ed, 1998) 431.

⁸ *Ibid* 431-2.

⁹ *Wallersteiner v Moir (No 2)* [1975] QB 373 (Lord Denning MR).

¹⁰ *Spokes v Grosvenor & West End Railway Terminus Hotel Co Ltd* [1897] 2 QB 124, 128 (Chitty LJ).

¹¹ See *Edwards v Halliwell* [1950] 2 All ER 1064.

'justice of the case' has been rejected in the United Kingdom,¹² but embraced by a Malaysian court,¹³ preferring to follow the Australian law.¹⁴

B The Inadequacy of the Common Law

There are a number of issues in the application of the common law derivative action. As one commentator puts it:

Despite judicial innovations, under the present law there are just too many hurdles to jump before bringing derivative suits. You must identify the wrongdoers, gather sufficient information, show there is fraud, prove the alleged wrongdoers control the company, and discover whether or not the acts complained of are ratifiable by a majority at a general meeting. Then you must somehow fund the action. In the face of all this and more, genuine grievances go unremedied.¹⁵

Thus, it has been extremely difficult, if not impossible, to bring an action against a miscreant director.¹⁶

Additionally, minority shareholders are often discouraged by the costs of the proceedings, limited access to information and the free-rider problem. These, together with the procedural issues, must be debated and resolved in court, resulting in delay and unnecessary extra expenses for the litigants. Numerous studies have identified these weaknesses.¹⁷

1 Legal Standing

The plaintiff minority shareholder must establish that he or she possesses the legal standing to bring a derivative action. This requirement was laid down in *Prudential's* case where it was held that the question of whether the plaintiff had the requisite *locus standi* would be considered by the court as a preliminary issue. Here the

¹² *Prudential Assurance Co Ltd v Newman Industries (No.2)* [1982] Ch 204 ('*Prudential*'); see also *Estmanco (Kilner House) Ltd v Greater London Council* [1982] 1 WLR 2.

¹³ *Abdul Rahim bin Aki v Krubong Industrial Park (Melaka) Sdn Bhd* [1995] 3 MLJ 417 (Court of Appeal).

¹⁴ For Australian authorities see *Hawkesbury Development Co Ltd v Landmark Finance Pty Ltd* [1969] 2 NSW 782; *Biala Pty Ltd v Mallina Holdings Ltd (No 2)* (1993) 11 ACLC 1082; *Ruralcorp Consulting Pty Ltd v Pynery Pty Ltd* (1996) 21 ACSR 161.

¹⁵ Jim Corkery, *Directors' Powers and Duties* (Longman Cheshire, 1987) 172.

¹⁶ M A Maloney, 'Whither the Statutory Derivative Action?' (1986) 64 *Canadian Bar Review* 309, 311.

¹⁷ See, eg, Companies and Securities Advisory Committee, Parliament of Australia, *Report on a Statutory Derivative Action* (1993) 5-6; Law Commission, Parliament of the United Kingdom, *Shareholders Remedies* (1997) Law Com No 246, [6.4].

plaintiff had to establish a prima facie case that the action falls within the exceptions to the rule in *Foss v Harbottle*. The reason for this was to save time and expense. However, the *locus standi* hearing itself could be contentious, lengthy and expensive and thus counter-productive.

By comparison Australian courts took a less restrictive approach. In *Hurley v BGH Nominees Pty Ltd* ('*Hurley*') the Supreme Court of South Australia did not consider the approach taken by the English Court of Appeal in *Prudential* as laying down a universal principle in all derivative actions. Instead it said the issue 'ought to be determined in each individual case according to what appears to be just and convenient in the circumstances of that case'.¹⁸ The test to be applied is whether it is 'just and convenient' to try the issue as a preliminary issue.¹⁹

The English approach taken in *Prudential* was followed by the Malaysian Supreme Court in *Alor Janggus Soon Seng Trading Sdn Bhd v Sey Hoe Sdn Bhd* [1995] 1 MLJ 241.²⁰

2 *Fraud on the Minority*

The main exception to the rule in *Foss v Harbottle* was that the defendants were in a position of control within the company and had perpetrated a 'fraud on the minority'.

Proving 'fraud' and 'control' is an onerous burden, and the meaning of those terms was uncertain, as was noted in *Abdul Rahim Aki v Krubong Industrial Park Sdn Bhd* [1995] 3 MLJ 417, 431.²¹ The existing English authorities on the question of what exactly amounts to a 'fraud on the minority' have been conflicting and difficult. This is illustrated in cases such as *Cook v Deeks* [1916] 1 AC 554 and *Pavlides v Jensen* [1956] Ch 565 where 'fraud' was interpreted very restrictively to include only actual fraud, that is, dishonesty. As one commentator remarked, anything less than expropriation of corporate assets would be unlikely to be considered fraud. Negligence, even gross negligence, falls short of 'fraud'.²² However, in *Daniels v*

¹⁸ (1982) 6 ACLR 791, 795.

¹⁹ *Ibid.* *Hurley* was followed in *Biala Pty Ltd v Mallina Holdings Ltd* (1988) 6 ACLC 1138 and *Dempster v Mallina Holdings Ltd* (1994) 15 ACSR 1.

²⁰ See also *Tan Guan Eng v Ng Kweng Hee* [1992] 1 MLJ 487. The courts in Singapore have also followed *Prudential*: see *Sinwa SS (HK) Co Ltd v Morten Innhaug* [2010] SGHC 157 (a case on the common law derivative action) where the High Court of Singapore considered the standing of the plaintiff before it went on to consider whether it would grant leave for a derivative action.

²¹ See also *Tan Guan Eng v Kweng Hee* [1992] 1 MLJ 487, 499.

²² Stanley M Beck, 'The Shareholders' Derivative Action' (1974) 52 *Canadian Bar Review* 159, 168.

Daniels [1978] Ch 408, Templeman J effectively removed the requirement of bad faith, holding that negligence or breach of duty, which not only harmed the company but also resulted in a profit to a director, amounted to fraud on the minority. While this is a more liberal interpretation of the rule, it retained the established requirement that an intention on the part of the defendant to benefit from the conduct must be shown. However, at trial, Vinelott J in *Prudential* thought that it was not necessary for the plaintiff to prove that a defendant acted with intention to benefit himself at the company's expense. He went further to say that there was no valid basis for the requirement of some benefit on the defendant's part as the whole point for the exception was to ensure that a claim was brought against persons whose interests conflicted with the interest of the company.²³

The English courts adopted a conservative approach to 'control', usually requiring that the defendants control a majority of the voting shares.²⁴ This made derivative actions difficult to bring except in small private companies.²⁵

3 Ratification

The other thorny issue is that the wrongdoing complained of in the derivative action (as long as it is not an illegal transaction) could have been ratified by the shareholders in general meetings which would pre-empt a derivative litigation. There is however no clear authority as to what breaches may or may not be ratified. Commentators have not been able to satisfactorily distinguish between cases such as *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (where it was suggested that shareholders could ratify the breach of duty by directors) and *Cook v Deeks* [1916] 1 AC 554 (where the breach of duty by the directors was held to be non-ratifiable).

In Malaysia, the High Court in *Teoh Peng Phe v Wan* [2001] 5 MLJ 149 made a novel distinction between (a) acts of directors which are within their powers (but failed the proper purpose test) and (b) acts of directors which are outside of their powers. Kang Hwee Gee J said acts which fall within the former can be ratified but not the latter. This case is not fully consistent with either of the two English authorities mentioned above.

²³ *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1981] Ch 257, 316.

²⁴ *Burland v Earle* [1902] AC 83; I Ramsay and B Saunders, 'Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action', Centre for Corporate Law and Securities Regulation, University of Melbourne, 2006.

²⁵ A J Boyle, *Minority Shareholders' Remedies* (Cambridge University Press, 2002) 29.

