Justifiable Loss of Confidence in Management:
Douglas Foo Peow Yong v ERC Prime II Pte Ltd and another appeal and other matters
[2018] SGCA 67

I. Executive Summary

Under section 254(1)(*i*) of the Companies Act (Cap 50, 2006 Rev Ed) (the "**Act**"), where misconduct by a company's director creates a "**justifiable loss of confidence**" in his/her management of the company, the court may grant an order for the company to be wound up. However, even if such grounds for winding up are established, the court retains a "**residual discretion**" to decline to grant such an order. In *Douglas Foo Peow Yong v ERC Prime II Pte Ltd* [2018] SGCA 67, the shareholders of two separate companies – Douglas Foo ("**Foo**") and Yap Chew Loong ("**Yap**") – each applied to wind up their respective companies on the basis of a justifiable loss of confidence in the directors. The High Court ("**HC**") denied their applications, but the Court of Appeal ("**CA**") granted their appeals.

This case involved two joint ventures entered into by Foo and Ong Siew Kwee ("**Andy Ong**"), being the acquisition and development of: (i) the Big Hotel at 200 Middle Road ("**Big Hotel project**"), and (ii) units in Bugis Cube mall at 470 North Bridge Road ("**Bugis Cube project**"). Foo invested in the Big Hotel project through *ERC Prime II Pte Ltd* ("**ERCP II**"), which held shares in ERC Unicampus Pte Ltd ("**ERCU**"); ERCU acquired and held the Big Hotel project.

Yap invested in the Bugis Cube project through *Gryphon Real Estate Investment Corporation Pte Ltd* ("**GREIC**"), which held shares in Griffin Real Estate Investment Holdings Pte Ltd ("**GREIH**"); GREIH acquired and held the Bugis Cube project. GREIH was involved in *Sakae Holdings Ltd v Gryphon Real Estate Investment Corp Pte Ltd* [2017] SGHC 73 and the subsequent appeal from that decision in *Ho Yew Kong v Sakae Holdings Ltd* [2018] 2 SLR 333 ("***Sakae (CA)***") (the two cases collectively referred to as the "***Sakae* cases**"). In the *Sakae* cases, GREIH was ordered to be wound up and placed under the control of court-appointed liquidators due to Andy Ong's and one Ong Han Boon's ("**Ong HB**") oppressive conduct as GREIH's directors. Criminal charges were also brought against Andy Ong and Ong HB for their conduct *vis-à-vis* GREIH. Separately, both Andy Ong and Ong HB, who had also been directors of ERCP II and GREIC, were disqualified from holding any directorship and ceased to be involved in the management of both ERCP II and GREIC.

ERCP II. The CA found a justifiable loss of confidence *vis-à-vis* ERCP II. It focused on the conduct of Ong HB as a director of ERCP II in relation to a share option granted by ERCU to a related company ERC Holdings (in which Andy Ong also had a financial interest). Pursuant to this share option, a significant number of ERCU shares were issued to ERC Holdings, thereby diluting ERCP II's shareholding in ERCU. The events surrounding this option showed a "serious and obvious lack of probity" on Ong HB's part in his conduct as a ERCP II director, and justified Foo's loss of confidence in his management. The CA also found that the HC erred in exercising its discretion to decline to wind up ERCP II.

GREIC. The CA also found a justifiable loss of confidence *vis-à-vis* GREIC. GREIC borrowed money from ERC Holdings to pay for another party's legal costs in the *Sakae* cases, even though there was no apparent basis for GREIC to do so. GREIC's directors also decided to refrain from collecting an uncontroversial debt from GREIH, which was prejudicial to the interests of GREIC's shareholders. The adverse findings against Ong HB in the *Sakae* cases were also a reason for a loss of confidence, even though the two judgments concerned GREIH and not GREIC. This was because there was a sufficient nexus between GREIC and the serious and fundamental deficiencies identified in the *Sakae* cases in relation to Andy Ong's and Ong

HB's conduct as GREIH directors. The criminal charges against Andy Ong and Ong HB in relation to their conduct *vis-à-vis* GREIH were also relevant to, and did contribute to, a loss of confidence in the management of GREIC by Andy Ong, Ong HB and their associates. Finally, the CA found that the HC also erred in exercising its discretion to decline to wind up GREIC.

