

THE RECOVERY OF LOSSES OCCASIONED BY CORPORATE CRIME—SUITS AGAINST OFFICERS WHO INVOLVE THEIR COMPANY IN A CRIME

I. INTRODUCTION

WHAT does a shareholder do when he discovers that the funds of the company of which he is a member have been paid away by the company's officers in the course of breaking the law?

To the layman, the answer is obvious: sue the officers responsible and make them replace the money. Unfortunately, in law the answer is not quite as obvious.

Because of the way the law relating to the liability of companies for crimes has developed, a paradoxical situation results when the board of directors or some responsible officer commits a crime and causes loss to the company. The problem arises in this fashion: the directors of a company commit a crime in the course of their duties, e.g., bribe a politician. The company suffers monetary loss. At law, though, the directors' acts are those of the company.¹ Ergo, the company is party to the crime. When it attempts to recover the money paid away in the commission of the crime, it is met with the defence that it is party to the illegality and therefore will not be assisted by the courts.

The problem is brought into sharp focus by the English case of *Belmont Finance Corporation Ltd. v. Williams Furniture Ltd.*² (Court of Appeal). In that case the defendant directors illegally authorised the use of Belmont's funds to finance the purchase of its shares contrary to section 54 of the U.K. Companies Act 1948.³ This was effected by means of a circular transaction involving the plaintiff company, its holding company and another company controlled by the other defendants. The entire transaction was for the defendants' benefit and inimical to the plaintiff's interest. Yet when Belmont sued to recover the money thus paid away illegally, Foster J. dismissed its action on the ground that it was party to the conspiracy and as a conspirator it could not sue its co-conspirators. The surprising thing about the case is not that Foster J. decided as he did; it is that, as the law stood, no one could say that he was wrong in law.⁴

This article will seek to explore the possibilities open to a shareholder who wishes to recover money paid away by corporate officers

¹ See discussion, *infra* pp. 3-5.

² [1979] 1 All E.R. 118.

³ Approximately equivalent to section 67 of the Companies Act Cap. 185 Singapore Statutes, 1970 Rev. Ed.

⁴ The case is discussed *infra*. The Court of Appeal reversed Foster J. on this point.

in the commission of a crime. The word "crime" is used in a wider sense than its popular meaning connotes. Apart from acts commonly recognized as crimes (*e.g.*, theft or bribery), it will be taken to include acts in contravention of some statutory provision that result in a sanction of some sort, *e.g.*, using a company's funds to finance the purchase of its shares. In a corporate context, this latter sort of "crime" is by far the more common.

To begin, it is necessary to understand how a company can be made responsible for the sins of its officers.

II. CRIME AND THE COMPANY

The question of a company's liability for crimes does not seem to have arisen often in Singapore and Malaysia. There appears to be no reported case on the point from Singapore.

In the Malaysian case of *Yue Sang Cheong Sdn. Bhd. v. P.P.*⁵ a company was charged under section 135(1)(d) of the Customs Act 1967 with "knowingly having in its possession" certain goods, the import of which was prohibited. One of the questions referred to the Federal Court was "...whether it is relevant to consider the relative importance of agents or officers of the limited company whose knowledge is to be imputed to the company." Ong C.J. (with whom Gill F.J. agreed) answered the question by quoting from the judgment of Lord Diplock in *Tesco Supermarkets Ltd. v. Natrass*:⁶

In my view, therefore, the question: what natural persons are to be treated in law as being the company for the purpose of acts done in the course of its business, including the taking of precautions and the exercise of due diligence to avoid the commission of a criminal offence, is to be found by identifying those natural persons who by the memorandum and articles of association or as a result of action taken by the directors, or by the company in general meeting pursuant to the articles, are entrusted with the exercise of the powers of the company, [sic]

There is also a dictum of Gill F.J. in *E. v. Comptroller General of Inland Revenue*⁷ to the effect that the state of mind of the persons who run the company is the state of mind of the company. Apart from these two cases there seems to be no other local authority on the point. In the absence of further guidance from local courts, one is driven back to English cases to determine how the courts have tackled the issue. These English cases are of course not binding on Singapore or Malaysian courts; however they provide an indication of how the local courts might decide.

The modern basis of a company's liability for crimes in English law is not vicarious liability,⁸ although some statutes may make a company vicariously liable for the criminal acts of its agents and employees.⁹ The company's criminal liability is predicated on the

⁵ [1973] 2 M.L.J. 77.

⁶ [1971] 2 All E.R. 127, 155.

⁷ [1970] 2 M.L.J. 117, 128.

⁸ See Leigh, *The Criminal Liability of Corporations in English Law* (1969).

⁹ See *e.g.* *Mousell Brothers Ltd. v. London & North Western Railway Co.* [1971] 2 K.B. 836; *Chuter v. Freeth & Pocock Ltd.* [1911] 2 K.B. 832; *James & Son Ltd. v. Smee* [1954] 3 All E.R. 273.

idea that some persons do not just act for the company; their acts are in law the acts of the company:

A living person has a mind which can have knowledge or intention or be negligent and he has hands to carry out his intentions. A corporation has none of these; it must act through living persons, though not always one or the same person. Then the person who acts is not speaking or acting for the company. He is acting as the company and his mind which directs his acts is the mind of the company. There is no question of the company being vicariously liable. He is not acting as a servant, representative, agent or delegate. He is an embodiment of the company, or, one could say, he hears and speaks through the persona of the company, within his appropriate sphere, and his mind is the mind of the company. If it is a guilty mind, then that guilt is the guilt of the company. (*Per* Lord Reid in *Tesco Supermarkets Ltd. v. Natrass*)¹⁰

The Company has also been likened to a human body:

It has a brain and nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind and will of the company. Others are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such. (*Per* Lord Denning in *H.L. Bolton (Engineering) Co. Ltd. v. T.J. Graham & Sons Ltd.*)¹¹

The problem which has exercised the courts is how to separate the hands from the brain, and to determine who represents the persona of the company and who does not. The following persons have been held to be the “directing mind and will of the corporation”: directors;¹² ‘managers’;¹³ a transport manager;¹⁴ the company secretary and branch manager;¹⁵ and a sales manager.¹⁶ On the other hand minions like a weighbridge operator¹⁷ or depot engineer¹⁸ have been held not to be acting through the persona of the company.

No more specific test has been enunciated by the courts to determine who is the alter ego of the company than that such a person

¹⁰ [1971] 2 All E.R. 127, 131.

¹¹ [1957] 1 Q.B. 152, 172. Approved of by Lord Reid and Viscount Dilhorne in the *Tesco* case, *supra* note 6, at pp. 132, 146.

¹² *Lennard’s Carrying Co. Ltd. v. Asiatic Petroleum Co. Ltd.* [1915] A.C. 705; *The Lady Gwendolen* [1965] P. 294; *Hill & Sons (Botley and Denmead) Ltd. v. Hampshire Chief Constable* [1972] R.T.R. 29, 34J-K.

¹³ *Bolton’s* case, *supra* note 11; the managers in this case happened also to be directors.

¹⁴ *D.P.P. v. Kent & Sussex Contractors Ltd.* [1944] K.B. 146; *R. v. Stanley Haulage Ltd.* (1964) 114 L.J. 25.

¹⁵ *Moore v. I. Bresler Ltd.* [1944] 2 All E.R. 515.

¹⁶ *Moore v. I. Bresler*, *supra* note 15; *R. v. Waterloo Mercury Sales Ltd.* (1974) 49 D.L.R. (3d) 131.

¹⁷ *John Henshall (Quarries) Ltd. v. Harvey* [1965] 2 Q.B. 233.

