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Abstract
In Lim Koei Ing v Pan Asia Shipbuilding & Engineering Co Pte Ltd the Singapore High Court had to consider whether a service contract to employ the plaintiff as managing director for a period of five years could be enforced by the plaintiff. This depended on whether the contract was entered into by the directors of the company in breach of their fiduciary duties. The court was given a great opportunity to consider the fiduciary duties of company directors.

Keywords
fiduciary duties, directors' duties, Lim Koei Ing v Pan Asia Shipbuilding & Engineering Co Pte Ltd

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DIRECTORS' DUTIES

LIM KOEI ING v PAN ASIA SHIPBUILDING & ENGINEERING CO PTE LTD

By
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Introduction

In *Lim Koei Ing v Pan Asia Shipbuilding & Engineering Co Pte Ltd*[1] the Singapore High Court had to consider whether a service contract to employ the plaintiff as managing director for a period of five years could be enforced by the plaintiff. This depended on whether the contract was entered into by the directors of the company in breach of their fiduciary duties. The court was given a great opportunity to consider the fiduciary duties of company directors.

Facts

The defendants were incorporated on 26 November 1968 and were in the business, inter alia, of shipbuilding and ship repairing. The defendants were wound up on 16 May 1986. The plaintiff joined the defendants as an executive officer in March 1972 and became a director in September 1972.

In the directors' report dated 19 June 1984, the plaintiff and her brother, who would be retiring in accordance with the defendants' articles of association, had offered themselves for re-election by the shareholders at the annual general meeting. The board agreed that the annual general meeting was to be held on 21 July and notice was given on 4 July.

On 5 July, the board of directors of the defendants approved the transfer of shares by another shareholder to Pan Electric Industries Ltd (Pan Electric). Pan Electric as new shareholders indicated that they would be proposing their own director to replace the plaintiff at the next annual general meeting.

On 14 July, the chairman of the defendants resigned. The plaintiff and 2 other directors, who represented the interests of the minority

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1 [1995] 1 SLR 499.

shareholders, passed resolutions to remove the managing director of the defendants and to appoint the plaintiff in his place. They also postponed the annual general meeting to November and appointed 4 new directors to the board.

On 19 July, together with the new directors, the plaintiff and the directors who represented the minority interests then caused the defendants to enter into a 5-year service contract with the plaintiff. The service contract contained, inter alia, a liquidated damages clause in the event of a pre-mature termination of her 5-year term as managing director.

The majority shareholders then held an extraordinary general meeting on 6 August and removed the plaintiff as director.

On 16 August the directors who represented the minority interests gave notice for a board meeting to be held on 20 August. The 3 directors who represented the majority interests were unable to attend the meeting. At the meeting, the plaintiff claimed damages for the pre-mature termination of the 5-year service contract on 21 August. The plaintiff had signed 2 cheques drawn on the defendants' bank account paying out a sum of $265,626 to herself.

The plaintiff in the proceeding claimed from the defendants the balance $900,000 allegedly owing to her under the service contract. The defence was that the service contract was entered into by the directors of the defendants in breach of their fiduciary duties and was unenforceable. The defendants counterclaimed for the return of the sum of $265,000 paid out to the plaintiff as money had and received.

The Decision

Sinnathuray J held that:

(1) The plaintiff should not have voted on the resolution appointing herself as managing director of the defendants. Article 83 prohibited a director from voting on any contract or proposed contract with the defendants.

(2) The postponement of the annual general meeting from 21 July to 12 November was for an improper purpose considering the manipulated events that happpened in July and August and the indication by Pan Electric that the plaintiff was to be replaced at the annual general meeting.

(3) The appointment of the new directors was not in the best interests of the defendants but was for the sole purpose of ratifying the plaintiff's service contract with the defendants, as no credible explanation had

been given as to why their services were required by the defendants at that particular point of time.

