A Practical Guide to Resolving Shareholder Disputes

Second Edition

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despite occasional divergent views on matters of management and strategy among us, such differences never shook our mutual trust and respect,nor impeded the continual growth of the firm. We thank our partners for their support and encouragement in the production of this work, and the dedicated staff members, particularly Ivy Wang and Wai-Sum Leong, who have assisted in the research and drafting for the book. We are also very grateful to Mr Anthony Rogers, QC, who has kindly reviewed the work, given us invaluable suggestions, and written a foreword for us. All mistakes remain ours.

We have sought to accurately state the law as at October 2020.

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(3) Scenario 3: a shareholder of the company may intervene in the proceedings before the court for the purpose of continuing, discontinuing or defending the proceedings on behalf of the company, if the company fails to diligently continue, discontinue or defend the proceedings because of misconduct committed against the company.[16]

[1-19] The shareholder has to show that:

(1) on the face of the application, it appears to be in the interest of the company that leave be granted to the shareholder;[17] and

(2) there is a serious question to be tried and that company has not brought the proceedings itself (under Scenarios 1 and 2 in **[1-18]**),[18] or the company has not diligently continued, discontinued or defended the proceedings (under Scenario 3 in **[1-18]**).[19]

3.1.1 Appears to be in the company's interest

[1-20] It is well-established that the threshold for the 'interest of the company' criterion is low and requires only the presence of an arguable case when determining whether the shareholder's proposed action is prima facie in the interests of the company. In *Re Li Chung Shing Tong (Holdings) Ltd*,[20] Harris J agreed that the plaintiffs were only required to surmount a relatively low threshold to satisfy the 'interest of the company' criterion. His Lordship also held that:

> I accept that in most cases if a 'serious question to be tried' has been demonstrated it will follow that it is *prima facie* in the interests of the company that proceedings are pursued and the converse, of course, will also be true.[21]

[1-21] It should also be noted that the definition of 'misconduct' under section 732 is quite wide and encompasses 'fraud, negligence, breach of duty, or default in compliance with any Ordinance or rule of law'.[22]

[1-22] However, it is also recognised that 'a company might have sound business reasons for not pursuing a cause of action open to it and that its management might legitimately have decided that the ... interests of the

16 Companies Ordinance, s 732(3).
17 Companies Ordinance, s 733(1)(a).
18 Companies Ordinance, s 733(1)(b)(i).
19 Companies Ordinance, s 733(1)(b)(ii).
20 *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKC 531, [2011] 5 HKLRD 274 (CFI).
21 *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKC 531, [2011] 5 HKLRD 274 (CFI) at para [26].
22 Companies Ordinance, s 731.

company would be served by not taking action'.[23] The relevant factors that the court would take into account in determining whether the proceedings would be in the interests of the company include but are not limited to the character of the company,[24] the effect of the proposed litigation on the business of the company,[25] the ability of the defendant to meet at least a substantial part of any judgment in favour of the company in the proposed derivative action and etc.[26]

[1-23] If the board has made a bona fide commercial decision that it is not in the interests of the company that proceedings be commenced, then the board's view should be given considerable weight and the court generally would be slow to override that decision.[27] But when the prospective claim is against a director, the board's view is of less significance, although each case would turn on its own facts.

3.1.2 Serious question to be tried

[1-24] In the case of *Re Li Chung Shing Tong (Holdings) Ltd*,[28] Harris J observed that in most cases one would expect that this criterion be examined first because if it could not be satisfied it would normally necessarily follow that it was not in the interest of the company to commence proceedings. This criterion was 'likewise of a relatively low threshold'.[29] Prospects of the plaintiff's success were to be investigated only to a limited extent and the court should be slow to find against the plaintiffs unless their prospects were so dim that they could not be said to have any expectation but only a hope of success.[30] In *Mothercare Ltd v Robson Books Ltd*,[31] Megarry V-C explained:

23 *Fiduciary Ltd v Morningstar Research Pty Ltd* [2005] NSWSC 442, [2005] 53 ACSR 732 at 742.
24 For example, see *Swansson v RA Pratt Properties Pty Ltd* [2002] NSWSC 583, (2002) 42 ACSR 313.
25 For example, see *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKC 531, [2011] 5 HKLRD 274 (CFI).
26 For example, see *Carpenter v Pioneer Park Pty Ltd (in liq)* [2004] 211 ALR 457 at 465.
27 *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKC 531, [2011] 5 HKLRD 274 (CFI).
28 *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKC 531, [2011] 5 HKLRD 274 (CFI).
29 *Re F&S Express Ltd* [2005] 4 HKLRD 743 at 746E–747D, [2005] HKCU 1759 (CFI); *Re Lucky Money Ltd & Ors* [2006] HKCU 1230 (unreported, HCMP 505/2006, 18 July 2006) (CFI) at paras 40–42; *Re Myway Ltd v Chan Kai Wing & Anor* [2008] 3 HKLRD 614 at 622–624, [2008] HKCU 629 (CFI); *Re Grand Field Group Holdings Ltd* [2009] 3 HKC 81 (CFI) at 86; *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKC 531, [2011] 5 HKLRD 274 (CFI) at paras 32–34.
30 *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKC 531, [2011] 5 HKLRD 274 (CFI) at para 33.
31 *Mothercare Ltd v Robson Books Ltd* [1979] FSR 466.

