Nair & Co.

LEGAL UPDATE

March 2019

Ozak Seiko Co Ltd v Ozak Seiko (S) Pte Ltd and another and other matters [2019] SGHC 34

Court dismisses action as shareholder lacked good faith

Introduction

Shareholders play an important role in corporate governance and have a myriad of options to remedy a situation in the event that the company fails to act in a proper manner. One such option is to apply to Court for leave under section 216A of the *Companies Act (Cap. 50)* to commence an action on the company's behalf against a wrongdoer ("**216A Application**"). However, in a 216A Application, the Court will scrutinise the merits of the case and the applicant's intentions. To obtain leave, the applicant must establish that proper notice was given to directors, that the 216A Application is brought in good faith, and that it is brought in the interests of the company.

In *Ozak Seiko Co Ltd v Ozak Seiko (S) Pte Ltd and another and other matters [2019] SGHC 34* (the "**Judgement**"), the Court dismissed a 216A Application, finding that the applicant failed to meet any of these requirements.

The Action

In HC/OS 1027/2018, the applicant, Ozak Seiko Co Ltd ("**Ozak Japan**"), sought leave under section 216A of the *Companies Act (Cap. 50)* to commence a derivative action against its director, Mr Tan Hock Seng ("**Tan**"), for breaches of director's duties owed to Ozak Seiko (S) Pte Ltd (the "**Company**").

Ozak Japan alleged that Tan had breached his director's duties to the Company by acting in conflict of the Company's interest by (among other things) wrongfully causing it to incur expenses on behalf of a company known as Shafttech Pte Ltd ("**Shafttech**").

Facts

The Company was incorporated on 2 October 1993. Mr Masakazu Ozaki ("**Ozaki**"), along with a nominee appointed by Tan's elder brother, were equal shareholders and the Company's only two directors. As Ozaki was at the material time based

in Japan, Tan was hired as an employee to oversee the daily operations of the Company in Singapore.

Shares were eventually transferred such that Ozak Japan and Tan each held 50% of the Company's shares, thus being the 2 shareholders of the Company.

Ozaki claimed that he did not know of Tan's involvement in Shafttech until early December 2013, when he chanced upon a Shafttech brochure which showed that Shafttech was operating from the same address and used the same contact details as the Company.

On 18 November 2014, Ozaki confronted Tan with a "Correction Document", estimating that Tan had caused the Company to suffer losses of at least $2.7m. However, Tan did not compensate the Company for the alleged losses.

Thereafter, on 31 December 2014, Tan was appointed as a director of the Company.

Subsequently, in or around January 2015, Ozak appointed WM Automation Pte Ltd ("**WM Automation**") as the new distributor for Ozak products in Singapore. As a result, the Company ceased operations and became dormant from February 2015 onwards.

On 27 June 2017, Ozak Japan's solicitors issued a letter of demand to the Company, Tan and Ozaki. The letter of demand alleged that Tan had acted wrongfully when he was an employee and when he was a director of the Company. Furthermore, the letter of demand also made an allegation against the Company for "dealing with" Ozak's trade mark without its permission.

The Decision of the Singapore High Court

Pursuant to section 216A(3) of the *Companies Act (Cap. 50)*, the Honourable Justice Tan Siong Thye considered whether the following statutory requirements had been met by Ozak Japan:

(a) Whether Ozak Japan had given 14 days' notice to the directors of the Company of its intention to apply to the Court under subsection section 216A(2) of the *Companies Act (Cap. 50)* if the directors of the Company did not bring an action against Tan (the "**Notice Requirement**");

(b) Whether Ozak Japan was acting in good faith (the "**Good Faith Requirement**"); and

(c) Whether it appears to be prima facie in the interests of the Company that the action against Tan be brought (the "**Company's Interests Requirement**").

The Notice Requirement

Ozak Japan relied on the letter of demand dated 27 June 2017 for the purposes of satisfying the Notice Requirement. However, the learned Judge rejected this. At the outset, the learned Judge noted that the letter of demand did not make any reference to section 216A of the *Companies Act (Cap. 50)*.

The learned Judge went on to observe that the letter of demand not only made allegations against Tan but also made allegations against the Company for "dealing with" Ozak's trade mark without its permission. His Honour noted that such an action for infringement of trade mark against the Company was not a matter for a derivative action on the Company's behalf under s 216A of the *Companies Act (Cap. 50)*.

Further, the learned Judge held that the letter of demand failed to specify that Ozak Japan intended to apply for leave to bring an action in the name and on behalf of the Company if the directors did not do so themselves. The 14 days' notice requirement was also not adhered to as only 7 days was given.

For these reasons, the learned Judge held that Ozak Japan failed to satisfy the Notice Requirement. Although this ground alone was sufficient to dismiss the 216A Application, the learned Judge nonetheless proceeded to consider whether the Good Faith and Company's Interests Requirements were satisfied.

The Good Faith Requirement

In a 216A Application, an applicant bears the burden of satisfying the Court that it is acting in good faith. In Ozak Japan's case, the learned Judge was not satisfied that it was acting in good faith for three reasons.