4 *The Cost of Litigation*

The cost of litigation poses a significant barrier to a shareholder contemplating litigation. Even if the shareholder is successful in his action, the fruits of his victory go to the company. At best the shareholder receives only a small pro-rata benefit of the judgment. If the shareholder loses, he or she has to bear his or her own costs and, possibly, also the defendant's. Only in appropriate cases will the unsuccessful shareholder's costs be indemnified by the company. In the case of *Wallesteiner v Moir (No 2)*,²⁶ Lord Denning held that a minority shareholder was entitled to the costs of a derivative action via an indemnity from the company because, if he was successful, the benefit will accrue to the company. The shareholder could apply for an indemnity at the interlocutory stage and would be granted the indemnity provided he or she was bona fide and acted reasonably in the interests of the company. The significance of this principle, however, was somewhat reduced in *Smith v Croft (No 1)* [1986] 2 All ER 551, where it was held that an indemnity should only be granted after discovery and only where there is evidence that it is genuinely needed. Hence, shareholders could not be assured of an indemnity in all cases.

5 *Evidence*

One other major difficulty facing a shareholder was in obtaining evidence to prove their case. Corporate wrongdoing is notoriously difficult to prove. Naturally the company would be unlikely to co-operate in providing the complainant access to the company's records.

III THE STATUTORY DERIVATIVE ACTION

The statutory derivative action in Malaysia was introduced in August 2007 through the insertion of s 181A-E into the *Companies Act 1965* (Malaysia). In the UK, Part 11 of the *Companies Act 2006* (UK) contains a new derivative action procedure which came into force on 1 October 2007. Sections 260-264 deal with derivative actions in England and Wales or Northern Ireland while ss 265-269 deal with derivative claims in Scotland. Statutory derivative action in Australia came into operation on 13 March 2000 through Part 2F.1A of the *Corporations Act 2001* (Cth). The Singaporean statutory derivative action copies Canadian legislation and is contained in s 216A and s 216B of the *Companies Act 1967* (Singapore), enacted in 1993.

²⁶ [1975] QB 373.

A *The Applicant*

The new derivative procedure in Malaysia enables a category of persons, with the leave of the court, to bring a derivative action on behalf of the company to intervene in or defend existing proceedings on behalf of the company.²⁷ This is broadly consistent with the provisions in other jurisdictions: (a) the action is brought by a member of the company, (b) the cause of action is vested in the company, (c) relief is sought on the company's behalf, and (d) leave of the court is required to commence proceedings.

In Malaysia the range of persons who can bring a derivative action is fairly broad. It includes a member, a person who is entitled to be registered as a member, a former member (if the application relates to circumstances in which the person ceased to be a member), a director,²⁸ and the Registrar (in the case of a company declared to be under an investigation by the Registrar).²⁹ It is broadly similar to the Australian legislation, except that the Australian *Corporations Act 2001* (Cth) allows applications to be brought by an officer or former officer of the company.³⁰

The Singapore legislation is even broader in that it allows an application to be made by any person who, in the discretion of the court, is a proper person to make an application.³¹ Although the Singapore provision does not express former shareholders or directors as potential complainants, as is the case in Malaysia and Australia, its scope of potential claimants is wider than the Malaysian and Australian provisions, and is most certainly wider than the position which existed at common law. If the claimant can satisfy the court that he or she is a proper person to make the application, leave will be granted at the court's discretion. Hence, a beneficial owner of shares or a shareholder of a related company or an individual director may apply for leave to bring a derivative action (as was the case in *Agus Irawan v Toh Teck Chye* [2002] 2 SLR 198 ('*Agus Irawan*'), where a director of a company applied for leave to commence an action against two other directors of the company for alleged breach of fiduciary duties).

²⁷ *Companies Act 1965* (Malaysia) s 181A(1). The action is brought in the name of the company: s 181A(2).

²⁸ In *Sime Darby Bhd v Dato' Seri Ahmad Zubir bin Haji Murshid* [2012] 9 MLJ 464 the company sued its directors for breach of fiduciary duties as directors. The defendant directors brought third party proceedings against the other directors seeking indemnity and contribution. The High Court dismissed the third party proceedings, saying that they were in fact a cloaked statutory derivative application.

²⁹ *Companies Act 1965* (Malaysia) s 181A(4).

³⁰ *Corporations Act 2001* (Cth) s 236(1)(a)(ii).

³¹ *Companies Act 1967* (Singapore) s 216A.

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The Australian and Singapore provisions are wider than the Malaysian legislation as a former member may apply for leave to bring a derivative action without having to establish that the application relates to circumstances in which the person ceased to be a member.

One notable feature of the Singapore derivative procedure is that it does not apply to listed companies. Members of listed companies will have to use the common law action if they wish to commence a derivative action.

The UK provision is much narrower in that it is open only to existing members.³² This retains the position at common law.

All these provisions go further than the common law derivative action as they allow a complainant to intervene in or defend an existing action.

A comparison of these jurisdictions' provisions on who may apply for leave is given in *Table 1*.

Table 1: *Who Can Apply for a Statutory Derivative Action?*

| MALAYSIA | UNITED KINGDOM | AUSTRALIA | SINGAPORE |
|---|--|-----------------------------------|--|
| <i>Companies Act</i> s181A(4): | <i>Companies Act</i> s260: | <i>Corporations Act</i> s 236(1): | <i>Companies Act</i> s 216A: |
| A member | Only existing members can apply | A member | A member |
| A person who is entitled to be registered as a member | Subscribers to memorandum become members on registration of the company even if the company fails to enter their names in the register (s 112) | A former member | The minister (in the case of a declared company under Pt IX) |

³² This includes a person to whom shares in the company have been transferred or transmitted by operation of law, for example, where a trustee in bankruptcy or personal representative of a deceased member's estate acquires an interest in a share as a result of the bankruptcy or death of a member. A member is defined in the *Companies Act 2006* (UK) s 112, which provides that the subscribers to the memorandum become members on registration of the company, even if the company fails to enter their names in the register of members.

| | | | |
|--|--|--|---|
| A former member (but application must relate to circumstances in which member ceased to be a member) | 'Member' includes a person who is not a member but to whom shares in the company have been transferred or transmitted by operation of law (s 260(5)) | A person entitled to be registered as a member | Any other person who, in the discretion of the court, is a proper person to make an application |
| A director | | An officer or former officer of the company | |
| The Registrar (in the case of a company declared to be under an investigation by the Registrar) | | | |

B The Scope of the Derivative Action

The Malaysian legislation does not specify the types of actions in respect of which a statutory derivative action may be brought. It is not even clear that it applies only where directors have breached their fiduciary duties. Prior to the Court of Appeal decision in *Celcom (Malaysia) Bhd v Mohd Shuaib Ishak* [2011] 3 MLJ 636 ('*Celcom*'), it could not be said for certain whether a statutory derivative action may be brought in respect of actions which fall outside the scope of directors' fiduciary duties, for example, where it is alleged that directors were negligent or in breach of their duties of care, skill and diligence. However, the decision in *Celcom* and *Lembaga Tabung Angkatan Tentera v Prime Utilities Berhad* [2012] 2 AMCR 521 ('*Lembaga Tabung Angkatan Tentera*') answers this question in the affirmative. In *Celcom* a former member of Celcom complained about certain decisions taken by the company's directors in entering into a conditional sale and purchase agreement with Telekom Malaysia Bhd. The Court of Appeal said that the intention of the statutory derivative procedure is to enable a member, present or past, to seek leave to bring an action in the name of the company to recover losses sustained by the company provided. In the case of a former member, there must be proof by the complainant of a direct causal nexus between the complaint and how he ceased to be a member. The Court of Appeal's broad interpretation of the scope of s 181A does seem to include directors' negligence and breach of their duties of care, skill and diligence. In *Lembaga Tabung Angkatan Tentera*, the complainant, a government-linked investment company, a minority shareholder in the defendant company, took a derivative action against the directors of the defendant company for failing to take any action to recover monies

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invested in an asset management company. In granting leave the High Court leaves little doubt that a derivative action may be brought against directors for breach of duty of care, skill and diligence. This was supported in *S Vigneswaran Sanasee v MIED*. The High Court in this case allowed a derivative action in respect of a director's breach of duty, obligations and negligence.³³

In the UK s 260(3) specifies the types of breaches of duty under which a derivative claim may be brought. The section provides that a derivative claim 'may be brought only in respect of a cause of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company'. In addition, a derivative claim may be brought in respect of an alleged breach of any of the general duties of directors in Chapter 2 of Part 10, including the duty to exercise reasonable care, skill and diligence.³⁴ The breach of duty under s 260(3) includes breaches under the Act as well as under the common law.