II. Issues on Appeal

ERCP II. The first appeal concerned Foo's application to wind up ERCP II under section 254(1)(*i*) of the Act. He first argued that he had a justifiable lack of confidence in the management of the company by Andy Ong and Ong HB as its directors. Alternatively, as the Big Hotel property had been sold, ERCP II had lost its substratum[1] and should therefore be wound up. ERCP II's principal business was the investment in the Big Hotel project via ERCU. The Big Hotel property was sold in 2015 and the monies distributed, and ERCP II's only remaining interests were its proportional share in the following assets: a security deposit from the purchaser of the property (held by ERCU); a sum held in escrow pending a related suit between ERCU and GREIH; and the potential interest in a sum held by the law firm which acted for the purchaser of the property. Foo also argued that the company should be wound up under section 254(1)(*f*) of the Act because the two directors had acted in their own interests rather than the shareholders' interest. ERCP II and two of its shareholders opposed Foo's application.

GREIC. The second appeal concerned Yap's application to wind up GREIC, also under section 254(1)(*i*). Similarly, he argued that misconduct by GREIC's directors had led to a justifiable loss of confidence in the management of the company. Alternatively, GREIC had lost its substratum as a majority of the units held by GREIH in the Bugis Cube property had been sold. GREIC's principal business was to invest in the Bugis Cube project via GREIH, and to distribute the sale proceeds from GREIC's assets to its shareholders. At the time of the CA hearing, GREIH had sold the first five floors of the six-storey Bugis Cube property, but the sixth floor remained unsold. GREIC and two other of its shareholders opposed Yap's application.

The HC dismissed both Foo's and Yap's applications. Notably, the decisions were delivered before the decision in *Sakae (CA)* was issued.

III. Decision of the CA

Under section 254(1)(*i*) of the Act, a court can order a company wound up where it is "just and equitable" that the company be wound up. One situation where this ground is satisfied is "where minority members have been oppressed or treated unfairly by controlling members and have justifiably lost confidence in the management of the company." Where the lack of confidence rests on a lack of probity[2] in the conduct of the company's affairs, such lack of confidence is justified, and it is just and equitable that the company be wound up. Moreover, as a general rule, allegations regarding loss of confidence must be proven before the court can order a winding up. Finally, even if there are grounds for winding up, a lower court's decision to exercise its discretion to decline to wind up a company should not lightly be disturbed.

A. ERCP II

Grounds for winding up. The CA focused on Ong HB's conduct with regard to a 2011 share option, involving 11.94 million ERCU shares, purportedly granted by ERCU to ERC Holdings. The option was authorised by both Andy Ong and Ong HB as the only two directors

[1] Losing the substratum means, generally, a change in the basis on which the parties entered into the relationship.
[2] This means, generally, integrity and honesty.

of ERCU at that time, even though they were both concurrently directors of ERC Holdings, and Andy Ong also held 91.85% of ERC Holdings shares. Subsequently, the share option agreement between ERCU and ERC Holdings was signed by Ong HB on behalf of ERCU, and by Andy Ong on behalf of ERC Holdings. In 2013, ERC Holdings purportedly exercised the option and acquired the ERCU shares. This amounted to around 25.4% of ERCU's new share capital, and immediately diluted the interests of the pre-existing ERCU shareholders, including ERCP II.

Moreover, this share issuance was made by ERCU pursuant to a 2013 resolution which conferred unfettered powers on ERCU's directors to issue new shares in ERCU. The resolution was passed via an Extraordinary General Meeting ("**EGM**"), which Ong HB had called for by a notice dated the same day as the EGM; he also voted in favour of dispensing with the requirement of 14 days' notice for the EGM. Ong HB then chaired the EGM *on behalf of ERCU*, but voted in favour of the resolution on behalf of *ERCP II* , even though this resolution would dilute ERCP II's shareholding in ERCU. And indeed, pursuant to this resolution, a significant number of shares were issued by ERCU to ERC Holdings. Moreover, Ong HB was, at the time of voting, concurrently a director of both ERCU *and* ERC Holdings, and ERC Holdings stood to benefit from the resolutions being passed. Finally, despite the apparent and immediate dilutive effect of the share option and issuance on the interests of ERCP II's shareholders, Ong HB did not disclose these events to the shareholders until around a year later. What the CA called "the gravity and audacity of Ong HB's misconduct" gave rise to a justifiable loss of confidence by Foo in Ong HB's management of ERCP II.

Furthermore, the CA decided that the loss of confidence in Ong HB's conduct remained relevant even though Stephen Tan ("**Tan**") had taken over as the director of ERCP II, and was subsequently joined by Chia Puay Khiang ("**Chia**") as a co-director. Both Tan and Chia were closely associated with Ong HB and Andy Ong. Indeed, there was some suggestion that Chia was a cheque signatory for ERC Holdings, which was inextricably implicated in the above-mentioned share option and issuance by ERCU. Moreover, in her affidavit announcing her appointment as a co-director of ERCP II, Chia did not disclose or disclaim her association with these companies or with Ong HB. This was despite the fact that she and her advisors must have known that such association would be a material concern. The CA found this omission deeply troubling. Additionally, the circumstances under which Tan purported to appoint Chia as a co-director of ERCP II also showed a lack of probity on Tan's part as director as ERCP II: the decision to appoint Chia was made unilaterally without notice to the other shareholders, using procedures which might even have breached an ERCP II's shareholder agreement.

