

Statutory oppression action: apex court confirms that remedies may extend to directors and third parties

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The Federal Court decision in *Auspicious Journey Sdn Bhd v Ebony Ritz Sdn Bhd*(1) confirms that remedies in a statutory oppression action may extend to the directors of the subject company and third parties.

Facts

Ebony Ritz Sdn Bhd was a joint venture company formed by the plaintiff (Auspicious Journey Sdn Bhd) and Hoe Leong Corporation Ltd. The plaintiff held 20% of the shares in Ebony Ritz, while Hoe Leong held the remaining 80%. The plaintiff had one nominee director on the board of Ebony Ritz and Hoe Leong had nominated two directors to the board.

Ebony Ritz was formed specifically to acquire 49% of the shares in Semua International Sdn Bhd, a company involved in tanker chartering. The remaining 51% were held by Sumatec Resources Bhd.

Various agreements were entered into involving Ebony Ritz and Sumatec's remaining 51% of the shares in Semua International. In effect, Ebony Ritz and the plaintiff were given two separate options that would collectively allow them to acquire Sumatec's 51% of shares in Semua International if Sumatec did not meet its contractual obligations. One such contractual obligation was a profit shortfall guarantee that Sumatec had given to Ebony Ritz on Semua International's performance.

Sumatec went into financial distress and was unable to meet its contractual obligations to make good on the profit shortfall guarantee.

The plaintiff then discovered that Hoe Leong had entered into a conditional sale and purchase agreement with its nominee, Setinggi Holdings Ltd, Ebony Ritz and Sumatec for the disposal of Sumatec's entire 51% of the shares in Semua International. From this 51% of the shares, 2% were sold to Hoe Leong and the remaining 49% were to be sold to Setinggi. This contravened the two options granted by Sumatec. Further, the conditional sale and purchase agreement required Ebony Ritz to indemnify Setinggi for the contractual obligations of Hoe Leong. These arrangements had taken place without the plaintiff's knowledge.

The plaintiff brought an action for oppression against:

- Hoe Leong;
- Paul Kuah and James Kuah (the Kuah brothers), who were directors of Hoe Leong and its nominees on the board of Ebony Ritz; and
- Setinggi and its sole director, Teh Teong Lay.

High court decision

The high court found the affairs of Ebony Ritz to have been conducted in a manner that was oppressive with respect to the plaintiff as its minority shareholder. The court ordered the winding up of Ebony Ritz but dismissed the claims against the other defendants. Ebony Ritz was not in good financial health.

The plaintiff appealed against the order to wind up Ebony Ritz and the dismissal of its claim against the

AUTHORS

[Foo Joon Liang](#)



[Carissa How](#)



defendants other than Hoe Leong (and Ebony Ritz). Hoe Leong also appealed the court's finding of liability on Hoe Leong's part.

Court of Appeal decision

The Court of Appeal dismissed the plaintiff's appeal. The finding of oppression against Hoe Leong was upheld. On the facts, the Court of Appeal found a buy-out order to have been inappropriate. Thus, the winding up of Ebony Ritz was also upheld.

The Court of Appeal then affirmed the high court finding that directors cannot be held personally liable for the acts of their companies unless it was a personal act or wrongdoing by the directors outside its obvious agency. Thus, the dismissal of the claim against the Kuah brothers was upheld.

With regard to Setinggi and its director, given that the conditional sale and purchase agreement was eventually not completed, the Court of Appeal found no tenable claim.

Leave was granted for the plaintiff to appeal the dismissal of the claims against the Kuah brothers and Teh personally.

Federal Court decision

The pivotal question before the Federal Court was whether the statutory remedy for minority oppression provides for remedies against directors of the subject company and third parties, aside from majority shareholders.

The Federal Court traced the origins of Section 181 under the previous regime of the Companies Act 1965 arising from judicial conservatism in deferring the majority rule and the rule in *Foss v Harbottle*. The court observed that Section 181(1)(a) identifies the conduct of directors as being the subject of scrutiny. It goes on to provide the courts with the freedom to fashion a wide array of remedies at Section 181(2). These may entail penalties against the directors personally. Drawing a distinction between remedies in contract and tort, the Federal Court held as follows:

To that extent statute has cut across or intervened to make provision for personal liability of directors or third parties which is not available under contract law or the common law. Oppression, it should be borne in mind, is a minority shareholder remedy against those controlling the company. That will naturally include the directors who manage the company at the behest of the majority, as well as the majority itself. Therefore, relief against the directors is a natural and logical consequence, if they have indeed behaved oppressively to the minority. This is so by reason of the express provisions of section 181.

The Federal Court went on to observe as follows:

It is of equal importance to incorporate into this construction the purpose and intent of the legislature in enacting this statutory remedy. It is a remedial provision to arrest the mischief of the inadequacies of the common law in protecting the interests of the minority shareholders as examined earlier.

The Federal Court drew support from consistent approaches throughout the Commonwealth. However, this approach was not new to the Malaysian courts. For example, in *Kejutan Holdings Sdn Bhd v Magnum 4D (Perak) Sdn Bhd*,⁽²⁾ the court had refused to strike out third-party companies which had been made parties to an oppression action.

