

14. INSOLVENCY LAW

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Introduction

14.1 Schemes of arrangement hogged the limelight in 2003, with four important cases being decided by the Singapore courts (*Wah Yuen Electrical Engineering Pte Ltd v Singapore Cables Manufacturers Pte Ltd* [2003] 3 SLR 629, *Hitachi Plant Engineering & Construction Co Ltd v Eltraco International Pte Ltd* [2003] 4 SLR 384, *Re Econ Corp Ltd* [2004] 1 SLR 273 and *Chew Eu Hock Construction Co Pte Ltd v Central Provident Fund Board* [2003] 4 SLR 137). These cases provide clear evidence of a recent trend, starting with the Court of Appeal's decision in *Daewoo Singapore Pte Ltd v CEL Tractors Pte Ltd* [2001] 4 SLR 35 (“*Daewoo*”), of creditors actively opposing the grant of court sanction for schemes of arrangement under s 210 of the Companies Act (Cap 50, 1994 Rev Ed), with a fair amount of success no less. Prior to *Daewoo*, there had been no reported Singapore case of a creditor opposing (successfully or otherwise) the grant of court sanction for a scheme of arrangement, apart from the decision in *Re Halley's Departmental Store Pte Ltd* [1996] 2 SLR 70. These cases have provided a useful forum for the courts to restate, develop and refine the principles governing the grant of court sanction. Accordingly, this year's review on schemes of arrangement is especially detailed.

14.2 It is interesting to note that the scheme of arrangement procedure has, since the late 1990s, been increasingly invoked in Singapore, with some success. In many other Commonwealth jurisdictions, the scheme of arrangement procedure has never been very popular and has been seen as time-consuming, costly and cumbersome, but the experience in Singapore has been different. The popularity of schemes of arrangement in Singapore has been largely due to the practical and commercial approach taken by the courts and the efficiency of the court system. The insolvency practitioners and advisers in Singapore have generally found that schemes of arrangement are an effective and practical option, as they may be implemented within reasonable time lines, and the cost and effort involved in preparing scheme documentation and obtaining creditors' approval and court sanction are not prohibitive. In particular, in many contexts, schemes of arrangement have emerged as the preferred alternative to judicial management, attracting less adverse publicity and allowing management to remain in possession of the company. The recent spate of cases involving creditor opposition to schemes of arrangement is probably a natural consequence of the increased use of

schemes of arrangement and a corresponding greater awareness on the part of creditors of their rights.

14.3 The avoidance provisions on transactions at an undervalue and unfair preferences continue to be a fertile source of litigation. This year's contributions comprise a Court of Appeal decision (*Mercator & Noordstar NV v Velstra Pte Ltd* [2003] 4 SLR 667) and two High Court decisions (*Re Tiong Polestar Engineering Pte Ltd* [2003] 4 SLR 1 and *ECRC Land Pte Ltd v Ho Wing On Christopher* [2004] 1 SLR 105). Given that the relevant provisions were enacted less than a decade ago and their drafting is, as this reviewer has on many occasions pointed out, less than satisfactory, one may expect more cases in this area for some time to come.

14.4 The above should not detract from the fact that important decisions were also forthcoming on all other major areas of insolvency law. The Court of Appeal had the opportunity to consider the priority of indemnity legal costs incurred by a defendant in successfully defending against a claim brought by the liquidators of a company (*Chee Kheong Mah Chaly v Liquidators of Baring Futures (Singapore) Pte Ltd*, [2003] 2 SLR 571), the duties and liabilities of receivers and managers in the conduct of receivership and debenture holders in exercising their right of appointment of a receiver and manager (*Roberto Building Material Pte Ltd v Oversea-Chinese Banking Corp (No 2)* [2003] 3 SLR 217), and whether to allow the huge Asia Pulp & Paper Group to continue with its debt restructuring efforts or to place the holding company under judicial management (*Deutsche Bank AG v Asia Pulp & Paper Co Ltd* [2003] 2 SLR 320). The High Court ruled on the priority of Central Provident Fund contributions in judicial management in a much-publicised case, *Chew Eu Hock Construction Co Pte Ltd v Central Provident Fund Board* (para 14.1 *supra*), restated the rules of service of bankruptcy demands in *United Overseas Bank Ltd v Ishak bin Ismail* [2003] 3 SLR 302, compelled the managing director of a company to be examined by the liquidators on the affairs of the company in *Re Lion City Holdings Pte Ltd* [2003] 3 SLR 493, and analysed the meaning of insolvency and the duties of directors in the insolvency of a company in *Chip Thye Enterprises Pte Ltd v Phay Gi Mo* [2004] 1 SLR 434. All these cases are no less significant additions to Singapore's insolvency law jurisprudence.

Liquidation

Leave to commence legal proceedings against company in winding up

14.5 Section 262(3) of the Companies Act states that, when a winding up order has been made or a provisional liquidator has been appointed, no action or proceeding shall be proceeded with or commenced against the company

except by leave of the court and in accordance with such terms as the court imposes. The object of this provision is to ensure, so far as is possible, the orderly administration of the liquidation, to ensure that the assets of the company in liquidation should be administered in accordance with the statute, to ensure that no person should get an advantage to which he is not properly entitled and to enable the court effectively to supervise all claims brought against the company (*Re Sydney Formworks Pty Ltd* [1965] NSW 645; (1965) 82 WN (Pt 1)(NSW) 558 at 562). The requirement of obtaining leave is to prevent the liquidator's task from being made more difficult due to a scramble among creditors in taking action or obtaining decrees against the company or its assets (see, in the context of the corresponding moratorium provision in bankruptcy, *Overseas Union Bank v Lew Keh Lam* [1999] 3 SLR 393). A counterclaim against the company falls within this moratorium (*Langley Constructions (Brixham) Ltd v Wells* [1969] 1 WLR 503).

14.6 In *Jumabhoy Rafiq v Scotts Investment (Singapore) Pte Ltd* [2003] 2 SLR 422, a company in liquidation commenced legal proceedings against a defendant, who then filed a counterclaim against the company and applied for summary judgment on the counterclaim. The company objected on the basis that leave of the court under s 262(3) of the Companies Act for the prosecution of the counterclaim had not been obtained, and the defendant accordingly applied for leave. The two issues before the court were, firstly, whether the court had jurisdiction to grant leave retrospectively or *nunc pro tunc*, and, secondly, if so, whether the court should exercise such jurisdiction.

14.7 Woo Bih Li J determined both issues in the affirmative. The learned judge held that whether leave should be granted in any case depended on the particular circumstances of that case, and there was no general rule discouraging the exercise of the jurisdiction to grant leave. As there was only one party claiming against the company, and there was nothing to show that the procedure in liquidation would be quicker and less expensive, especially since the counterclaim had already gone some way in the legal proceedings, leave would be granted. On the other issue of granting leave retrospectively, Woo J declined to follow the earlier English authorities and accepted the position established by the Australian authorities and the later English case of *In re Saunders* [1997] Ch 60 that the court has the jurisdiction to grant leave *nunc pro tunc*. The learned judge pointed out that it would cause injustice and inconvenience if the court has no such jurisdiction, as a claimant might take steps in proceedings without finding out that the other party has been placed in liquidation. A claimant might also be encouraged or misled into commencing or continuing legal proceedings against the other party without obtaining the requisite leave, and it would not be correct for the latter to then assert that the legal proceedings were a nullity on the basis that the leave of the

court has not been obtained. The learned judge was also of the view that the fact that the jurisdiction to grant leave *nunc pro tunc* might assist a claimant to overcome limitation defences did not mean that there should be no such jurisdiction. It is not the purpose of s 262(3) to confer a windfall on a company in liquidation in this respect.

Rights of liquidator in respect of uncompleted execution against the company

14.8 Section 334(1) of the Companies Act states that, where a creditor has attached any debt due to the company and the company is subsequently wound up, he shall not be entitled to retain the benefit of the attachment against the liquidator unless he has completed the attachment before the date of the commencement of the winding up. However, s 334(1)(c) states that the rights conferred by s 334(1) on the liquidator may be set aside by the court in favour of the execution creditor to such extent and subject to such terms as the court thinks fit. In *Re Tiong Polestar Engineering Pte Ltd* (para 14.3 *supra*), the liquidator of a company applied to recover a sum which had been received by a judgment creditor of the company one day after the commencement of winding up, pursuant to a garnishee order absolute. The judgment creditor sought to invoke the jurisdiction of the court to set aside the right of the liquidator to recover this payment. The judgment creditor pointed out that its request for the payment of the sum had been made several days before the commencement of winding up, and that the cashier's order by which the sum was paid was actually dispatched to it one day before, that is, the day of the commencement of winding up.

14.9 Woo Bih Li J right dismissed this argument and ordered that the judgment creditor was not entitled to retain the benefit of the sum as against the liquidator. In his Honour's view, it is incumbent on a creditor to try and get payment as soon as possible and if receipt of payment is delayed by the act of another party, the interests of the general creditors will have to prevail. No authority was cited for this principle, but it is undoubtedly correct. Indeed, there are few reported authorities dealing with the exercise of the jurisdiction of the court to allow a judgment creditor to retain the benefit of an attachment. This is perhaps because the court will not make absolute a garnishee order if the judgment debtor company is insolvent; attachment is an equitable remedy and will not be given if its effect will be to prefer one creditor over another (*Pritchard v Westminster Bank, Ltd* [1969] 1 All ER 999).

14.10 However, useful guidance may be obtained from cases dealing with the exercise of the court's discretion to allow a judgment creditor to retain the benefit of an execution. It has been said in these cases that, in exercising its discretion, the court should bear in mind that the basic legislative scheme is

for unsecured creditors to rank *pari passu* and where an execution creditor has not completed execution at the commencement of the winding up he is in the same position as any other unsecured creditor (*Re Redman (Builders) Ltd* [1964] 1 WLR 541 at 546). Thus, weighty reasons are necessary to justify the court in exercising its discretion to interfere (*In re Caribbean Products (Yam Importers) Ltd* [1966] Ch 331 at 348 and 354), and mere misfortune in not being able to successfully carry out the execution is not enough (*Re Lake & Hot Springs Country Club (HK) Ltd* [1986] HKLR 827). Neither will the court grant relief on the ground that the judgment creditor has been extra vigilant (*In re Caribbean Products (Yam Importers) Ltd (supra)* at 347).