(4) The contract of service was made by the plaintiff with the connivance of the other directors appointed by the minority shareholders in her self-interest. The plaintiff had put her desire to derive additional benefits before her duty to act in the best interests of the defendants. The contract of service was entered into by the directors in breach of their fiduciary duties and was a voidable contract at the instance of the defendants. As the defendants had clearly avoided the contract by the removal of the plaintiff as director, the contract was not binding on them. Hence the sum of $265,000 was to be paid back to the defendants as money had and received. Also, the liquidated damages clause was unreasonable.

(5) The late notice dated 16 August but only sent on 17 August for the 20 August board meeting was a deliberate attempt to prevent the other 3 directors who represented the majority interests from attending the board meeting. The learned judge came to this conclusion in the light of the fact that it was at this meeting that the plaintiff's claim was admitted and that it was likely that these 3 directors would not have supported the resolution to admit the plaintiff's claim.

(6) The plaintiff in signing the cheques on 22 August had no authority to do so (pursuant to article 79, as she was no longer a director at the material time).

(7) The defendants' counterclaim for the return of the sum of $265,000 was allowed.

(Editorial note: The plaintiff had appealed to the Singapore Court of Appeal. However, the appeal was dismissed.)

Comments

Sinnathuray J in stating the law first quoted section 157(1) of the *Singapore Companies Act*[2] which stated:

> A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office.

Then he said:

2 Cap 50, Revised Edition, 1994.

> There is considerable case law on the subject. Here, it is sufficient to say that it is settled law that this duty to act honestly includes the duty to act in the best interests of the company. A director must not put himself in a position where his duty and interest conflict; nor must he use the powers and assets entrusted to him for improper purposes.[3]

Section 157 is not derived from any English statute. Instead, it is derived from a similar provision in Australian Acts. Here the learned judge rightly stated that the duty to act honestly in section 157(1) included the common law fiduciary duty of a director. Section 157(1) does not purport to be an exhaustive statement of a director's duties; section 157(4) specifically provides that 'this section is in addition to and not in derogation of any other written law or rule of law relating to the duty or liability of directors or officers of a company'. Hence, the common law and equitable rules relating to the duty of directors are still relevant.

The learned judge referred to the Australian case of *Hannes v MPH Pty Ltd & Ors*,[4] a case relied on by the defendants and the only authority referred to in the case. Here, the learned judge seemed to be of the view that a director who had acted for an improper but subjectively honest purpose might be said to have failed to act 'honestly'. To put it in another way, 'Is the fiduciary duty breached if the director honestly acted in the interest of the company but for an improper purpose?'. The learned judge was of the view that it was not enough for the director to believe that he was acting in the interest of the company; he must also have not acted for an improper purpose. This is in line with the view taken by the Privy Council in *Howard Smith v Ampol Petroleum Ltd*[5] where Lord Wilberforce emphasised that the court must find whether the purpose for which the directors acted was objectively proper or improper. This is a question that is not totally settled in Australia.

In Australia, section 232(2) of the *Corporations Law* states that 'an officer of a corporation shall at all times act honestly in the exercise of his or her powers and the discharge of the duties of his or her office'. 'Officer' is defined in section 232(1) to include a director. Ford and Austin outlined the history of section 232(2) *Corporations Law* as follows:

> Section 232(2) stems from section 124(1) of the *Uniform Companies Act* 1961 (UCA), which stated that a director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office. The duty with respect to care and diligence is now found in section 232(4). In 1982 the components relating to honesty and care were separated from one another, and different penalties were introduced for failure to act honestly. For the purpose of imposing a penalty, a

3 See above n 1 at 509.
4 [1992] ACLC 400.
5 [1974] AC 821.

> distinction was drawn between cases of fraudulent purpose or intent to deceive or defraud the company, members, or creditors, and cases where this intentional element was not present. Then in 1993 the differential penalties were removed from section 232 and section 232(2) became a civil penalty provision.[6]

However:

> criminal proceedings can be instituted for contravention of a civil penalty provision only where the contravener acted or omitted to act knowingly, intentionally or recklessly and, in addition, the contravener either:
> (1) was dishonest and intended to gain an advantage for himself or herself or any other person; or
> (2) intended to deceive or defraud someone: section 1317 FA.[7]

In *Marchesi v Barnes*,[8] Gowans J concluded that to 'act honestly' refers to acting bona fide in the interests of the company, and that a breach of this obligation involves consciousness that what is being done is not in the interests of the company, and deliberate conduct in disregard of that knowledge.