Hence, in the UK an action may be brought in respect of any negligence by a director of a company. As discussed above, common law makes a distinction between mere negligence or incompetence and negligence benefitting the wrongdoer.³⁵ The UK Act removes this distinction. Now, in bringing a derivative action against directors for negligence, shareholders need not establish that the directors received any advantage or benefit from their negligence or wrongdoing. This is a significant departure from the common law position.

The *Companies Act 2006* (UK) also provides that the cause of action may be against the director, a third party, or both.³⁶ This means that a member could bring a derivative claim against a third party where the damage suffered by the company arose from an act involving a breach of duty on the part of the director, and the third party has improperly received property as a result of the said breach (for example, for knowing receipt of money or property transferred in breach of trust or for knowing assistance in a breach of trust).

³³ [2011] 2 CLJ 678. This decision was upheld by the Court of Appeal but, at the time of writing, an appeal was pending before the Federal Court.

³⁴ Companies Act 2006 (UK) s 174.

³⁵ In *Paolides v Jensen* [1956] Ch 565 it was held that mere negligence or incompetence on the part of controlling directors does not justify a derivative suit. In contrast, in *Daniels v Daniels* [1978] Ch 406, the Court deemed it necessary to show that the directors, or persons connected with them, have derived benefits from the negligence of directors.

³⁶ Companies Act 2006 (UK) s 260(3).

A derivative claim may be brought by a member in respect of wrongs committed prior to his or her becoming a member.³⁷ Although there is no equivalent provision in the legislation of the other jurisdictions, it might be argued that a member in these other jurisdictions would nonetheless be entitled to bring a derivative claim in respect of wrongs committed prior to his becoming a member, because the provision in the UK Act reflects the fact that the rights being enforced are those of the company rather than those of the member. This is the position at common law.

The definition of a 'director' includes a former director, and a shadow director is treated as a director for the purpose of a derivative claim.³⁸ The general duties of directors apply to shadow directors as well.³⁹

The UK provision allows a broader range of claims to be brought and gives a much clearer guidance to the courts and to shareholders when considering whether to pursue a derivative claim. By comparison, the legislation in Malaysia, Australia and Singapore do not specify the situations when the derivative claim is available. There could be an advantage in that it leaves room for judicial discretion as is clearly evident from *Celcom* and *Lembaga Tabung Angkatan Tentera*. On the other hand, the absence of a clear guide for the courts has led to inconsistent rulings, which adds to uncertainty and additional expense, a major problem which was supposed to be cured by legislation.

C Procedural Requirements

In Malaysia a derivative action can only be instituted with the leave of the court. In deciding whether or not to grant leave, the court shall take into account whether the complainant is acting in good faith and whether it appears, prima facie, to be in the best interest of the company that the application be granted.⁴⁰ It would appear that the court's discretion is limited to either grant or refuse leave. If leave is refused the courts do not have the power or discretion to grant any consequential orders; for example, an order as to costs to the complainant. An order for costs can only be made if leave is granted.⁴¹

By contrast, the UK legislation empowers the courts to make consequential orders if leave is not granted. Once proceedings have been brought, the member is required to

³⁷ Ibid s 260(4).

³⁸ Ibid s 260(5).

³⁹ Ibid s 170.

⁴⁰ *Companies Act 1965* (Malaysia) s 181B(4).

⁴¹ Ibid s 181E.

apply for permission to continue the claim.⁴² This is a two-stage process. At the first stage, the applicant is required to establish a prima facie case for the grant of permission, and the court will consider the issue on the basis of the applicant's evidence alone without requiring evidence to be filed by the defendant. The court must dismiss the application at this stage if what is filed does not show a prima facie case, and the court may make any consequential order that it considers appropriate (for example, a costs order or a civil restraint order against the applicant). At the second stage, if the application is not dismissed, the court may direct the company to provide evidence and, on hearing the application, may grant permission, refuse permission and dismiss the claim, or adjourn the proceeding and give such directions as it thinks fit.⁴³

In Australia and Singapore, upon satisfying the standing requirements, a member needs to apply for leave to proceed with the statutory derivative action. In Singapore, like Malaysia, the court is only empowered to either grant or refuse leave. The Singapore legislation does not give any power to the court to make consequential orders in the event leave is not granted.⁴⁴ However, the Australian legislation empowers the court to make any orders and give any directions that it considers appropriate on an application for leave.⁴⁵

D The Leave Criteria

In Malaysia, in deciding whether or not to grant leave, the court shall take into account whether the complainant is acting in good faith and whether it appears, prima facie, to be in the best interest of the company that the application be granted.⁴⁶ Where leave has been granted by the court, the complainant must commence the action within thirty days from the grant of leave. Once leave has been granted, any proceedings brought on behalf of the company, intervened in or defended on behalf of the company, shall not be discontinued, compromised or settled except with the leave of the court.⁴⁷ This enables the court to keep abreast of the proceedings and prevent unfair compromises and other underhanded dealings between the complainant and the defendants, which may not be in the interest of the company.

In *Celcom*, the plaintiff, a former member of the defendant company (Celcom) applied for leave to bring a statutory derivative action in respect of certain business decisions

⁴² *Companies Act 2006* (UK) s 261.

⁴³ Explanatory Notes, *Companies Act 2006* (UK).

⁴⁴ *Companies Act 1967* (Singapore) s 216A(3).

⁴⁵ *Corporations Act 2001* (Cth) s 241.

⁴⁶ *Companies Act 1965* (Malaysia) s 181B(4).

⁴⁷ *Ibid* s 181C.

taken by the directors of Celcom. At the High Court,⁴⁸ the main issue was whether or not the requirements of s 181B(4) were satisfied; namely, that (i) the plaintiff was acting in good faith and (ii) it appears, *prima facie*, to be in the best interest of the company that the application for leave be granted. Ramli J was of the view that for s 181B(4) to be satisfied the complainant had to demonstrate 'that there was a reasonable basis for the complaint and that the proposed action was legitimate and arguable, in that it had some semblance of merit'.⁴⁹ The learned judge said that at the leave stage, which is the threshold stage, the court is not to go into substantial issues on merits. All the applicant had to do was to show a *prima facie* case and that there was some substance in the grounds supporting the application, that is. the low threshold test.⁵⁰

The Court of Appeal overturned the High Court decision. The Court of Appeal said the intention of the statutory derivative procedure is to enable a member, present or past, to seek leave to bring an action in the name of the company to recover losses sustained by that company. As such, leave to bring a derivative action must not be given lightly. Abdul Hamid Embong JCA, delivering the judgment of the appellate court, went on to say that the High Court judge was wrong in stating that the matter before him was 'only an application for leave' and relying on the low threshold test used under Order 53 of the Rules of the High Court. The learned judge said:

the learned judge must, as a matter of judicial prudence exercise a greater caution in satisfying himself that the requirements under s 181A of the CA are met. A low threshold of merely determining if there existed a *prima facie* case is therefore a wrong basis for granting the leave. There needs to be a strict interpretation of s 181A and compliance to those statutory requirements ... Section 181A should thus be restrictively applied. It curtails former members of the company from filing derivative action under any circumstances. The qualification under sub-s (4)(b) requires proof by the respondent that there must be a direct causal nexus between the complaint and how he ceased to be a member.⁵¹

The Court said in this case the alleged breach or complaint did not have the consequences of making the complainant cease to be member of Celcom.