Examination of officers

14.11 Section 285 of the Companies Act confers on the court a wide power to summon, for the purposes of examination on oath and production of books and papers in his custody, any officer of the company, any person who may in possession of the company's property or who may be indebted to it, or any person considered to be capable of giving relevant information about the affairs of the company. This power is directed to enabling the court to help a liquidator to discover the truth of the circumstances connected with the affairs of the company in order that the liquidator may be able, as effectively as possible and with as little expense as possible, to complete his function as liquidator, to put the affairs of the company in order and to carry out the liquidation in all its various aspects, including the getting in of any assets of the company available in the liquidation (*Re Rolls Razor, Ltd* [1968] 3 All ER 698 at 700).

14.12 Despite its practical importance and utility, s 285 has been the subject of only two local decisions (*Chi Man Kwong Peter v Lee Kum Seng Ronald* [1984–1984] SLR 227 and *Re China Underwriters Life and General Insurance Co Ltd* [1988] SLR 217, affirmed in *Official Receiver of Hong Kong v Kao Wei Tseng* [1990] SLR 29). A welcome addition to our case law on this provision is the decision in *Re Lion City Holdings Pte Ltd* (para 14.4 *supra*). In this case, the liquidators of a company had applied *ex parte* and obtained an order under s 285 against the respondent who was the former managing director of the company. The latter applied for the discharge of the order, on the ground that he had already answered the liquidators' queries to the best of his ability. The respondent also argued that, at the *ex parte* hearing, the liquidators had not disclosed to the court that they had already commenced an action against him for breach of fiduciary duty and that the liquidators' application was a fishing expedition to seek admissions and a rehearsal of his cross-examination. In response, the liquidators argued that full co-operation had not been forthcoming from the respondent. They further explained that they had filed the action only to avoid a time bar and did not have sufficient information to

prosecute the action, and had never intended to conceal the fact of the action from the court.

14.13 Following the English position, Tay Yong Kwang J held that the court's power to order an examination is discretionary and must be exercised after carefully balancing the liquidator's need to carry out his task and the need to avoid making an order which is wholly unreasonable, unnecessary or oppressive to the person concerned. The factors to be taken into account include the extent of co-operation already extended to the liquidator, the views of the liquidator, and the fact that an oral examination is likely to be more oppressive than the other possible orders. The fact that there is a risk that a respondent might expose himself to liability is not conclusive. Further, the liquidator is entitled not only to general information but to specific information concerning possible claims against specific persons. The mere fact that the liquidator has commenced or is about to commence proceedings against the respondent is not an absolute bar to the making of an order.

14.14 On the facts, the respondent was the former managing director of the company and should be well-placed to fill in the gaps in the liquidators' knowledge. The respondent had not replied to all the liquidators' questions. Further, there were rival factions within the board of directors and the liquidators should not appear to be taking sides by acting on the words of one faction without making reasonable queries from the other. The learned judge also accepted the liquidators' explanation that they had inadvertently omitted to disclose the action against the respondent when they obtained the order. In the circumstances, Tay J declined to set aside the order.

14.15 This case provides a useful illustration of how the balancing exercise has to be carried out in every case where a liquidator seeks to invoke s 285 for the purpose of obtaining information or documents in respect of an actual or potential claim of the company. The exercise can sometimes be a difficult one, as the lines have not been clearly drawn. It has long been the law that s 285 may be used to find out facts before bringing an action so as to avoid cost and delay which would follow from commencing expensive and ultimately fruitless litigation (*In re Gold Company* (1879) 12 Ch D 77 at 85). However, more considerations come into play where a liquidator has commenced or decided to commence proceedings against the respondent. There is the danger that s 285 may confer a tactical or forensic advantage on the liquidator *qua* litigant which amounts to an abuse of process. Although the basic balancing exercise still applies (*Cloverbay Ltd v Bank of Credit and Commerce International SA* [1991] Ch 90), the precise threshold at which a legitimate use of the examination process becomes an unfair or oppressive litigation manoeuvre has evaded definition by the courts.

14.16 For instance, in *Re Sasea Finance Ltd* [1998] 1 BCLC 559, a case which was relied upon by the respondent in *Re Lion City Holdings Pte Ltd*, the liquidators of a company sought information against the company's auditors in respect of a possible claim for negligence against the auditors. The liquidators had issued a protective writ and obtained a postponement of their obligation to serve a statement of claim until information was provided by the defendants. Sir Richard Scott VC dismissed the liquidators' application, and held at 572 that it crossed "the line between legitimate tactic and abuse of process".

14.17 *Re Sasea Finance Ltd* was presumably distinguished by Tay J in *Re Lion City Holdings Pte Ltd*, but the grounds for doing so were not expressed in the grounds of decision. This reviewer would venture to suggest that, despite some similarity in the factual contexts of the two cases, both were correctly decided on their facts. The two cases are distinguishable if one were to pay attention to the nature of the claim, the relationship between the defendant and the company and the purpose for which the examination process was being invoked. In *Re Sasea Finance Ltd*, the learned Vice-Chancellor assigned weight to the fact that the liquidators were contemplating only a simple negligence claim, and wanted only to improve on the case against the auditors by extracting admissions. At the same time, he acknowledged that the situation might be different if the defendants had secreted away assets of the company or were obstructing attempts by liquidators to discover what had happened to the assets of the company. In contrast, in *Re Lion City Holdings Pte Ltd*, the respondent was the former managing director of the company who was suspected of having acted in breach of his fiduciary duty, including having sold the company's shares in two other entities at an undervalue to a company which was owned or beneficially owned by him. Further, the main objective of the liquidators was to obtain information about the company's affairs of which he would be in possession, and he had failed to answer to all their queries.

Estate Costs Rule and liquidation expense principle

14.18 In *Chee Kheong Mah Chaly v Liquidators of Baring Futures (Singapore) Pte Ltd* (para 14.4 *supra*), the Court of Appeal had the rare opportunity to consider two rules relating to the priority of post-liquidation claims against a company in liquidation, namely, the Estate Costs Rule and the liquidation expense principle. The appeal arose out of Lai Kew Chai J's decision in *Chee Kheong Mah Chaly v Liquidators of Baring Futures (Singapore) Pte Ltd* [2002] SGHC 273, which was discussed in last year's review ((2002) 3 SAL Ann Rev 243 at paras 14.17 to 14.21).

14.19 In this case, the liquidators of the company had sued its previous auditors in England for negligence in the auditing of the company's accounts. The auditors sought a declaration that, if the liquidators failed in the suit, the auditors would be entitled to costs against the company on an indemnity basis and that such costs would be entitled to priority against other claims against the company. In essence, there were three issues before the Court of Appeal, only the last of which involved insolvency law. Although the auditors succeeded on the first of these issues, the ultimate decision of the Court of Appeal was to refuse the declaration sought by the auditors.

14.20 The first issue was whether the auditors had any contractual basis for claiming indemnity costs in the event that the company's action against them was unsuccessful. In this regard, the auditors argued that Art 110 of the company's articles of association, which provided for an officer of the company to be indemnified by the company in certain circumstances, had been incorporated into their terms of appointment. At first instance, Lai J had dismissed this argument. However, the Court of Appeal agreed with the auditors and held that, on the facts, Art 110 had been incorporated into the terms of appointment of the auditors.

14.21 The second issue was whether Art 110 in fact operated to indemnify the auditors for costs incurred in defending the suit brought by the company. Article 110 operated to indemnify an officer of the company "against all losses or liabilities (including any such liability as is mentioned in the [Companies] Act), which he may sustain or incur in or about the execution of the duties of his office or otherwise in relation thereto". After reviewing several authorities, the Court of Appeal agreed with Lai J that the wording of Art 110 did not cover the costs incurred by the auditors in successfully defending an action by the company.

14.22 The third issue was whether the auditors' claim for indemnity costs ranked in priority to other claims against the company. Although it was not strictly necessary to consider this issue given that the second issue had been decided against the auditors, the court proceeded to consider the two arguments put forth by the auditors.

14.23 The first argument was that the auditors were entitled to claim for indemnity costs under the Estate Costs Rule. It was undisputed that, if the auditors' defence was successful, their claim for standard costs would be entitled to priority under the Estate Costs Rule, as it has long been established that a defendant who is unsuccessfully sued by a company in liquidation would be entitled to priority for his legal costs on a standard basis. His claim for standard costs has priority even over the liquidator's costs (*In re Home Investment Society* (1880) LR 14 Ch D 167). The court was of the view that if

the English court exercised its discretion to award indemnity costs to the auditors, such indemnity costs would also be entitled to priority. However, the court rightly rejected the contention that the *contractual* claim of the auditors to indemnity costs pursuant to Art 110 would similarly be entitled to priority. The auditors' claim under Art 110 was a contractual claim under a pre-liquidation contract, and must rank *pari passu* with claims under other contracts.

14.24 The second argument of the auditors was that their claim for indemnity costs under Art 110 was entitled to priority under the liquidation expense principle. This was also rejected by the Court of Appeal. Citing from the recent House of Lords' decision in *In re Toshoku Finance UK plc* [2002] 1 WLR 671, the court noted that the liquidation expense principle had historically been applied to the incurring of rental by a liquidator in respect of the continued use of property leased by the company. Although such incurring of rental would not strictly be an expense of the winding up, as it was a liability which was incurred by the company before the winding up for the whole term of the lease, the liquidation expense principle mandated that it would be just and equitable to treat the rental as if it were an expense of the liquidation. However, the court held that the principle could not be extended to cover the instant case, as it was difficult to image that the liquidators had continued the company's obligation under Art 110 for the benefit of the winding up.

