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Unlocking a Deadlock with Derivative Action

Perak Integrated Networks Services Sdn Bhd v Urban Domain Sdn Bhd and Another

| by Christine Lay Kei Een |

The classic case of *Foss v Harbottle*[1] articulates the notion of "judicial non-interference in corporate affairs". Where a company suffers an injury and is capable of being put in motion to initiate a legal action, the court would not allow shareholders to bring an action on behalf of themselves and other shareholders: *Mozley v Ashton*.[2] The exception to the general rule known as "fraud on minority" allows minority shareholders to initiate a derivative action on behalf of the company where the wrongdoers are in control of the company.

A difficulty arises when there is a deadlock in the company and there is no minority shareholder, as such.

The Federal Court has recently ruled that a derivative action can be initiated for the benefit of a company in a situation where there is a deadlock in the board of directors and shareholders.

Pursuant to an agreement, Perak Integrated and Urban Domain formed a separate entity known as PINS, in which each held 50% of the shares. There were only two directors in PINS, representing the two shareholders. Disputes arose when the directors and shareholders in PINS could not agree on issues regarding rental proceeds and other payments received from communication operators.

Perak Integrated took over all the books and accounts of PINS, and Urban Domain commenced a common law derivative action on behalf of itself and PINS for loss and damage. The court held that:

(a) In situations where the demarcation between majority and minority shareholders is not as straightforward, a shareholder is not barred from bringing a derivative action. The test is one of *de facto control*. Control can come in many forms including situations where there is manipulation to deliberately ensuring

that the company is prevented from initiating a legal action: *Parallel Media Ground & Anor v Asia PGA Bhd & Ors*.[3]

(b) The option of winding up the company on just and equitable grounds provided under s 218(1)(i) of the Companies Act 1965 (now s 465(1)(h) of the Companies Act 2016) does not operate as a bar to a shareholder bringing a derivative action on behalf of the company: *Pang Yong Hock & Anor v PKS Contracts Services Pte Ltd*.[4]

The Federal Court recognised that s 347(3) of the Companies Act 2016 had abrogated the derivative action at common law and confined its discussion to actions filed before the Act came into force.

Notwithstanding the abrogation of the common law remedy, the principles governing the common law derivative action are likely to be taken into consideration in determining the availability of the statutory derivative action.

The full judgment may be viewed here.

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[1] (1843) 67 ER 189

[2] (1847) 41 ER 833

[3] [2004] 6 MLJ 37

[4] [2004] 3 SLR 1