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... the prospects of the plaintiff's success are to be investigated to a limited extent, but they are not to be weighed against his prospects of failure. All that has to be seen is whether the plaintiff has prospects of success which, in substance and reality, exist. Odds against success no longer defeat the plaintiff, unless they are so long that the plaintiff can have no expectation of success, but only a hope. If his prospects of success are so small that they lack substance and reality, then the plaintiff fails; for he can point to no question to be tried which can be called 'serious', and no prospect of success which can be called 'real'.

[1-25] Kwan J (as she then was) held in *Re F&S Express Ltd* that the court:

will not normally enter into the merits of the proposed derivative action to any great degree" to determine whether there is a serious question to be tried, and the applicant has "the same relatively low threshold to surmount as in the case of an application for an interlocutory injunction.[32]

3.1.3 Intervening in ongoing proceedings

[1-26] A shareholder may only intervene in an ongoing proceeding commenced by the company if there is evidence that the company has failed to diligently continue, discontinue or defend the action.[33] In such cases, the court must additionally be satisfied that it would be in the company's interests for the shareholder to take over the conduct of the proceeding against the wishes of its board of directors. In *Hou Hsiao Bing v China Technology Solar Power Holdings Ltd*,[34] although the court accepted that the company has not pursued the action as diligently as it should have, the shareholder was unable to show that the board of directors as a whole has not acted bona fide, has a conflict of interest or has been motivated by any improper purpose. The court made clear that cogent evidence of this sort is required if a shareholder wishes to intervene in proceedings which have already commenced and which are in progress to succeed.

[1-27] However, in the Singapore case of *Chong Chin Fook v Soloman Alliance Management Pte Ltd*,[35] the Singapore Court of Appeal clarified that the shareholder need only show that it is probable that the company would not diligently prosecute or defend the action; it is not necessary to show actual lack of diligence since that would set the bar too high. The relevant considerations for deciding whether the 'probable' threshold is met include the steps already taken by the company to prosecute the case and the degree of the directors' conflicting interests. In *Chong Chin Fook*, the court granted the shareholder's application to take control of an ongoing proceeding

32 *Re F&S Express Ltd* [2005] 4 HKLRD 743, [2005] HKCU 1759 (CFI). Applying *Swansson v RA Pratt Properties Pty Ltd* [2002] NSWSC 583, (2002) 42 ACSR 313.
33 Companies Ordinance, s 732(3).
34 *Hou Hsiao Bing v China Technology Solar Power Holdings Ltd* [2020] HKCU 4156, [2020] HKCFI 2957.
35 *Chong Chin Fook v Soloman Alliance Management Pte Ltd* [2017] 1 SLR 348.

because there was clear evidence that the directors were materially conflicted and hence unlikely to diligently prosecute the action.

3.1.4 Indemnity of costs

[1-28] The court may make an order that costs incurred by shareholder in such application for leave to bring derivative action and in any proposed proceedings brought or intervened by the shareholder to be paid and indemnified by the company[36] provided that it is satisfied that the shareholder was acting in good faith and had reasonable grounds for bringing or intervening in the proceedings or making the application.[37]

[1-29] Two questions will generally be relevant to the issue of whether the applicant is acting in good faith: firstly whether the applicant honestly believes that a good cause of action exists and has reasonable prospects of success; and secondly whether the applicant is seeking to act in the derivative capacity for such a collateral purpose as would amount to an abuse of process.[38]

[1-30] There are reasonable grounds, if legal action was a reasonable and prudent course to take in the circumstances and the company should indemnify the plaintiff against legal costs incurred by him on the company's behalf.[39]

[1-31] In *Re Li Chung Shing Tong (Holdings) Ltd*,[40] the plaintiff's minority shareholders sought an order that costs incurred by them in that application and the proposed proceedings should be paid and indemnified by the company. Having regard to the company's financial position, Harris J held that it would not be appropriate at that stage to make such an order, but the plaintiffs could renew that part of their application when they were able to put forward further information regarding costs of the proceedings and financial state of the company which could justify further consideration of this issue.

36 Companies Ordinance, s 738(1).
37 Companies Ordinance, s 738(3). In Singapore, the shareholder's good faith is a substantive requirement that has to be satisfied before leave is granted to the shareholder to bring a statutory derivative action: see s 216A(3)(b) of the Companies Act 1967 (Singapore). However, the jurisprudence as to what constitutes good faith appears to be similar to that in Hong Kong: see *Ang Thiam Swee v Low Hian Chor* [2013] 2 SLR 340.
38 *Swansson v RA Pratt Properties Pty Ltd* [2002] NSWSC 583, (2002) 42 ACSR 313.
39 *Wallersteiner v Moir (No 2)* [1975] QB 373, [1975] 1 All ER 849, [1975] 2 WLR 389 (CA, Eng); *Jaybird Group Ltd v Greenwood* [1986] BCLC 319.
40 *Re Li Chung Shing Tong (Holdings) Ltd* [2011] 5 HKC 531, [2011] 5 HKLRD 274 (CFI).

