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Case Comment

A MATTER OF COMMERCIAL JUDGMENT: CHALLENGING THE DECISIONS OF JUDICIAL MANAGERS UNDER SINGAPORE LAW

Yihua Lifestyle Technology Co, Ltd v HTL International Holdings Pte Ltd [2021] 2 SLR 1141

[2022] SAL Prac 20

This note comments on the recent Singapore Court of Appeal's decision in *Yihua Lifestyle Technology Co, Lloyd v HTL International Holdings Pte Ltd* [2021] 2 SLR 1141, where the Court of Appeal affirmed the applicable test for determining whether a judicial manager's exercise of discretion may be challenged on the basis of "unfairness" under s 227R of the Companies Act (Cap 50, 2006 Rev Ed) (now s 115 of the Insolvency, Restructuring and Dissolution Act (Act 40 of 2018)). This note observes that the decision presented a welcome clarification in this area on the law of insolvency. In addition, this note compares this decision with the UK administration regime to understand the legal basis for bringing a challenge against the judicial managers' exercise of discretion premised on "unfairness". This note then concludes the discussion by highlighting two issues that the Singapore courts may wish to further explore, should the occasion arise, namely: (a) the party that bears the burden of proof; and (b) the threshold for bringing a successful challenge.

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I. Introduction

1 A financially distressed or insolvent company has one of three options to get itself out of its predicament. First, it can go into immediate liquidation, which typically results in the cessation of the company as a going concern and the sale of its assets on a piecemeal basis. Second, it can attempt to secure a sale of its business or assets on better terms than could be achieved in an immediate winding up. Finally, it can seek to restructure its liabilities and trade out of its difficulties. Whatever the case may be, these commercial objectives may be pursued through, amongst others, putting the company under judicial management as provided under the Insolvency, Restructuring and Dissolution Act 2018[2] ("IRDA").

2 Once a company is placed under judicial management, the judicial manager will step into the shoes of the company's management and decide the most viable course of action. Where the underlying business model is a viable one, the judicial manager will, in practice, attempt to nurse the company back to going-concern status. But where this is not possible, the judicial manager will either seek to restore the company to a state where it can be sold off as a going concern, or to dispose of the company's assets on terms more advantageous than could have been obtained if the company were to go into immediate liquidation.

1 The article is written in the authors' personal capacity, and the opinions expressed in the article are entirely the authors' own views. All errors remain the authors' alone.
2 Act 40 of 2018.

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3 Two options are therefore presented to judicial managers: to save the company, or to conduct a trade sale of its business or its assets. This note will primarily focus on the latter. The context contemplated is one where a judicial manager is presented with two sale options, one made to a third party and another made to a company whose controllers are related to the distressed company. Where, despite the seemingly better offer made by the third party than the related party, the judicial manager decides to sell the company's assets to the related company, can the creditors and members of the distressed company challenge the judicial manager's decision?

4 According to the Singapore Court of Appeal in *Yihua Lifestyle Technology Co, Ltd v HTL International Holdings Pte Ltd*[3] ("*Yihua Lifestyle*"), the answer to the above is yes. Specifically, such challenges can be brought under s 227R of the Companies Act[4] (now located under s 115 of the IRDA).[5] That provision prescribes, amongst others, that a creditor or member of a company under judicial management may apply to the court for relief where the judicial manager's actual or proposed act or omission is, or would be, "unfairly prejudicial to the interests of" the company's creditors or members. The Court of Appeal's approach in *Yihua Lifestyle* further illustrates the high threshold for mounting a successful challenge.

5 This note seeks to unpack the framework for bringing a challenge under s 227R of the Companies Act or s 115 of the IRDA as endorsed by the court in *Yihua Lifestyle*. This would, in turn, be useful in informing both legal and insolvency practitioners as to when challenges brought by creditors or members of a company placed under judicial management may be successful.

3 [2021] 2 SLR 1141.
4 Cap 50, 2006 Rev Ed.
5 Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) s 115(1)(*a*) read with s 115(1)(*b*).

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II. Facts

A. Background

6 HTL International Holdings Pte Ltd ("HTL") was the holding company of a group of companies involved in the furniture trade, and was originally founded by Phua Yong Tat ("PYT") and Phua Yong Pin (collectively, "the Founders"). HTL is indirectly owned by Yihua Lifestyle Technology Co Ltd ("the Shareholders"), the plaintiff/appellant in the matter.