First, the learned Judge held that Ozak Japan failed to act expediently. His Honour noted that Ozak Japan knew about Tan's alleged breaches in December 2013 when Ozaki discovered a Shafttech brochure. Then, on 18 November 2014, Ozaki confronted Tan with a "Correction Document". Despite the discovery and confrontation, the learned Judge observed that Ozak Japan's 216A Application was made only on on 20 August 2018, more than 4 years after the discovery in December 2013. There was no satisfactory explanation for the delay.

Second, His Honour held that Ozak Japan's motivations in commencing the proceedings were questionable. Despite having knowledge of the alleged wrongful acts between December 2013 and 18 November 2014, Ozak Japan nonetheless agreed to appoint Tan as a director of the Company on 31 December 2014. The learned Judge opined that if Ozak Japan was truly concerned by Tan's alleged wrongdoing, it should have acted expediently to correct or remedy the situation and should not have waited until August 2018 to do so. At the very least, it should not have allowed Tan to be appointed as a director.

Third, the learned Judge was of the view that Ozak Japan lacked candour in bringing its 216A Application. A crucial fact in the 216A Application was the timing of Ozak Japan's knowledge of Tan's beneficial interest in Shafttech. Ozak Japan initially claimed that it first became aware of this in November 2014. However, when confronted with objective evidence showing otherwise, it shifted its position by stating that it had discovered Tan's beneficial interest only in December 2013, when it came across a Shafttech brochure. This change of position over a crucial fact was not viewed favourably by the learned Judge.

In view of the above, the learned Judge held that Ozak Japan failed to satisfy the Good Faith Requirement.

The Company's Interests Requirement

Finally, the learned Judge also found that Ozak Japan's 216A Application was not prima facie in the interests of the Company.

On a matter of procedure, the learned Judge stated that the Court was "only able to deal with matters raised in the prayers in OS 1027/2018". As OS 1027/2018 prayed for leave in respect of Tan's alleged breach of director's duties and not his alleged breach of employee's duties, the Court found that it was not able to consider allegations of loss or wrongdoing which occurred prior to Tan's appointment as a director on 31 December 2014.

Further, His Honour was not satisfied that it was "in the practical and commercial interests of the Company" to pursue an action against Tan for an alleged breach of director's duties.

The learned Judge emphasised that Ozak Japan was aware of the alleged wrongful acts of Tan between December 2013 and 18 November 2014 (at the latest). Notwithstanding this knowledge, Ozak Japan agreed to Tan's appointment as a director of the Company on 31 December 2014.

It was also observed that Ozak Japan appointed WM Automation in or around January 2015, thereby replacing the Company. In February 2015, the Company became dormant. His Honour opined that the purported losses sustained by the Company, if any, between 31 December 2014 (the date Tan was appointed as director of the Company) and February 2015 (when the Company became dormant), would not be large. His Honour however went on to say that even if losses were suffered by the Company as a result of Tan's failure to disclose his alleged wrongful acts, Ozak Japan was fully aware of the breaches but chose not to pursue an action when it had the opportunity to do so.

Finally, it was clear to the learned Judge that the relationship between Ozaki and Tan had broken down and that there was "no viable prospect of the two parties working together again".

Given the above, the learned Judge was not satisfied that it was prima facie in the interests of the Company to be embroiled in costly and drawn-out litigation.

Practical Implications

Ozak Japan's 216A Application was dismissed as it failed to satisfy any of the requirements under section 216A(3) of the *Companies Act (Cap. 50)*. Notably, the learned Judge observed that Ozak Japan failed to act expediently when it discovered Tan's alleged wrongful conduct in December 2013.

In respect of the Notice Requirement, the Honourable Justice Judith Prakash (as she then was) stated in *Fong Wai Lyn Carolyn v Airtrust (Singapore) Pte Ltd and another [2011] 3 SLR 980*, that the Court has the power to dispense with notice or to make such orders as the court thinks fit for the giving of notice if it is not expedient to give notice prior to the commencement of the action. The burden thus falls on an applicant to show why notice, as required under s 216A(3)(a) of the Act, could not have been given.

Although the case of *Fong Wai Lyn Carolyn v Airtrust (Singapore) Pte Ltd and another [2011] 3 SLR 980* was not expressly referred to in the Judgement, it can be seen that the learned Judge was not prepared to hold that the Notice Requirement had been satisfied as Ozak Japan failed to explain why the required 14 days' notice could not have been given. This case shows that the Court may be slow to exercise

its power to dispense with the Notice Requirement if no satisfactory explanation is provided.

This Judgement also stresses the need to act quickly if wrongdoing committed by a company employee or director is uncovered. Inordinate delays in bringing an action under section 216A of the *Companies Act (Cap. 50)* may show a lack of good faith if such delays cannot be satisfactorily explained.

Finally, the Judgement shows that the Court will consider the practical and commercial interests of the Company when determining whether leave should be granted under section 216A of the *Companies Act (Cap. 50)*, even if losses may have been sustained by the alleged wrongdoing.

The Defendant, Tan, was represented by **Mr Bryan Tan** and **Ms Chantik Bhatt** of Nair & Co LLC.

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