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[1-32] In *Re Grand Field Group Holdings Ltd*,[41] the plaintiff sought an order that the costs of the application be indemnified by the company. However, Kwan J (as she then was) held that she considered it would be more appropriate to defer the determination of costs in these circumstances as it would be better to look at the whole picture in exercising the discretion to award costs in that complex dispute, so as not to fetter the court's discretion in any way, particularly as this involves awarding costs on an indemnity basis.[42] She therefore ordered that the costs of the application for leave to commence derivative action are also to be deferred.[43]

[1-33] In *Re F&S Express Ltd*,[44] Kwan J made an order for costs of the leave application and indicated that before making an indemnity costs order in relation to the derivative action, the court had to be satisfied as to the company's ability to pay such costs.

3.2 Common law derivative action

[1-34] It should be noted that the statutory provisions governing derivative actions in the Companies Ordinance (Cap 622) are not meant to completely replace and abolish common law derivative action. As sections 732(6) and 736 make clear, it is still possible for a minority shareholder to bring a derivative action under common law, although such action may be ordered to be amended or stayed or even dismissed by the court if such minority shareholder also brings a statutory derivative action, as discussed below.

[1-35] In paras 13–14 of the Court of Final Appeal's decision in *Waddington Ltd v Chan Chun Hoo*,[45] Mr Justice Ribeiro PJ gave a helpful description of the common law derivative action regime in Hong Kong:

> The derivative action is a procedural device invented by the courts to afford protection to the minority. Procedurally, there is no requirement at common law for a person seeking to sue derivatively first to obtain the leave of the court. But it does not follow from this that there is no threshold requirement to be met by the plaintiff. Substantively, such an action is only permitted where it can prima facie be shown that there exists a viable cause of action or equitable claim vested in the company which, if made good, would establish a fraud on the minority; as well as control of the company by the alleged wrongdoers such as to enable them to stifle any proposed action against themselves.

[1-36] The most common exception to the rule of *Foss v Harbottle* is where the wrongdoers commit a fraud and are themselves in control of the company. In such circumstances, a shareholder is entitled to bring

41 *Re Grand Field Group Holdings Ltd* [2009] 3 HKC 81 (CFI).
42 *Re Grand Field Group Holdings Ltd* [2009] 3 HKC 81 (CFI) at para 54.
43 *Re Grand Field Group Holdings Ltd* [2009] 3 HKC 81 (CFI) at para 55.
44 *Re F&S Express Ltd* [2005] 4 HKLRD 743, [2005] HKCU 1759 (CFI).
45 *Waddington Ltd v Chan Chun Hoo* [2009] 4 HKC 381, (2008) 11 HKCFAR 370 (CFA).

a common law derivative claim on behalf of and for the benefit of the company.

[1-37] The notion of fraud in this context includes equitable fraud, the essential concept of which is abuse or misuse of power. At para 13 of *Kim Sie Joong v Ng Cheuk Ngon*,[46] Deputy Judge Muttrie held that fraud does not simply mean deceit but also includes breaches of the director's fiduciary duties, such that 'the directors use their powers intentionally or unintentionally, fraudulently or negligently in a manner which benefits themselves at the expense of the company'.[47]

[1-38] For example, in *Tan Eng Guan v Southland Co Ltd*,[48] the director misused the company's assets by making interest-free loans to himself and other corporate defendants in which he was interested. The court noted that while such conduct does not amount to fraud strictly so-called, the court can nonetheless entertain a derivative action founded on fraud on minority.

[1-39] In *Harris v Microfusion 2003-2 LLP & Ors*,[49] the English court held that the fraud on minority exception applies to cases of actual fraud or in the absence of actual fraud, the alleged wrongdoing must have resulted in loss to the company and personal gain by the wrongdoer. In *Wang Pengying v Ng Wing Fai*,[50] the Hong Kong Court of Appeal clarified that the appropriate test for the purposes of the fraud on minority exception lies not in the requirements of loss to the company and personal benefit to the wrongdoers, but in whether the company (in general meeting, *ex hypothesi* by a majority) can lawfully release the directors from that breach. In particular, Yuen JA explained that under the test, a plaintiff must adduce evidence to the prima facie case standard that the vote by the company in general meeting releasing the directors was not a bona fide exercise of shareholders' voting power. In this respect, it may reasonably be assumed that a director in breach of duty would, when voting as a shareholder, vote to exonerate himself, and hence his power to vote would not be exercised bona fide for the proper purpose. Whether that could be ascribed to other shareholders forming the majority who are not themselves in breach of duty would depend on the facts, including whether there is any evidence that the shareholders had voted (or would vote) simply as the directors directed.