On the requirement of good faith, the Court of Appeal said the complainant must show he or she was acting in good faith in making the application. The onus of proof

⁴⁸ *Mohd Shuaib Ishak v Celcom (Malaysia) Bhd* [2008] 5 MLJ 857.

⁴⁹ *Ibid* 891.

⁵⁰ This was the test used for applications for judicial review under *Rules of the High Court 1980* (Malaysia) Order 53.

⁵¹ *Celcom* [2011] 3 MLJ 636, 646.

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is on the complainant on the balance of probabilities. The Court of Appeal followed the decision in the Australian case of *Swansson v RA Pratt Properties Pty Ltd* [2002] NSWSC 583 (*'Swansson'*) and said that the test of good faith is two-fold: (i) the complainant must have an honest belief that a good cause of action exists and has a reasonable prospect of success, and (ii) the application is not brought up for a collateral purpose.

The Court of Appeal said the High Court judge had completely failed to take the two-fold test into consideration. In this case, the complainant had commenced a personal action which was virtually identical to the derivative action and with identical reliefs sought. The Court of Appeal found there was an inconsistency as in the personal action the complainant was suing Celcom for damages while in the derivative action he was purportedly trying to recover damages on behalf of the company. This raised a suspicion on the complainant's true motive in bringing the derivative action. The Court of Appeal concluded that the complainant did not have the interest of the company at heart but was merely advancing his own interest.⁵² In these circumstances, the complainant was not acting in good faith and leave should not have been granted. In addition, leave should not be granted as there was no reasonable commercial sense of the derivative action and it would be counter-productive to the company's interests.

In determining whether the derivative action was in the interest of the company, the Court of Appeal applied and followed the tests set out in the Singapore case of *Pang Yong Hock v PKS Contracts Services Pte Ltd* [2004] 3 SLR, 1 (*'Pang Yong Hock'*) and in the Canadian case of *Ontario Ltd v Bernstein* (2000 OTC 758).

The relevant passage in the Singapore case referred to by the Court reads as follows:

Having established that an applicant is acting in good faith and that a claim appears genuine, the court must nevertheless weigh all the circumstances and decide whether the claim ought to be pursued. Whether the company stands 'to gain substantially in money or in money's worth' (per Choo JC in *Agus Irawan*) relates more to the issue of whether it is in the interests of the company to pursue the claim rather than whether the claim is meritorious or not. A \$100 claim may be meritorious but it may not be expedient to commence an action for it. *The company may have genuine commercial consideration for not wanting to pursue certain claims. Perhaps it does not want to damage a good, long-term, profitable relationship. It could also be that it does not wish*

⁵² Although one might argue that just because the complainant has personal interest in the matter this does necessarily mean that the proceedings are not in the best interest of the company.

*to generate bad publicity for itself because of some important negotiations which are underway.*⁵³

The passage in *Ontario Ltd v Bernstein* is as follows:

Whether or not a corporation shall seek to enforce in the courts a course of action for damages is, like other business questions, ordinarily a matter of internal management and is left to the discretion of the directors, in the absence of instruction by vote of the stockholders. *Courts interfere seldom to control such discretion intra vires the corporation, except where the directors are guilty of misconduct equivalent to a breach of trust, or where they stand in a dual relation which prevents an unprejudiced exercise of judgment.*⁵⁴

The Court of Appeal took into consideration that the directors of Celcom made a prudent business and commercial decision based on the advice of an independent committee of independent directors, who in turn based their decision on independent legal advice. In such a situation the court will be slow to interfere and substitute its own judgment. The court will only interfere with the internal management of the company if the directors have acted in bad faith.

The decision in *Celcom* shows that the courts will subject the granting of leave to bring a derivative action to strict scrutiny, to ensure that the process is not abused by complainants seeking to challenge decisions taken by companies for collateral or self-serving purposes.⁵⁵

It should also be noted that there were no attempts made to highlight the distinction between the different phrases used in the legislation of these countries. The legislation in Singapore and Canada requires an applicant to show that it 'appears prima facie in the interest of the company'⁵⁶ that leave be granted, while Malaysian legislation states 'it appears prima facie to be in the best interest of the company'.⁵⁷ The Australian provision requires an applicant to show that 'it is in the best interest of the company that the applicant be granted leave'.⁵⁸ The approach taken by the Court of Appeal appears to be a correct one as the words 'prima facie' in the

⁵³ *Pang Yong Hock* [2004] 3 SLR 1, 7-8 (emphasis added).

⁵⁴ *Ontario Ltd v Bernstein* (2000 OTC 758) (emphasis added).

⁵⁵ The Court of Appeal decision in *Celcom* [2011] 3 MLJ 636 has been upheld by the Federal Court.

⁵⁶ *Companies Act 1967* (Singapore) s 216A(3)(c).

⁵⁷ *Companies Act 1965* (Malaysia) s 181B(4)(b).

⁵⁸ *Corporations Act 2001* (Cth) s 237(2)(c).

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Malaysian legislation denotes a lower threshold than that of the Australian provision.⁵⁹

*S Vigneswaran Sanasee v MIED*⁶⁰ followed the test in the High Court in *Celcom* but made no reference to the Court of Appeal judgment. On appeal, however, the Court of Appeal affirmed the High Court decision.

In *Lembaga Tabung Angkatan Tentera* the High Court applied the high threshold test, following the Court of Appeal in *Celcom*. The Court was also satisfied that the plaintiff was acting in good faith and that it was in the best interest of the company that leave be granted.

In the UK, at the second stage (that is, after the first stage where the court is satisfied that the applicant has a prima facie case) the court will decide in a main permission (or leave) hearing and on evidence from the applicant and the defendant whether the case should proceed. Section 263 of the *Companies Act 2006* (UK) sets out the criteria which the court is required to take into account at this stage. The court will refuse permission to continue the claim under s 263(2) if it is satisfied that: (a) a person acting in accordance with the duty to promote the success of the company would not bring the claim, or (b) if the act or omission complained of has been authorised or ratified by the company. In considering whether to give permission, the court must take into account the following criteria:⁶¹

- a) whether the member is acting in good faith in seeking to continue the claim;
- b) the importance that a person acting in accordance with s 172 (duty to promote the success of the company) would attach to continuing it;
- c) where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be ratified by the company;
- d) where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be or would be likely to be ratified by the company;
- e) whether the company has decided not to pursue the claim;
- f) whether the act or omission gives rise to a cause of action that the member could pursue in their own right (that is, a personal action) rather than on behalf of the company.

⁵⁹ See *Swansson* [2002] NSWSC 583.

⁶⁰ [2011] 2 CLJ 678.

⁶¹ *Companies Act 2006* (UK) s 263(3).

Further, in considering whether to give permission, the court shall have particular regard to any evidence before it as to the views of independent members of the company who have no personal interests, direct or indirect, in the matter.⁶²

Section 263(2)(a) has codified the common law test in *Airey v Cordell* [2006] EWHC 2728 (*'Airey'*) in determining whether permission ought to be given in the bringing of a derivative claim. In this case the Court held that this would depend on whether a hypothetical and independent board of directors would sanction the claim, and that it was not for the court to assert its own view of what it would do if it were the board, but merely to be satisfied that a reasonable board of directors could take the decision that the minority shareholder applying for permission to proceed would like it to take.