¹⁸ *Magda Plant Ltd. v. Mitchell* (1966) 110 S.J. 349.

must be the "directing mind and will of the corporation".¹⁹ Usually the acts of the board of directors or the managing director will be the acts of the company; but there is no magic in the appellation 'director' and it must still be shown that the person in question was part of the brain and not merely a hand.²⁰ However, even subordinate personnel may come within the "brain area" if there is a delegation by the board of directors of "some part of the functions of management giving to their delegate full discretion to act independently of instructions from them."²¹ Despite dicta by Lord Diplock in the *Tesco* case,²² the courts have not usually looked at the memorandum and articles of association of the company to determine who its alter ego is. Rather they have treated it as a question of law for the judge to decide once the jury has established the facts.²³

Two things should be noted. Firstly, the persons acting need not intend to benefit the company by their actions. In *Moore v. I. Bresler Ltd.*²⁴ the secretary of the company (who was also a branch manager) and the sales manager of the branch sold some of the company's goods with intent to defraud the company. Nevertheless the company was held to be guilty of an offence under the Finance (No. 2) Act 1940, section 35 for furnishing a false tax return. The company could only act through humans, and these particular humans were the ones who were responsible for providing the returns; they spoke "through the persona of the company", to use Lord Reid's phrase, notwithstanding that they had actually intended to defraud the company. Thus it is possible that the company's alter ego may involve it in a crime while acting for his own benefit and against the company's interest; the only limitation being that he is acting within the scope of his authority from the company, otherwise his acts cannot be taken to be corporate actions at all.²⁵

Secondly, the directing mind and will of the company need not necessarily be that of the board of directors. In *H.L. Bolton (Engineering) Co. Ltd. v. T.J. Graham & Sons Ltd.*²⁶ it was argued that the landlord company did not have the necessary intention to occupy premises to satisfy the Landlord and Tenant Act 1954, on the ground that there was no meeting of the board of directors to express the company's intention. This contention was rejected by both the trial judge and the Court of Appeal. The intention of the company's business managers (who happened in that case also to have been directors) was that of the company. It is conceivable that a single director with delegated authority or even a mere employee might for some purposes represent the company's mind. This is especially likely in a large company where the day to day running of the business is delegated to salaried managers. In *Moore v. I. Bresler*²⁷ a branch manager and a sales manager of a branch were held to be the company's

¹⁹ *Per* Viscount Haldane L.C. in *Lennard's case*, *supra* note 12.

²⁰ *Per* Eveleigh J. delivering the judgment of the Court of Appeal in *R. v. Andrews Weatherfoil Ltd.* [1972] 1 All E.R. 65.

²¹ *Per* Lord Reid in the *Tesco* case, *supra* note 6 at p. 132.

²² *Supra* note 6.

²³ *Per* Eveleigh J. in the *Andrew Weatherfoil* case, *supra* note 20 at p. 70, applying dicta of Lord Reid in the *Tesco* case, *supra* note 6, p. 132.

²⁴ *Supra*, note 15.

²⁵ Leigh, *The Criminal Liability of Corporations in English Law* (1969) at p. 46.

²⁶ *Supra*, note 11.

²⁷ *Supra*, note 15.

directing mind and will; in *D.P.P. v. Kent and Sussex Contractors*²⁸ and in *R. v. Stanley Haulage Ltd.*²⁹ it was a transport manager. In none of these cases was it clear from the reports whether the persons involved were actually directors. However, the basis of the courts' decisions was that they were the people entrusted by the company with the particular duties in question. This did not depend on their membership of the board of directors; the duties could equally have been discharged by a salaried employee to whom some of the functions of management had been delegated. It is thus possible, and perhaps even likely, that a company could get entangled in a crime without the knowledge and assent of the board of directors and in disregard of corporate policy. What is even more likely is that the company will get involved in a crime without the knowledge and assent of the vast majority of the shareholders, who will in most cases be presented with a *fait accompli*.

Assuming that it is the "directing mind and will" that is involved, the company will be a party to the crime. This creates problems when the company seeks to recover its money. Public policy will preclude it from recovering the money paid away in an action against a third party. The company cannot rely on the transaction as "the source of civil rights".³⁰

The classic statement of the principle is that of Lord Mansfield in *Holman v. Johnson*.³¹

The principle of public policy is this; *ex dolo malo non oritur actio*. No court will lend its aid to a man who founds his cause of action upon an immoral or illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise *ex turpi causa*, or the transgression of a positive law of this country, then the court says that he has no right to be assisted. It is upon this ground that the court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff.

In applying such a principle to companies however, the courts may be drawing the net too wide. In law the money that is paid away is the company's; in law it is the company that is guilty of the illegality. But in reality it is the officer of the company who is responsible for the crime, and the money of the corporators that is lost. When a company claims to recover money that has been paid away for an illegal purpose, it is usually the liquidator of the company or a new board that brings the action on the company's behalf. The public policy that prevents a wrongdoer from recovering back his money does not apply in such a case. The veil of incorporation should not obscure this reality. To deny the company—meaning the innocent shareholders—recovery in this situation serves no sensible purpose. No court has yet recognised this fact of life, however.

As long as this attitude of the courts persists, the shareholders will have to look elsewhere for compensation. The obvious candidate

²⁸ *Supra*, note 14.

²⁹ *Supra*, note 14.

³⁰ See dicta of Ungood-Thomas J. in *Selangor United Rubber Estates Ltd. v. Craddock (No. 3)* [1968] 1 W.L.R. 1555, 1655.

³¹ (1775) 1 Cowp. 341, 343.

is the person responsible for losing the money, namely the officer who committed the crime. In many cases there will be no possibility of recovering the money from the third party anyway, as where the money has been spent by the third party, or removed from the country or is otherwise untraceable. When this happens the officer responsible should be made to replace the money. English courts have granted the company relief in cases where directors have misapplied the company's funds, notably where there has been a breach of section 54 of the Companies Act 1948.³² It is submitted that in principle where a company's funds are used for an illegal purpose, fairness at least demands that the officer responsible should be liable to compensate the company for the loss. The alternative means that the shareholders will have to bear the loss; persons who are guilty of no wrong except that of choosing the wrong man to trust.

The first step in getting a suit against the officer responsible on its feet is to determine on what basis he may be held to have breached his duty to the company.

III. THE LIABILITY OF THE COMPANY'S OFFICERS

It is when one comes to consider the liability of the company's officers to the company when their acts cause the company to be personally liable for a crime that one steps into a conceptual minefield. On one hand the officer in question is the directing mind and will of the company, its alter ego;³³ his acts are the company's acts and his mind the company's mind. Yet on the other hand he is an agent and fiduciary of the company. If he has a contract with the company he will also be a servant and employee.

The problems created by this multi-faceted — one might even say schizophrenic — relationship may be sorted out if the 'alter ego' theory of corporate liability is laid aside for the moment. For the purpose of determining the officer's liability to the company, he is treated as a fiduciary or employee of the company, as the case may be, just as any other agent or employee of the company who does not represent the alter ego. It is submitted that getting one's company involved in a crime is a breach of duty to the company, as much as usurping a corporate opportunity or misusing corporate funds are.³⁴

The Companies Act sums up the duties of a director thus: "A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office."³⁵

An Australian judge has interpreted similar words in the Companies Act of Victoria³⁶ in the following way:

"[A]ct honestly" refers to acting bona fide in the interests of the company in the performance of the functions attaching to the

³² Now superseded by sections 42 to 44 of the Companies Act 1981. Approximately equivalent to section 67 of the Companies Act, Cap. 185.

³³ The label "alter ego" is used as a convenient shorthand, notwithstanding Lord Reid's criticism of it as being inaccurate and misleading: *Tesco Supermarkets Ltd. v. Nattrass*, *supra*, note 6, pp. 132-133.

³⁴ See *Selangor United Rubber Estates Ltd. v. Craddock (No. 3)*, *supra*, note 30, p. 1656.

³⁵ Section 132(1).