It has become clear, particularly in cases since *Marchesi v Barnes*,[9] that directors are obliged not only to act in good faith in what they consider to be the interests of the company, but also to exercise their powers for proper purposes. Directors may fail to exercise a power for proper corporate purposes even though their decision gives them no personal benefit and they honestly believe that they are acting in the best interests of the company. The question which arises is whether directors who have acted for an improper but subjectively honest purpose might be said to have failed to 'act honestly in the exercise of their powers'. Gowans J's reference to 'consciousness that what is being done is not in the interests of the company' suggests that directors who honestly believe their decision to be in the interests of the company do not contravene the section though their decision is voidable on the proper purpose doctrine.

King CJ in *Australian Growth Resources Corp Pty Ltd v Van Reesema*[10] took a contrary view. He was of the view that section 232(2) is capable of applying to a case where a director exercises powers honestly but for a purpose which the law judges to be an improper one. As Ford and Austin stated:

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6 Ford H, *Ford & Austin's Principles of Corporations Law* 7th Edition, 1995, at 280.
7 See above n 6 at 280, 281.
8 [1970] VR 434.
9 Above n 8.
10 (1988) 13 ACLR 261.

> It is possible that King CJ may have taken a different interpretation because the differential penalties had been introduced after Gowans J's decision. The differential penalties suggest that the section applies to conduct which is non-fraudulent but 'dishonest'.[11]

Later cases like *CAC v Papoulias*[12] and *Southern Resources Ltd v Residues Treatment & Trading Co Ltd*[13] have reverted to Gowans J's approach holding that directors may fail to act honestly and so contravene section 232(2) by consciously failing to act in the interests of the company, without intending either to deceive or to defraud. On this view, directors who honestly believe that they are acting in the best interests of the company do not contravene the subsection (though presumably there could be a contravention if no reasonable person could share their belief).

According to Ford and Austin:

> Now that section 232(2) has become a civil penalty provision, we may find that King J's approach will be restored. This is because section 1317A seems to assume that contraventions can occur without knowing, intentional or reckless conduct and a fortiori, without a dishonest intention to gain an advantage or to deceive. The result is probably that section 232(2) now applies to any breach of the duty to act in good faith in the interests of the company and the duty to act for proper purposes, whether or not the director subjectively and honestly believed that he or she was acting in the company's interests, but unless conscious dishonesty or an intention to deceive is present, there is no criminal offence.[14]

The learned judge held that the director is:

> to act in the best interests of the company. A director must not put himself in a position where his duty and interest conflict; nor must he use the powers and assets entrusted to him for improper purposes.[15]

Here the learned judge used the phrase 'best interests'. Must it be in the 'best interests' of the company or is it sufficient if the director was acting in the 'interest' of the company?

As stated by Mayson, French and Ryan:

> the general statement of the duty of directors when exercising their directorial powers is normally taken from the judgment of Lord Greene M

11 Above n 6 at 281.
12 (1990) 2 ACSR 655.
13 (1990) 3 ACSR 207.
14 Above n 6 at 282.
15 Above n 1 at 509.

> R in *Re Smith & Fawcett Ltd.*[16] The Master of the Rolls said at p306 that directors of a company must act '... bona fide in what they consider - not what a court may consider - is in the interests of the company, and not for any collateral purpose'.[17]

Secondly, what exactly does it mean to 'act in the interests of the company?' Who is the company? Is it the members as a whole, the hypothetical member, the employees or the creditors? Is the fiduciary duty breached if the director had acted in what he personally thought was in the interest of the company, that is, is the test subjective or objective?