7 HTL was placed under interim judicial management following its run of financial troubles. The interim judicial managers ("IJMs") entered into a share purchase agreement with the first respondent, Golden Hill Capital ("Golden Hill"), a company that was beneficially owned by the Founders. The agreement envisioned the sale of HTL's interests in its subsidiaries ("the Asset") to Golden Hill for approximately US$80m. In addition, PYT agreed to extend two bridging loans to HTL to alleviate its cashflow issues during the sale process. HTL subsequently entered judicial management and the IJMs continued on as the judicial managers.

8 Shortly before completion of the sale with Golden Hill, Man Wah Holdings ("Man Wah"), a third-party entity, offered to purchase HTL's shares in its subsidiaries for US$100m. A bidding war ensued between Man Wah and Golden Hill. Crucially, Man Wah stated that it was prepared to offer US$10m more than any offer made by Golden Hill. Man Wah's offer, however, required two to six months to complete the acquisition.

9 Despite Man Wah's seemingly more attractive offer, the judicial managers accepted Golden Hill's offer. The disgruntled Shareholders made an application to the Singapore High Court under s 227R of the Companies Act seeking, *inter alia*, orders declaring the sale of HTL's shares to Golden Hill as void, and directions that the judicial managers accept Man Wah's offers. The Shareholders argued that the judicial managers had "acted perversely" in preferring Golden Hill's offer over Man Wah's offer

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even though the latter was "superior in terms of shareholder returns".[6]

B. Proceedings before the Singapore courts

10 Given the novelty of this issue under Singapore law, the High Court had recourse to the authorities interpreting the English equivalent of s 227R of the Companies Act. The High Court held that s 227R permitted the court to interfere with the judicial managers' decisions where two cumulative requirements are fulfilled. First, the act complained of must have caused prejudice to the interests of the company's creditors or members generally or part thereof. Second, this prejudice must be "unfair".[7] Applying the test to the facts, the High Court found that the judicial managers had fairly evaluated both offers and were justified in their commercial assessment that Golden Hill's offer promised greater shareholder returns. This was especially given the need for swift injection of funds owing to the company's dire financial situation and that its key manufacturing subsidiaries were at risk of collapse.[8] The High Court thus dismissed the Shareholders' application.

11 Dissatisfied, the Shareholders appealed against the decision. Unfortunately, their appeal was dismissed by the Court of Appeal, which agreed with the High Court's reasons and endorsed a two-stage test to determine when an applicant could challenge a judicial manager's decision under s 227R of the Companies Act.[9] The first stage considers whether the action complained of has, or would have, caused harm to the complainant in his capacity as member or creditor of the company. The second stage considers whether the harm caused was unfair.

12 Elaborating on the nature of "unfairness", the Court of Appeal set out two situations in which a judicial manager's

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6 *Re HTL International Holdings Pte Ltd* [2021] 5 SLR 58 at [17]–[19].
7 *Re HTL International Holdings Pte Ltd* [2021] 5 SLR 58 at [29].
8 *Re HTL International Holdings Pte Ltd* [2021] 5 SLR 58 at [45].
9 *Yihua Lifestyle Technology Co, Ltd v HTL International Holdings Pte Ltd* [2021] 2 SLR 1141 at [17], relying on *Four Private Investment Funds v Lomas* [2008] EWHC 2869 (Ch) at [24] and [27].

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conduct can be characterised as unfair. The first is when there is a conspicuously unfair or differential treatment to the applicant's disadvantage relative to the rest of the creditors or members of the company. In that situation, unfairness is made out where the differential treatment was not justifiable either by reference to the objectives of the judicial management or the interests of the members or creditors as a whole. The second situation is when the judicial manager's decision has caused harm to the company's members or creditors as a whole. In this case, the Court of Appeal underscored that the court will only intervene in this situation where the judicial managers' decision lacked legal or commercial justification, such that it was "perverse (*ie*, unable to withstand logical analysis)".[10]

13 The dispute in *Yihua Lifestyle* was concerned with the second situation. The Shareholders' principal complaint was, in essence, that the preference of Golden Hill's offer over that of Man Wah's was not commercially justified with the latter ostensibly leading to a higher shareholder return.[11] Applying the test, the Court of Appeal concluded that the judicial managers' analysis could not be characterised as perverse. There was no reason to doubt the judicial managers' analysis of the financial implications of each offer. Indeed, the Shareholders' expert witness accepted that the judicial managers were more familiar with the terms of Golden Hill's offer.[12] Further, the judicial managers were entitled to take the view that Man Wah's offer was not commercially viable, and nothing suggested that such a view was unreasonable.[13]