³⁶ Victoria Companies Act section 124.

office of director. A breach of the obligation to act bona fide in the interest of the company involves a consciousness that what is being done is not in the interest of the company and deliberate conduct in disregard of that knowledge.³⁷

When a director, acting as the “directing mind and will” of the company, commits a crime to benefit himself at the expense of the company, he is not acting bona fide in the interests of the company. Such deliberate conduct will amount to a breach of his obligation to act honestly under section 132(1). Accordingly, he will be liable for any damage suffered by the company as a result of the breach.³⁸ If the company’s money has been expended in the course of the crime, it is submitted that it may be recovered from the director involved under section 132(3)(a).

Apart from this statutory statement of a director’s liability, a director owes several duties to the company at common law. Gower analyses these common law duties into the following elements:³⁹

- (1) The directors must act bona fide, i.e., in what they believe to be the best interests of the company.
- (2) They must exercise their powers for the particular purpose for which they were conferred and not for some extraneous purpose.
- (3) They must not fetter their discretion to exercise their powers in accordance with the foregoing rules; and
- (4) They must not place themselves in a position where their duties and their self-interest conflict.

The intentional commission of a crime for the director’s own benefit will constitute a breach of at least elements (1) and (4) of Gower’s analysis. In the case of *Wallersteiner v. Moir*⁴⁰ for instance, the chairman of a company caused a loan to be made to another company that he controlled. He then used this money to discharge the liability that he had incurred (through another puppet corporation) in purchasing the first company’s shares. The transaction was in direct contravention of section 54 of the U.K. Companies Act 1948;⁴¹ the company was liable under that provision to be fined and was therefore considered to be criminally responsible for the act. Although section 54 did not provide for the civil recovery of loans made (unlike section 67(4) of the Companies Act, Cap. 185), the Court of Appeal had no difficulty in holding the director liable to compensate the company for the monies lost. It took no sophisticated analysis of the nature of a director’s duty to his company to come to the conclusion that the chairman was guilty of misfeasance and in breach of his duty to the company.

The common law has traditionally treated directors strictly where the company’s funds are concerned. They are regarded as trustees of those funds.

³⁷ *Per* Gowans J. in *Marchesi v. Barnes* [1970] V.R. 434, 438.

³⁸ Section 132(3)(a).

³⁹ Gower, *Principles of Modern Company Law* (4th Ed., 1979), p. 576.
⁴⁰ [1974] 1 W.L.R. 991.

⁴¹ Equivalent to section 67 of the Companies Act, Cap. 185.

The principle was stated by Lord Romilly M.R. in the old case of *Land Credit Company of Ireland v. Lord Fermoy*:⁴² "Directors are so far as regards the employment of the funds of the company trustees ... and answerable to their *cestuis qui trust* for the due employment of the funds entrusted to them." It would not be difficult, it is submitted, to characterise a use of the company's funds for an illegal purpose as a breach of that trust.

A director's acts in getting the company involved in a crime might also be classified under the rubric of abuse of powers (to use Gower's analysis).⁴³

The cases on abuse of powers by the fiduciaries of a company have arisen mainly in connection with the issue of shares. The law was considered by the Privy Council in *Howard Smith Ltd. v. Ampol Petroleum Ltd.*⁴⁴ The question before the court was whether the directors of a company had abused their powers when they issued shares to a certain party. The directors had the power to do so under the company's articles of association. The company needed new capital. However the evidence was that the shares had been issued to dilute the control exercised by two shareholders. The Privy Council held that this was an improper exercise of the power and invalidated the issue. If the directors had acted out of self-interest there would have been a clear breach of their duty to act *bona fide* in the interests of the company. *Per* Lord Wilberforce, "Where the self-interest of the directors is involved, they will not be permitted to assert that their action was *bona fide* thought to be, or was, in the interest of the company."⁴⁵ However the directors' *bona fides* is only one element to consider in determining whether the power has been abused. The nature and extent of the power and the use to which it was actually put are circumstances to look at. In the *Ampol* case it was held that the power was abused notwithstanding that the directors had not acted for themselves, but in what they conceived to be the company's interest.

Extrapolating from this, when a director intentionally misuses a delegated power for a criminal purpose for his own ends, that will be a breach of his duty to the company to act *bona fide* in its interest. Even if his own interest is not involved there may be a misuse of the power and a breach of his duty to the company. *Ex hypothesi* he will have acted "through the persona of the company" so that it will be personally liable for the crime. There will be no question of invalidating the act or disowning it. If the company suffers loss as a result of the director's breach it would be reasonable to allow the company to recover compensation from him as damages in respect of his breach of duty towards it.

The *Ampol* case raises the question of what happens if the director is not actuated by self-interest, but acts from a misguided appreciation of what is good for the company. It may be said that a crime is a crime is a crime and if the company suffers loss, the person responsible

⁴² (1869) L.R. 8 Eq. 7, 10.

⁴³ *Supra*, note 39. See also dicta of Gill C.J. in *Re Kong Thai Sawmills (Miri) Sdn. Bhd.* [1976] 1 M.L.J. 54, 74F.

⁴⁴ [1974] A.C. 821.

⁴⁵ *Ibid.*, p. 834.

should compensate it, whatever his motives were in acting as he did. On the other hand section 132(1) requires that a director "act honestly ... in the discharge of the duties of his office."⁴⁶ "Honestly" as defined by Gowans J. means "*bona fide* in the interest of the company."⁴⁷ *Ex hypothesi* the director has acted in what he considers to be the best interest of the company, and so it might be argued that he is not in breach of his duty to the company.

In the absence of a clearer judicial exposition of the nature of a director's duties under section 132(1), recourse must be had to the common law for an indication as to the proper solution.

As discussed above⁴⁸ directors are treated by the common law as trustees of the company's funds. Because of the characterisation of directors as trustees of the company's funds it matters not that a director may act without intending to benefit himself. He is equally liable if he contravenes the law and misapplies the company's funds believing it to be in the company's interest.⁴⁹ The apparent harshness of this rule is mitigated by the power of the court to relieve the officer concerned from all or part of his liability if it is fair to do so under the circumstances.⁵⁰ Secondly, it was established by the *Ampol* case⁵¹ that there can be an abuse of a director's powers even if he is acting in what he conceives to be the interests of the company. Getting the company involved in a crime is such an abuse of powers, it is submitted. An abuse of powers is a breach of the director's duty to the company. If loss to the company flows from that breach, it is submitted that it is only fair to allow the company an action against the director.

On balance it would appear that at common law a director would be in breach of his duty to the company even if he acted in what he saw as the interest of the company. The same should obtain with regard to section 132(1) of the Companies Act.

Apart from these duties that the law imposes there may be other duties that arise by virtue of the contractual relationship between the company and officer. An officer who is in a position to control the management of the company so as to make it personally liable for his criminal acts is likely to be serving under a contract of some sort, express or implied. This is especially likely where the officer is actually paid for his services. It is submitted that it will be an implied term of such a contract that the powers delegated to him will be used for their proper purpose and not for some extraneous and illegal purpose. Such a term will not usually be written into the contract expressly; it is something so obvious that it goes without saying, "so that, if, when the parties were making their bargain, some officious bystander were to suggest some express provision for it in their agreement, they would testily suppress him with a common 'Oh, of course!'"⁵²

⁴⁶ Section 132(1), Companies Act, Cap. 185.

⁴⁷ *Supra*, note 37.

⁴⁸ *Supra*, note 42.

⁴⁹ *Re Sharpe* [1892] 1 Ch. 154; *Cullerne v. The London & Suburban General Permanent Building Society* (1890) 25 Q.B.D. 485.

⁵⁰ Under s. 354 of the Companies Act, Cap. 185.

⁵¹ *Supra*, note 44.

⁵² To use McKinnon L.J.'s words in *Shirlaw v. Southern Foundries (1926) Ltd.* [1939] 2 K.B. 206, 227.