46 *Kim Sie Joong v Ng Cheuk Ngon* [2003] HKCU 1275 (unreported, HCA 552/2002, 18 November 2003) (CFI).
47 *Daniels v Daniels* [1978] Ch 406, [1978] 2 All ER 89, [1978] 2 WLR 73.
48 *Tan Eng Guan v Southland Co Ltd* [1996] 2 HKC 100, [1996] 2 HKLR 117 (CA).
49 *Harris v Microfusion 2003-2 LLP & Ors* [2016] EWCA Civ 1212, [2017] All ER (D) 32 (Jan).
50 *Wang Pengying v Ng Wing Fai* [2021] 4 HKC 1, [2021] HKCA 100.

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[1-40] In addition to fraud, it is necessary for the member to also plead and prove control of the company by the wrongdoer. Control, for this purpose, is not determined by the percentage of its shareholdings. Rather, as Knox J put it in *Smith v Croft (No 2)*,[51] the essential question to be asked is whether the company is being prevented from pursuing a claim which the company legitimately had. Therefore, the element of control is established if the company is deadlocked in that two beneficial shareholders control 50% of the shares of the company each.[52]

[1-41] A similar approach was adopted in *Waddington Ltd v Chan Chun Hoo*,[53] in which the Court of Appeal rejected the view that it is always necessary to establish that the wrongdoers themselves hold at least 50% of the voting rights. Rather, the court took the view that the more flexible concept of de facto control should be adopted and stated that control is a practical matter and what amounts to control would vary with the circumstances of each company.

[1-42] The common law derivative action has long been criticised as being 'complex and arcane'[54] and 'greater transparency in the requirements for a derivative action is highly desirable'.[55] Upon introducing the statutory derivative regime, some jurisdictions completely abolished the common law regime.[56] However, the common law derivative action regime is preserved in Hong Kong. The preservation, according to the Legislative Council Brief, seems to cater for foreign companies controlled by Hong Kong residents.[57] The position is similar in Singapore, where it has been held that the statutory derivative action applies only to Singapore-incorporated companies.[58] Hence, shareholders who wish to bring derivative actions in respect of foreign-incorporated companies will have to utilise the mechanism available at common law.

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51 *Smith v Croft (No 2)* [1988] Ch 114, [1987] 3 All ER 909, [1987] 3 WLR 405.
52 See *Anglo-Eastern (1985) Ltd v Knutz & Ors* [1987] 3 HKC 80, [1988] 1 HKLR 322 (CA).
53 *Waddington Ltd v Chan Chun Hoo* [2006] 2 HKLRD 896, [2006] HKCU 859 (CA).
54 Sarah Watkins, 'The Common Law Derivative Action: An Outmoded Relic?' (1999) 30 Cambrian Law Review at 40.
55 English Law Commission Report (No 246) at para 6.4.
56 See, for example, s 236(3) of the Corporations Act 2001 (Australia). In the UK, it has been held that common law actions may still be brought in respect of double or multiple derivative actions as s 260(2) of the Companies Act 2006 (UK) only has the effect of abolishing 'ordinary' derivative action at common law that are brought by a shareholder of the company for whose benefit the action is brought: see *Universal Project Management Services Ltd v Fort Gilkicker Ltd* [2013] EWHC 348 (Ch), [2013] Ch 551, [2013] 3 All ER 546.
57 See Bills Committee of the Legislative Council, Report on Companies (Amendment) Bill 2003, LC Paper No CB(1) 2264/03-04 (Printing Department 30 June 2004) at paras 126–129.
58 *Sinwa SS (HK) Co Ltd v Morten Inhaug* [2010] 4 SLR 1.

[1-43] Further, by preserving the common law action, the legislative framework in Hong Kong contemplates that a shareholder of a Hong Kong company may choose to utilise either the common law or statutory action. This may be inferred from section 736, which explicitly provides for a situation where a member commences a common law derivative action even when a statutory action is available. In other jurisdictions, the position is less clear when the statutory provisions do not explicitly recognise the co-existence of common law actions.[59] Practically speaking, however, it is unlikely that shareholders would choose such a course since the onus of proof is usually lighter under the statutory regime.

[1-44] As discussed above, leave must be sought before the commencement of statutory derivative claim. The fact that no leave is required to bring a common law derivative action, however, does not necessarily mean that there is no threshold whatsoever. In fact, in *Waddington Ltd v Chan Chun Hoo*,[60] the Court of Final Appeal held that in a common law derivative action, the plaintiff is required to show a prima facie case that the company is entitled to the relief claimed and that the action falls within an applicable exception to the *Foss v Harbottle* rule, when his *locus* to sue derivatively on behalf of the company is challenged.