As to the meaning of 'company', Lord Evershed M R in *Greenhalgh v Ardene Cinemas*[18] said that:

> the phrase 'the company as a whole' does not (at any rate in such a case as the present) mean the company as a commercial entity as distinct from the corporators: it means the corporators as a general body.

Although this was said in the context of members voting in general meetings, it seems equally true in the present context.

Further, as was stated in *Gower's Principles of Modern Company Law*:

> Despite the separate personality of the company it is clear that directors are not expected to act on the basis of what is for the economic advantage of the corporate entity, disregarding the interests of the members. They are, for example, clearly entitled to recommend the payment of dividends to the members and are not expected to deny them a return on their money by ploughing back all the profits so as to increase the size and wealth of the company. If, as will normally be the case, the directors themselves are shareholders, they are entitled to have some regard to their own interests as shareholders and not think only of the others. [19]

As was stated in the Australian case of *Mills v Mills*,[20] directors are:

> not required by the law to live in an unreal region of detached altruism and to act in a vague mood of ideal abstraction from obvious facts which must be present to the mind of any honest and intelligent man when he exercises his powers as a director.

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16 [1942] Ch 304.

17 Mayson S, French D, Ryan C, *Mayson, French and Ryan on Company Law*, 12th Edition, 1995-96 at 457.

18 [1951] Ch 286 at 291.

19 Gower L, *Gower's Principles of Modern Company Law*, 5th Edition, 1992 at 554.

20 (1938) 60 CLR 150 at 164.

However, this test of benefit to the company as a corporate whole is not helpful when there is a conflict between different factions or classes of shareholders in a company. Perhaps the test in such a case, as suggested in *Mills v Mills*,[21] is not a question of the interests of the company as a whole but a question of what is fair as between different classes or factions of shareholders.

In *Walker v Wimborne*,[22] *Nicholson v Permakraft (NZ) Ltd*[23] and *Kinsela v Russell Kinsela Pty Ltd*[24] the courts held that where the company is insolvent, then the interests of the company must extend to the interests of creditors.

As to whether the test is subjective or objective, Lord Greene M R in *Re Smith & Fawcett Ltd*[25] held that directors are required to act:

> bona fide in what they consider - not what a court may consider - is in the interests of the company...

Hence, the subjective test is to be used.

In arriving at the conclusion that the contract of service had not been entered into in good faith or in the best interests of the defendants and that the plaintiff had put her desire to derive additional benefits before her duty to act in the best interests of the defendants, the learned judge relied on *Hannes' case*.[26] The Court of Appeal in *Hannes' case*[27] agreed with the lower court's findings on evidence, inter alia, that the service agreement:

> was entered into after the receipt of the notices of meetings designed to remove JD Hannes as a director of the four respondent companies

and

> was entered into by JD Hannes for his own benefit in a situation of uncertainty as to his future and without negotiation.

Altogether eight factors were taken into account.

However, in the present case, the learned judge accepted the defendants' contention that it was entered into in breach of their fiduciary duties, as the appointment of the plaintiff as managing director by a resolution to which the plaintiff herself was a signatory, was an improper

21 Above n 20 at 164 per Latham CJ.
22 (1976) 50 ALJR 446.
23 [1985] 1 NZLR 242.
24 (1986) 4 NSWLR 722.
25 Above n 17 at 306.
26 Above n 4.
27 Above n 4.

exercise of the plaintiff's power as a director and contravened Article 83 of the defendants' articles of association. It is submitted that the judge should have required more evidence before coming to the conclusion that the plaintiff had put her desire to derive additional benefits before her duty to act in the best interests of the company. The plaintiff had claimed (at p 507) that in February 1984, Yeo, the then managing director suggested the idea of having a formal contract of service for the two of them. She claimed that Yeo said that as they had served the defendants loyally and competently for the preceding twelve years, it would only be right to have their contracts of service in writing. The defendants' solicitors at that time completed a draft agreement but no action was taken until July 1984. It is submitted that Yeo should have been called as a witness as he was the one who suggested the service contracts.