Not all crime (in the wider sense) is the result of intentional acts. With the proliferation of statutory provisions governing all aspects of commercial life, it is not difficult to imagine a situation in which the company's alter ego gets it into trouble negligently rather than deliberately. Ignorance of the law is of course no excuse. The defendant directors pleaded it in *Steen v. Law*.⁵³ In the course of rearranging the capital structure of the company to gain a tax advantage they had unwittingly (so they said) contravened section 148 of the Companies Act 1936 of New South Wales (equivalent to section 67 of the Companies Act, Cap. 185). All the judges from the trial court to the Privy Council unanimously rejected this as a defence. Their guilty acts were the guilty acts of the company. On such facts, would there have been a breach of some duty of care and skill owed to the company?

Section 132(1) requires that a director display "reasonable diligence" in discharging his duties. It says nothing about the level of competence that he is required to display. Again one is driven to the common law to find an answer.

In contrast to the strict fiduciary duty that a director owes to the company, the duties of care and skill owed by him at common law are inconsequential. It is said that a director need not exhibit a greater degree of skill in the performance of his duties than may reasonably be expected from a person with his knowledge and experience; he is not bound to give continuous attention to the affairs of his company; and he may properly trust that delegates will perform their duties honestly.⁵⁴ As long as directors act honestly and within the powers given to them, they are not liable to the company for any breach of duty; "however ridiculous and absurd their conduct might seem, it was the misfortune of the company that they chose such foolish directors."⁵⁵ The forbearance of the company apparently extends to directors who are "an amiable set of lunatics."⁵⁶

Three qualifications must be made to these general statements.

Firstly if the directors negligently pay away or allow to be paid away the company's money for an illegal purpose, they will be liable to replace it. This flows from their status as trustees of the company's funds.⁵⁷ Thus if they act as the puppets of some evil genius and implement his designs without taking care, they will be liable to compensate the company for any loss that it may suffer.⁵⁸

Secondly, where a director actually makes a profit out of his negligence the court may not be quite so forbearing. As Templeman J. said in *Daniels v. Daniels*:⁵⁹ "To put up with foolish directors is

⁵³ [1963] 3 W.L.R. 802.

⁵⁴ *Per* Romer J., *In re City Equitable Fire Insurance Company Ltd.* [1925] Ch. 407, 428-429.

⁵⁵ *Turquand v. Marshall* (1869) 4 Ch. App. 376, *per* Lord Hatherley L.C. at p. 386.

⁵⁶ *Pavrides v. Jensen* [1956] Ch. 575, as interpreted by Templeman J. in *Daniels v. Daniels*, *infra* note 59.

⁵⁷ *Supra*, note 42.

⁵⁸ As happened to the defendant directors Barlow-Lawson and Jacobs in the *Selangor Rubber* case, *supra* note 30, pp. 1611-1614.

⁵⁹ [1978] 2 W.L.R. 73, 80.

one thing; to put up with directors who are so foolish that they make a profit... at the expense of the company is something entirely different." In that case he was prepared to allow minority shareholders to proceed against the company's directors on the company's behalf. It is open to the court in such a situation to find that something more than mere negligence is involved.

The third qualification is this: the statements quoted above are apt when the director concerned is one of the rubber-stamping breed whose function in life is to grace the board-room table once a year. They are less apt when applied to directors who are paid to run the company's day-to-day affairs. They have no application at all to a manager who is employed to manage the company's business. The duties of care and skill owed by a director who attends one board meeting a year may be inconsequential; but such a creature is unlikely to represent the directing mind and will of the company. In *H.L. Bolton (Engineering) Co. Ltd. v. T.J. Graham & Sons Ltd.*⁶⁰ the Court of Appeal held that the intention of the company was not reflected in the mind of the board of directors, who only met once a year. It was the intention of the actual managers who ran the business that mattered.

It is submitted that the persons who run the company should have to show a greater degree of care and skill than suggested by the cases cited above. In most cases they will have been appointed to their posts because of some professed competence in the area. The appointment is likely to be governed by some express or implied contract. This applies *a fortiori* if they are actually paid to perform those duties. It is submitted that it will be a term of the contract (implied if not expressed) that they should have to show a reasonable amount of care and skill in the discharge of their duties.⁶¹ The danger of placing too heavy a burden on such persons in terms of potential liability to the company is again mitigated by the courts' power to excuse them from liability if it is fair to do so under the circumstances.⁶²

Thus far the discussion has concentrated on the duties of directors. However, the person whom the courts consider to be the company's alter ego need not be a director.⁶³ He will be fairly high in the corporate hierarchy and could probably be classed as senior management. Whether he is a director or not, it is submitted that he should owe to the company the same fiduciary duties as do directors. Gower, writing of directors' fiduciary duties, opined that "these duties, except insofar as they depend on statutory provisions expressly limited to directors, are not so restricted but apply equally to any officials of the company who are authorized to act on its behalf and in particular those acting in a managerial capacity."⁶⁴

This passage was expressly approved of by the Supreme Court of Canada in *Canadian Aero Services Ltd. v. O'Malley*.⁶⁵ One of the issues before the court was whether certain persons owed a fiduciary

⁶⁰ *Supra*, note 11.

⁶¹ Boyle and Sykes, *Gore-Brown on Companies* (43rd Ed., 1982), 27-31.

⁶² Under s. 354 of the Companies Act, Cap. 185.

⁶³ *Supra*, notes 26-29.

⁶⁴ Gower, *Principles of Modern Company Law* (4th Ed., 1979), p. 574.

⁶⁵ (1973) 40 D.L.R. (3d) 371.

duty to the company. The persons in question were the president and chief executive and the executive vice-president respectively. Laskin J., delivering the judgment of the court, stated that it did not matter whether they were properly appointed as directors or not, or whether they acted as such. It was enough that they were, in the words of the judge, "senior managerial officers", "top management" and not merely employees. Their position as senior officers "charged them with initiatives and responsibilities far removed from the obedient role of servants." Consequently "theirs was a larger, more exacting duty which, unless modified by statute or by contract... was similar to that owed to a corporate employer by its directors."⁶⁶

It is submitted that the last statement is correct in principle. In an age where the running of companies is increasingly being delegated to a class of professional managers, it is difficult to see why the duty such a person owes to the company should not be at least equal to that owed to it by a rubber-stamping director. Any other situation would be anomalous. Anyone who is in a position to be considered the alter ego of the company will be a member of the "top management" and so should be subject to the same duties of good faith towards the company as a director. If however the courts are not willing to go as far as this in extending the ambit of a manager's duties, there is the possibility that such "top management" could be characterized as directors. "Director" is defined in section 4 of the Companies Act, Cap. 185 to include "a person in accordance with whose directions or instructions the directors of a corporation are accustomed to act". This could be interpreted to extend to persons who actually run the company and whose acts are rubber-stamped by the directors.

To sum up this part of the discussion:

1. If directors or senior managerial officers intentionally break the law, intending to benefit themselves, they will be in breach of their fiduciary duties, both under section 132(1) and at common law.
2. Even if their intention was not to benefit themselves, they may still be in breach of their duty to the company, either on the ground that they have misapplied the company's funds or that they have abused the powers entrusted to them.
3. If the crime is committed negligently, it is likely that they will have failed to exhibit the degree of care and skill required of them, and so should be liable for the consequences of their want of care and skill.
4. The same duties, it is submitted, will be owed by officers who are not directors, but who can be classed as senior management, *i.e.*, those whom the courts are likely to consider to be the alter ego of the company.

IV. ILLEGALITY — A SHIELD?

Establishing a breach of duty on the part of the errant officer does not end the company's problems. The next step is to enlist the courts' assistance in obtaining redress.

⁶⁶ *Ibid.*, at p. 381.