III. Analysis

14 The Court of Appeal's decision and the observations are welcome clarifications to the insolvency jurisprudence under

10 *Yihua Lifestyle Technology Co, Ltd v HTL International Holdings Pte Ltd* [2021] 2 SLR 1141 at [17].
11 *Yihua Lifestyle Technology Co, Ltd v HTL International Holdings Pte Ltd* [2021] 2 SLR 1141 at [14] and [18].
12 *Yihua Lifestyle Technology Co, Ltd v HTL International Holdings Pte Ltd* [2021] 2 SLR 1141 at [20].
13 *Yihua Lifestyle Technology Co, Ltd v HTL International Holdings Pte Ltd* [2021] 2 SLR 1141 at [21]–[23].

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Singapore law. This section examines in greater detail the test articulated by the court.[14]

A. Harm to the applicant's interests

15 The first step in bringing a challenge under s 115 of the IRDA is to establish that the applicant has suffered some form of harm to his "interests". Specifically, the applicant must show that he has a *sufficiently recognisable* interest that was prejudiced as a result of the judicial manager's decision. Three requirements flow from this element.

16 First, the applicant must show that his interest *qua* creditor or member has been prejudiced. This requirement is statutorily reflected in s 115 of the IRDA, and relates to the applicant's *locus standi* to bring an application under this provision. In this regard, Norris J in *BLV Realty Organization Ltd v Batten*[15] ("*BLV Realty*") dismissed an applicant's challenge against the decision of administrators to terminate an ongoing contract for services provided by the applicant. This was because the applicant's true complaint was, in substance, in respect of "its interests as a contractor". The mere fact that the applicant is a creditor or member would therefore not entitle him to bring a challenge against the judicial manager's decision, if the substance of the applicant's complaint is that he was prejudiced in his other capacities.[16]

17 Second, the applicant must demonstrate a relevant interest of his that has been harmed. The concept of "interests" has been accepted to be wider than the concept of "rights". As

14 Reference will be made to the English case law interpreting s 27 of the UK Insolvency Act 1986 (c 45) (which is now located in para 74 of Schedule B1 of the same Act) throughout the course of this note. These provisions govern the administration regime under UK insolvency law, which is the functional equivalent to Singapore's judicial management regime. These provisions are also *in pari materia* to s 227R of the Companies Act (Cap 50, 2006 Rev Ed).

15 [2009] EWHC 2994 (Ch).

16 *Hockin v Masden* [2014] EWHC 763 (Ch) at [14]; *Re Coniston Hotel (Kent) LLP* [2013] EWHC 93 (Ch) at [35]; *Fraser Turner Ltd v PricewaterhouseCoopers LLP* [2019] EWCA Civ 1290 at [77].

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Millet J observed in *Re Charnley Davies Ltd (No. 2)*[17] ("*Re Charnley Davies*"), the crux of a challenge brought under s 27 of the UK Insolvency Act[18] (which is *in pari materia* to s 115 of the IRDA) is directed to the *manner* in which the administrator has managed the company's affairs, and not the alleged *breach of duty* giving rise to the loss in question.[19] In other words, the concept of "interests" focuses on the nature of the act, without the need to go further to demonstrate that the act in question necessarily amounts to a wrongdoing that infringes upon the creditor's or member's legal rights,[20] or that the judicial manager's actions amounted to misconduct.[21] Hence in *Yihua Lifestyle*, the Singapore High Court held that the inquiry turned on whether the judicial managers' decision to prefer a sale to Golden Hill instead of Man Wah prejudiced the Shareholders in terms of diminished shareholders return.[22] Indeed, much of the court's analysis turned on the commercial viability and value of the offers made by both Golden Hill and Man Wah, instead of identifying any misconduct on the judicial managers' part. On the contrary, in *Re Charnley Davies*, the court dismissed the creditors' application because the administrator's impugned conduct founded a cause of action in professional negligence, which would simply have amounted to misconduct instead of unfair prejudice suffered by the creditors of the company.[23]

18 Lastly, the applicant must establish a causative link between the judicial manager's impugned decision or proposed decision and the unfair harm suffered by the creditor or member. In *Unidare plc v Cohen*,[24] the court dismissed the applicant's challenge against the administrator's decision to reject the applicant's claim as a secured creditor against the company, which allegedly deprived the applicant an opportunity to vote