Beneficial ownership of the assets of a company in liquidation

14.25 The topic of the beneficial ownership of the assets of a company in liquidation was raised in the context of revenue legislation in *Kuok (Singapore) Ltd v Commissioner of Stamp Duties* [2003] 4 SLR 43. The central issue was whether an instrument of transfer of shares executed by a company in liquidation in favour of its sole shareholder to pay off a debt owed to that shareholder attracted *ad valorem* stamp duty. Woo Bih Li J answered this question in the affirmative.

14.26 What is relevant for the purposes of this review is that, in support of its position, the shareholder argued that the assets of a company in liquidation are held on trust for its shareholders and that the transfer of the shares was a transfer by a bare trustee to the beneficial owner. The learned judge rightly rejected this contention, and pointed out that Chan Sek Keong J's decision in *Low Gim Har v Low Gim Siah* [1992] 2 SLR 593 had held that a shareholder of a company in liquidation becomes beneficially entitled *in specie* to a particular property held by the company where he is in a position to demand that it be transferred to him. On the facts, the shareholder was not entitled to demand the transfer of the shares until the debt owed to the shareholder had been

resolved, and could not be regarded as the beneficial owner of the shares held by the company.

14.27 It was not necessary for the learned judge to address the vexed question of where the beneficial ownership of the assets of a company in liquidation vests (prior to the shareholders being entitled to demand a transfer of the assets), and its resolution must be left to another day. It now seems clear that the beneficial ownership is not vested in the shareholders of the company, prior to the shareholders being entitled to demand for the transfer of the company's assets (*Low Gim Har v Low Gim Siah (supra)*; *Kuok (Singapore) Ltd v Commissioner of Stamp Duties (supra)*).

14.28 *Low Gim Har v Low Gim Siah* itself appears to further suggest that such beneficial ownership remains with the company notwithstanding its liquidation. However, such an interpretation would be contrary to decisions of the House of Lords and the Singapore Court of Appeal which hold that, upon its liquidation, the company ceases to be the beneficial owner of its assets as a statutory trust springs into place (*Ayerst (Inspector of Taxes) v C & K (Construction) Ltd* [1975] 2 All ER 537; *Ng Wei Teck Michael v Oversea-Chinese Banking Corp Ltd* [1998] 2 SLR 1). Even if it is accepted that the company is divested of the beneficial ownership of its assets, there is still no clear consensus as to exactly where the beneficial interest resides. The Singapore Court of Appeal has held that the creditors of an insolvent company in liquidation are in the nature of *cestui que trust* with beneficial interests extending to all the company's property (*Ng Wei Teck Michael v Oversea-Chinese Banking Corp Ltd*). On another occasion, the Singapore Court of Appeal suggested that, upon the winding up of a company, the beneficial interest in the company's assets vests in the liquidator (*Good Property Land Development Pte Ltd v Societe-Generale* [1996] 2 SLR 239; see also *In re Lines Bros Ltd* [1983] Ch 1 at 14). Yet another line of authority, which this reviewer prefers, is that the beneficial ownership of the assets of a company in liquidation is in suspense (*J Sainsbury Plc v O'Connor* [1991] 1 WLR 963 at 972). This position has received recent endorsement from the House of Lords in *Buchler v Talbot* [2004] 2 WLR 582 at [28], where Lord Hoffmann stated that a statutory trust of the assets of a company in liquidation is "a special kind of trust because neither the creditors nor anyone else have a proprietary beneficial interest in the fund".

Judicial management

Exercise of discretion to make judicial management order

14.29 In last year's review, the decision of Lai Siu Chiu J in *Deutsche Bank AG v Asia Pulp & Paper Co Ltd* [2002] SGHC 257 was discussed at some

length (see (2002) 3 SAL Ann Rev 243 at paras 14.32–14.38). Lai J had declined to make a judicial management order on the petition of two of the bank creditors of the subject company (“APP”) but had stated that if there was no visible improvement in the restructuring process in six months, a fresh petition could be presented and the court would then be more than willing to appoint judicial managers. It will be recalled that APP, a Singapore-incorporated company, had no business operations of its own but was an investment holding company with shareholdings in a large number of companies in several countries (“the APP Group”). After the APP Group defaulted on its loans, a debt restructuring exercise was undertaken with the participation of various professional advisers and creditors’ committees. The petitioning bank creditors were not happy with the progress of the debt restructuring efforts and alleged that the APP Group was not cooperating with the professional advisers. The petitioning creditors also asserted that the APP Group was engaging in and had failed to disclose certain questionable transactions, and had failed to establish satisfactory controls and monitoring mechanisms over its operating cash flows.

14.30 Lai J was of the view that a judicial management order would not achieve any of the statutory objectives of judicial management. The learned judge was of the view that the judicial managers would not be able to make any headway in the discharge of their duties outside Singapore, as they would not be able to secure the cooperation of Indonesia’s Bank Restructuring Bank Agency (“IBRA”) (which had agreed to take a leading and proactive role in the consensual debt restructuring discussions) and APP’s Chinese creditors.

14.31 In *Deutsche Bank AG v Asia Pulp & Paper Co Ltd* (para 14.4 *supra*), the Court of Appeal was invited to reverse Lai J’s decision. The only issue before the court was whether a judicial management order ought to be made. In this regard, the court approved the “real prospect” test laid down by Hoffmann J (as he then was) in *Re Harris Simons Construction Ltd* [1989] BCLC 202, namely, whether there was a “real prospect” that the making of a judicial management order would achieve one or more of the statutory purposes stated in s 227B of the Companies Act.

14.32 The court held that Lai J had considered the pros and cons of making a judicial management order and there were no compelling reasons for the court to interfere with her exercise of judicial discretion. The court reaffirmed the entrenched principle that an appellate court will only interfere with a trial judge’s exercise of discretion if the trial judge has misdirected himself with regard to the applicable principles governing the exercise of his discretion, if he has taken into account irrelevant matters or has not taken into account relevant matters, or if his decision is plainly wrong. The court then examined the reasoning of Lai J and the considerations that were taken into account in

the exercise of her discretion. The court was of the view that, whatever its own views on the matter were, Lai J's decision could not be interfered with and the court dismissed the appeal accordingly. However, the court concluded its judgment by echoing Lai J's sentiment that, if the debt restructuring remained stalled or if questionable transactions continued to be entered into by the APP Group, a future judicial management petition might be successful.

No priority for Central Provident Fund contributions

14.33 The decision in *Chew Eu Hock Construction Pte Ltd v Central Provident Fund Board* (para 14.1 *supra*) ("*Chew Eu Hock*") garnered, somewhat unexpectedly, a substantial amount of publicity. The simple proposition laid down by this case is that contributions to the Central Provident Fund ("CPF"), which a company is liable to make, generally do not enjoy any priority in payment over the other liabilities of the company when the company is placed under judicial management, unless expressly ordered by the court. One would have thought that this is quite apparent. Nonetheless, concern was voiced by some quarters, from a public and social policy standpoint, that CPF contributions should enjoy preferential ranking *vis-à-vis* the other general debts and liabilities of the company. With respect, this reviewer is of the view that much of the concern is misplaced. The result in *Chew Eu Hock* has more to do with the responsibilities and obligations of creditors in relation to a scheme of arrangement presented by a company in judicial management than the priority of claims against a company in judicial management.

14.34 The company, which was under judicial management, had presented a scheme of arrangement to its creditors, proposing that their debts be assumed by its parent, a public listed company. The parent would then issue shares in full discharge of these debts. The company applied for and obtained the leave of the court to summon a meeting of creditors to consider and vote on the scheme. At the creditors' meeting, the scheme was approved by 96% in value of the creditors and the scheme was subsequently sanctioned by the court.

14.35 The CPF Board lodged a proof of debt in the sum of \$322,866 against the company and this was admitted by the judicial manager. Notices of the creditors' meeting to vote on the scheme were advertised in the newspapers and sent to the CPF Board. Further, copies of the scheme and the explanatory statement were sent to the CPF Board. The CPF Board did not attend the creditors' meeting to vote on the scheme, or appear to object at the hearing for the sanction of the scheme. However, the CPF Board informed the judicial manager that it was unable to accept shares in payment of its claim, and demanded cash payment from the company. The company then applied to

the court for an order that the CPF Board was bound by the terms of the scheme of arrangement.

14.36 It was common ground that the objectives of the CPF were to provide a scheme for compulsory contributions to ensure every employee would, upon retirement, have a nest egg to live on. However, the CPF Board argued that, in its experience, judicial managers of other companies had always treated the CPF Board as preferential creditors and made payment in cash. It was further contended that the scheme of arrangement should have been drafted to give recognition to the priority status of the CPF Board.

14.37 Lai Siu Chiu J rejected these arguments and granted the order sought by the company. The learned judge correctly pointed out that there is no legislation that accords CPF contributions priority in payment where an employer is placed under judicial management. Section 328 of the Companies Act, which confers priority on CPF contributions, applies only in the winding up of a company and does not automatically apply in the judicial management of a company. The learned judge noted that s 227X(b) of the Companies Act gives the court the discretion to direct that s 328 should apply in relation to a particular judicial management. However, the onus was on the CPF Board, and not the judicial manager, to ask the court to give special consideration to CPF contributions under this provision. The CPF Board had failed to do so at the stage where the court was asked to sanction the scheme, and it was too late for the CPF Board to raise the issue. The court also found that the CPF Board's explanation for not attending the creditors' meeting was unacceptable.