The company's alter ego commits a crime. The company is liable for that crime. The company sues him for its loss. At this point the courts are caught in a cleft stick. On one hand the company is the victim. Yet on the other hand it is in law the perpetrator of the crime and equally guilty as a human actor. That the courts will not assist one wrongdoer to recover compensation from another wrongdoer is a principle firmly enshrined in English law: "No court will lend its aid to a man who founds his course of action on an immoral or an illegal act," *per* Lord Mansfield in *Holman v. Johnson*.⁶⁷

This principle also forms part of our law. This was made clear by Lord Denning, delivering the judgment of the Privy Council, when he cited and applied Lord Mansfield's dictum in the case of *Palaniappa Chettiar v. Arunsalam Chettiar*⁶⁸ (Privy Council on appeal from the Federation of Malaya, 1962). This principle applies as much to companies as to natural persons; a recent example of its application to a limited company may be found in *Patriot Pte. Ltd. v. Lam Hong Commercial Company*⁶⁹ (Court of Appeal, Singapore, 1980).

On the face of it therefore a company's claim against an officer who makes it party to a crime may be defeated from the start by a plea of illegality. In two notable cases the defendant had the gall to plead just that. Both cases involved the use of a company's funds to finance the purchase of its shares, contrary to section 54 of the U.K. Companies Act 1948.⁷⁰

In *Selangor United Rubber Estates Ltd. v. Craddock (No. 3)*⁷¹ an action was brought by the Board of Trade in the name of the company against nine defendants, including four directors. The legal formulation of the claim against the directors was to account as trustees for the monies lost.⁷² It was submitted on behalf of the defendants that insofar as the claim was founded on a breach of section 54, it was unlawful and the plaintiff should therefore be barred from recovery.

The claim against the defendants in *Belmont Finance Corporation Ltd. v. Williams Furniture Ltd.*⁷³ was brought in the company's name by a receiver appointed out of court under debentures issued by the company. The statement of claim alleged a conspiracy on the part of the defendants which resulted in damage to the plaintiff. There was an alternative claim against the 7th and 8th defendants (who were directors of the company) on the basis that they were guilty of misfeasance and breach of trust in their capacities as directors of the plaintiff company in procuring it to enter into an agreement in contravention of section 54 of the Companies Act 1948.⁷⁴ Again the illegality was pleaded as a defence to the action.

The defence failed (and quite rightly too) in both cases, though for different reasons.

⁶⁷ *Supra*, note 31.

⁶⁸ (1962) 28 M.L.J. 143, 146G.

⁶⁹ [1980] 1 M.L.J. 135.

⁷⁰ Equivalent to s. 67 of the Companies Act, Cap. 185.

⁷¹ [1968] 1 W.L.R. 1555.

⁷² *Supra*, note 71, at p. 1563F.

⁷³ [1979] 1 All E.R. 118.

⁷⁴ *Supra*, note 70.

In the *Selangor Rubber* case, Ungood-Thomas J. accepted that when directors act for a company in an illegal transaction, the company is itself a party to that transaction and to the illegality.⁷⁵ It therefore could not rely on the transaction "as a source of civil rights" nor sue a third party with regard to rights which it was claimed that the transaction conferred. The courts would not assist in such a case if the action was founded on the illegality. However, he also recognized that where the cause of action is not dependant upon the illegality, the courts might legitimately aid the plaintiff; in support of this proposition he cited *Sajan Singh v. Sardara Ali*,⁷⁶ a Privy Council decision on appeal from the Federation of Malaya. In a claim based on an illegal breach of trust, said the judge, the claimant does not rely on a right conferred or created by that breach. The plaintiff's claim was against the directors for perpetrating the transaction and making the plaintiff company a party to the illegal transaction.⁷⁷ The judge then concluded that the illegality did not prevent the plaintiff from recovering the money from the defendants, notwithstanding that it was privy to the illegality.

Ungood-Thomas J.'s decision is so plainly correct that comment seems superfluous. If the route that he took seems roundabout, that was because of the peculiarities inherent in the doctrine of corporate responsibility for crimes.

In contrast Foster J., hearing *Belmont Finance Ltd. v. Williams Furniture Ltd.*⁷⁸ at first instance, dismissed the plaintiff's claim on the ground that one party to a conspiracy to do an illegal act could not sue a co-conspirator in relation to that act. The directors had conspired with the other defendants to evade the law. The point of the transaction was to enable the third to sixth defendants to purchase Belmont without having to raise any funds. The conspiracy could fairly be said to have been aimed at Belmont. Nevertheless, the law said that Belmont was a party to the illegality, and therefore Belmont could not recover. Mr. Bumble's comment that "the law's an ass" might have been made with this very case in mind.

Fortunately, sanity reasserted itself and the Court of Appeal held that the company was not prevented from suing the defendants. Buckley L.J. delivered the leading judgment on this point. He felt that the view that the plaintiff was a vital party to the conspiracy was "too simplistic a view, and [did not] probe far enough into the true circumstances of the case". The company was the victim of the conspiracy. He thought that it was irrational that the directors should be treated as having transmitted their knowledge of the illegality to the plaintiff; on the ground that the plaintiff lacked guilty knowledge, the learned lord justice held that it should not be regarded as being a party to the conspiracy.⁷⁹ As a further ground, he also held that the conspiracy had existed before the illegal agreement to which the company was a party had been concluded. Since the agreement was adduced as an "overt act" establishing the existence of the conspiracy,

⁷⁵ *Supra*, note 71, at p. 1153G-H.

⁷⁶ (1960) 26 M.L.J. 52.

⁷⁷ *Supra*, note 71, at p. 1656 D-F.

⁷⁸ *Supra*, note 73.

⁷⁹ *Supra*, note 73, at p. 126.

it followed that the plaintiff was not a party to the conspiracy.⁸⁰ Consequently the plaintiff was not prevented from suing the defendants.

The result reached by the Court of Appeal is eminently sensible. The company was unquestionably more sinned against than sinning. Yet it is difficult to reconcile the *Belmont* decision with principle and authority. Doubtless the company in that case was the victim and not a principal in the conspiracy. However the directors of the company had acted in their capacity as directors. They were the directing mind and will of the company in this matter. On principle their acts should have been treated as the company's acts and their mind as the company's mind. "If it is a guilty mind, then that guilt is the guilt of the company".⁸¹ It would seem that the maxim "*in pan delicto potior est conditio defendentis*" ought to have applied. As Rajah J. explains in *Cheng Mun Siah v. Tan Nam Sui*⁸² (High Court, Singapore, 1980):

Under the maxim a party to an illegal contract who seeks to recover what he has transferred under it will normally be denied relief on the ground that he cannot be heard to allege his own turpitude and that any loss he may suffer is well-deserved.

Buckley L.J. felt able to dissociate the company from the illegal acts because he felt that section 54 was meant to protect the company. The unspoken assumption was that where a statutory provision is meant for the protection of a party, that party cannot be considered to be *in pari delicto* with the other wrongdoers and so is not debarred from suing them notwithstanding the illegality.⁸³ Two points can be made about this reasoning. Firstly, it is not beyond argument that section 54 was meant for the protection of companies. There are dicta in *Wallersteiner v. Moir* to the effect that it is;⁸⁴ against these must be balanced dicta in *Essex Aero Ltd. v. Cross* that the section is not for the company's protection and that the company cannot rely on it.⁸⁵ More tellingly, as pointed out by Sealy,⁸⁶ how can the section be for the company's protection when the company is itself made liable under it?

Secondly, the assumption that the company is not *in pari delicto* is incompatible with the holding that it was not a party to the illegality. If a party is not privy to the illegality, no question of being *in pari delicto* even arises. The exception in favour of parties not *in pari delicto* assumes such parties to be privy to the illegality; but the rule that one wrongdoer cannot sue another is relaxed in favour of such persons. The fact that the statute was meant for the protection of

⁸⁰ *Supra*, note 73, at p. 127 G-H.

⁸¹ *Per* Lord Reid, *Tesco Supermarkets v. Natrass*, *supra*, note 6.

⁸² [1980] 2 M.L.J. 209.

⁸³ Lord Mansfield explained the principle in *Browning v. Morris* (1778) 2 Cowp. 790, 792: "But where contracts or transactions are prohibited by positive statutes, for the sake of protecting one set of men from another set of men; the one, from their situation and condition, being liable to be oppressed or imposed upon by the other; there, the parties are not in *pari delicto*; and in furtherance of these statutes the person injured, after the transaction is finished and completed, may bring his action and defeat the contract."