17 [1990] BCLC 760.
18 Now located in para 74 of Schedule B1 of the UK Insolvency Act (c 45).
19 *Re Charnley Davies Ltd (No. 2)* [1990] BCLC 760 at 783–784.
20 *Re Coniston Hotel (Kent) LLP* [2013] EWHC 93 (Ch) at [37]. See also William Trower QC *et al*, *Corporate Administrations and Rescue Procedures* (Bloomsbury Publishing, 3rd Ed, 2017) at para 14.4.
21 *Brake v Swift* [2020] EWCA Civ 1491 at [81].
22 *Re HTL International Holdings Pte Ltd* [2021] 5 SLR 58 at [46].
23 *Re Charnley Davies Ltd (No. 2)* [1990] BCLC 760 at 784.
24 [2005] EWHC 1410 (Ch).

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at the creditors' meeting. The court found that the applicant would not have voted at the creditors meeting regardless of the administrator's finding as to the applicant's status as a secured creditor. On either alternative, therefore, there is no causative link between the harm caused to the applicant and the administrator's decision.[25]

B. Commercial unfairness

19 Even if the applicant can show that he has *locus standi*, and that his interest has been prejudiced, that alone does not guarantee a successful challenge under s 115 of the IRDA. As the High Court in *Yihua Lifestyle* observed, "most, if not all, commercial decisions of a company in judicial management will probably cause detriment or prejudice to one or other of the members and creditors" and that it will be "very rare … for a commercial decision in respect of [a financially distressed] company to be … uncontroversial or spares everyone pain and loss".[26]

20 The presence of competing interests amongst creditors and members of a financially distressed company means that any decision which a judicial manager makes, while seeking to promote general creditor and member welfare, would invariably come at the expense of the welfare of individual creditors or members. It is thus necessary for the applicant to go further and demonstrate that the decision made was contrary to commercial expectations and commercial morality. This must be correct, or else every decision made by the judicial manager would subject him to a successful challenge mounted by the creditors or members of the company. This would render the discharge of the judicial manager's duties extremely onerous. This brings

25 *Unidare plc v Cohen* [2005] EWHC 1410 (Ch) at [78].

26 *Re HTL International Holdings Pte Ltd* [2021] 5 SLR 58 at [29]. See also *BLV Realty Organization Ltd v Batten* [2009] EWHC 2994 (Ch) at [20], where Norris J observed that an administrator may, in discharging his duties, exercise his discretion in a manner that subordinates the interests of a particular creditor in favour of the interests of the creditors as a whole. Such a decision, if made, would not amount to a breach of the administrator's obligation.

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into focus the second element necessary to make out a claim under s 115 of the IRDA, namely that of "unfairness".

(1) The high threshold in demonstrating "unfairness"

21 To appreciate the exact threshold required to make out a case for "unfairness" under s 115 of the IRDA, it is necessary to first examine the two situations where a judicial manager's decision is said to be unfair.[27]

22 The first involves an allegation that the applicant was subjected to differential treatment from other creditors or members in the same class, or from the rest of the creditors or members. In this case, the mere fact of unequal or different treatment is insufficient to evince unfairness.[28] Rather, the applicant must show that the decision cannot be justified by reference to either the interests of the creditors as a whole or the objectives of the judicial management. If there is a cogent rational explanation or sound commercial justifications for the differential treatment of a particular creditor or member, it follows that the applicant would not have suffered unfair harm.[29]

23 Hence, in *BLV Realty*, the applicant's complaint that the administrators' decision to terminate the company's contract with the applicant had occasioned unfair harm was dismissed. The administrators justified their termination of the applicant's contract on the basis that the applicant was not sufficiently competent to complete the redevelopment on time and to budget, and there were very good prospects of finding a competent and cost-efficient replacement.[30] Norris J accepted these justifications as constituting "sound commercial reasons relating to the interests of the creditors as a whole for choosing some (rather than all) existing contractors to carry the project to completion".[31] Crucially, Norris J held that the administrators' duty to perform

27 See above at para 12.
28 *BLV Realty Organization Ltd v Batten* [2009] EWHC 2994 (Ch) at [20].
29 *Hockin v Masden* [2014] EWHC 763 (Ch) at [19]–[20]. See also Amanda Cohen, "The Duty of Administrators to Act in the Interests of Creditors as a Whole and the Concept of Unfair Harm" (2010) 2 BJIB & FL 117 at 117.
30 *BLV Realty Organization Ltd v Batten* [2009] EWHC 2994 (Ch) at [10].
31 *BLV Realty Organization Ltd v Batten* [2009] EWHC 2994 (Ch) at [22].