The learned judge further held that the purported liquidated damages clause was unreasonable. It is submitted that the learned judge meant that it was a penalty and hence void. Could the plaintiff have claimed compensation for loss of office? Under section 168(1)(a) of the *Companies Act*, it shall not be lawful for a company 'to make to any director any payment by way of compensation for loss of office as an officer of the company', unless approval by the company has been given. This section is to be contrasted with the Australian situation where 'compensation for loss of office as a director' is referred to. It was held in *Lincoln Mills (Aust) Ltd v Cough*[28] and *Taupo Totara Timber Co Ltd v Cough*[29] that the Australian section did not apply to a payment as compensation for breach of a contract as a managing director. This is to be contrasted to the Singapore position. Since 'loss of office as an officer' is used in the Singapore statute, if a managing directorship is an office, as it probably is,[30] compensation for loss of office as a managing director thus also requires approval unless exempted under subsection (5).

Section 168(5)(a) exempts any payment under an agreement entered into before 1st January 1967.

Section 168(5)(b) exempts any agreement for payment if approved by a special resolution. The Australian position in contrast requires an ordinary resolution.

Section 168(5)(c) exempts any bona fide payment by way of damages for breach of contract.

28 [1964] VR 193.
29 [1977] 3 All ER 123 (Privy Council).
30 See Woon W and Hicks A, *The Companies Act of Singapore, An Annotation* (1994) at 361.

Exemption under section 168(5)(d) is:

> any bona fide payment by way of pension or lump sum payment in respect of past services ... where the value or amount of the pension or payment, except in so far as it is attributable to contributions made by the director, does not exceed the total emoluments of the director in the three years immediately preceding his retirement or death.

This exemption seems to say that total pension or payment less director's contributions must not exceed the last three years' emoluments.

Section 168(5)(e) exempts:

> any payment to a director pursuant to an agrement between the company and him before he became a director of the company as consideration

for agreeing to serve the company as a director.

If, however, the agreement is construed as a penalty clause designed to inhibit breach, it will be unenforceable.[31] This would be so in the present case.

Another point that counsel should have brought up is whether a managing director's salary is within the scope of section 169. Section 169 provides that emoluments for a director in respect of his office must be approved by the company by a resolution. Any resolution passed in breach shall be void. A person can be a director as well as an accountant of a company. In such a case, it is possible to separate the emoluments he receives as an employee from the emoluments he receives as a director. In the case of a managing director, this distinction between employee and director is much harder to make. It may be that a managing director's salary is given to him 'in respect of his office' as managing director; in that case shareholder approval would be necessary. However:

> any holding to this effect by a court would doubtless be greeted with dismay by managing directors, who as a general rule do not have their remuneration packages approved by the general meeting. [32]

If the payment is made to a managing director 'in respect of his office', approval by the general meeting is required. If it is made to him in respect of services rendered, then the decision to pay is a management decision that can be taken by the board who will have to exercise their discretion in accordance with their fiduciary duty to act in the best interests of the company. This would accord with the mischief addressed by the section

31 See *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1915] AC 9.
32 Woon W and Hicks A, see above n 30 at 365.

(that is, to prevent directors overpaying themselves without shareholder approval) as well as with commercial reality.

It is submitted both learned counsel should have taken this opportunity to expound clearly the law as regards the duties of a director and dealt with some of the issues highlighted above. It is a pity that only one case, *Hannes v MPH*,[33] was cited. Also, it would have been helpful if the learned judge had discussed the basis for holding that the contract of service entered into by the directors in breach of their fiduciary duties was voidable. Is it an equitable principle akin to undue influence?[34] Further, counsel for the defendants had referred to the *Companies Act* (Cap 50, 1970 Ed). It is to be noted that the 1994 Revised Edition is the latest, preceded by the 1990 Edition and 1988 Edition.

33 Above n 4.
34 See Woon W, *Company Law* (1988) at 207.