[1-45] However, it should be noted that the member is not allowed to bring both a common law and statutory derivative action in respect of the same matter. If the court has allowed a statutory derivative action to proceed, the court may strike out any common law action subsequently commenced by the plaintiff.[61] In a similar vein, the court may refuse to grant leave to bring statutory derivative action if the court is satisfied that the member has, in the exercise of any common law right, brought proceedings on behalf of the company in respect of the same cause or matter.[62] In *Waddington Ltd v Chan Chun Hoo*,[63] the Court of Final Appeal noted that there is no express provision relating to the situation where a common law derivative action is instituted after statutory leave has been refused and the converse situation of seeking leave after a common law derivative action has been struck out. The Court of Final Appeal stated that:

> where a party seeks to take advantage of the availability of both the statutory and the common law derivative action, the court should exercise its powers, both

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59 In Singapore, there is uncertainty as to whether a shareholder may bring a common law derivative action when a statutory action is available: see *Petroships Investment Pte Ltd v Wealthplus Pte Ltd* [2016] 2 SLR 1022 at paras 64–72.
60 *Waddington Ltd v Chan Chun Hoo* [2009] 4 HKC 381, (2008) 11 HKCFAR 370 (CFA) at para 67.
61 Companies Ordinance, s 736.
62 Companies Ordinance, s 733(2).
63 *Waddington Ltd v Chan Chun Hoo* [2009] 4 HKC 381, (2008) 11 HKCFAR 370 (CFA).

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express and inherent, to prevent the abuse of the court's process and to ensure that the dispute is resolved fairly and expeditiously without unnecessary procedural complications.[64]

3.3 Double or multiple derivative actions

[1-46] A double derivative action refers to the situation where a member of Company A, which in turn is a member of Company B, seeks to bring a derivative action on behalf of Company B. For example, where the controllers of the parent company perpetrate a wrong on the subsidiary, then prima facie the controllers could prevent the subsidiary from taking actions against themselves, and moreover there would be no minority member in the subsidiary to bring a derivative action on its behalf.

[1-47] Moreover, the minority member in the parent company is debarred from suing to recover a loss of the parent company which is merely a reflection of the loss suffered by the subsidiary, though he could seek to recover the loss directly suffered by the subsidiary.[65]

[1-48] In *Universal Project Management Services Ltd v Fort Gilkicker Ltd*,[66] the Chancery Division of the English High Court confirmed that double derivative actions at common law were not abolished upon the coming into force of the English statutory regime. Briggs J stated the following:

> Once it is recognized that the derivative action is merely a procedural device designed to prevent a wrong going without a remedy … then it is unsurprising to find the court extending locus standi to members of the wronged company's holding company, where the holding company is itself in the same wrongdoer control.

[1-49] Likewise, in *Waddington Ltd v Chan Chun Hoo Thomas*,[67] the Court of Final Appeal held that multiple derivative actions can be brought under common law in Hong Kong. Lord Millet NPJ noted that the very same reasons which justify a single derivative action also apply to the case of multiple derivative action. If wrongdoers must not be allowed to defraud a parent company with impunity, they must not be allowed to defraud its subsidiary with impunity. His Lordship emphasised that the

64 *Waddington Ltd v Chan Chun Hoo* [2009] 4 HKC 381, (2008) 11 HKCFAR 370 (CFA).

65 See *Landune International Ltd v Cheung Chung Leung* [2006] 1 HKLRD 39, [2006] HKCU 61 (CA); see **[1-59]** et seq. for discussion of the rule against recovery of reflective loss.

66 *Universal Project Management Services Ltd v Fort Gilkicker Ltd* [2013] EWHC 348 (Ch), [2013] Ch 551, [2013] 3 All ER 546.

67 *Waddington Ltd v Chan Chun Hoo Thomas* [2009] 4 HKC 381, (2008) 11 HKCFAR 370 (CFA).

question of whether a derivative action can be brought is simply a question of the plaintiff's standing to sue:

> On a question of standing, the court must ask itself whether the plaintiff has a legitimate interest in the relief claimed sufficient to justify him in bringing proceedings to obtain it. The answer in the case of a person wishing to bring a multiple derivative action is plainly 'yes'. Any depletion of a subsidiary's assets causes indirect loss to its parent company and its shareholders.

The Court of Final Appeal expressed hope that there would be legislative change in due course creating a statutory mechanism for multiple derivative actions.

[1-50] The law was subsequently changed to confirm the Court of Final Appeal's decision. First introduced in amendments to the former Companies Ordinance (Cap 32) in 2010, it is now possible for double or multiple derivative actions to be brought under statute.[68] The standing to apply for leave to bring a statutory derivative action or to intervene proceedings on behalf of the company has been extended to members of an associated company, which includes a subsidiary of the body corporate, a holding company of the body corporate, or a subsidiary of such a holding company.

3.4 Derivative actions and liquidation

[1-51] It is well-established that a common law derivative action may not be brought where a company is in liquidation. The rationale behind is that the company is no longer in control of the alleged wrongdoers, in which event the reason for any exception to the rules in *Foss v Harbottle* disappears.

[1-52] As Barma J put in *Grand Gain Investment Ltd v Cosimo Borrelli & Anor*,[69] when a company is in liquidation, control of its affairs passes from its directors to its liquidators:

> Where the company is still operating, it may be possible for an aggrieved shareholder to pursue a cause of action on its behalf by way of a derivative action where the company itself fails to do so. Where the company is in liquidation, a derivative action will no longer be available. However, a shareholder or creditor then has available to him the remedy provided by s 276 of the Companies Ordinance (Cap 32).