14.38 Lai J further noted that there was nothing in reg 4 of the Central Provident Fund Regulations (Cap 36, Rg 15, 2001 Rev Ed) to prohibit the CPF Board from receiving contributions, as it merely stated that contributions "may be" paid in cash. There was no reason why the CPF Board could not first accept the shares in lieu of cash contributions and then convert the shares into cash. Accordingly, the court ordered the judicial manager to establish a Central Depository account into which the shares could be credited on behalf of the CPF Board. Subsequently, as the CPF Board did not give any instructions for the sale of the shares, the court directed the judicial manager to sell the shares and pay the net proceeds of sale to the CPF Board.

14.39 This reviewer agrees fully with the decision and reasoning of Lai J. With all due respect, it seems naïve for the CPF Board to take the position that, notwithstanding the absence of any legislative provision, it was entitled to expect that judicial managers would grant indulgence and accord to it gratuitous priority rights in a scheme of arrangement. Indeed, it may fairly be said that a judicial manager will be acting in breach of his duties if he

voluntarily accords such priority to the CPF Board without the approval of the creditors of the company or the sanction of the court.

14.40 More importantly, it should be appreciated that the perceived “mischief” has little to do with the lack of any priority status given to CPF contributions *vis-à-vis* a company under judicial management. Put simply, there are substantial differences between judicial management and corporate liquidation (see *Re Boonann Construction Pte Ltd* [2002] 3 SLR 338). There is good reason why there is no statutory provision in the judicial management legislation conferring priority on CPF contributions (or, for that matter, on any of the other statutory preferential debts enumerated in s 328(1) of the Companies Act).

14.41 It is not an objective of judicial management to generally distribute assets to the creditors of the company in reduction or discharge of their debts and a company under judicial management should only make such distributions under exceptional circumstances and with the leave of the court (see *Re WBSL Realisations 1992 Ltd* [1995] 2 BCLC 576). There is no statutory power specifically or explicitly given to a judicial manager to declare and distribute dividends to creditors (see ss 227G(3) and 227G(4) and the Eleventh Schedule of the Companies Act). In fact, s 227G(6) expressly prohibits a judicial manager from paying any debt to which the company was subject as at the date of the judicial management order, unless the payment is sanctioned by the court or made pursuant to a compromise or arrangement, or the payment is in discharge of a debt which is secured or covered by quasi-security.

14.42 It will also be noted that the judicial management regime does not provide for a detailed mechanism for making distributions to creditors (unless the court exercises its discretion under s 227X(b) of the Companies Act to import the liquidation provisions). The proving of debts in a judicial management is for the purpose of ascertaining the voting entitlements of the creditors (see *Re Boonann Construction Pte Ltd* (para 14.40 *supra*)). Indeed, there are also no statutory forms for judicial managers to declare dividends, unlike in liquidation (see Forms 49–52 of the Companies (Winding Up) Rules (Cap 50, R 1, 1990 Rev Ed)).

14.43 Where a company under judicial management wishes to make distributions under a repayment or settlement plan with its creditors, a scheme of arrangement (which should stipulate its own rules in relation to proof of debts and the making of distributions or payments) should be used, as expressly envisaged in s 227B(1)(b)(ii) of the Companies Act. Where, on the other hand, the company has been placed under judicial management for the purpose of effecting a more advantageous realisation of its assets than in a

winding up, the proper procedure is for the judicial manager to petition for the winding up of the company after the realisation has been completed so that the proceeds of realisation may be distributed to the creditors in the winding up. This is why a judicial manager is expressly given the *locus standi* to petition for the winding up of the company by s 253(1)(g) of the Companies Act. In either case, unless there are exceptional circumstances, there should not be any general distributions made to creditors by the company while under judicial management.

14.44 Seen against this background, the result in *Chew Eu Hock* has more to do with the law on schemes of arrangement than judicial management. The fact that CPF contributions are not given priority in judicial management is neutral; it is not intended that there should be payments made by the company in any event. Indeed, one can totally exclude the judicial management from consideration. If a company which is not under judicial management presents a scheme which does not confer any priority on payment on CPF contributions, and the CPF Board fails to attend the creditors' meeting and vote against the scheme, or to object to the scheme at the hearing for sanction by the court, surely the CPF Board will be bound by the scheme. The principle at play is a simple one; a creditor who, having been given proper notice of a scheme and the convening of a creditors' meeting to vote on the scheme, fails to turn up at the meeting and to object to the scheme at the hearing to obtain the court's sanction of the scheme, is bound by the scheme in the event that the scheme is duly approved by the creditors and sanctioned by the court. Otherwise, the whole scheme of arrangement procedure will be completely undermined. A creditor who is affected by a scheme of arrangement has the responsibility to object to the scheme if he feels that he is not accorded proper treatment by the scheme; he remains apathetic at his own peril.

14.45 It should also be noted that, although a scheme of arrangement presented by a company under judicial management under s 227X(a) of the Companies Act does not have to be approved by each class of creditors (as compared to a scheme presented under s 210 of the Companies Act), the Court of Appeal has clarified that, in considering whether to sanction the scheme, the interests of different classes of creditors need to be taken into account in order to ensure that the scheme is fair and reasonable to the creditors as a whole (*Hitachi Plant Engineering & Construction Co Ltd v Eltraco International Pte Ltd* (para 14.1 *supra* at [46])). The CPF Board could have, at the hearing for the sanction of the scheme, argued that it was in a different class from the other unsecured creditors, as it would be a statutory preferential creditor in the liquidation of the company. The court would then have had to consider whether, taking this consideration into account, the scheme was nevertheless fair and reasonable as a whole. There is therefore

adequate protection for statutory preferential creditors such as the CPF Board.

14.46 This reviewer would therefore suggest that any amendment to the judicial management legislation is unnecessary and unwarranted. The present position works effectively, provided that creditors are properly educated that they need to voice their objections if they find a scheme to be unduly prejudicial, and that they cannot rely on anyone else to protect their interests. Further, any legislative amendment to grant automatic priority to the CPF Board and other statutory preferential creditors in judicial management would place these creditors in too advantageous a position. No scheme of arrangement by a company under judicial management will get off the ground unless it has the approval of such preferential creditors. For instance, on the facts of *Chew Eu Hock*, it might not have been possible for the company's creditors to accept the scheme for their debts to be converted into equity in the company's parent, if the CPF Board insisted on being paid in cash. If the company was unable to raise the cash to pay the CPF Board, the scheme would have failed and both the CPF Board and the company's other creditors would remain unpaid; in other words, everybody loses. Surely, the right balance is struck by the present position which gives the court the power to decide whether a scheme of arrangement is fair and reasonable to all concerned.

Receivership

14.47 In *Roberto Building Material Pte Ltd v Oversea-Chinese Banking Corp (No 2)* (para 14.4 *supra*), the Court of Appeal affirmed Lai Kew Chai J's first instance decision (see [2003] 2 SLR 237). The factual background to this case as well as a summary of Lai J's judgment have been set out in last year's review (see (2002) 3 SAL Ann Rev 243 at paras 14.49–14.60) and will not be repeated here. Before the Court of Appeal, the appellants (who were the company who had been placed under receivership by the first respondent and the guarantors of the debt owed to the respondent) advanced substantially the same grounds which had been considered and dismissed by Lai J. The Court of Appeal dismissed the appeal, largely affirming the reasoning of Lai J.

14.48 The first complaint was that the first respondent, a bank, had acted in bad faith when it appointed a receiver and manager and refused to revoke the appointment. The Court of Appeal reaffirmed the principle that a secured lender is entitled to act in his own interest in exercising his power of appointment of a receiver and manager, and owes no general duty of reasonable care to consider or have regard to the interests of the debtor. All that the law requires is that he must act in good faith. A successful challenge of the appointment requires dishonesty or improper motive on the part of the

lender, and negligence *per se* is insufficient. The leading judicial statements in this respect by the English courts in *Shamji v Johnson Matthey Bankers Ltd* [1991] BCLC 36 and *Medforth v Blake* [2000] Ch 86 were approved by the court.

14.49 The court then rejected the appellants' argument that the bank's appointment of a receiver and manager and refusal to revoke the appointment was so commercially unreasonable as to evidence bad faith. The evidence showed that the bank honestly held the view that the first appellant should be placed under receivership and had acted reasonably under the circumstances in preferring an independent person to conduct the prospective sale of the mortgaged property. The appellants had therefore failed to show that the bank had acted with bad faith, dishonesty or recklessness. The court further held that the fact that the appointment of a receiver and manager might depress the price of the mortgaged property must be regarded as a consequence within the contemplation of the parties when the security was granted.

14.50 The second complaint of the appellants was that the bank was legally obliged to give a reasonable time for the appellants to meet a debt payable on demand, before it could exercise its power to appoint a receiver and manager. The appellants conceded that, according to English authorities, a debtor is entitled only to such time as might be necessary to implement the mechanics of payment, that is, to get the money from some convenient place. A debtor is not entitled to have an opportunity to raise funds from other sources. However, the appellants submitted that the alternative approach favoured by the Canadian courts should be adopted in Singapore. This approach requires a lender to give a "reasonable time" to the debtor to repay a debt which is repayable on demand, and the meaning of a reasonable time is to be determined with reference to factors such as the amount of the loan, the risk to the creditor of losing his money or security, the length of the relationship between the debtor and the creditor, the character and reputation of the debtor, the potential ability to raise the money required in a short period, the circumstances surrounding the demand for payment, and any other relevant factors.

14.51 The Court of Appeal rejected this submission and embraced the English position. The court noted that, contrary to the appellants' contentions, the Canadian approach has not been adopted in Australia and New Zealand. Those jurisdictions preferred a test closer to the English "mechanics of payment" test. Further, the court was of the view that the Canadian approach would introduce uncertainty into a commercial arrangement where it was essential that there should be clarity. In any case, on the facts, the bank had given the appellants some 18 days, after the issue of a demand, to make payment before it proceeded to appoint a receiver and

manager. The court found that, even applying the Canadian approach, a reasonable time had been given.