⁸⁴ [1974] 3 All E.R. 217, 239 (*per* Lord Denning M.R.), 255 (*per* Scarman L.J.).

⁸⁵ (1961) Unreported. Cited in *Wallersteiner v. Moir*.

⁸⁶ Sealy, "Assistance by a Company to Purchase its own Shares — Illegality, Constructive Trust and the Pleading of Fraud", [1979] Camb L.J. 278.

the company (assuming it to have been) does not necessarily lead one to the conclusion that the errant directors' acts ceased to be the acts of the company, under the doctrine propounded by Lord Reid in the *Tesco* case.⁸⁷

However commendable the result reached in the *Belmont* case, it is suggested that the reasoning of Buckley L.J. is fatally flawed. It may be, as the learned Lord Justice points out, that it is "irrational" to treat the company—the victim—as a party to the conspiracy.⁸⁸ But that irrationality is a result of the present doctrine of corporate liability for crime. It is submitted that Buckley L.J. has not convincingly surmounted the difficulty posed by the 'alter ego' theory.

Ungoed-Thomas J.'s approach seems far better. In getting the company involved in an illegal transaction, an officer is breaching his duty to the company. When the company sues him to recover compensation for its loss, it is depending not on the illegality (to which in law it is a party) but on the officer's breach of duty. This analysis neatly side-steps the obstacle that the "alter ego" doctrine creates. Unnatural it may seem; but as long as the present doctrine of corporate liability holds sway, it is the only way in which the company might obtain redress against its defaulting officers. It is a pity that the breach of trust and misfeasance argument was not pressed in the *Belmont* case.⁸⁹ The Court of Appeal said nothing either in approbation or disapproval of the course taken by Ungoed-Thomas J.

One point should be noted. Had the cases come to trial here, there would have been less difficulty in recovering the money paid away in pursuance of the illegal transaction. This is because section 67 of the Singapore Act, unlike section 54 of the English Act, explicitly provides that the company may recover such monies (in sub-section 4). The reasoning in the two cases nevertheless remains of interest.

Extrapolating from the cases discussed above, whenever the acts of an officer involve a company in an illegal transaction the defence of illegality may be circumvented by pleading the action as one in respect of the breach of that officer's duty to his company. It may seem artificial to make the company's chances of success depend so much on a point of pleading; but that is the fault of the doctrines that currently obtain. Ultimately it is a question of policy whether a court will entertain such an action. It is suggested that the courts should come down in favour of allowing such suits. The defence of illegality is in this context a purely technical one and even more unmeritorious than it normally would be when only natural persons are involved. The veil of incorporation should not be allowed to obscure the reality of who is the wrongdoer and who the wronged.

V. WHO CAN SUE?

Thus far the discussion has concentrated upon establishing the company's cause of action. But a company cannot in a literal sense sue,

⁸⁷ *Supra*, note 6.

⁸⁸ *Supra*, note 73, at p. 126a.

⁸⁹ The case against the eighth defendant was discontinued on compassionate grounds. The seventh defendant was not made a respondent to the subsequent appeal against Foster J.'s second dismissal of the company's claim: [1980] 1 All E.R. 393, 396.

any more than it can commit a crime, That is left to its organs, the Board of Directors or the body of shareholders.

On the assumption that the Board of Directors will not initiate a suit, the last but by no means least problem is to determine under what circumstances a disgruntled shareholder might sue. The main obstacle in the shareholder's path is the fact that in law the company and the corporators are distinct. The duties owed by the company's officers—whether fiduciary, contractual or otherwise—are owed to the company, not to the shareholders, even shareholders who own 99% of the company's shares.⁹⁰ The general rule is that the officers of the company owe no fiduciary duties to the shareholders.⁹¹

It follows from this that the proper party to sue is therefore the company. The problems inherent in treating a metaphysical entity as the only proper plaintiff are legion. Who is the company for this purpose? The courts have come down in favour of majority rule. If a majority of the members wish to sue, the company will sue; if the majority do not wish to sue, a minority member will not be entitled to do so on the company's behalf. This essentially is what the rule in *Foss v. Harbottle*⁹² is all about. As Jenkins L.J. explained in *Edwards v. Halliwell*:⁹³

The rule in *Foss v. Harbottle*, as I understand it, comes to no more than this. First the proper plaintiff in an action in respect of a wrong alleged to be done to a company... is prima facie the company... itself. Secondly, where the alleged wrong is a transaction which might be made binding on the company ... and all its members by a simple majority of the members, no individual member of the company... is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company... is in favour of what has been done, then cadit quaestio. No wrong has been done to the company... and there is nothing in respect of which anyone can sue. If, on the other hand, a simple majority of the members of the company is against what has been done, then there is no valid reason why the company... itself should not sue.

(The Malaysian Federal Court has accepted that this rule is part of Malaysian law.⁹⁴ The same is probably true of Singapore law.⁹⁵)

Thus if the aggrieved shareholders own a majority of the company's shares, in practice they will be able to institute a suit. If the Articles of Association reserve the power of suing to the General Meeting, then it is just a matter of passing the necessary resolutions. If the power to sue is vested in the Board of Directors, compliance with the wishes of the majority may be obtained by the threat to remove, or the actual removal of, the recalcitrant directors.

⁹⁰ Lord Atkin in *Bell v. Lever Brothers Ltd.* [1931] All E.R. 1, 33

⁹¹ *Percival v. Wright* [1902] 2 Ch. 421.

⁹² *Foss v. Harbottle* (1843) 2 Hare 461.

⁹³ [1950] 2 All E.R. 1064, 1066.

⁹⁴ E.g. see *Paidah Genganaidu v. Lower Perak Syndicate Sdn. Bhd.* [1974] 1 M.L.J. 220; *Re Kong Thai Sawmill (Miri) Sdn. Bhd.* [1976] 1 M.L.J. 59.

⁹⁵ There appears to be only one reported case, a decision of Choor Singh J. at first instance, applying the rule in Singapore. See *Data Aw Kow v. Haw Par Bros. (Pte.) Ltd.* [1972] 2 M.L.J. 225.

It is where the aggrieved shareholders do not own or control a majority of the company's shares that the most intractable problems arise. They may still sue on the company's behalf in a derivative action (an Americanism that has found acceptance in the English courts.)⁹⁶ In prosecuting this derivative action the minority shareholder is seeking to vindicate the company's rights and not his own personal rights. Procedurally the action takes the form of a representative action under Order 15 rule 12 of the Rules of the Supreme Court. The company is made a nominal defendant, to ensure that it will be bound by the result.⁹⁷

Unless the minority shareholder can bring the facts of the case within one of the exceptions to the rule in *Foss v. Harbottle* he runs the risk that the majority will cut the ground from under his feet by electing not to sue. In the customary analysis there are four exceptions to the rule:⁹⁸

- (a) where the act complained of is ultra vires the company or illegal;
- (b) where a special majority is required for doing the act;
- (c) where a personal right of the plaintiff has been infringed; and
- (d) where there has been a fraud on the minority.

What these exceptions boil down to is this: a minority shareholder can only sue when what he complains of could not validly be effected or ratified by an ordinary resolution.⁹⁹

Where the breach of duty in respect of which the suit is sought to be brought is a breach of a contractual duty, it is open to the majority to ratify the breach. A minority shareholder would therefore be unable to maintain a derivative action. Similarly if the officer's breach of duty consists only of negligence, even gross negligence, the court will not allow a minority shareholder to sue on the company's behalf.¹ However, in *Daniels v. Templeman J.* was prepared to allow a minority shareholder's action where the directors had benefitted from their own negligence. The probable basis of that decision was that such self-serving negligence might point to bad faith on the part of the directors in using their powers or to fraud.³ Be that as it may, mere negligence is *prima facie* ratifiable and a minority shareholder cannot maintain an action if the majority will not.