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their functions in the interests of "the creditors as a whole" does not require them to perform this obligation identically in relation to each creditor or member or their respective classes.[32]

24 The second situation is one where the judicial manager's decision causes harm to the creditors or members as a whole. In this case, the applicant must go further to show that the decision lacked legal or commercial justification, such that it can only be characterised as "perverse". As canvassed above, the Shareholders in *Yihua Lifestyle* failed to demonstrate that the judicial managers' decision to reject Man Hua's offer in favour of Golden Hill's offer was so lacking in commercial sense as to be perverse.[33] Similarly, in *Re Meem SL Ltd*, the court held that the administrators' decision to procure a sale of the company's asset (which was a cause of action against the company's minority shareholder) by way of an auction would not cause unfair harm to the applicant, given that it would allow for the asset to be sold off quickly at an ascertainable and fixed price. On that basis, the administrators' decision could not be said to be illogical or unreasonable.[34]

(2) Rationale for the high threshold

25 The common thread underlying these grounds of challenges is the court's preference to adopt a more careful approach when scrutinising a judicial manager's (or administrator's) commercial decisions. That must necessarily be correct. Once appointed, a judicial manager effectively takes over the management of the company's affairs in achieving the statutory objectives of judicial

32 *BLV Realty Organization Ltd v Batten* [2009] EWHC 2994 (Ch) at [20].

33 See above at paras 19–22.

34 *Re Meem SL Ltd* [2017] EWHC 2688 at [46]. On the other hand, a situation where a decision has reached the level of perversity was seen in the case of *Lehman Brothers Australia Ltd v MacNamara* [2020] 3 WLR 147. In that case, the appointed administrators refused to correct a clerical error in a deed which led to the creditor receiving a lesser amount for payment of its debts than what it was entitled to. The English Court of Appeal held that the administrators' refusal to correct that mistake was so irrational that no right-thinking person would have acted in that manner. Evidently, the threshold for demonstrating perversity in a judicial manager's decision was extremely high.

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management.[35] He occupies a central role in the company's management moving forward, being involved in the day-to-day management of the company and is empowered to trade freely, to dispose of the company's business or its assets on a going-concern basis, or to make distributions. In this regard, one must appreciate the context in which a judicial manager discharges his functions. As Snowden J observed in *Davey v Money*, insolvency practitioners tasked with business rescue are often placed in a situation where the exercise of "substantial amount of commercial judgment" has to be done "under significant time pressures".[36] Indeed, a judicial manager will invariable be operating in a fast-paced context where the lack of perfect information coupled with the urgency of business imperatives calls for quick thinking on the part of the judicial manager if value is to be preserved and the purpose of judicial management achieved.

26 The judicial manager's role thus involves, at its core, the exercise of business judgment. And where the review of management decisions is concerned, it is well established that the court will not readily substitute its own business judgment for that of those helming the reins of a company. This is readily apparent in the context of a solvent company, where courts have been generally reluctant to interfere with the business judgment of directors.[37] By parity of reasoning, it follows a similar approach should be adopted when reviewing the decisions, acts and transactions of a judicial manager, whose role is similar to that of a company director, albeit seen in the context of the specific statutory objectives of judicial management.

27 All of this is not to say, however, that the insolvency practitioner's decisions are immune from review. What this simply means is that the court will not be too ready to review and

35 See ss 99(2) and 99(3) of the Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018).

36 *Davey v Money* [2018] EWHC 766 (Ch) at [255]. See also *Re T&N Ltd* [2005] 2 BCLC 488 at [76].

37 *ECRC Land Pte Ltd v Ho Wing On Christopher* [2004] 1 SLR(R) 105 at [49]; *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 at 832. See also Hans Tjio, "The Rationalisation of Directors' Duties in Singapore" (2005) 17 SAcLJ 52 at 64.

