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Oppressed Minority Shareholders May Seek Remedies Against Directors and Third Parties

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Majority rule is the bedrock of company law. But there is a thin borderline between exercising majority power and oppressing the minority. Often, the conduct of majority shareholders will toe this line, but the courts will interfere when the majority is found to have abused their powers and are depriving the minority of their rights.

When this happens, the oppressed minority may seek remedies under Section 181 of the Companies Act 1965 (CA 2016) (now Section 346 of the Companies Act 2016 (CA 1965)). In the recent case of Auspicious Journey[i], the Federal Court considered whether company directors and/or third parties may be held liable for any oppressive, prejudicial, or detrimental conduct under the said provision.

Background Facts

Auspicious Journey Sdn Bhd (AJ) and Hoe Leong Corporation Ltd (HL) formed a joint venture company named Ebony Ritz Sdn Bhd (ER). The purpose of the joint venture was to acquire a 49% shareholding in a third entity, known as Semua International Sdn Bhd (SI). At that time, SI was a wholly owned subsidiary of Sumatec Resources Berhad (Sumatec).

Under this joint venture, AJ was the minority shareholder in ER, holding 20% of the shares, whereas HL was the majority shareholder, holding 80% of the shares. ER and Sumatec entered into a Sale and Purchase Agreement to purchase 49% of the latter's shares in SI. ER, Sumatec and AJ also concluded an Options and Financial Representation Agreement (OFRA).

In brief, the OFRA provided for:

(a) A guarantee to ER that Sumatec would make good any shortfall in Semua's profits as compared to the financial representations made.

(b) In the event of a shortfall, a call option would be granted by Sumatec to ER for not less than 2% of Sumatec's shares.

(c) Sumatec would grant a call option to AJ for not less than 49% of Sumatec's shares.

Later, when Sumetec fell into financial distress, they were obligated to make good the profit shortfall under the OFRA. However, they failed to do so.

Unbeknownst to AJ, HL had then entered into a conditional sale and purchase agreement (Conditional SPA) with ER, Sumatec and Setinggi Holdings (Setinggi) to dispose of Sumatec's retained 51% interest in SI. The agreement provided that 2% would go to HL and 49% would go to Setinggi.

Essentially, HL would gain Sumatec's entire retained 51% shareholding as Setinggi was in effect HL's nominee. Nevertheless, the conditional SPA ultimately never became unconditional, and the sale did not go through. When AJ became aware of this arrangement, it was made known to them that HL was prepared to place the 2% shareholding in SI into ER, if AJ came up with its proportionate contribution. AJ refused to do so.

Having been left out of these happenings, a disgruntled AJ then filed an originating summons against:

(a) ER, as a nominal defendant.

(b) HL and its directors, Paul and James Kuah (collectively the Kuah brothers).

(c) Setinggi and its director, Teh Teong Lay (Teh).

AJ contends that it had been oppressed and had suffered prejudice due to the conditional SPA because:

(a) ER's 2% call option was expropriated by HL.

(b) AJ's own 49% call option was expropriated by HL and its nominee.

(c) HL and the Kuah brothers had utilised HL's majority powers to waive ER's entitlements under the OFRA.

(d) HL and the Kuah brothers had caused for any indemnity to Sumatec against any claims and a reassignment of dividends to the detriment of ER.

At The High Court

The High Court found that the affairs of ER had been conducted in a manner that was oppressive to AJ disregarding its interests as a minority shareholder. However, the High Court dismissed AJ's claims against the defendants other than HL and ER.

The High Court found that the actions of the Kuah brothers were in the best interest of HL in respect of its investment in SI. Citing Imperial Oil[ii] and Q2 Engineering Sdn Bhd[iii], the High Court stated that directors were entitled to take such steps in the exercise of their directors' duties. Further, it applied Abdul Manaf[iv], where the Court of Appeal held that directors were merely agents of a company and could not be personally liable for acts of the company.

As for the remedy, the High Court decided that winding up ER was the most appropriate in the circumstances. This decision was made considering ER's financial situation, the current relationship between the shareholders and the ultimate purpose of the joint venture.

Furthermore, if a buy-out of AJ's shares was ordered, SI would be in breach of the provisions of the Merchant Shipping Ordinance 1952 (MSO), which requires any company involved in the oil tanker industry (which SI was) to be a majority-Malaysian company.

AJ appealed against the decision of the High Court in dismissing the claim against the other defendants and also the granting of a winding-up order (as it preferred a buy-out); whereas HL appealed against the finding that it was liable.

At The Court of Appeal

The Court of Appeal dismissed both appeals. On the granting of the winding-up order, the Court of Appeal agreed with the High Court both as to the unsuitability of a buy-out as well as their reasoning.

On the issue of the directors' liability, the Court of Appeal affirmed the High Court's decision, stating that it was trite that directors could not be held personally liable for acts of the company, unless it was a personal act or wrongdoing by the directors and that act is outside its obvious agency.