[1-53] This is the case even if the company was not in liquidation at the time the derivative action was commenced. Once a company goes into liquidation, there is no wrongdoer control and the decision whether

68 Companies Ordinance, s 732, predecessor Companies Ordinance (Cap 32), ss 168BC–168BK.

69 *Grand Gain Investment Ltd v Cosimo Borrelli & Anor* [2006] HKCU 872 (unreported, HCCW 334/2004, 1 June 2006) (CFI) at para 54.

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to continue with the action should best be left to the judgment of an independent liquidator.[70] In *Re Shun Kai Finance Co Ltd*,[71] a common law derivative action was brought on behalf of a company of which the liquidator was a director in respect of an alleged wrong by the liquidator to the company, the Judge at first instance dismissed the claim against the liquidator for the reason that a claim against a liquidator did not fall within an exception to the rule in *Foss v Harbottle*.

[1-54] On appeal, the Court of Appeal upheld the Judge's decision. However, the Court of Appeal observed, without deciding that leave might be granted to bring a statutory derivate action notwithstanding that the company was in liquidation, because the wrongdoer control requirement for a common law derivative action is not a preclusive condition for the bringing of a statutory derivative action. The court, however, did not come to a firm view as to whether a statutory derivative action is available where the company is in liquidation.

[1-55] In Singapore, there are few occasions when shareholders seek derivative actions after a company has been placed in liquidation. In *Petroships Investment Pte Ltd v Wealthplus Pte Ltd*,[72] the Singapore Court of Appeal held that a member could not seek leave to bring a statutory derivative action after the company had been placed under member's voluntary winding up, observing that derivative actions were typically sought in respect of companies that were going concerns. The court reasoned that the statutory action was not needed in liquidation cases as was no risk of the company being in wrongdoer control. Once a company goes into litigation, the board's management power is ceded to the liquidator who is duty bound to act impartially and is empowered to unilaterally bring or defend legal proceedings. If the liquidator fails to act in the company's interests, an aggrieved shareholder has various avenues for redress under the relevant companies legislation and at common law. Likewise, other jurisdictions such as the United Kingdom and Australia have confined statutory derivative actions to companies that are going concerns.[73]

4. Members' Personal Actions

[1-56] Where a wrong is done which infringes the personal rights of a member, the rule in *Foss v Harbottle* is inapplicable, because the rights

70 See *Ever Joint (Holdings) Ltd v Nice Theme Ltd & Ors* [2007] 2 HKC 101, [2006] 4 HKLRD 516 (CFI).
71 *Re Shun Kai Finance Co Ltd* [2015] 2 HKC 403, [2015] 2 HKLRD 264 (CFI).
72 *Petroships Investment Pte Ltd v Wealthplus Pte Ltd* [2016] 2 SLR 1022.
73 See, for example, *Cinematic Finance Ltd v Dominic Ryder* [2010] EWHC 3387 (Ch), [2010] All ER (D) 283 (Oct); *Hedley v Albany Power Centre Ltd (in liq)* [2005] 2 NZLR 196; and *Chahwan v Euphoric Pty Ltd* [2008] NSWCA 52.

forming the subject matter of the claim are simply not vested in the company. In *Edwards v Halliwell*,[74] Asquith LJ emphasised:

> When in circumstances such as I have described a remedy is sought by an individual, complaining of a particular act in breach of his rights and inflicting particular damage on him, it seems to me the principle of *Foss v Harbottle* ... does not apply either by way of barring the remedy or supporting the objection that the action is wrongly constituted because the union is not a [claimant].

[1-57] Personal rights of members can arise pursuant to the company's articles of association, common law, shareholders' agreements and statute. The main statutory provisions conferring personal remedies on members are the provisions on unfair prejudice[75] and winding up on just and equitable grounds.[76] Other statutory protections for members include, among others, provisions enabling members to obtain access to company records.[77]

[1-58] Before discussing these remedies, it is necessary to first consider the restriction on the ability of members to bring personal action where the loss of the individual shareholders is merely reflecting the loss of the company.

4.1 Rule against reflective loss

[1-59] According to the 'no reflective loss' principle, a shareholder may not claim for a loss that is merely reflective of a loss suffered by the company, ie, a loss that would be made good if the company had pursued and enforced its rights in full against its debtor, even if the company, acting through its constitutional organs, has declined or failed to make good that loss.[78] The shareholders' rights stem from the company's articles. They have no interest in the assets of the company. The most they have is a right to receive a share of the proceeds upon a solvent liquidation of the company.

[1-60] In *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)*,[79] members of the defendant company had approved in general meeting of an acquisition of the assets of another company, in which its director was substantially interested. The shareholders' approval was given on the basis of a circular which was alleged to be fraudulent and misleading. The

74 *Edwards v Halliwell* [1950] 2 All ER 1064 (CA, Eng).
75 Companies Ordinance, Pt 14, Div 2.
76 Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32), s 177(1)(f).
77 Companies Ordinance, Pt 14, Div 5.
78 *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1, [2001] 1 All ER 481, [2001] 2 WLR 72 (HL).
79 *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204, [1982] 1 All ER 354, [1982] 2 WLR 31 (CA, Eng).