⁹⁶ See *Wallersteiner v. Moir (No. 2)* [1975] Q.B. 373; *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)* [1982] 2 All E.R. 354.

⁹⁷ Chitty L.J. in *Spokes v. The Grosvenor & West End Railway Terminus Hotel Co. Ltd.* [1897] 2 Q.B. 124, 128.

⁹⁸ Schmitthoff, *Palmer's Company Law* (22nd Ed., 1976), p. 603; Boyle and Sykes, *Gore-Brown on Companies* (43rd Ed., 1982) 28-3; Pennington, *Company Law* (4th Ed., 1979), p. 592; Gower, *op.cit.*, *supra* note 62, p. 644; Wedderburn, "Shareholders' Rights and the Rule in *Foss v. Harbottle*", [1957] Camb L.J. 194, 203.

⁹⁹ Gower, *op. cit.*, *supra* note 64, p. 645.

¹ *Pavlides v. Jensen* [1956] Ch. 565.

² *Supra*, note 59.

³ See Boyle, "Minority Shareholders' Suits for Breach of Directors' Duties" (1980) 1 Co. Law 3.

Where the officer has breached his fiduciary duty in making his company a party to a crime, three possibilities suggest themselves. Firstly, the minority shareholder might sue on the basis that some personal right of his had been infringed. In *Prudential Assurance Co. Ltd. v. Newman Industries Ltd. (No. 2)*⁴, Prudential sued in their personal capacity as well as on behalf of the other shareholders of Newman. The Court of Appeal considered that this was a tactical move designed to circumvent the rule in *Foss v. Harbottle*. They held that the personal action was “misconceived”. In the first place the shareholders had suffered no damage independently of the damage done to the company, the Court of Appeal held. The plaintiff’s shares were merely a right of participation in the company on the terms of the articles of association; these were still the plaintiff’s own absolutely unencumbered property, and had not been directly affected by the company’s loss (cold comfort one might think if the defendant’s deceit had rendered them valueless). The “loss” was not one in respect of which an individual shareholder might sue. Secondly, the Court of Appeal felt that to allow the personal action would be to subvert the rule in *Foss v. Harbottle*. They considered that this would be undesirable.⁵ In view of the attitude of the Court of Appeal it is unlikely that a personal action would be allowed in a claim such as this.

The second possibility is to bring the facts within the exception in respect of acts that are *ultra vires* or illegal. If the act complained of is beyond the powers of the company or, *a fortiori*, illegal, it is said that the minority shareholder has a right to sue to restrain the company from committing that act.⁶ What is the situation when the act has already been committed and the company has suffered loss thereby? May the majority ratify such an act so that a minority shareholder is debarred from suing?

It is important to distinguish between the illegality and the officer’s breach of duty. The company’s cause of action, and therefore that of the minority shareholder prosecuting the derivative action, does not arise out of the crime *per se*; it arises out of the officer’s breach of duty in making the company party to the illegal transaction. Some breaches of duty have been held to be ratifiable⁷ by a majority of the company, *e.g.* in a conflict of interest situation⁷ or where an officer has used his powers for an improper purpose.⁸ On the other hand if the breach amounts to a fraud on the minority it cannot be ratified and the minority shareholder may sue to enforce the company’s rights whatever the wishes of the majority.

This leads us to the third possibility, the fraud on the minority exception to the rule in *Foss v. Harbottle*. To establish that there has been a fraud on the minority it is necessary to show firstly that the wrong to the company was a wrong of a fraudulent character and

⁴ *Supra*, note 96.

⁵ *Ibid.*, pp. 366d-368d.

⁶ *Powell v. Kempton Park Racecourse* [1897] 2 Q.B. 242, 260 (*per* Lindley L.J.), 268 (*per* Lopes L.J.); also Wedderburn, *supra* note 98, p. 205; Pennington, *op. cit.*, *supra* note 104, p. 592.

⁷ *E.g. Regal (Hastings) Ltd. v. Gulliver* [1942] 1 All E.R. 378; *North Western Transportation Co. Ltd. v. Beatty* (1887) 12 App. Cas. 589.

⁸ *E.g. Bamford v. Bamford* [1969] 2 W.L.R. 1107; *Hogg v. Cramphorn* [1967] 2 Ch. 254.

secondly that the wrongdoers were in control of the company.⁹ The exact ambit of the word "fraud" in this context has not yet been definitively defined. The scarcity of cases in which this exception has been successfully invoked indicates the difficulty of pleading and proving "fraud". Perhaps for this reason there seems to have been a slight tendency to relax the exception in recent cases.

In *Daniels v. Daniels*¹⁰ Templeman J. clearly felt that fraud did not have to amount to common law fraud. He allowed a minority shareholder's action to proceed notwithstanding that no fraud was either pleaded or alleged. The principle that he gleaned from the authorities was that "a minority shareholder who has no other remedy may sue where directors use their powers, intentionally or unintentionally, fraudulently or negligently, in a manner that benefits themselves at the expense of the company."¹¹

In the *Prudential Assurance* case¹² Vinelott J. said this in relation to the meaning of the word "fraud":

The authorities show that the exception applies not only where the allegation is that directors who control a company have improperly appropriated to themselves money, property or advantages which belong to the company or, in breach of their duty to the company, have diverted to themselves business which ought to have been given to the company, but generally where it is alleged that directors... are guilty of a breach of duty to the company (including their duty to exercise proper care) and as a result of that breach obtain a benefit.¹³

The judge felt that the use of the majority's voting power to prevent an action being brought was "unconscionable" and might amount to fraud.¹⁴ As regards control Vinelott J. decided that the test was whether the defendants were "able by any means of manipulation of their position in the company to ensure that the action was not brought by the company".¹⁵ This meant that the defendants could be in control of the company even though they did not own a majority of the shares. The Court of Appeal dissented from the judge's innovative reasoning on the issue of control. They felt that the shareholders should have been given the chance to decide whether to sue or not. The Court of Appeal said nothing however with respect to the judge's exposition of the meaning of "fraud"; nor did they comment on the judgment of Templeman J. in *Daniels v. Daniels*.¹⁶

Wedderburn criticises the dicta on the meaning of fraud in the judgment of Vinelott J.¹⁷ In his view, precedent suggests that the line between ratifiability and non-ratifiability should be drawn where

⁹ Vinelott J. in *Prudential Assurance Co. Ltd. v. Newman Industries Ltd.* (No. 2) [1980] 2 All E.R. 841, 861.

¹⁰ *Supra*, note 59.

¹¹ *Ibid.*, p. 80.

¹² *Supra*, note 108.

¹³ *Ibid.*, at p. 869a-c.

¹⁴ *Ibid.*, at p. 862d-f.

¹⁵ *Ibid.*, at p. 875f.

¹⁶ *Supra*, note 59.

¹⁷ Wedderburn, "Derivative Actions and *Foss v. Horbottle*", (1981) 44 M.L.R. 202.

the directors act *mala fide* (presumably meaning not *bona fide* in the interests of the company) or where the property of the company has been misappropriated directly or indirectly. Standard textbooks are content merely to enumerate the situations in which a fraud has been held to have occurred.¹⁸

What is common to all these academic and judicial statements is the notion that if the director obtains some benefit at the company's expense there is likely to be a fraud in respect of which a minority shareholder may bring a derivative action. Adverting to the distinction drawn above¹⁹ between situations in which an officer acts to benefit himself and situations where he acts out of a misguided appreciation of what is in the company's interest, it is submitted that in the former case there will be sufficient grounds to justify a minority shareholder's action. That is to say, if the officer intentionally involves the company in a crime, acting for his own benefit, a minority shareholder should be able to sue him on the company's behalf if the majority will not. Conversely, if he intentionally involves the company in a crime thinking that it is in the company's interest and he obtains no benefit at the company's expense, it is open to the majority to forgive him his trespasses. A minority shareholder would not in this case be entitled to sue. Although the statements quoted above were all made in connection with directors, it is submitted that the same principles also apply to managerial officers who are not directors.²⁰

VI. THE ALTERNATIVE REMEDY

As an alternative to a derivative action—with all its attendant problems—an aggrieved shareholder might try to invoke section 181. This section, though it traces its descent from section 210 of the U.K. Companies Act 1948 and from section 186 of the Australian Companies Act 1961, is significantly wider than the corresponding provisions in those acts.²¹

Section 181 comes into play under the following circumstances:²²

- (1) If the affairs of the company are being conducted in a manner oppressive to a member; or
- (2) If the affairs of the company are being conducted in disregard of a member's interests; or
- (3) If the powers of the directors are being exercised in a manner oppressive to a member; or
- (4) If the powers of the directors are being exercised in disregard of a member's interests; or

¹⁸ E.g. Gower, *op. cit.*, *supra*, note 64, pp. 616-623; Schmitthoff, *op. cit.*, *supra*, note 98, pp. 603-607; Pennington, *op. cit.*, *supra*, note 98, pp. 594-600.