However, the CA disagreed with Foo's submissions, which relied on the findings against Andy Ong and Ong HB in the *Sakae* cases, to show that they must have used similarly unfair and oppressive methods on other companies in the Big Hotel project, including ERCP II. It was inappropriate to rely solely on a director's conduct in one case to allege a propensity for similar conduct in another case, when the cases involved different sets of companies and different business ventures.

HC's decision to not exercise its discretion to wind up. The CA held that the HC had erred in exercising its discretion not to wind up ERCP II. First, the HC had said that there was no pressing reason for the immediate liquidation of ERCP II, and that it remained open to the liquidators (when appointed) to investigate any alleged wrongdoing by Andy Ong and Ong HB. However, the CA noted that the HC had omitted to consider the prejudice that such a delay in an independent investigation of ERCP II's past affairs might have on any potential claim

against its previous management for breach of fiduciary duty and/or other claims, especially if there was a time-bar.[3]

Second, the HC was concerned about potentially complicating ERCU's defence in the dispute between ERCU and GREIH over the escrow sum. However, the CA stated that this concern was better addressed through other means, including a closer supervision of the appointment of ERCP II's liquidators.

Third, the HC opined that having liquidators handle any potential distribution of ERCP II's share in the escrow sum to its shareholders would incur additional and unnecessary expenses. The CA held that this concern was overstated, since liquidators' fees and investigative costs would have to be incurred in any event, even if the company was wound up only after the complete distribution of all returns. Indeed, given the present slow-moving state of affairs, immediate liquidation might result in a faster resolution of the company's affairs and the parties' differences.

Fourth, the HC had stated that not all shareholders were in favour of winding up ERCP II at this point. However, the CA noted while the views of the two dissenting shareholders, who collectively had a 3.96% stake, ought to be given some weight, they were not overriding given the seriousness of the misconduct and the finding of lack of probity, and also given that Foo had a significantly greater shareholding (19.8%) in ERCP II at the material time.

The CA also briefly dealt with the other two grounds for winding up relied on by Foo: (i) that ERCP II had lost its substratum, and (ii) an order pursuant to section 254(1)(*f*) and/or 254(1)(*i*) was appropriate in light of allegations of misconduct against Andy Ong and HB. Regarding the alleged loss of substratum, the CA noted that this ground is usually invoked where the company's original purpose is frustrated or no longer practicable; where the substratum has been fulfilled, the better course would be a voluntary winding up of the company. In any case, given the nature of the investment and ERCP II's shareholder agreement, the substratum of the company must include the recovery and distribution of investment returns from the Big Hotel project, which to date remained uncompleted. Regarding the second ground, the CA observed that several of these allegations related to ERCU instead of ERCP II, and therefore may not fit within the statutory requirement that the directors "acted in the affairs of the company." In any event, there was no need to rely on either of these grounds given the findings above.

B. GREIC

Grounds for winding up. The CA focused on two allegations concerning mishandled money. The first allegation involved GREIC's loans of around $1.12 million over about three years taken out from ERC Holdings, purportedly for the payment of legal costs incurred by one Ho Yew Kong ("**Ho**") in connection with the *Sakae* cases. Ho had been director of both GREIC and GREIH. The CA found at least two acts of misconduct here: (i) the loans were taken out contrary to GREIC's shareholders' agreement, which required GREIC to seek the prior written approval of shareholders holding at least 75% of the company's shares; and (ii) there was no apparent basis for GREIC to have paid for Ho's legal costs. In the *Sakae* cases, Ho was acting as Andy Ong's representative, not GREIC's. The CA disagreed with GREIC's argument that it was in GREIC's interest to assist Ho simply because GREIC was also a co-defendant in the *Sakae* cases. By that logic, GREIC would have paid the legal costs of all co-defendants. Moreover, there was no evidence that GREIC borrowed money for its *own* legal costs in the *Sakae* cases.

[3] This means, generally, a legally prescribed time period within which a claim has to be made.

The second allegation involved GREIC's directors causing GREIC to refrain from collecting on a $370,000 undisputed debt from GREIH. The CA found that this was clearly prejudicial to the interests of GREIC's shareholders, including Yap, and favoured the interests of other shareholders of GREIH.