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claimants brought a derivative claim in respect of Newman's losses. They also brought a personal claim for damages for the diminution in the value of their minority shareholding and loss of dividends. The personal claim was upheld by the trial judge on the basis that the claimant shareholders had suffered loss as a result of the conspiracy of the directors.

[1-61] On appeal, the English Court of Appeal described the personal claim as 'misconceived'. The court held that although a shareholder could, in principle, bring a personal claim against those who had also committed a wrong against the company:

> what he cannot do is to recover damages merely because the company in which he is interested has suffered damage. He cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because such a "loss" is merely a reflection of the loss suffered by the company. The shareholder does not suffer any personal loss. His only "loss" is through the company, in the diminution in the value of the net assets of the company … The claimant's shares are merely a right of participation in the company on the terms of the articles of association. The shares themselves, his right of participation, are not directly affected by the wrongdoing. The [claimant] still holds all the shares as his own absolutely unencumbered property.[80]

[1-62] Although diminution in the value of the shares and loss of dividends are paradigm examples of reflective loss, the principle also applies to 'all other payments which the shareholder might have obtained from the company if it had not been deprived of its funds'.[81]

[1-63] In *Johnson v Gore Wood & Co (a firm)*,[82] Lord Millet explained the rationale of the principle, where he said:

> If the shareholder is allowed to recover in respect of such loss, then either there will be double recovery at the expense of the defendant or the shareholder will recover at the expense of the company and its creditors and other shareholders. Neither course can be permitted. This is a matter of principle; there is no discretion involved. Justice to the defendant requires the exclusion of one claim or the other; protection of the interests of the company's creditors requires that it is the company which is allowed to recover to the exclusion of the shareholder.

[1-64] Importantly, the principle against reflective loss applies notwithstanding that the company declines or fails to sue. In *Waddington Ltd v Chan Chun Hoo*,[83] Lord Millett explained that the appropriate course of action to take in such circumstances is to allow the shareholder to bring

80 *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204, [1982] 1 All ER 354, [1982] 2 WLR 31 (CA, Eng).

81 *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1, [2001] 1 All ER 481, [2001] 2 WLR 72 (HL).

82 *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1, [2001] 1 All ER 481, [2001] 2 WLR 72 (HL).

83 *Waddington Ltd v Chan Chun Hoo* [2009] 4 HKC 381, (2008) 11 HKCFAR 370 (CFA).

a derivative action, as allowing the shareholder to bring an action for its own benefit would produce precisely the result which is identified as unacceptable in *Johnson v Gore Wood & Co (a firm)*.[84] Moreover, the rule against reflective loss remains applicable even if the company settles with the wrongdoer on comparatively generous terms.[85]

[1-65] Where the member's loss is separate and distinct from the company's loss, the member is entitled to bring a personal action against the wrongdoer. In determining such, it is relevant to see if the loss is one which would be made good if the company was able to recover its own loss. In *Johnson v Gore Wood & Co (a firm)*,[86] the plaintiff, a businessman, conducted his affairs through a number of companies, including W Ltd, in which he held all but two of the issued shares. On behalf of W Ltd, the plaintiff instructed the defendants, a solicitors firm, to act for W Ltd in connection with a proposed purchase of a piece of land. However, due to the negligence of the defendants, by the time the conveyance was completed, W Ltd had suffered substantial loss. In January 1991, W Ltd started proceedings against the defendants for professional negligence and the plaintiff shareholder also brought a personal action against the defendants in respect of the diminution in value of his pension and of his majority shareholding in W Ltd. The House of Lords struck out his claims for compensation for payments that the company would have paid into his pension fund, as such loss is merely a reflection of the company's loss. However, the court did not strike out the claim for enhancement in value of the pension, had the payment been duly made, the court held that the loss suffered by the plaintiff shareholder was separate and distinct from any loss suffered by the company, for, in the circumstances of the case, such loss 'would not have been recompensed even if the company had achieved a 100% recovery in its action'.[87]

[1-66] Although the rule against reflective loss has been well-established and indeed set out in statute,[88] it is still often overlooked by practitioners leading to substantial wasted costs. In *Lehman & Co Management Ltd v*

84 *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1, [2001] 1 All ER 481, [2001] 2 WLR 72 (HL).

85 *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1, [2001] 1 All ER 481, [2001] 2 WLR 72 (HL); *Giles v Rhind* [2002] EWCA Civ 1428, [2003] Ch 618, [2003] 1 BCLC 1.

86 *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1, [2001] 1 All ER 481, [2001] 2 WLR 72 (HL).

87 *Johnson v Gore Wood & Co (a firm)* [2002] 2 AC 1, [2001] 1 All ER 481, [2001] 2 WLR 72 (HL). Also see Andrew Tettenborn, 'Creditors and reflective loss—a bar too far?' LQR 2019, 135 (Apr) at 182–186, in which the author suggests that the reflective loss principle might have been applied too widely.