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set aside a judicial manager's exercise of discretion.[38] Whereas parties in a courtroom may have the benefit of 20/20 hindsight in scrutinising commercial decisions with a fine-toothed comb, the same cannot be said in the context of a financially distressed company's boardroom. The measure of deference that the courts accord to the commercial judgment of insolvency practitioners, as experts and regulated professionals, thus reflects an institutional judgment that these professionals are better placed than the court to formulate and implement commercial strategy according to the unique circumstances of each company. This is especially so given that a person may only be appointed as a judicial manager if he is a qualified insolvency practitioner, a requirement that is statutorily enshrined under s 91(3)(*a*) of the IRDA.[39] The High Court observed in *Yihua Lifestyle* that the rationale for this is because insolvency practitioners are deemed by Parliament as having the "qualifications, knowledge and expertise" in running the company with the view of achieving the statutory objectives set out above.[40]

28 Given the high threshold, the question then arises as to the situations in which a challenge brought under s 115 of the IRDA would be successful. Put another way, in what situations would the court find that the judicial manager's decision was so lacking in commercial probity as to be perverse? Admittedly, cases where a successful challenge was brought are few and far between. A rare instance was in the English Court of Appeal's decision in *Lehman Brothers Australia Ltd v MacNamara*[41] ("*Lehman Brothers*"). In *Lehman Brothers*, the appointed administrators refused to correct a clerical error in a deed which led to the creditor receiving a lesser amount for payment of its debts than what it was entitled to. The court held that the administrators' refusal to

38 *Re T&N Ltd* [2005] 2 BCLC 488 at [76]. See also *Re Lehman Brothers International (Europe) Ltd* [2009] BCC 632.

39 Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) s 93(1)(*a*).

40 *Re HTL International Holdings Pte Ltd* [2021] 5 SLR 58 at [40], citing *Parliamentary Debates, Official Report* (26 March 1987), vol 49 at cols 1194–1195 (Richard Hu Tsu Tau, Minister for Finance).

41 [2020] 3 WLR 147.

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correct that mistake in *Lehman Brothers* was so irrational that no right-thinking person would have acted in that manner.[42]

29 Admittedly, the facts in *Lehman Brothers* were rather extreme, and would unlikely occur in most other cases. That being said, no bright line rule can be discerned from the cases that the authors have explored. Despite this, the authors submit that a successful challenge is likely where the transaction is, on its face, one which no reasonable judicial manager would have entered into, bearing in mind considerations of commercial viability. There may no doubt be some element of circularity phrased in this test. But this may be inevitable as the issue is, more often than not, a fact-centric inquiry.

30 To this end, borrowing from the facts of *Yihua Lifestyle*, the authors proffer an example, where perhaps a stronger case for setting aside a judicial manager's decision may be made out. In *Yihua Lifestyle*, the judicial managers preferred Golden Hill's offer over Man Wah's offer on the basis that Man Wah's offer would take a significantly longer time to complete, and that Man Wah's $20m interim facility was insufficient to enable HTL to generate income. Consider, however, the hypothetical alternative where either (a) Man Wah's offer could be completed as fast as Golden Hill's offer; or (b) that Man Wah was willing to offer a larger interim facility to facilitate HTL's. Or assume that a mix of (a) and (b) was possible such that HTL could continue generating income. In those situations, perhaps a stronger case could be made that Man Wah's offer was on its face more commercially viable than Golden Hill's, such that doubts would be raised as to the judicial managers' decision to prefer the latter's offer. In such an event, the burden would likely shift to the judicial manager to explain why the seemingly more viable option was not selected.

31 Ultimately it remains to be seen whether a future case may arise where the Singapore courts would find in favour of a successful challenge under s 115 of the IRDA.

42 *Lehman Brothers Australia Ltd v MacNamara* [2020] 3 WLR 147 at [103]–[104].

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IV. Further issues to be considered

32 While the Court of Appeal's decision in *Yihua Lifestyle* has largely and helpfully clarified the law surrounding an application brought under s 115 of the IRDA, the authors submit that two points merit further consideration should the occasion arise.

A. Burden of proof

33 The first relates to the issue of burden of proof. Specifically, both the High Court and Court of Appeal in *Yihua Lifestyle* did not expressly elaborate on the party that bears the legal burden of proving that the administrators' decision had caused unfair harm. Despite this, the authors submit that it is likely to be the applicant that bears the burden of establishing the legal elements in such an application.