14.52 The final complaint of the appellants was that the second respondent, the receiver and manager, had breached his duties in relation to the manner in which he had disposed of the company's stocks, wound up the company's business and failed to realise the value of concluded contracts. It was also alleged that the receiver and manager had failed to pursue certain offers for the purchase of the mortgaged property and to rent out the mortgaged property. The Court of Appeal referred to a number of English authorities and helpfully restated the legal position of a receiver and manager *vis-à-vis* the company under receivership. There is no general duty of care owed by a receiver to the company, as his primary duty is owed to the secured lender. In deciding to exercise his power of sale, the receiver only has the duty to act in good faith. However, once he has decided to exercise his power of sale, he owes a duty to exercise reasonable care to obtain a proper price for the mortgaged property. Interestingly, the Court of Appeal proceeded to approve the somewhat controversial English decision of *Medforth v Blake* (para 14.48 *supra*) and held that this duty extended to the carrying on of the company's business by the receiver. A receiver and manager is not obliged to continue the company's business, but if he chooses to do so, he is under a duty to exercise due care to run it properly and profitably.

14.53 On the facts, however, the court found that none of the allegations under this complaint were established on the evidence. The sale of the mortgaged property had not fallen through because of the neglect of the receiver and manager; rather, the fact was that the prospective purchasers decided not to proceed with the purchase. The court also rejected the appellants' contentions that the sale of the stocks should have been conducted by way of private treaty, as opposed to a public auction. There was no evidence that a private treaty should be the preferred mode of sale for the stocks. On the contrary, the court noted that, generally, a public auction provides an open forum for open competitive bidding and ensured transparency. With respect to an allegation that the receiver and manager had failed to find short term tenants for the mortgaged property, the court found that the receiver and manager was still seeking purchasers and had been professionally advised not to let out the mortgaged property as it was more marketable on a vacant basis.

14.54 In this reviewer's humble view, the reasoning and conclusions of the Court of Appeal cannot be faulted. The clear statements of the law and the express adoption of the English position are also to be welcomed. Some concern, however, arises out of the court's apparently unqualified endorsement of the extension laid down in *Medforth v Blake*, namely, that a

receiver and manager who chooses to continue the business of the company owes a duty to the company to exercise due care to run it properly and profitably. With respect, this cannot be a blanket principle and it is simplistic to treat it as an extension of the principle that, in exercising the power of sale, a receiver and manager is under a duty to exercise due care to obtain a proper price.

14.55 A receiver and manager does not owe a general duty to the company to exercise due care in the conduct of the receivership because his primary duty is to the secured creditor and not to the company. In other words, in conducting the receivership, the receiver and manager is to have primary regard to the interests of the secured creditor and not the company. He only owes a general duty of good faith to the company, consistent with the secured creditor's own duty of good faith to the company. It would be unworkable if the receiver and manager has a duty to the company to exercise due care in the conduct of the receivership as well as have primary regard to the interests of the secured creditor. The interests of the secured creditor and the interests of the company are often dramatically different, if not diametrically opposite, and it is impossible to reconcile a duty to the secured creditor to have primary regard to his interests with a duty to the company to exercise due care in the conduct of the receivership.

14.56 Conversely, where there are no conflicting interests, there is no reason why the receiver and manager should not be under both duties. The best example of a situation where there is no conflict of interests is where the receiver and manager has decided to exercise his power of sale over the charged property and is undertaking the sale process. There is a convergence in that the interests of both the secured creditor and the company are in the same course of action or conduct, namely, that the charged property achieves the best realisable price so that the secured debt is reduced as much as possible or discharged completely. If the charged property may realise more than the secured debt, the secured creditor has no interest and there is no conflict for the receiver and manager to attempt to obtain the best possible price for the company. This is why the law imposes a duty on a receiver and manager to exercise due care when taking steps to realise the charged property.

14.57 Similarly, a receiver and manager should be under a duty to the company to exercise due care when carrying on the company's business where there is no conflict of interests. This will be the case where ministerial acts are involved, that is, acts which do not require any exercise of discretion by the receiver and manager. For instance, the receiver and manager will have a duty to exercise due care in ensuring that the company's stock-in-trade are properly stored and preserved and the company's contracts are properly performed. Similarly, he owes a duty to exercise due care to serve rent review

notices to the company's tenants to avoid any depreciation in the value of the tenanted property (see *Knight v Lawrence* [1991] BCC 411, though note that this decision pre-dates *Downsview Nominees Ltd v First City Corporation Ltd* [1993] AC 295 and proceeded on the now-discredited basis that the receiver and manager's duties to the company rest in tort as opposed to equity).

14.58 However, there are many circumstances in relation to the carrying on of the company's business in which a receiver and manager may have to exercise his managerial discretion, for instance, he has to decide on balancing costs and output quality, the appropriate risk and profit margins for new contracts, the preservation of the company's goodwill and reputation with its customers and so on. How a receiver and manager may exercise his discretion in carrying on a business in the short to medium term to preserve the value of the company for the benefit of the secured lender (as is probably the objective of most receivers and managers who decide to carry on the business of the company) may conceivably be very different from how the company's own management would run the business. It will obviously be unrealistic to impose on the receiver and manager a duty to the company to exercise due care in relation to the exercise of such managerial discretion. The exercise of discretion necessarily imports a duty to consider relevant interests. The receiver and manager in an impossible position if, in addition to the interests of the secured lender, he also has to exercise due care to consider the interests of the company. This reviewer would therefore respectfully suggest that the receiver and manager's duty to exercise due care in carrying on the company's business should be restricted to situations where he is not required to exercise any managerial discretion and where the interests of both the secured lender and the company dictate the same course of conduct. In cases where the exercise of discretion is required, the receiver and manager's duty is to act primarily in the interests of the secured creditor, subject to only a duty of good faith to the company. Hopefully, if the opportunity arises, this distinction could be clarified by the courts.

Schemes of arrangement

Interpretation of schemes of arrangement

14.59 In *Hitachi Plant Engineering & Construction Co Ltd v Eltraco International Pte Ltd* (para 14.1 *supra*), the subject company was the main contractor for a project to develop a condominium and had engaged the appellants to be nominated sub-contractors. Under the main contract between the company and the developer, the developer had the right to make direct payment to the nominated sub-contractors in certain circumstances. The company was placed under judicial management and its judicial managers subsequently proposed a scheme of arrangement to the company's

creditors. Under the scheme, the company's assets, mainly accounts receivable from completed projects (including the condominium project in question) would be paid entirely to the creditors on a *pro rata* basis. At the creditors' meeting, creditors representing 86.5% in value of the company's debts (including some of the appellants) voted in favour of the scheme. The judicial managers were appointed as the scheme administrators under the scheme. The scheme was sanctioned by the court sometime in 2000 and the company was discharged from judicial management.

14.60 In 2002, it transpired that the developer was willing to make direct payments to the appellants as provided for in the main contract between the company and the developer. In fact, sometime earlier, the company had allowed the developer to make direct payment to another nominated sub-contractor for waterproofing ("Uni-Strong") in order to persuade Uni-Strong to issue a waterproofing warranty. However, when it came to the proposed direct payments to the appellants, the company objected. The company applied to the court for an injunction to restrain the developer from making the direct payments and to direct the appellants to authorise the developer to make the payments to the company instead.

14.61 MPH Rubin J in the High Court granted the injunctive relief sought by the company (see *Eltraco International Pte Ltd v Sennet Electrical Engineering Pte Ltd* [2003] SGHC 40) and the appellants appealed to the Court of Appeal. One of the main issues before the court was whether, on its true interpretation, the scheme prohibited the appellants from receiving the direct payments. The appellants argued that the scheme did not contain any express term preventing them from receiving the direct payments and, as such, their right to receive the direct payments could not be prejudiced. The court of Appeal disagreed with this contention. The court accepted that, as a general principle, a right of the creditors cannot be taken away or affected by a scheme of arrangement unless there is an express term to that effect in the scheme. However, the application of this general principle depends on the facts and circumstances of each case. The court first has to decide whether the creditors have a right that requires protection through an express term in the scheme of arrangement and, if so, the court then has to decide whether the terms of the scheme are sufficiently expressed to affect that right.

14.62 The court noted that the appellants had conceded that they had no legally enforceable right to compel the developer to make the direct payments. The appellants contended, however, that they had a right against the company to receive and retain the direct payments from the developer if the developer chose to make the direct payments. The court was of the view that this was not a right which required protection under the scheme at the time that the scheme was proposed and sanctioned, and it was not permissible to assess

creditors' rights in the light of subsequent events. Further, the court decided that the term "accounts receivable" in the scheme was wide enough to encompass the direct payments proposed to be made to the appellants, and that the scheme consequently prevented the appellants from receiving the direct payments. In the circumstances, the court dismissed the appeal.

14.63 With regard to the direct payment that the scheme administrators had allowed to be made to Uni-Strong, the court found that the scheme administrators had acted inconsistently and had discriminated against other creditors who had taken a more docile approach. The court disapproved of the scheme administrators' conduct in this regard and noted that an aggrieved creditor could seek recourse against the scheme administrators for breach of the scheme in a separate action.

Application of pari passu principle in schemes of arrangement

14.64 Another very important aspect of the Court of Appeal's decision in *Hitachi Plant Engineering & Construction Co Ltd v Eltraco International Pte Ltd* (paras 14.1 and 14.59–14.63 *supra*) is the holding that the *pari passu* principle of distribution does not apply in schemes of arrangement. Rubin J in the High Court had decided against the appellants on two grounds, namely, that the scheme prohibited the appellants from receiving the direct payments proposed to be made by the developer and that the direct payment clause in the main contract between the company and the developer was struck down by the scheme of arrangement as it contravened the *pari passu* principle.

14.65 As seen above, the Court of Appeal upheld Rubin J's decision on the first ground. However, the court disagreed with the learned judge on the second ground. The decision of *Joo Yee Construction Pte Ltd v Diethelm Industries Pte Ltd* [1990] SLR 278 had established that a direct payment clause in a main contract between a developer and the main contractor is struck down in the liquidation of the main contractor as being contrary to public policy, as it contravened the *pari passu* principle of distribution. Rubin J extended the rationale of this decision to schemes of arrangement, and decided that a direct payment clause is also rendered void where the main contractor successfully implements a scheme of arrangement.