88 Companies Ordinance, s 725(5).

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Efficient Ltd,[89] the trial judge awarded damages for breaches of fiduciary duties committed by a director/shareholder of the company to the other shareholder in an unfair prejudice petition. On appeal, such award was set aside and all costs incurred in relation thereto, including expert and legal costs for assessing the damages, were ordered to be paid by the petitioner.

[1-67] The reflective loss principle is not without controversy. If applied indiscriminately it could cause serious injustice. In the UK Supreme Court case of *Sevilleja v Marex Financial Ltd*,[90] the claimant obtained judgment against two BVI companies controlled by the defendant. However, before the claimant was able to enforce such judgments, the defendant stripped the companies of their assets. Therefore the claimant sued the defendant for unlawfully causing loss to it. The defendant argued that the claimant's loss could not be maintained as it infringed the reflective loss principle. The UK Supreme Court reviewed the authorities and gave a detailed critique of the reflective loss principle. It held that it had been given too wide a scope and wrongly applied in certain cases. Whilst short of abolishing the rule, it held that the reflective loss principle had no application in cases concerning claims by creditors of the company. As regards claims by shareholders in respect of loss which they have suffered in the capacity as shareholders, in the form of diminution in share value and other share-related losses, the UK Supreme Court maintained by a majority that it would still be upheld.

[1-68] In *Burnford & Ors v Automobile Association Developments Ltd*,[91] the English High Court struck out a claim by the former shareholders of a dissolved company against the defendant, an investor. The claimants alleged that the defendant had made a number of misrepresentations to them which undermined the success of the company, thereby constituting an implied breach of the Investment Agreement signed between them. The court rejected the claimants' arguments that the misrepresentation were independent wrongs committed against them as members and that the breach of contract was separate and distinct form the company's claim. It was not relevant that the company had later been dissolved and that the claimants therefore ceased to be shareholders because the time for assessing the status of the claim was when the alleged losses arose, not when the claim was made.[92]

89 *Lehman & Co Management Ltd v Efficient Ltd & Anor* [2013] HKCU 576 (unreported, CACV 272/2011, 13 March 2013) (CFI).
90 *Sevilleja v Marex Financial Ltd* [2020] UKSC 31, [2021] AC 39, [2021] 1 All ER 585.
91 *Burnford & Ors v Automobile Association Developments Ltd* [2022] EWHC 368 (Ch), [2022] All ER (D) 12 (Mar).
92 See *Primeo Fund (in official liq) v Bank of Bermuda (Cayman) Ltd & Anor (Cayman Islands)* [2021] UKPC 22, [2022] 1 All ER (Comm) 1219, [2022] 1 BCLC 151.

[1-69] In *Miao Weiguo v Tendcare Medical Group Holdings Pte Ltd*,[93] the Singapore Court of Appeal similarly affirmed the reflective loss principle in the narrow form, ie, that it would bar only shareholder claims in respect of diminution in share value and other share-related losses. This narrow principle is justified because a person who acquires shares in a company implicitly agrees for his fate to be tied to the company's. In other words, he accepts the risks of his share value rising and falling in tandem with changes in the company's fortunes. Hence, a shareholder cannot seek to recover a diminution in share value only because the company has suffered a wrong, since the occurrence of such wrongs is part and parcel of a company's fortunes. Indeed, such changes in fortunes are the precise risks that the shareholder has agreed to bear when he acquires shares.

[1-70] In both *Sevilleja v Marex Financial Ltd*[94] and *Miao Weiguo v Tendcare Medical Group Holdings Pte Ltd*,[95] the courts made clear that the reflective loss principle is not based on the policy of avoiding double recovery. This is because the principle would apply even when there is no risk of double recovery. It is also wrong to assume that allowing the recovery of share-related losses would necessarily result in double recovery, since there does not always exist a direct or linear relationship between the company's and the shareholder's recovery. More importantly, an exclusive focus on the fact of overlapping losses has the tendency to extend the principle beyond its original remit of regulating shareholder claims to that of preventing all overlapping claims, including those of creditors.

[1-71] Taken together, these developments suggest that the practical scope of the reflective loss principle is much reduced. However, one may reasonably expect the principle to continue to generate controversy as shareholders will no doubt seek creative ways to circumvent its application. For example, some may attempt to challenge the characterisation of losses as share-related losses while others may attempt to expressly contract out of the principle, for example, via shareholders' agreements. Currently, it is unclear whether the application of the reflective loss principle can be ousted by contractual devices. In any event, a purported exclusion of such rights could lead to unintended results.

4.2 Personal rights under the corporate constitution

[1-72] Under section 86 of the Companies Ordinance (Cap 622), a company's articles have effect as a contract under seal between the

93 *Miao Weiguo v Tendcare Medical Group Holdings Pte Ltd* [2021] SGCA 116.
94 *Sevilleja v Marex Financial Ltd* [2020] UKSC 31, [2021] AC 39, [2021] 1 All ER 585.
95 *Miao Weiguo v Tendcare Medical Group Holdings Pte Ltd* [2021] SGCA 116.

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