34 First, a closer reading of the High Court and Court of Appeal's decisions in *Yihua Lifestyle* supports the view that the burden of proof falls on the applicant. This can be inferred from the language chosen by the Court of Appeal in framing the test for demonstrating that the judicial manager has acted or proposed to act in a manner which would unfairly harm the interests of the applicant. This is also apparent in the reasonings of the High Court and Court of Appeal, whereby the courts turned first to analyse the Shareholders' arguments as to why unfair harm was caused, before referring to the judicial managers' explanation justifying their decision. Second, such an approach is consistent with the margin of deference that the court accords to a judicial manager's decision, given that the courts are in fact asked to review what is otherwise a business decision made by an experienced and qualified professional, and which the latter is better placed to assess. Finally, placing the burden of proof onto the applicant accords with the view that he who asserts must prove as such. Indeed, this trite principle is given expression under ss 103 and 104 of the Evidence Act 1893.[43]

43 2020 Rev Ed.

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35 The authors submit, however, that a concern may stem from the fact that creditors or members who raised challenges against a judicial manager's disposal of the company's asset to related parties bear the burden of proof and must discharge that burden at the threshold of "perversity". From a commercial standpoint, that a trade sale is made to the very same individuals who brought the company into financial distress may be doubtful. Indeed, such an approach may be commonly adopted by owners of a distressed business who, despite the manner in which they have managed their businesses, wish to get a second bite at the cherry and to start the business on a clean slate.

36 Crucially, the occurrence of related party transactions may undermine the role of judicial managers in achieving the statutory objectives of judicial management in an independent and effective way. For instance, transactions involving related parties may give rise to concerns that assets or groups of assets may have been disposed of at less than market value and/or on more favourable terms than would have been available to an independent third party. Permitting such related party transactions to stand without scrutiny may result in prejudice suffered by the company's creditors and contributories. Others may point out that a related party disposal would not necessarily be prejudicial to the interests of creditors and contributories of the company. This is especially so where the situation is urgent, and where value can be realised on short notice. Facilitating related party transactions in such instances may actually benefit the business through preserving enterprise value.

37 Whatever the case may be, it is important that the judicial manager acts and is seen to be acting in the interests of the creditors as a whole, and is able to demonstrate this. Where the judicial manager's decision involves executing a transaction with a related party, therefore, the authors suggest that the burden of proof should fall on the judicial manager in justifying the commercial rationale underlying that transaction.[44]

44 See also Rizwaan Jameel Mokal & John Armour, "The New UK Corporate Rescue Procedure — The Administrator's Duty to Act Rationally" (2004) 1(3) *International Corporate Rescue* 1 at 8–9.

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B. Applicability of the threshold of "perversity"

38 As canvassed above, the threshold of "perversity" applies where the application under s 115 of the IRDA is brought on the basis that harm was caused to the company's members or creditors as a whole. One may, however, question whether this same threshold ought to apply where a challenge is brought on the ground that the applicant has received differential treatment *vis-à-vis* the other creditors or members. The threshold of "perversity" was not expressly mandated by the Court of Appeal in *Yihua Lifestyle*, at least on the face of the applicable test.

39 Be that as it may, the authors submit that there are nevertheless good reasons for applying the same threshold in either situation. As discussed above, the rationale for applying the threshold of perversity stems from the margin of deference that the court accords to a judicial manager's commercial judgment. It matters not whether the unfairness stems from the differential treatment which the applicant member or creditor faced, or the fact that the judicial management's decision has prejudiced the interests of all the company's members or creditors. In both situations, it remains that the judicial manager's decision would be set aside only where the decision cannot be commercially justified. It therefore follows that the same threshold of perversity should apply.

40 Further, applying this threshold across every situation of alleged unfairness also makes sense when considering the judicial manager's role as an agent of the company (which is explicitly provided under s 102(1)(*a*) of the IRDA). Mokal and Armour argued (with respect to the English administration regime) that the administrators' role as agent of the company, and the fact that they are entrusted with care over its property and its management, places administrators in a role analogous to that of a trustee with fiduciary-like qualities clothing his conduct. In such a case, any challenges against the administrators' decision-making process would be subjected to the test of rationality, in that the administrators' decision should only be set aside if it can be shown that the administrators have, amongst others, "perversely shut their eyes to the facts" such that their decision

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is considered irrational.[45] If this is accepted, then it follows that any review of a judicial manager's decision should also be subjected to a test of irrationality or perversity, regardless of the context and the purported unfair treatment giving rise to the challenge.