That said, whether the remedies will be extended to such directors will depend on the facts of each case. The English courts have applied the sufficient connection test – namely, whether the director was connected to the unfairly prejudicial conduct in such a way that it would be just in the context of the statutory regime to grant a remedy against that director in connection to said conduct.

The Federal Court concluded that it was:

open to the courts in this jurisdiction to impose liability against directors or third parties provided there is a sufficiently close nexus between the oppressive or unfairly discriminatory conduct, or disregard of the minority's interests or otherwise prejudicial conduct and that party. It requires something more than the mere fact of their being directors who had conduct of the affairs of the company at the material time. It requires deliberate involvement in the impugned transactions, or a sufficiently close nexus, participation or connection to warrant the imposition of liability to directors or third parties.

This is obviously fact sensitive. The Federal Court went on to outline the steps to make this determination in Paragraph 128 of its judgment.

However, on the facts of the present case, the Federal Court accepted the finding of the high court and the Court of Appeal that what the Kuah brothers and Hoe Leong had effected was a salvage and warehouse arrangement, in the best interests of Ebony Ritz. The Federal Court considered the fact that the plaintiff did not want to inject further funds into the joint venture, while Hoe Leong had previously injected RM38 million into Semua International to keep it afloat. As such, the Federal Court agreed that liability should not be visited upon the directors or third parties.

With regard to whether Ebony Ritz should have been wound up, the Federal Court considered the potential statutory contravention of a buy-out order, as that would have resulted in Ebony Ritz no longer being majority Malaysian owned, as well as Ebony Ritz's insolvent state. Ultimately, the Federal Court did not see a basis to interfere with the exercise of judicial power by the high court, which the Court of Appeal had affirmed.

Comment

In this case, the directors concerned were directors of the subject company (Ebony Ritz) and the majority shareholder (Hoe Leong). The *ratio decidendi* of the Federal Court decision concerned the claim against them as directors of the subject company. The Federal Court held that the reach of a remedy in minority oppression extended to third parties.

The Federal Court decision provides a helpful and direct authority for the proposition that remedies in a statutory oppression action may extend to non-majority shareholders. The statutory provision – Section 346 of the Companies Act 2016 (previously Section 181 of the Companies Act 1965) – is clear in this respect. Malaysian case law is consistent. For example, the courts have long been prepared to consider remedies against directors who are in breach of their fiduciary duties (eg, *Automobiles Peugeot SA v Asia Automobile Industries Sdn Bhd*).⁽³⁾ Remedies in statutory oppression actions being wide and unfettered is not new to Malaysian case law (see, for example, *Re Kong Thai Sawmill (Miri) Sdn Bhd*).⁽⁴⁾

The intent of statutory remedies is "bringing to an end or remedying the matters complained of". Unless the remedies extend to third parties which have wrongfully benefited from an oppressive act, the matter complained of may not be brought to an end and the oppressive act may not be sufficiently remedied. For example, if a third party has wrongfully received funds misappropriated from the subject company by conduct of the majority, without the wide remedies afforded to the minority, and aside from an action in oppression, the minority may also have to commence a derivative action in the name of the company to recover funds from that third party. The need for a further or separate action does not accord with the intent of Section 346(2) of the Companies Act 2016 (or Section 181(2) of the Companies Act 1965).

On the facts of *Auspicious Journey*, given that the courts accepted the conduct of Hoe Leong to have been oppressive with respect to the plaintiff, it is unclear how the directors (of Ebony Ritz) could be exculpated on the basis that what they and Hoe Leong had effected was in the best interests of Ebony Ritz. On the facts, there was a finding that these directors had conducted the affairs of Ebony Ritz (as its directors) in a manner which unfairly discriminated against the plaintiff.

It would seem more appropriate to have exculpated the directors from liability on the basis that they were not sufficiently connected to the oppressive conduct that would make it fair and just to impose personal liability on them. In this regard, the Court of Appeal observed that it was not the plaintiff's case "that the acts of [the directors] had entered the realm of personal wrongdoing or that they had gone on a personal frolic of their own without Hoe Leong's sanction". Had the Kuah brothers not been nominees of Hoe Leong (as shareholder) on Ebony Ritz's board, this would have been the question to ask. The question should not have been any different with them being nominees of Hoe Leong; it was their conduct which was called into question, not their capacity. After all, they held duties as directors of Ebony Ritz.

Facts aside, the Federal Court decision establishes the wide scope and remedies available in a statutory oppression action, in line with its expressed purpose of "bringing to an end or remedying the matters complained of". This provides welcome clarity with regard to Section 346 of the Companies Act 2016.

For further information on this topic please contact [Foo Joon Liang](mailto:foonliang@ganlaw.my) or [Carissa How](mailto:carissa@ganlaw.my) at Gan Partnership by telephone (+603 7931 7060) or email (foonliang@ganlaw.my or carissa@ganlaw.my). The Gan Partnership website can be accessed at www.ganlaw.my.

Endnotes

(1) [2021] 1 LNS 302.

(2) [2005] 2 CLJ 766.

(3) [1988] 3 MLJ 209.

(4) [1978] 2 MLJ 227.

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