14.66 The Court of Appeal accepted the appellants' contention that this was incorrect in law and that the *pari passu* principle had no application in relation to schemes of arrangement. While there was no decision in any Commonwealth jurisdiction ruling directly on the point, the court surveyed a number of authorities and noted that they indicated that the *pari passu* principle applied only in the liquidation of a company. Applying first principles, the court agreed with the appellants' contention that there are

fundamental differences between a scheme of arrangement and liquidation, and that a scheme of arrangement is a corporate rescue mechanism. The court pointed out that schemes of arrangement had in fact been used in other jurisdiction to depart from the *pari passu* principle even in instances of insolvency. Also, schemes of arrangement could be used in situations which have nothing to do with insolvency at all, for instance, reorganisation of a company's share capital. The court further noted that the creditors who are subject to a scheme of arrangement do not require the additional protection of the *pari passu* principle, as every scheme of arrangement is subject to the scrutiny of the court before it can be implemented.

Disclosure of relevant information to creditors to make a meaningful choice

14.67 The importance of the principle of due disclosure in schemes of arrangement was underscored in two cases. In *Wah Yuen Electrical Engineering Pte Ltd v Singapore Cables Manufacturers Pte Ltd* (para 14.1 *supra*) (“*Wah Yuen*”), the company had presented a scheme of arrangement to its creditors pursuant to which creditors who were owed \$2,000 or less would be paid in full while creditors who were owed more than \$2,000 would be paid \$2,000 or 15% of their claims, whichever was the greater. Claims by related parties would be fully subordinated. At the creditors' meeting, a majority in number of the creditors holding 82% of the admitted debts voted in favour of the scheme, and the company applied to the court for sanction of the scheme. One of the creditors who voted against the scheme objected to the company's application for sanction on the grounds that there had been inadequate disclosure of pertinent information and that the creditors had not been divided into proper classes. As noted in last year's review, S Rajendran J in the High Court refused to sanction the scheme (*Wah Yuen Electrical Engineering Pte Ltd v Singapore Cables Manufacturers Pte Ltd* [2002] SGHC 297).

14.68 The Court of Appeal dismissed the company's appeal. The court held that, apart from the statutorily-mandated explanatory statement (see s 211(1) of the Companies Act), it is an independent principle of law that the creditors should be put in possession of such information as is necessary to make a meaningful choice. While the creditors are the best judges of what is to their commercial advantage, this is premised on the assumption that they are provided with the necessary information to make an informed decision. On the facts, the court held that there had been a lack of transparency on the part of the company over the debts owed by related parties. The company had not responded to the opposing creditor's queries on the related party debts the creditors were not in a position to assess the fairness and reasonableness of the scheme. The court was particularly critical of the company telling the opposing creditor to challenge the scheme in court if it had concerns.

14.69 It should be noted, however, that the court's decision was based on the exercise of its discretion in deciding whether to sanction the scheme. The opposing creditor had argued that, given the lack of information on the related party debts, the related parties should not have been allowed to vote at all and the approval threshold for creditor approval would not have been reached. The court declined to follow this approach and preferred to base its decision on the exercise of judicial discretion. The court pointed out that, if a company had to satisfy each creditor of the genesis and extent of all of its debts before the scheme could be put to vote, the entire process would be cumbersome and administratively inconvenient, especially when the scheme may itself already provide for a procedure for the adjudication of claims for voting purposes.

14.70 The principle of due disclosure emphasised in *Wah Yuen* was followed and applied in *Re Econ Corp Ltd* (para 14.1 *supra*). The company was the main operating subsidiary of its public-listed parent and held licences from the building authorities to undertake top-end infrastructure and construction projects. The company suffered severe losses during the 1997 economic crisis and presented a scheme of arrangement to its creditors whereby creditors would receive cash payment, redeemable loan stock and shares in the parent company. At the creditors' meeting, the scheme was approved by 89% in value of the creditors. However, the company's application to the court for sanction was opposed by a number of creditors.

14.71 The main complaint of the opposing creditors was that there was a lack of information provided by the company on the losses incurred by its parent company and the transfer of certain of the company's machinery to particular creditors. This was denied by the company.

14.72 Lai Siu Chiu J examined the decision in *Wah Yuen* in detail and held that, on the facts, there had been a lack of transparency and a withholding of information on the part of the company. The company had withheld information on its parent company's extensive losses which, if disclosed, might have caused the voting to go the other way. There were also disturbing features in the accounts of the company. Lai J also found the transfers of the company's machinery to certain parties to be highly questionable and concluded that they were intended to confer preferences on such parties or to transfer assets to them at an undervalue. In the circumstances, the learned judge declined to sanction the scheme.

Classification of creditors

14.73 The Court of Appeal in *Wah Yuen* also clarified the law relating to the classification of creditors for the purposes of voting on a scheme of

arrangement. In this regard, the court approved the formulation of Lord Millett NPJ in *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (2001) 4 HKCFAR 358 that the test is based on similarity or dissimilarity of legal rights against the company, and not on similarity or dissimilarity of interests not derived from legal rights. As such, the court accepted the company's contention that related parties did not form a separate class of creditors for voting purposes simply because they were related parties.

14.74 The opposing creditor further contended that the creditors were not properly divided into classes. As will be recalled, the scheme provided that creditors who were owed \$2,000 or less would be paid in full while creditors who were owed more than \$2,000 would be paid \$2,000 or 15% of their claims, whichever was the greater. The opposing creditor pointed out that 36 of the 75 creditors who voted in favour of the scheme stood to recover various different percentages of their respective claims, and ought to have been put in a different class. Of the 36, 14 stood to recover 100% of their claims, while the remaining 22 stood to recover between 15% and 89% of their claims.

14.75 The court rejected this contention and held that creditors need not be placed in different classes simply because there were minor differences in their respective percentage recoveries. The court pointed out that, if the contention was accepted, there would be at least 12 classes of creditors which needed to be constituted, and the court will be careful not to enable a small minority to thwart the wishes of the majority by fragmenting the creditors into small classes. The court will adopt a fairly robust approach and classify the creditors in a broad and objective manner, as complete identity of interest among the creditors was impossible. At the same time, the court also felt that the 14 creditors who stood to recover in full should have been put in a different class. However, the court did not have to come to a definitive view on this issue as it preferred to rest its decision on the lack of transparency on the part of the company on its related party debts.

14.76 The Court of Appeal's view that creditors who stand to recover their debts in full should be placed in a different class from creditors who had less than 100% recovery was endorsed and applied by Lai Siu Chiu J in *Re Econ Corp Ltd* (paras 14.1 and 14.70–14.72 *supra*). As the scheme in that case provided that creditors who were owed \$4,000 or less would be paid in full, the learned judge held such creditors should have voted in a different class.

14.77 With the deepest respect, this reviewer has some reservations on the approach of the Court of Appeal in *Wah Yuen* that creditors need not be placed in different classes if they have different percentage recoveries, unless they stand to receive full recovery. The court was clearly seeking to strike a fine balance between the interest in maximising the flexibility of the

commercial terms which a scheme of arrangement may contain and the interest in ensuring that the creditors are treated fairly and there is no oppression of minority creditors. However, in the context of percentage recoveries, this seems an impossible exercise. There is no rational basis for saying that creditors with percentage recoveries ranging between 15% and 89% may be put in the same class but creditors with 100% recovery should be in a class of their own. Further, the difference between 15% and 89% can hardly be labelled as “minor” and, indeed, 15% is obviously further from 89% than 100%. It is also difficult to see how it can be fair to require a creditor with a 15% recovery to vote in the same class with a creditor with an 89% recovery. Most importantly, there is a serious lack of certainty as to when creditors with different percentage recoveries should be placed in different classes.

14.78 Further, in the case of mathematical formulae, the court should apply a uniform theoretical approach rather than look at the facts on a case-by-case basis. Another scheme of arrangement may use a similar formula but with a very different constitution of creditors (for instance, having 100 creditors with an 89% recovery and one lone creditor having a 15% recovery). It cannot be right that the rules on constitution of classes of creditors should differ from case to case, with respect to the same mathematical formula.

14.79 While this reviewer is a firm believer in allowing the commercial bargain in schemes of arrangement to have as much flexibility as possible, it seems that the right approach is to adopt fairly strict rules of classification of creditors in relation to percentage recoveries. Beyond a small amount of leeway (this should probably be not more than 5%), creditors with different percentage recoveries should be placed in different classes. This is not an impractical solution. It merely places the onus on the company to bear in mind an additional consideration when deciding on the commercial terms of the scheme of arrangement. If having too many creditor classes will undermine the likelihood of success of the scheme, the company simply has to expend a bit more effort and time to work out appropriate commercial terms to ensure that there is reasonable uniformity in the percentage recoveries of the creditors subject to the scheme, so as to reduce the number of creditor classes. It should not be too difficult to achieve this.

14.80 One point which was not argued in *Wah Yuen* was that the related parties should not have voted in the same class as the ordinary creditors. In last year’s review, this reviewer had pointed out that the related parties, whose claims were subordinated under the scheme, should not have been allowed to vote in the same class as the ordinary creditors ((2002) 3 SAL Ann Rev 243 at paras 14.64–14.66). They stood to gain nothing from the scheme until after all the other creditors had received their benefits under the scheme. Clearly, their

rights were affected in a very different way by the scheme as compared to the other creditors, and a strong argument could have been made that they ought not to have voted in the same class.