The difficulties concerning the question of whether someone with a duty acting to promote the success of the company (that is, a hypothetical independent director) would seek to continue the claim or not were considered in *Franbar Holdings Ltd v Patel* [2008] BCC 885 (*'Franbar'*). In this case, one of the reasons the application for permission to continue a derivative action was refused was because a director, acting in accordance with his duty to promote the success of the company, would not seek to continue the claim. The Court outlined several factors which the hypothetical director would take into account which included: the prospects of success of the claim, the ability of the company to make a recovery on any award of damages, any damage to the company's reputation and business in the event of the action failing, and the cost of the proceedings. Another important reason for the refusal was the ability of the shareholder to seek relief on the basis of unfair prejudice (that is, the criteria in the *Companies Act 2006* (UK) s 263(3)(f)).

In *Mission Capital plc v Sinclair* [2008] EWHC 1339, the Sinclairs' appointment as directors was terminated by the board and a new director, P, was appointed. The Sinclairs challenged the validity of the board action. They applied for permission to continue a derivative claim against the non-executive directors and P, claiming that the company would not be managed satisfactorily without them. The Court refused permission because the alleged damage to the company was speculative and a notional director would not attach much importance to it. In addition, the former executive directors could pursue an action by way of an unfair prejudice petition.

In *Stimpson v Southern Private Landlords Association* [2009] EWHC 2072 (*'Stimpson'*), permission to continue a derivative action was again refused. The factors considered by the Court in refusing permission were: (i) only one of the alleged breaches of duty

⁶² Ibid s 263(4).

was realistically arguable, (ii) the value of the claim was modest, (iii) the costs of the litigation would be relatively substantial and the Association could not fund such expenditure, and (iv) if the claim was unsuccessful, it would expose the Association to the risk of insolvency. Further, permission was refused because there was no evidence that the Association's merger with a larger landlord's association was not beneficial to the Association's members, which suggested a lack of good faith on the claimants' part. In view of these factors, the Court concluded that a hypothetical director, acting in accordance with their duty to promote the success of the company, would not seek to continue the claim.

Iesini v Westrip Holdings Ltd ('*Iesini*') concerned an application against the newly constituted board of directors of a company for breach of duty.⁶³ The Court held that as the directors had followed the advice of eminent professionals they had not been negligent or breached their duties. It should be noted that s 263(4) of the *Companies Act* (UK) makes reference to the views of members without a personal interest rather than those of independent directors. A strict interpretation of this provision would not permit the court to take into account the views of parties outside the company.

In *Langley Ward Ltd v Trevor* ('*Langley*'), the High Court refused permission to continue the claim on the basis that (a) no hypothetical director seeking to comply with their duties under s 172 of the Act would consider it appropriate to prosecute certain claims and (b) the company was a natural candidate to be wound up and it was therefore appropriate to leave the dispute to be dealt with by a liquidator rather than by litigation in a derivative action. Donaldson J agreed with the judges in the previous cases (*Airey, Franbar* and *Iesini*) that since there are many cases where a director acting in accordance with s 172 could properly decide either to continue the claim or not, s 263(2) must be interpreted as requiring the court to be satisfied that *no* director complying with s 172 would seek to continue the claim.⁶⁴

In *Kleanthous v Paphitis* the factors taken into account by the High Court in refusing Mr Kleanthous permission to continue the claim were: (a) it was strongly opposed by independent committees of the company formed to consider the claim, (b) it was open to the claimant to seek redress by means of an unfair prejudice application, and (c) much of any money recovered from the defendant directors could be expected to be returned to them by way of distribution.⁶⁵

⁶³ [2010] BCC 420.

⁶⁴ *Langley Ward Ltd v Trevor* [2011] AER(D) 78 (Jul).

⁶⁵ *Kleanthous v Paphitis* [2011] AER(D) 33 (Sep).

As a result of these decisions and the safeguards set out in the *Companies Act 2006* (UK) s 263, even if the claimants manage to establish a prima facie case they will face an uphill task to overcome the second hurdle.

The view of the hypothetical director as to whether permission should be granted to continue the claim having regard to their duty under the *Companies Act 2006* (UK) s 172 (to promote the success of the company), is of significant importance. The court is empowered under s 263(4) to take into account the views of an independent committee appointed by the board in determining how the hypothetical director might act in a given situation, as the court did in *Kleanthous v Paphitis*.⁶⁶ It would appear that the decision as to what will promote the success of the company and what constitutes such success is one for the directors and not the courts. As long as such decisions are made in good faith, the courts would not substitute their views in place of the directors.⁶⁷

The list under the *Companies Act 2006* (UK) s 263(3) is not exhaustive. The particular circumstances of the case may require additional factors to be considered, including the potential effect of the proceedings on the company's employees or former employees (*Stimpson*), the size of the claim, the cost of the proceedings, the company's ability to fund the proceedings, the ability of the potential defendants to satisfy a judgment, and the impact on the company if it lost the claim and had to pay not only its own costs but the defendant's as well.⁶⁸ In addition, the ability to settle the dispute by way of other statutory processes (for example, by way of an unfair prejudice application as in *Kleanthos* and *Franbar*, or liquidation as in *Langley*) is also an important factor to be considered.

In Australia, once an applicant has established that he or she has standing under the *Corporations Act 2001* (Cth) s 236(1), he or she is required to apply to the court for leave to bring or intervene in proceedings under s 237. The applicant seeking leave will be required to establish all the elements of s 237(2):

- (a) *It is probable that the company will not itself bring the proceedings.*

The Court in *Swansson* asserted that the fact that the company will not bring proceedings may be evident from a board resolution or a refusal of a request of the applicant to bring the proceedings. Where the company has not given a clear

⁶⁶ [2011] AER(D) 33 (Sep).

⁶⁷ One will note that a similar approach was taken by the Malaysian Court of Appeal in *Celcom*.

⁶⁸ Per Donaldson J in *Langley* [2011] AER(D) 78 (Jul); see *Franbar* [2008] BCC 885, 895 [36]; repeated in *Iesini* [2010] BCC 420, 441 [85].

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and unambiguous refusal to take specific proceedings after the applicant has made a detailed request to do so the applicant must show that, in all the circumstances of the case, actual refusal or the probability of refusal is to be inferred.⁶⁹

The court will infer that the company will not bring the proceedings where the company has limited or insufficient funds.⁷⁰ In *Saltwater Studios Pty Ltd v Hathaway* [2004] QSC 435 Atkinson J concluded that in that case it was unlikely that the companies would bring any action against the respondents given they were the purported directors of the subject companies.⁷¹

(b) *The applicant is acting in good faith.*

The court will take into consideration a two-fold test laid down by Palmer J in *Swansson*:

- (i) whether the applicant honestly believes that a good cause of action exists and has a reasonable prospect of success. This test involves both the subjective and objective elements. A mere assertion by the applicant that they honestly held such a belief would not be sufficient. The applicant may be disbelieved if 'no reasonable person in the circumstances could hold that belief',⁷² and
 - (ii) whether the applicant is seeking to bring the derivative action for a collateral purpose that would amount to an abuse of process.⁷³ The applicant may satisfy (i) above and yet not be acting in good faith if the intention is to use the action for some type of personal advantage. The purpose of the action must be for the benefit of the company and not for the benefit of the applicant.
- (c) *It is in the best interests of the company that the applicant be granted leave.*

Relevant factors to be considered are the company's character and business, including whether it is a going concern, the ability of the proposed defendant to meet any judgment and the proposed effect the litigation will have on the company.⁷⁴ If the applicant is able to achieve the desired result by other means; for example, if they can bring proceedings in their own name, then it

⁶⁹ *Swansson* [2002] NSWSC 583, [29] (Palmer J).