¹⁹ *Supra*, part III.

²⁰ *Supra*, part III.

²¹ See comments of Lord Wilberforce in *Re Kong Thai Sawmill (Miri) Sdn. Bhd.* [1978] 2 M.L.J. 227, 228F. His Lordship's remarks, though made with reference to s. 181 of the Malaysian Companies Act 1965, are equally applicable to s. 181 of the Companies Act, Cap. 185.

²² See P. Pillai, "Enforcement of Directors' Duties and Oppression" [1976] 1 M.L.J. 1xxii; "Oppression of Minority Shareholders: The Singapore and Malaysian Experience", [1979] Mal. L.R. 241.

- (5) If some act of the company has been done which unfairly discriminates against a member; or
- (6) If some act of the company has been done which is prejudicial to a member; or
- (7) If some act of the company is threatened which unfairly discriminates against a member; or
- (8) If some act of the company is threatened which is prejudicial to a member; or
- (9) If some resolution of the company has been passed which unfairly discriminates against a member; or
- (10) If some resolution of the company passed which is prejudicial to a member; or
- (11) If some resolution of the company is proposed which unfairly discriminates against a member; or
- (12) If some resolution of the company is proposed which is prejudicial to a member.

The court is empowered "to make such order as it thinks fit";²³ conceivably this could include authorising civil proceedings to be brought in the company's name by a minority shareholder where the majority refuses to do so.²⁴

The terms of section 181 seem wide enough to cover the situation where an officer of the company dissipates the company's funds in committing a crime. Such conduct might fairly be described as conduct "in disregard of [a member's] interests" or an act "prejudicial" to a member.

However, when the company's funds are dissipated all members suffer alike. Lord Wilberforce (delivering the judgment of the Privy Council) spoke in terms of a minority suffering at the hands of the majority when he defined "oppression" and "disregard" in the *Kong Thai* case.²⁵ Can it be inferred from this that section 181 only applies in a majority-minority situation, and that it has no application where all members are equally prejudiced?

Section 181 is not on the face of it limited to the case of a majority acting at the expense of the minority. The real question is, if the majority refuse to sue an officer in respect of his breach of duty, should a minority shareholder be allowed to do so? What the answer will be depends essentially on judicial policy. If the courts allow such a suit, section 181 is wide enough in its terms to accommodate it.

It is suggested that the courts should come down in favour of allowing such suits under section 181. First, as discussed in Part V above, the acts of the officer in the situation postulated are probably not ratifiable at common law. If a minority shareholder could sue under the more restrictive common law rule, it seems absurd that he

²³ Section 181(2).

²⁴ In the U.K. s. 75(4) (c) of the Companies Act 1980 explicitly provides for this. This section has superseded s. 210 of the Companies Act 1948.

²⁵ *Supra*, note 21 at p. 229.

cannot do so under section 181. Secondly, it has been the English experience that the rule in *Foss v. Harbottle* is too restrictive; it was for this reason that the Jenkins committee recommended that the court have power to authorise civil proceedings to be brought in the company's name.²⁶ English law has been reformed to achieve this aim by the introduction of section 75 of the Companies Act 1980. It would be a shame if local courts were to interpret section 181 so narrowly that litigants are driven back to the rigours of *Foss v. Harbottle*. Finally, it is submitted that as a matter of public policy, it should not be open to the majority to forgive a corporate officer for breaking the law. Any shareholder so minded should as a matter of policy be entitled to make such an officer account to the company.

The remedy of last resort is that contained in section 305 of the Companies Act, Cap. 185. This provides that in a winding-up a contributory may petition the court to "examine into" the conduct of corporate officers. If the court finds that such an officer has "mis-applied or retained or become liable or accountable for any money or property of the company or been guilty of any misfeasance or breach of trust or duty", it may order that the officer compensate the company for its loss. Since this remedy can only be obtained on winding-up, it is unlikely to be of much utility to a shareholder who does not desire to kill the goose that has thus far laid golden eggs.

VII. CONCLUSION

Given the increasing dominance of the corporate form of business organisation, it is not unlikely that the problem of corporate crime will increase rather than decrease. Two examples from America illustrate the kind of sums that a company could lose when its officers involve it in crime.

In 1976, in the wake of the inquiry into the Watergate Scandal, three top executives of the U.S. corporation R.J. Reynolds Industries were forced to resign from the board of directors after disclosures that up to US\$100,000 in corporate funds had been expended in questionable payments to foreign government officials. A further US\$65,000 to US\$90,000 had been contributed illegally to state and federal political candidates.²⁷ In the same year the chairman and chief executive of the Gulf Oil Corporation was asked by the board of directors to resign after a court-ordered report criticised the corporation's illegal political activities, which involved the expenditure of US\$12 million in corporate monies.²⁸ No further action was taken in either of the cases to recover any of the money lost to the corporations, although the three executives of R.J. Reynolds did agree to make good some of the payments.

One must sympathise with the shareholders of the corporations involved. The focus of the court's attention has thus far been on how best to punish companies involved in crime. Little thought has been spared for the persons who are actually called upon to pay the penalty — the innocent shareholders. A shareholder who is called upon to pay for someone else's sins may very well feel that the whole business

²⁶ Report of the Company Law Committee (1964) Cmnd. 1749, para. 206.

²⁷ *New York Times*, 29 May 1976, p. 1 col. 5.

²⁸ *New York Times*, 14 Jan. 1976, p. 1 col. 2.

is unjust. It was with this person in mind that this article was written. The following summary is directed at such a shareholder who may feel inclined to try to recover compensation on the company's behalf from the officers responsible.

1. In order to succeed in such a suit, the shareholder must establish that the corporate officer is in breach of some duty to the company.
2. Involving one's company in an illegal transaction is a breach of a corporate officer's duty to his company:
 - (a) If the officer intentionally involves the company in a crime he will be in breach of his duty under section 132(1) to act in the company's interests on the ground that:
 - (i) he has misapplied funds of which he is in law trustee and/or
 - (ii) he has abused the powers entrusted to him.
 - (b) If he negligently involves the company in a crime, he is likely to be in breach of a duty to use care and skill in the discharge of his duties.
3. The problem is that if the corporate officer represents the company's directing mind and will in the transaction, the company will be party to the illegality. A party to an illegality cannot be assisted by the courts in an action based upon that illegality.
4. To avoid this problem, the action should be pleaded on the basis of the officer's breach of trust and misfeasance, rather than on the basis of the illegal transaction.
5. Having established the foregoing, the shareholder should obtain the sanction of the majority to institute a derivative action.
6. If he cannot obtain the sanction of the majority he may either
 - (a) institute a minority shareholder's action under the 'fraud on the minority' exception to the rule in *Foss v. Harbottle* or
 - (b) institute an action under section 181 of the Companies Act, Cap. 185 alleging either that the affairs of the company are being conducted in disregard of his interests or that some act of the company has been done that is prejudicial to himself.

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