14.81 It should be recorded that, in *Re Econ Corp Ltd* (paras 14.1 and 14.70–14.72 *supra*), it was held that contingent creditors should be placed in a different class from present creditors. In that case, the contingent creditors were banks which had issued performance bonds at the request of the company, and these performance bonds had not been called as at the date of the creditor's meeting. Lai Siu Chiu J correctly pointed out that the banks would not acquire present rights against the company unless the performance bonds were called and the company defaulted on the indemnities it would have issued to the banks in turn.

14.82 Two important points on classification of creditors were established by the Court of Appeal in *Hitachi Plant Engineering & Construction Co Ltd v Eltraco International Pte Ltd* (paras 14.1 and 14.59–14.66 *supra*), although in *obiter dicta*. The facts and main holding of this case have been set out above. As the appellants failed to persuade the Court of Appeal on the main ground, namely, that the scheme did not prohibit them from receiving the direct payments proposed to be made by the developer, it was strictly not necessary for the court to consider the appellants' other contentions. However, the court decided to comment on two specific arguments raised by the appellants.

14.83 The first argument was that, assuming the scheme did in fact prohibit the nominated sub-contractors from receiving direct payments from the developer, the appellants should have been placed in a different class as their rights were dissimilar to the rights of the other creditors. The Court of Appeal did not express any definite view on this argument. However, after referring to the principles stated by Lord Millett NPJ in *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin* (para 14.73 *supra*) with regard to the classification of creditors, the court commented that there is nothing to prevent the court from considering nominated sub-contractors as a different class when sanctioning a scheme if that is necessary to ensure that the scheme is fair and reasonable to the creditors as a whole.

14.84 The second argument raised by the appellants was an important one relating to the special rules applicable to a scheme of arrangement proposed by a company in judicial management. Such a scheme is presented under s 227X(a) of the Companies Act which, unlike s 210 of the Act, does not provide that the creditors have to be divided into classes. The appellants argued that, notwithstanding this omission, the role and function of the court in deciding whether to sanction a scheme presented under s 227X(a) could not be any different. The Court of Appeal agreed with this submission and

held that, notwithstanding the differences in wording between ss 227X(a) and 210, there is nothing to preclude the court from considering the nominated sub-contractors as a different class when sanctioning a scheme under s 227X(a).

Hypothetical recounting of votes

14.85 In *Wah Yuen* (paras 14.1 and 14.67–14.80 *supra*), the company had argued, in response to a contention by the opposing creditors that certain related party claims should have been excluded from the vote, that the requisite 75% value threshold would have been crossed even if the related parties had voted on less favourable terms. The Court of Appeal rejected this, saying that it was always possible to cobble together some hypothetical scenario to show that the percentage requirements could have been met, and that the scenarios presented did not allay the real concerns as to the related party debts. This reasoning was followed by Lai Siu Chiu J in *Re Econ Corp Ltd* (paras 14.1, 14.70–14.72 and 14.81 *supra*) in dismissing a similar argument put forth by the company seeking a sanction of its scheme of arrangement.

14.86 It must be cautioned that these cases should not be interpreted as rejecting *in toto* all arguments based on a hypothetical recounting of votes. It should be noted that *Wah Yuen* and *Re Econ Corp Ltd* were cases where the subject companies had been found wanting in the disclosure of information, and were seeking to defend against this deficiency by hypothetically recounting the votes. This argument was rejected in both cases because there was no certainty that the creditors would have voted the same way had full disclosure been made.

14.87 The position might be different in a case where it is undisputed that all relevant information had been provided to the creditors, and the challenge to the scheme is based on other grounds such as purported wrongful classification of creditors or erroneous quantification or computation of a creditor's claim. In such cases, there seems to be no good reason why a hypothetical recounting of votes should not be relied upon to mount a persuasive argument that the objection would have made no difference to the ultimate result of the voting, and that it would be a waste of time to reconvene the creditors' meeting.

Relevance of liquidation analyses

14.88 In both *Wah Yuen* and *Re Econ Corp Ltd*, the companies seeking court sanction of their respective schemes of arrangement had sought to rely on liquidation scenarios to argue that the likely recovery of creditors in a liquidation scenario would be lower than under the schemes of arrangement.

However, in both basis, the courts refused to place any weight on such reports in the particular circumstances before them.

14.89 In *Wah Yuen*, the Court of Appeal held that no reliance could be placed on the report of the company's financial advisers that the recovery of the creditors in a liquidation scenario would be much less, since the financial advisers had made their assessment based on the company's unaudited accounts and had expressly stated that they were unable to verify such accounts. In *Re Econ Corp Ltd*, the company pointed out that the scheme would yield a 65% return for the creditors and result in the subordination of all related company debts, while a liquidation would produce only a 3% recovery for the creditors. Lai Siu Chiu J was sceptical of this, given the disturbing features in the company's accounts and the general circumstances of the case. Lai J also referred to the Court of Appeal's judgment in *Wah Yuen* declining to put any weight on the report of the financial advisers in that case, and further noted that liquidation was not the only alternative to the scheme of arrangement as the opposing creditors had given notice that they intended to apply to put the company under judicial management.

14.90 Notwithstanding these cases, this reviewer would venture to suggest that liquidation analyses are relevant in appropriate cases, in particular, where the issue is whether the scheme is a fair and reasonable one. However, it is essential that such liquidation scenarios are prepared on the basis of objective, reliable and updated information and, preferably, by independent professionals. In a case where there are allegations that there has been material non-disclosure, it is likely that the courts will take the same attitude as in *Wah Yuen* and *Re Econ Corp Ltd*.

Improper motives for presenting a scheme of arrangement

14.91 In *Wah Yuen*, the opposing creditor argued that the company had presented the scheme of arrangement for the improper purpose of avoiding liquidation and investigations into the company's affairs. Reliance was placed on G P Selvam J's decision in *Re Halley's Departmental Store Pte Ltd* (para 14.1 *supra*). The court declined to make a finding of improper purpose on the facts, but did not cast any doubt on the authoritativeness of *Re Halley's Departmental Store Pte Ltd*. It would appear, therefore, that the court implicitly accepted that a scheme of arrangement may not be sanctioned if there is evidence to show that the scheme was being implemented for the purpose of avoiding liquidation and consequent inquiries into its affairs.

Ulterior motives for opposing a scheme of arrangement

14.92 The company also counter-argued that the opposing creditors (“Supermix”) had ulterior motives in objecting to the scheme and that, in particular, one of the main opposing creditors had obtained a garnishee order absolute against the company and would stand to gain if the scheme was rejected by the court. Although Supermix stood to gain from the failure of the scheme and probably did not have altruistic reasons for opposing the scheme, its arguments should not be completely disregarded.

Finality of a scheme of arrangement once sanctioned by the court

14.93 The High Court’s decision in *Chew Eu Hock Construction Pte Ltd v Central Provident Fund Board* (paras 14.1 and 14.33–14.46 *supra*) has already been considered in some detail above. As noted earlier, the simple principle affirmed by the court is that CPF contributions which a company is liable to make do not enjoy any priority in payment over the other liabilities of the company when the company is placed under judicial management, unless expressly ordered by the court. However, also as noted earlier, this in itself should have been irrelevant to the ultimate decision of the court to dismiss the objections of the CPF Board. The fact of the matter was that the CPF Board had not attended the creditors’ meeting to approve the scheme of arrangement or objected to the scheme at the hearing to obtain the sanction of the court on the ground that it should be placed in a different class on account of its priority rights. Even if the judicial management legislation had expressly conferred priority on CPF contributions, the court would not disturb the scheme once it has been approved by the requisite majority of creditors and sanctioned by the court.

14.94 This consideration featured prominently in the judgment of Lai Siu Chiu J. The learned judge noted that the CPF Board raised its objections far too late, well after the scheme had been sanctioned and its operation had commenced. To accept the CPF Board’s objections at such a late stage would be unfair, unreasonable and prejudicial to the judicial managers, the new investors in the company and the other creditors. Lai J also rejected the explanation of the CPF Board that it did not attend the creditors’ meeting because it expected the court to exercise its powers under s 227X(b) of the Companies Act to confer priority on CPF contributions. The onus was on the CPF Board, and not the judicial managers, to request the court to grant such priority.

14.95 The same principle was affirmed in *Hitachi Plant Engineering & Construction Co Ltd v Eltraco International Pte Ltd* (paras 14.1, 14.59–14.66 and 14.82–14.84 *supra*). The court made it clear that any objection that

different classes of creditors should have been constituted should be raised at the stage when sanction is being sought for the scheme. If the challenge is not made at that juncture and the scheme is sanctioned, the court will not entertain the objection if raised subsequently.

Bankruptcy

Service of bankruptcy statutory demands

14.96 Rule 96(3) of the Bankruptcy Rules (Cap 20, R 1, 2002 Rev Ed) provides that if a creditor is not able to effect personal service of a bankruptcy statutory demand on a debtor, the statutory demand may be served by such other means as would be most effective in bringing the demand to the notice of the debtor. According to r 96(4), one of the modes of effecting substituted service is to post the statutory demand at the door or some other conspicuous part of the last known place of residence or business of the debtor or both. However, r 96(6) provides that a creditor shall not resort to substituted service unless he has taken all such steps which would suffice to justify the court making an order for substituted service of a bankruptcy petition, and the mode of substituted service would have been such that the court would have ordered in the circumstances.

14.97 In *United Overseas Bank Ltd v Ishak bin Ismail* (para 14.4 *supra*) (“*Ishak bin Ismail*”), the clerk employed by the petitioning creditors’ solicitors had visited the debtor’s last known address twice. On the first visit, nobody answered his knocks on the door. On the second visit, he was informed by an Indian male that there was no one of the debtor’s name staying at that address. A property tax search also showed that the debtor was not the owner of the premises at that address. Subsequently, the clerk posted the demand on the front door of the address.