⁷⁰ *Carpenter v Pioneer Park Pty Ltd (In Liq)* [2004] NSWSC 1007.

⁷¹ *Saltwater Studios Pty Ltd v Hathaway* [2004] QSC 435, [6].

⁷² *Swansson* [2005] NSWSC 583, [36] (Palmer J); *Maher v Honeysett Maher Electrical Contractors* [2005] NSWSC 859, [29].

⁷³ *Swansson* [2005] NSWSC 583, [36] (Palmer J).

⁷⁴ *Ibid.*

is not in the best interests of the company that the applicant be granted leave.⁷⁵

In contrast, the Malaysian legislation requires the applicant to show that the action 'appears prima facie to be in the best interest of the company';⁷⁶ whilst the Singapore legislation requires the applicant to show that the action 'appears prima facie to be in the interest of the company'.⁷⁷ It was held in the case of *Swansson* that this is a lower threshold than the Australian legislation. Under the Australian provision, it was insufficient if it may be, or was prima facie, in the company's best interests. The court must actually be satisfied that it 'is' in the company's best interests to bring the proceedings.

(d) *There is a serious question to be tried.*

This phrase is not defined in the Corporations Act 2001 (Cth). However, in *Swansson* the Court held that 'the applicant has the same relatively low threshold to surmount as in the case of an application for an interlocutory injunction'.⁷⁸

The phrase has been interpreted to mean that an applicant must be able to identify the legal or equitable rights to be determined at trial in respect of which the final relief is sought,⁷⁹ or that an applicant must show 'a solid foundation ... giving rise to a serious dispute',⁸⁰ or an 'arguable case'.⁸¹

(e) *Notice.*

Either:

- (i) at least 14 days before making the application, the applicant gave written notice to the company of the intention to apply for leave and of the reasons for applying; or

⁷⁵ *Swansson* [2002] NSWSC 583 (Palmer J); *Talisman Technologies Inc v Queensland Electronic Switching Pty Ltd* [2001] QSC 324, cited in *Vinciguerra v MG Corrosion Consultants Pty Ltd* [2010] FCA 763, [121] (Gilmour J).

⁷⁶ *Companies Act 1965* (Malaysia) s 181B(4)(b).

⁷⁷ *Companies Act 1967* (Singapore) s 216A(3)(c).

⁷⁸ *Swansson* [2002] NSWSC 583, [25].

⁷⁹ *Ragless v IPA Holdings Pty Ltd (in liq)* (2008) 65 ACSR 700, [40] (Debelle, Sulan and Vanstone JJ); *Oates v Consolidated Capital Services Ltd* (2008) 66 ACSR 277.

⁸⁰ *BL & GY International Co Ltd v Hypec Electronics Pty Ltd* (2001) 19 ACLC 1622, 1638 [75].

⁸¹ *Mhanna v Sovereign Capital Ltd* [2004] FCA 1300, [31].

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(ii) it is appropriate to grant leave even though subparagraph (i) is not satisfied.⁸²

If the applicant fails to satisfy any of the above conditions the court must refuse the application.⁸³

The Australian provisions do not allow the views of parties outside the company to be taken into account at leave stage.⁸⁴ In the UK, following *Iesini*, the court took into account the fact that the directors had followed the advice of eminent professionals.

In Malaysia and Singapore there is no statutory provision equivalent to s 263(4) of the UK legislation. It is arguable, therefore, whether the court might take into consideration the views of members without a personal interest, directors, or any other outside parties. It may be recalled that the Court of Appeal in *Celcom* considered the views of the independent directors who relied on independent legal advice.

In Singapore the legislation states that the court must be satisfied that: (a) the complainant is acting in good faith, and (b) it appears, prima facie, in the interests of the company that the action should be brought.⁸⁵ On the first requirement of good faith, the approach taken by the Singapore courts is to assume that every party who comes to court with a reasonable and legitimate claim is acting in good faith unless proven otherwise by the defendant.⁸⁶

There must be a reasonable basis for the complaint and the intended action must be a legitimate or arguable one; that is, it has a reasonable semblance of merit and is not one which is frivolous, vexatious or bound to be unsuccessful.⁸⁷

Hostility between factions in itself is generally insufficient evidence of lack of good faith. Tay J in *Pang Yong Hock* summarised the requirement as follows:

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

⁸² *Corporations Act 2001* (Cth) s 237(2)(e).

⁸³ *Swansson* [2002] NSWSC 583, [24]; *Goozee v Graphic World Group Holdings Pty Ltd* (2002) 42 ACSR 534, [27]; *Vinciguerra v MG Corrosion Consultants Pty Ltd* [2010] FCA 763, [15].

⁸⁴ *Carpenter v Pioneer Park Pty Ltd* (in liq) [2004] NSWSC 1007, [16].

⁸⁵ *Companies Act 1967* (Singapore) s 216A(3)(b) and (c).

⁸⁶ *Agus Irawan* [2002] 2 SLR 198, approved by the Court of Appeal in *Pang Yong Hock* [2004] 3 SLR 1.

⁸⁷ *Teo Gek Luang v Ng Ai Tiong* [1999] 1 SLR 434; *Agus Irawan* [2002] 2 SLR 198; *Pang Yong Hock* [2004] 3 SLR 1; *Urs Meisterhans v GIP Pte Ltd* [2011] 1 SLR 552; *Fong Wai Lyn Carolyn v Airtrust (Singapore) Pte Ltd* [2011] 3 SLR 980 ('Fong Wai Lyn Carolyn').

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.⁸⁸

Only conduct related to the commencement of the derivative action is relevant to substantiate any alleged lack of good faith and past conduct of the applicant is irrelevant.⁸⁹

With regards to the second requirement that it appears *prima facie* to be in the interest of the company that the application for leave be granted, it was observed in *Agus Irawan* that the requirement of good faith overlaps with the second requirement. The second requirement was interpreted in that case to mean that the claim must have a reasonable semblance of merit. It was not necessary to prove that it was 'bound to succeed or likely to succeed but that if proved, the company will stand to gain substantially in money or money's worth'.⁹⁰ The phrase 'to gain substantially in money or money's worth' was clarified in *Pang Yong Hock* to be related to whether it is in the interests of the company to pursue the claim rather than whether the claim is meritorious or not.⁹¹

The availability of an alternative remedy (for example, the winding up of the company) may be a factor to be taken into consideration in deciding whether leave ought to be granted. In the case of *Pang Yong Hock* there was a deadlock in the management of the company and the company was not financially sound. The Court held that the appropriate remedy was to wind up the company and leave was refused. However, it is clear from the Singapore Court of Appeal's decision of *Ting Sing Ning (alias Malcolm Ding) v Ting Chek Swee (alias Ting Chik Sui)* [2008] 1 SLR 197 that the mere fact that an alternative remedy is available to the applicant is not sufficient ground for the court to refuse leave. The Court of Appeal pointed out that

⁸⁸ *Pang Yong Hock* [2004] 3 SLR 1, 7 [20].

⁸⁹ *Fong Wai Lyn Carolyn* [2011] 3 SLR 980.

⁹⁰ *Agus Irawan* [2002] 2 SLR 198, 203 [8].

⁹¹ *Pang Yong Hock* [2004] 3 SLR 1, 7-8 [21].

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in *Pang Yong Hock's* case, the applicant failed because he had not made out a *prima facie* case against the defendants to justify the court to grant leave, not because, as a matter of law, winding up was an alternative remedy.⁹²

A comparison of the provisions in Malaysia, the UK, Australia and Singapore relating to the leave criteria is given in *Table 2*.