41 It is appropriate, at this juncture, to point out that at least one English court has differed from the approach in *Yihua Lifestyle* in requiring the applicant to demonstrate that the applicable threshold is that of "perversity". In *Hockin v Masden*[46] ("*Hockin*"), the court held that it was not necessary to show that the administrator's decision was "perverse" to be considered unfair. This was because the requirement of "perversity" was not found within the language of para 74 of Schedule B1 of the UK Insolvency Act.[47] Instead, the applicable test is to demonstrate the lack of commercial justification underlying the administrator's decision.[48]

42 The authors submit that this holding in *Hockin* is doubtful for several reasons. First, it appears that the court in *Hockin* has, with respect, conflated the applicable test for demonstrating unfair harm with the threshold for the test. It is true that the language of "perversity" is not expressly used in the applicable statutory provision. However, as the court itself accepted, the test for determining whether the harm caused to the company's creditors or members as a whole is unfair is to show that the decision which the administrator made was lacking in commercial justification. A decision which lacked commercial justification would more likely than not be irrational or illogical, such that it must necessarily be characterised as "perverse". Second, to require the threshold of "perversity" to be made out before overturning a judicial manager's decision is consistent with the nature of the judicial manager's role as discussed above. Finally,

45 See Rizwaan Jameel Mokal & John Armour, "The New UK Corporate Rescue Procedure — The Administrator's Duty to Act Rationally" (2004) 1(3) *International Corporate Rescue* 1 at 4–5.

46 [2014] EWHC 763 (Ch).

47 *Hockin v Masden* [2014] EWHC 763 (Ch) at [16].

48 *Hockin v Masden* [2014] EWHC 763 (Ch) at [19]. See also *Kerr & Hunter on Receivers and Administrators* (Thomas Robinson & Peter Walton eds) (Sweet & Maxwell, 21st Ed, 2020) at pp 531–532.

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even following the decision in *Hockin*, the English courts have maintained the requirement of a high threshold to be met before interfering with an administrator's business judgment.[49] Such an approach would also be consistent with the requirement for challenging a liquidator's decision,[50] and there is no good reason for suggesting why the threshold for challenging a judicial manager's decision should be any different.

V. Conclusion

43 An application brought under s 115 of the IRDA turns on one crucial factor: whether the judicial manager has given thought to all relevant considerations and such that his decisions are properly informed by logical considerations that are commercially sensible. If so, the court will not seek to substitute the judgment of the judicial manager for its own judgment.

44 Commentators have argued that such wide latitude may be less than desirable, given that such a high standard of proof makes it extremely difficult for aggrieved applicants to gather evidence or formulate arguments relating to the unfairness which they have suffered.[51] Such arguments, with respect, fail to consider that the judicial manager's ultimate function is to achieve the statutory objectives of judicial management in the interests of the company's creditors as a whole.[52] In balancing the varying interests of the company's stakeholders, therefore, it would be practical for the judicial manager to focus on the aggregate outcomes and overall consequences. In the context

49 See *Re Meem SL Ltd* [2017] EWHC 2688 at [44(ii)]; *Lehman Brothers Australia Ltd v MacNamara* [2020] 3 WLR 147 at [82]–[85]. See also Vanessa Finch & David Milman, *Corporate Insolvency Law: Perspectives and Principles* (Cambridge University Press, 3rd Ed, 2017) at p 364.

50 See *Re Edennote Ltd* [1996] 2 BCLC 389 at 394, where Millet LJ held that the applicable standard for reviewing the decisions of a liquidator turns on whether, in the absence of fraud and bad faith, the liquidator's decision is "so utterly unreasonable and absurd that no reasonable man would have done it". As can be seen, this threshold effectively requires the applicant to demonstrate that the liquidator's decision was perverse and beyond all logic.

51 See, *eg*, Andrew Mace, "Challenging Administrators: Can They Ever Do Wrong?" (2010) 3(4) CR & I 141; Eugenio Vaccari, "Promoting Fairness in English Insolvency Valuation Cases" (2019) 29 Int Insolv Rev 285.

52 See Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) s 89.

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of insolvency, prejudice to certain creditors or members is an inevitable fact of life.

45 Subject to the further clarifications raised above, the authors submit that the decisions of the High Court and Court of Appeal in *Yihua Lifestyle* represent a proper mix of efficiency and accountability incumbent on judicial managers. They are also consistent with Singapore's aim to foster a pro-business rescue environment in the light of its objectives of establishing a regional insolvency hub.

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