

Derivative Proceedings – Leave of Court a Substantive Requirement of Law

The Court of Appeal in *Ng Boon Teik v Chang Tong Lee*¹ rules that section 347(1) and (2) of the Companies Act 2016, requiring leave of court to be obtained before any action may be initiated on behalf of a company and that any such action be brought in the name of the company, are substantive law and not merely procedural.

Section 347 of the Companies Act 2016

Section 347 provides for statutory derivative proceedings. It reads as follows:

- (1) A complainant may, with the leave of the Court initiate, intervene in or defend a proceeding on behalf of the company.
- (2) Proceedings brought under this section shall be brought in the company's name.
- (3) The right of any person to bring, intervene in, defend or discontinue any proceedings on behalf of a company at common law is abrogated.

In *Ng Boon Teik*, one of the arguments raised by the respondent is that the non-compliance of section 347(1) and (2) is mere irregularity which can be cured and/or be amended.

Facts of the case

In the case, the respondent obtained an order from the High Court to commence a legal action, purportedly on behalf of the company. The respondent then brought a writ action against the alleged wrongdoers including the appellant (a director of the company) and named the company as a nominal defendant. In the writ action, the respondent pleaded that the action was commenced pursuant to the said order of the High Court and sought remedies on behalf of the company.

However, the said order of the High Court does not state that leave was granted for the respondent to initiate an action *on behalf of* the company. To the contrary, the said order states that it gives leave to the respondent to initiate an action *against* the company. The appellant therefore applied to strike out the writ action against him.

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Legal Position

We acted for the appellant both at the High Court and at the Court of Appeal. We argued that the requirement for leave of the court under section 347(1) is not merely form or procedural in nature. It is to be regarded as substantive because it is only with permission of the court that a complainant has standing to bring the claim for or on behalf of the company².

In furtherance of that argument, we also contended that the writ action could not be saved by amendments because the illegalities concern the locus standi of the respondent to bring the action on behalf of the company.

As this was a novel point of law in Malaysia, we sought guidance from foreign authorities.

The BVI Business Companies Act 2004 has similar provision as our section 347 of the Companies Act 2016:

184C. (1) Subject to subsection (3), the Court may, on the application of a member of a company, grant leave to that member to (a) bring proceedings in the name and on behalf of that company; or (b) intervene in the proceedings to which the company is a party for the purpose of continuing, defending or discontinuing the proceedings on behalf of the company.

On the application of section 184C, it was observed in *Novatrust Ltd v Kea Investments Ltd and other companies*³ that:

*40. Vaughn v. LJ International Inc, an unreported decision of the Court of Appeal of the State of California, was concerned with a derivative claim commenced in California in respect of a BVI registered company. Permission to commence the proceedings had not been obtained from the BVI Court and the claim was struck out. That decision was upheld on appeal. There as here it was argued that the requirement for permission was procedural rather than substantive and thus the absence of permission from the BVI Court was not a bar to bringing the claim. That argument was rejected both at first instance and on appeal. The Court of Appeal of California held that s.184C had the effect of limiting the entitlement to sue to those shareholders who had complied with its provisions. **It acknowledged that the requirement to apply for leave was in a sense procedural but the requirement for permission from the BVI court was to be regarded as substantive because it was only with permission that a shareholder had standing to bring the claim.** In reaching that conclusion, the Court of Appeal of California applied Hausman (ante) - the authority applied in the authority approved and followed by Lawrence Collins J in Konananeni at [50].*

² *Novatrust Ltd v Kea Investments Ltd and other companies* [2014] EWHC 4061 (Ch), at paragraph 40

³ *Novatrust Ltd v Kea Investments Ltd and other companies* [2014] EWHC 4061 (Ch)

Also, in *Wong Ming Bun v Wang Ming Fan & Ors*⁴, a derivative claim had been brought in Hong Kong by a shareholder in a BVI registered company. Leave had not been obtained from the BVI High Court as required by section 184C and the case was struck out. Ng J analysed the position in these terms:

*whether a shareholder can commence a derivative action in the name and on behalf of the company is **a matter of substantive law**, and is governed by the law of the place of incorporation ... In the present case, this question is governed by BVI law. **Under BVI law, a shareholder can commence a derivative action ... with leave of the BVI Court. No leave has been obtained. The action as presently constituted is defective.***

Comments

Following the Court of Appeal decision, it is now clear that the violations of section 347(1) and (2) are not mere irregularities, but illegalities.

Therefore, it is a plain and obvious case for striking out where leave of the court has not been obtained to commence a derivative action on behalf of a company. The take-away is that, one must get leave of the court before commencing a derivative proceeding and the leave order must reflect that the leave granted is for the complainant to take action on behalf of the company.

It must also be borne in mind that the common law derivative action has been abrogated. Thus, a derivative action on behalf of a company cannot be initiated by way of a representative capacity. The complainant, upon obtaining leave of the court to commence an action on behalf of the company, must name the company as the plaintiff in the intended action. It is proven to be futile even if the pleadings made it clear that the action is brought for the benefits of the company.

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