Table 2: *Leave Criteria – Factors Which the Court Must Take into Account*

| |
|--|
| MALAYSIA |
| <p>Section 181B(4): whether</p> <ul style="list-style-type: none"> a) the complainant is acting in good faith, and b) it appears, <i>prima facie</i>, to be in the best interest of the company that the application be granted. |
| UNITED KINGDOM |
| <p>Section 263(2): whether</p> <ul style="list-style-type: none"> a) a person acting in accordance with the duty to promote the success of the company would not bring the claim, or b) the act/omission complained of has been authorised or ratified by the company. <p>If the above criteria are satisfied, the court will refuse permission to continue the claim.</p> <p>If the above criteria are not satisfied, the court must consider factors in s 263(3), that is, whether:</p> <ul style="list-style-type: none"> a) the member is acting in good faith in seeking to continue the claim, b) the importance that a person with the duty to promote the success of the company would attach to continuing, c) where an act/omission is yet to occur, whether it could be ratified by the company, d) where an act/omission has already occurred, whether it could be or would be likely to be ratified by the company, e) the company has decided not to pursue the claim, f) the act/omission gives rise to a cause of action that a member could pursue in their own right (that is, a personal action) rather than on behalf of the company. <p>Section 263(4): the court shall have particular regard to any evidence before it as to the views of independent members of the company who have no personal interests, direct or indirect, in the matter.</p> |

⁹² Ibid 8 [22]-[23].

| |
|---|
| AUSTRALIA |
| Section 237(2): whether a) it is probable that the company will not itself bring the proceedings, b) the applicant is acting in good faith, c) it is in the best interests of the company that the applicant be granted leave, d) there is a serious question to be tried, e) either: i) at least 14 days before the application, the applicant gave written notice to the company, or ii) it is appropriate to grant leave even though sub-para (i) is not satisfied. |
| SINGAPORE |
| Section 216A(3)(b) and (c): a) the complainant is acting in good faith, and b) it appears, prima facie, in the interest of the company that the application be brought. |

E Notice

The Malaysian provision requires the complainant to give 30 days' notice in writing to the directors of their intention to apply for leave.⁹³ However, where a complainant gives shorter notice, this will be regarded as a mere irregularity provided no injustice is caused to the defendants as a result of the short notice. This was so held in *Ng Hoy Keong v Chua Choon Yang* [2011] 4 CLJ 545, where the plaintiff gave only nine days' notice to the directors. In reaching this conclusion the Court made reference to the legislation in Hong Kong, Singapore and Canada. The Court said that the fact that this legislation has specific provisions to empower the court to grant abridgment of time or to dispense with the notice to appear reiterate the point that an application need not necessarily be shut out from obtaining this relief simply because it had not complied with the time specified for the giving of the relevant notice.

Where leave has been granted by the court, the complainant must commence the action within 30 days from the grant of leave.

In Australia the complainant must serve a written notice on the company, 14 days before making the application for leave, of their intention to apply for leave and the reasons for applying.⁹⁴ However, this requirement may be dispensed with if

⁹³ *Companies Act 1965* (Malaysia) s 181B(2).

⁹⁴ *Corporations Act 2001* (Cth) s 237(2)(e)(i).

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appropriate in the circumstances.⁹⁵ The courts are willing to grant leave even if the notice requirement has not been satisfied.⁹⁶

The Singapore legislation requires 14 days' notice to be given, to the directors of the company, of the complainant's intention to apply to the court for leave.⁹⁷ However, the court has the discretion to dispense with the notice requirement where the complainant can show why notice could not be given.⁹⁸ Hence, this is not an absolute rule and in cases where it is not practicable to give 14 days' notice, the complainant may give less notice or none at all before the application is made, as was held in the recent case of *Fong Wai Lyn Carolyn*. In this case Fong sought leave to pursue a derivative action under s 216A in the name of and on behalf of the first defendant, Airtrust, against the second defendant, Lynda Kao, who had been Airtrust's managing director since 1996, for breach of her fiduciary duties. The directors of Airtrust were given seven days' notice of Fong's leave application. Fong's reason was that such notice would have likely alerted Kao to impending discovery and would have spurred her to conceal assets or tamper with evidence. Despite there being no evidence of these allegations, the High Court held that insufficient notice did not jeopardise the pursuit of a statutory derivative action. To determine whether it was inexpedient to give notice, the court would look at the totality of circumstances. The scope of matters to be considered thus was not restricted to the state of affairs at the time of filing the application but, in addition, encompass the conduct of the parties after such an application had been brought to the notice of the company. The Court took into consideration that after the notice was received by the Airtrust board, no action or decision was made to pursue or investigate Fong's complaint or whether it would be in the best interests of Airtrust to take any action. The Court noted that the purpose of the notice period was to enable the directors of the company to evaluate and act on the complaint provided in the notice and that, in this case, it appeared that 'even if proper notice was given, this intention would not have been met'.⁹⁹

The requirement of notice does not feature in the UK legislation. However, as the company must be made a defendant to the claim, the complainant is required to forward to the company a copy of the claim form and the application by the complainant for the court's permission to continue the claim.

⁹⁵ Ibid s 237(2)(e)(ii).

⁹⁶ *Braga v Braga Consolidated Pty Ltd* [2002] NSWSC 603, [8]; *Prendergast v Daimler Chrysler Australia Pacific Pty Ltd* [2005] NSWSC 131, [100].

⁹⁷ *Companies Act 1967* (Singapore) s 216A(3)(a).

⁹⁸ Ibid s 216A(4).

⁹⁹ *Fong Wai Lyn Carolyn* [2011] 3 SLR 980, 990-91 [18].

F *Ratification*

The Malaysian legislation provides that if members of the company ratify or approve the conduct which is the subject matter of the action, this will not prevent the complainant from bringing the statutory derivative action. However, the court may take into account the ratification or approval in determining what order to make.¹⁰⁰

The Singapore provision is similar to the Malaysian legislation in that it provides that the fact that the alleged breach of a right or a duty owed to the company may be approved by members is not by itself sufficient for a stay or dismissal of the action, but it is a factor which the court may take into account when deciding whether to grant or refuse leave.¹⁰¹ The Australian provision on ratification is also similar to the Malaysia and Singapore provisions. This provision enables the court to inquire and ensure that the ratification is made by a fully informed meeting acting for a proper purpose and also avoids the complex question of whether a particular breach is ratifiable.¹⁰²

In contrast, in the UK the court will refuse permission to continue the claim for derivative action if it is satisfied that the act or omission complained of has been authorised or ratified by the company.¹⁰³ It also allows the court to consider whether ratification would be likely to occur.¹⁰⁴ However, the UK legislation prohibits self-interested members from participating in the ratification vote.¹⁰⁵ Hence, a director or member, who is directly or indirectly connected with the act or omission complained of, is prohibited from voting in the ratification. Such votes, if taken, will not count. A ratification obtained by such votes may be ineffective and disregarded by the court.

Thus, the fact that a wrong is capable of ratification but not yet ratified will not prevent a shareholder from commencing a derivative action in the UK. However, if there has been effective ratification, this would be a complete bar to the action. Reisberg argued that the issue of whether the ratification is effective will have to be considered by the court at the permission stage, and the difficult questions of 'control' which existed at common law will re-surface and dominate the hearing for

¹⁰⁰ *Companies Act 1965* (Malaysia) s 181D.

¹⁰¹ *Companies Act 1967* (Singapore) s 216B.

¹⁰² *Corporations Act 2001* (Cth) s 239.

¹⁰³ *Companies Act 2006* (UK) s 263(2)(c).

¹⁰⁴ *Ibid* s 263(3)(c).