As for the claim against Setinggi and its director, the Court of Appeal held that there was no tenable claim as nothing had materialized from the conditional SPA.

AJ went on to appeal to the Federal Court.

The Federal Court's Decision

1. Directors' or third parties' liability

The Federal Court held that directors and third parties can be made personally liable in oppression actions under Section 181 of the CA 1965 (now Section 346 of the CA 2016) if they are closely connected to the oppressive conduct.

In deciding as such, the Federal Court placed great emphasis on the following phrases in limb (a) of Section 181:

"*affairs of the company are being conducted*" and "*where the powers of the directors are being exercised in a manner oppressive*".

The Federal Court found that these phrases envisage scrutiny over the exercise of directors' powers under this provision. Moreover, Section 181(2) grants the court wide

powers to bring oppressive conduct to an end, or to remedy the minority's grievances.

Read conjunctively, this reveals the legislature's intention to allow courts the freedom to fashion a remedy as deemed appropriate. This would include the power to devolve liability on directors who had perpetrated acts giving rise to oppressive conduct.

The Federal Court also considered the notable judicial pronouncements in Re Kong Thai[v] and Koh Jui Hiong[vi], which stated that the wording of Section 181 is broader than its English origins in Section 219 of the United Kingdom (UK) Companies Act 1985. Thus, it should be interpreted in a liberal and broad manner. The court then assessed the jurisprudence of various Commonwealth countries, namely the UK, Canada, and Hong Kong, and identified a common trend in their statutory oppression regimes: "*the greatest possible flexibility*" was accorded to the courts to tailor a remedy for each particular set of facts.

This included powers to impose liability on directors and/or third parties where the facts justify such an exercise of discretion. A restrictive interpretation of the oppression regime was regarded as defeating the legislative intention.

Furthermore, the Federal Court found that liability may devolve on third parties and directors because they may be made respondents to an oppression action. Any other interpretation would render such joinders pointless.

2. The Legal Test Applicable

The Federal Court combed through comparable Commonwealth jurisdictions to determine the legal test to impose liability on a director or third party, and ultimately adopted the Canadian test set out in the Wilson case[vii].

In summary, the test is whether there is a sufficiently close nexus to the oppressive conduct such that it would be fair and just to impose liability on them for such conduct. Insofar as oppressive conduct is concerned, the courts below had found and confirmed that there was oppression against AJ. While not articulated as such, it was evident from the

undisputed facts that the acts of oppression derived from the conduct of the Kuah brothers. Thus, there was a sufficient nexus.

But the courts below had also recognised that the Kuah brothers and HL had acted in the best interests of ER. Therefore, the Federal Court held that liability should not be visited upon them. Setinggi and Teh were also found to be not liable.

3. Remedy

Regarding the remedy, the Federal Court affirmed the lower courts' decision that ER should be wound up. It stated that Section 181 was not intended to allow a party to escape a bad bargain, which seemed to be AJ's intention.

Further, the Federal Court also noted that AJ's losses were merely a reflection of the losses suffered by ER. A personal claim is unsustainable lest the claimant demonstrate that it had suffered personal loss, distinctive from that suffered by the company.

Commentary

Following this decision, directors and third parties can now be held personally liable for oppressive conduct by the company where there is a sufficiently close nexus. This is subject to considerations of fairness and equity.

Significantly, the Federal Court had recognised that Section 181 is uniquely worded, and need not develop in congruence with comparative jurisprudence, for instance its English roots. It also confirmed that the provision is to be given a liberal and broad interpretation. Thus, the Malaysian courts essentially have carte blanche in exercising its powers to ensure a just and fair outcome.

Besides that, another interesting remark made by the Federal Court was on winding up being an "extreme" and "drastic" remedy. The court also recognised that the present case had "unique facts", such as the potential non-compliance with the MSO. The weightier justification required for appellate intervention was also taken into

account in the Federal Court's decision to leave undisturbed the lower courts' choice as to remedy.

Taken together, this may hint at a judicial reluctance to grant winding-up orders as a remedy in anything but the most "extreme and drastic" of cases.

Authored by Michelle Lim Li Ann, associate with the firm's Dispute Resolution team.

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[i] Auspicious Journey Sdn Bhd v Ebony Ritz Sdn Bhd & Ors [2021] MLJU 307
[ii] Imperial Oil Ltd v C & G Holdings Ltd [1990] 62 DLR
[iii] Q2 Engineering Sdn Bhd v PJI -LFGC (Vietnam) Ltd & Ors [2013] 8 MLJ 157
[iv] Abdul Manaf Mohd bin Ghows & Ors v Nusantara Timur Sdn Bhd & Ors [1997] 3 MLJ 661
[v] Re Kong Thai Sawmill (Miri) Sdn Bhd [1978] 2 MLJ 227
[vi] Koh Jui Hiong @ Koa Jui Heong & Ors v Ki Tak Sang @ Kee Tak Sang and another appeal [2014] 3 MLJ 10
[vii] Wilson v Alharayeri [2017] 1 SCR 1037

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