Although it refused to allow the adverse findings against Ong HB in the *Sakae* cases as a reason for the loss of confidence in the ERCP II directors, the CA allowed those adverse findings to be recognised as a reason for the loss of confidence in the GREIC directors. This was even though the *Sakae* cases were actually related to GREIH and not GREIC. The CA applied a "**sufficient nexus**" test: as between companies of the same group, evidence of a justifiable lack of confidence by shareholders in the management of one company could form the basis for finding a justifiable lack of confidence in the management of another company of the same group, where there is a sufficient nexus between the management of the latter company and the misconduct premising the lack of confidence in the former company. Here, there was a sufficient nexus between GREIC and the serious and fundamental deficiencies identified in the *Sakae* cases, in relation to Andy Ong's and Ong HB's conduct as the directors of GREIH.

The CA identified three factors relevant to the sufficient nexus test. First, GREIC was GREIH's shareholder and was invested in the same venture, *viz*. the Bugis Cube project. Indeed, GREIC was a special purpose vehicle set up primarily to hold shares in GREIH, and these GREIH shares were GREIC's sole asset. Any financial misconduct affecting GREIH's economic interest would affect GREIC's economic interest. Second, GREIC and GREIH shared the same management personnel in Andy Ong, Ong HB, and Ho for significant periods. Third, Andy Ong and Ong HB were found to have entered into acts of oppression in the *Sakae* cases. These acts, comprising several transactions by Andy Ong and Ong HB on behalf of GREIH, were found to be fraudulent and entered into with full knowledge that the transactions were false. These findings went beyond GREIH's internal affairs and directly affected GREIC's economic interest.

For similar reasons, the CA also found that the criminal charges brought against Andy Ong and Ong HB in relation to their conduct *vis-à-vis* GREIH contributed to a justifiable loss of confidence in the management of GREIC. These charges, based on the *Sakae* cases, alleged (amongst other things) criminal breach of trust by dishonest misappropriation of sums belonging to GREIH; cheating GREIH and thereby inducing it to deliver shares to ERC Holdings; forgery and fabrication of evidence; and money laundering of the monies of GREIH obtained in breach of trust. Given the relationship between GREIC and GREIH, the fact that Andy Ong and Ong HB were, for substantial periods, directors of both GREIC and GREIH, and the nature and content of the charges, the CA held that the highly proximate nexus between GREIC and these charges made it impossible for any shareholder in GREIC to "turn a blind eye" to such alleged criminal wrongdoing. Even though these were merely charges and the presumption of innocence should apply, it did not preclude consideration of the fact that charges had been brought. The relevant inquiry was whether the charges could reasonably lead or contribute to a loss of confidence in the management of a company by persons who were the subject of the charges, not whether the charges established directorial misfeasance.

Additionally, similar to ERCP II, Tan had taken over as director of GREIC and later appointed Chia as a co-director. The CA found that Tan's conduct here again served as a further reason for a justifiable loss of confidence in his management of GREIC.

HC's decision to not exercise its discretion to wind up. The CA similarly found no reason for the HC to decline an order to wind up GREIC. First, more than half of the GREIC shareholders – in number and in shareholding – appeared to support the winding up application. Thus the opposition by the two dissenting shareholders (3.19%) carried less weight. Second, in *Sakae (CA)* the decision to wind up GREIH was largely based on misdeeds by Andy Ong and Ong HB in relation to GREIH. It was imperative that GREIC remained in a position to supervise GREIH's liquidation. Thus, it was not proper that the same individuals (ie, Andy Ong and Ong HB), whose conduct with regard to GREIH was being scrutinised, be allowed to influence the liquidators of GREIH through their proxies appointed as directors of GREIC, who would be supervising GREIH's liquidation.

IV. Legal Implications

This case has clarified aspects of a winding-up application under section 254(1) of the Act. First, where a winding up is sought on "just and equitable" grounds, the "sufficient nexus" test could potentially be used to link *established* mismanagement in one company to a loss of confidence in the management of the company in question. Factors that could be considered include:

- whether the two companies invested in the same project, particularly where the company in question was used solely as a vehicle for or tool in project implementation by the first company;
- the extent to which the companies have overlapping management personnel; and
- whether the specific acts committed by the management of the first company directly affected the economic interests of the company in question.

A nexus will likely not be found where there are two different and unrelated sets of companies, and different business ventures are involved.

Second, in deciding whether to defer or delay the winding up of a company, the courts may consider the prejudice that a delay in independent investigation of the company's past affairs might have on potential actions against its previous management, especially if there is a time-bar that might be operative. Further, the courts may consider the potential impact that a winding up order might have on related companies, particularly where claims of the management's breach of fiduciary duty and/or related claims are involved.

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