¹⁰⁵ *Ibid* ss 180(4), 239.

leave.¹⁰⁶ In addition, courts will once again have to deal with the issue of which directors' duties are ratifiable and which are not.¹⁰⁷

G Costs

In Malaysia, where leave is granted, the law gives wide discretion to the court to make orders it thinks appropriate, including an order requiring the company to pay reasonable legal fees and disbursements incurred by the complainant in connection with the action, and also an order as to indemnification for costs.¹⁰⁸ Singapore has a similar provision.¹⁰⁹ An order for costs cannot then be ordered where leave is refused. Even where leave is granted, an order for costs is not automatically given but is left to the discretion of the court.

The law in the UK and Australia is more liberal in that the court has broad discretion to grant costs even if permission to continue the action is refused.¹¹⁰ The thinking behind this was that this will encourage shareholders' actions. In practice, English courts also have taken a very cautious approach in granting costs so as not to impose a potentially significant financial obligation on the company.¹¹¹ Similarly, in Australia where the leave application was successful, only in 21 per cent of the cases was the applicant granted costs.¹¹² In the other cases costs were reserved or not discussed at all. In none of these cases did the court grant costs in relation to the substantive litigation.

¹⁰⁶ Arad Reisberg, 'Derivative Claims Under the Companies Act 2006: Much Ado About Nothing?' in J Armour and J Payne (eds), *Rationality in Company Law: Essays in Honour of D D Prentice* (Hart Publishing, 2008).

¹⁰⁷ A J Boyle, 'The New Derivative Action' (1997) 18 *Company Lawyer* 256, 258.

¹⁰⁸ *Companies Act 1965* (Malaysia) s 181E.

¹⁰⁹ *Companies Act 1967* (Singapore) s 216A(5)(c).

¹¹⁰ *Companies Act 2006* (UK) s 261; *Corporations Act 2001* (Cth) s 242.

¹¹¹ *Stainer v Lee* [2010] EWHC 1539 (Ch) [55], [56]; *Kiani v Cooper* [2010] BCC 463; *Callise & Cumbria United Independent Supporters' Society Ltd v CUFC Holdings Ltd* [2010] EWCA Civ 463.

¹¹² Research in Australia has found that the Australian statutory derivative action has not resulted in a greater increase of judgments than the common law action which it replaced. In a large number of cases the applicant was able to satisfy the criteria for leave and leave was granted by the court. This appears to suggest the leave criteria did not present an insurmountable difficulty for the applicants, but the uncertainties in the law relating to costs may well discourage a shareholder in bringing a statutory derivative action: I Ramsay and B Saunders, 'Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action' (Research Report, Centre for Corporate Law and Securities Regulation, University of Melbourne, 2006) 35.

The potentially enormous costs incurred by minority shareholders for enforcing a corporate right is probably the biggest disincentive for minority shareholders, but the Malaysian court's discretion to make an order for the complainant's costs can only be made when the court grants leave.¹¹³ There is a possibility that where the application for leave is unsuccessful the complainant may have to bear not only his but the defendant's costs as well. This was what happened to the complainant in *Celcom*. It might therefore be preferable for the statute to specifically provide that costs be granted as of right to a successful applicant, but even where leave is refused the courts should still have discretion to grant costs where appropriate.

An issue closely related to cost is the length of time it takes to complete even the leave stage. In *Celcom* the petition was filed in 2008. An order for leave was granted by the High Court later the same year, but the appeal process took another two years to complete. The time it takes for the leave stage and the full trial, together with the appeal process, will deter all but the most determined minority shareholders.

H Evidence

The new statutory provisions now give courts the discretion to make orders or directions that the company supply further information or evidence relating to the suit and for proceedings to be adjourned for this purpose.

The Malaysian law provides that the court may make such orders as it thinks appropriate for any person to provide assistance and information to the complainant, including allowing inspection of company's books.¹¹⁴ The court has the power to adjourn the proceedings to allow it to give directions for the conduct of the proceedings.¹¹⁵

The UK law allows the court to 'give directions as to evidence to be provided by the company' and 'adjourn the proceedings to enable evidence to be obtained'.¹¹⁶

In Singapore the law gives the court power to make such orders as it thinks fit in the interests of justice. This may include giving the complainant access to the company's records in order to gather the evidence for the action against the wrongdoers.¹¹⁷

The Australian legislation allows the court to make any orders or directions it considers appropriate in relation to an application for leave or proceedings brought

¹¹³ *Companies Act 1965* (Malaysia) s 181E(1)(e).

¹¹⁴ *Companies Act 1965* (Malaysia) s 181E(1)(c).

¹¹⁵ *Ibid* s181E(1)(b).

¹¹⁶ *Companies Act 2006* (UK) s 261(3).

¹¹⁷ *Companies Act 1967* (Singapore) s 216A(5).

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pursuant to a successful application.¹¹⁸ In particular, the court is empowered to appoint an independent person to investigate and report to the court as to the company's financial position, the facts and circumstances giving rise to the cause of action, and the costs involved in the proceedings. To ensure such an investigator may effectively carry out his or her duties, the investigator is conferred the right to inspect books of the company.¹¹⁹ This will ensure that the court makes its decision based on independently provided information.¹²⁰

IV CONCLUSION

It is generally accepted that the statutory derivative action has increased the scope of shareholder intervention and is thus a valuable tool to deter managerial misconduct. However, in terms of statutory drafting (at least in the Malaysian context) there is room for improvement. The late Professor Gower noted more than fifty years ago that no one who reads the *Companies Act 1965* (Malaysia) can 'really understand it unless he is reasonably familiar with those decided cases.'¹²¹ This, he explained, was because

[m]any of the most vital principles are never embodied in the Act at all, though often exceptions from them and corollaries to them are stated. It presupposes the basic principles which it never states.¹²²

This observation might have been made in reference to the Malaysian statutory derivative action. The idea and purpose of the provision is not easily understood without a basic understanding of the common law derivative action and reference to foreign legislation and case law. The law is silent on what a derivative action is and the circumstances when it can be brought; it gives only vague guidance on when leave is or is not to be granted and when the court can make an order for costs. The preservation of the common law derivative action makes it even more confusing for many.¹²³

¹¹⁸ *Corporations Act 2001* (Cth) s 241.

¹¹⁹ *Ibid* s 241(2).

¹²⁰ Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998 (Cth) [6.62]-[6.64].

¹²¹ LCB Gower, 'Company Law Reform' (1962) *Malaya Law Review* 36, 38.

¹²² *Ibid*.

¹²³ *Companies Act 1965* (Malaysia) s 181A(3). There is to date one reported decision on the common law derivative action since the statutory derivative action was introduced: *Ho Hup Construction Company Bhd v Bukit Jalil Development Sdn Bhd* [2011] 1 AMCR 86.

One can reasonably expect a clearer understanding after the passage of time when more cases have been decided, reported, analysed, and commented upon. In the meantime, the lack of legislative guidance means that the propensity of Malaysian courts to rely on foreign court decisions will continue.¹²⁴ While there could be arguments in favour of legal borrowings, especially in the ever shrinking world, this may lead to confusion when foreign precedents are applied with little regard to the differences in the local statute. In *Celcom*, for example, the Court of Appeal relied on foreign cases to determine the threshold test at the leave stage without drawing a distinction between the words used in the various legislation.

As in the UK, the Malaysian legislation improves on the common law derivative action in that the test for leave is more certain, although more legislative guidance on the leave criteria and the issue of costs could promote more certainty. Also, as evidenced especially from *Celcom*, a conservative approach has made it difficult for shareholders to succeed.¹²⁵

¹²⁴ This was highlighted in the context of the shareholders oppression remedy: see M R Salim and P Lawton, 'The Law in a Post-Colonial State: The Shareholders Oppression Remedy in Malaysia' 28(1) *Global Jurists (Frontiers)* 1.

¹²⁵ This was also the case in the UK; however this was a result of the UK legislation which created barriers for the complainant: Arad Reisberg, 'Derivative Claims under the Companies Act 2006: Much Ado about Nothing?' in Armour and Payne, above n 106.