14.98 Rajendran J affirmed the decision of Assistant Registrar Phang Hsiao Chung ([2003] SGHC 131) that the statutory demand was not properly served on the debtor and ought to be set aside. The last known address of the debtor had been determined by the petitioning creditor from loan documents executed by the debtor more than one and a half years ago and there was no evidence that the debtor was still residing at that address at the time. In fact, the evidence indicated to the contrary. The learned judge agreed with the assistant registrar that the posting of the statutory demand on the front door of the address was not the most effective means of bringing the demand to the notice of the debtor as required by r 96(3). Neither was it a mode of substituted service that the court would have ordered in the circumstances, as stipulated by r 96(6). In the opinion of Rajendran J, the petitioning creditor should have advertised the demand in a local newspaper in a language which

the debtor is known to understand or, if the office address of the debtor was known, attempted to serve the statutory demand at the office address before resorting to other modes of service.

14.99 This reasoning is clearly correct thus far. However, it must be pointed out that the earlier decision of the same learned judge in *Wong Kwei Cheong v ABN AMRO Bank NV* (“*Wong Kwei Cheong*”) [2002] 3 SLR 594 was not adequately discussed by the judge himself or the assistant registrar. In that case, the creditor had attempted to effect personal service of a statutory demand on the debtor on three occasions at the last place of residence known to the petitioning creditor. On all three occasions, the premises were locked. Further, a property tax search revealed that the premises were not owned by the debtor. The creditor then proceeded to advertise a notice of the statutory demand in the press as substituted service. The court decided that this was not effective substituted service and held that it is only where the creditor has no knowledge of the last known place of residence, business or employment of the debtor that the creditor is entitled to advertise the statutory demand in the press. The court also noted that the creditor knew the last known place of residence of the debtor, and should have effected substituted service at such last known place of residence. The learned judge was of the view that by failing to do this and by proceeding to advertise the notice of statutory demand in the press, the creditor had abused the process of the court.

14.100 The parallels between *Wong Kwei Cheong* and *Ishak bin Ismail* are apparent. However, in the latter case, the court disposed of *Wong Kwei Cheong* somewhat summarily. Rajendran J merely pointed out that *Wong Kwei Cheong* could be distinguished on the ground that the pre-requisites for effecting substituted service of the statutory demand by advertisement had not been met. The learned judge also highlighted that, in *Wong Kwei Cheong*, the creditor was in contact with the debtor’s solicitors but did nothing to serve the demand through the debtor’s solicitors. With respect, this treatment of *Wong Kwei Cheong* is less than satisfactory. There was a clear holding in *Wong Kwei Cheong* that the creditor should have effected substituted service at the debtor’s last known place of residence instead of proceeding to advertise the notice of statutory demand in the press. This was despite the fact that the service clerk had visited the last known place of residence three times and found the premises locked, and the property tax search showed that the debtor was not the owner of the premises. Indeed, it is entirely plausible that the creditor in *Ishak bin Ismail* relied on the decision in *Wong Kwei Cheong* in coming to the decision to post the statutory demand on the door of the debtor’s last known address.

14.101 There is no clear explanation as to why this holding in *Wong Kwei Cheong* did not apply on the facts of *Ishak bin Ismail*. It is difficult to be

persuaded by the analysis that *Wong Kwei Cheong* was a case where the pre-requisites for effecting substituted service by advertisement had not been met, and *Ishak bin Ismail* was a case where such pre-requisites had been met but the chosen mode of substituted service was unacceptable. Both cases involved a situation where the creditor's service clerk could not locate the debtor at his last known residence despite repeated visits, and property tax searches showed that the residence was not owned by the debtor. In one case, it was decided that the creditor should not have advertised the statutory demand in the press but should have posted the statutory demand on the door of the residence. In the other, the decision was that the creditor should not have posted the statutory demand on the door of the residence but should have advertised the statutory demand in the press. The only factual difference was that, in *Ishak bin Ismail*, the service clerk had been informed by a person at the debtor's last known place of residence that no one of the debtor's name was residing there. However, this in itself is surely not enough to justify the opposite conclusions in the two cases.

14.102 This reviewer would respectfully suggest that the two cases are not easy to reconcile, and would accept the position set out in *Ishak bin Ismail* in preference to that stated in *Wong Kwei Cheong*. For the reasons set out in (2002) 3 SAL Ann Rev 243 at paras 14.76 and 14.77, the reasoning in *Wong Kwei Cheong* is questionable and should not be followed. Unfortunately, in *Ishak bin Ismail*, the court distinguished *Wong Kwei Cheong* on, it is submitted, tenuous grounds. Until the inconsistency between the two decisions is expressly dealt with on another occasion, there will be a certain amount of uncertainty in the proper mode of substituted service of a bankruptcy statutory demand.

Setting aside of bankruptcy statutory demands

14.103 In *C & K Credit Pte Ltd v Lee Chin Kwee Calvin* [2003] 1 SLR 141, an assignee of a debt had served a bankruptcy statutory demand against the debtor and had attached a notice of assignment to the statutory demand. One of the arguments raised by the debtor, in seeking to set aside the bankruptcy statutory demand, was that the notice of assignment was ineffective as bankruptcy proceedings had commenced. Choo Han Teck JC (as he then was) rejected this argument, and affirmed the simple point that the service of a bankruptcy statutory demand does not constitute the commencement of bankruptcy proceedings.

14.104 This reviewer would add that the debtor's argument was misconceived on two other grounds. First, an assignee of a debt may serve a bankruptcy statutory demand on the debtor without giving any notice of assignment. An assignment of a debt without any notice of assignment being

given to the debtor is valid and effective as an equitable assignment. It is well established that an equitable assignee of a debt can present a winding up petition against the debtor (*In re Steel Wing Company, Limited* [1921] 1 Ch 349), and it should follow that he can serve a bankruptcy statutory demand and present a bankruptcy petition against the debtor. Secondly, there is no reason why a notice of assignment cannot be effectively served on a debtor after the commencement of bankruptcy proceedings against the debtor. The service of a notice of assignment is clearly not an action, execution or other legal process against the debtor which is subject to s 76(1)(c) of the Bankruptcy Act (Cap 20, 2000 Rev Ed). In any case, a stay on such action, execution or legal process is not automatic but must be granted by an order of the court.

14.105 *C & K Credit Pte Ltd v Lee Chin Kwee Calvin* (para 14.103 *supra*) also underscores the importance of providing sufficient detail in a bankruptcy statutory demand so as to enable the debtor to ascertain the particulars of the debt which he is said to owe. In this case, the sum set out in the bankruptcy statutory demand had purportedly taken into account administrative and other expenses incurred by the creditor, but these expenses were not explained in the demand or on affidavit. Choo Han Teck JC (as he then was) rightly held that the demand ought to be set aside.

Bankruptcy orders

14.106 It is clear law that, notwithstanding that a debtor is unable to pay his debts, the court has the discretion not to make a bankruptcy order. In *United Overseas Bank Ltd v Fernandez Victor FA* [2003] SGHC 246, however, the debtor failed to persuade the court, on appeal, to exercise this discretion and rescind the bankruptcy order made by the assistant registrar. The main submission of the debtor was that all he needed was more time to pay his debts, and that the petitioning creditor should wait until he (the debtor) turned 55 and could withdraw his Central Provident Fund (“CPF”) moneys. He contended that his other creditors had granted him time and that the petitioning creditor was unreasonable in refusing to grant him similar indulgence. He further sought to rely on s 65(3) of the Bankruptcy Act.

14.107 Lai Siu Chiu J rejected these arguments and dismissed the appeal. This is unsurprising; commercial certainty and creditors’ rights would be completely undermined if such arguments were accepted. Lai J pointed out that there was no evidence supporting the debtor’s claims, such as the amount of CPF funds which could be withdrawn, the amount of his debts or even his age. The learned judge also noted that s 65(3) of the Bankruptcy Act only directed the court to take into account the contingent liabilities, and not the contingent assets, of a debtor, and did not therefore assist the debtor. Further,

the petitioning creditor's bankruptcy statutory demand and bankruptcy petition had complied with the statutory requirements, and the debtor had admitted his liability to the petitioning creditor and could not raise any dispute in that regard.

Bankruptcy offences

14.108 Section 141(1)(a) of the Bankruptcy Act provides that it is an offence for a bankrupt to obtain credit beyond \$500 without informing the lender that he is an undischarged bankrupt. It would appear that this is an offence the prosecution for which is becoming increasingly frequent. Prior to 2001, there had been no High Court decision on this offence apart from *R v Schefelaar* [1939] MLJ 45. Since 2001, however, there have been four High Court and subordinate court decisions on this offence.

14.109 The most recent of these is the High Court decision in *PP v R Sekhar s/o R G Van* [2003] 2 SLR 456, in which the Chief Justice reversed the Magistrate Court's decision to grant the accused a discharge amounting to an acquittal ([2003] SGMC 4). The accused, who was an undischarged bankrupt, had stayed at a hotel for more than a year until he was eventually locked out of his room after he failed to pay arrears of the hotel charges. The hotel subsequently sued and entered default judgment against him for a sum of over \$23,000, though the accused disputed that the amount owing was only about \$7,000.

14.110 The Magistrate's Court acquitted the accused on the ground that the Prosecution's evidence was hearsay and unreliable, and did not prove that the hotel had failed to enquire about the solvency status of the accused. It followed that it was not proven that the accused had not disclosed his bankruptcy status to the hotel. The Prosecution appealed.

14.111 Yong Pung How CJ disagreed with the reasoning of the Magistrate's Court. The learned Chief Justice highlighted that s 141(1)(a) states that a bankrupt shall be guilty of an offence if he obtains credit to the extent of \$500 or more from any person "without informing that person that he is an undischarged bankrupt". As such, the onus lay on the accused to show that he had disclosed his bankruptcy status to the lender, and not on the Prosecution to show that he had not made such a disclosure. Yong CJ pointed out that the object of s 141(1)(a) is to protect the person from whom the undischarged bankrupt seeks to obtain credit, and to prevent innocent people and business organisations from being misled by a bankrupt's appearance of solvency and a promise to pay. Further, the learned Chief Justice referred to his earlier decision in *PP v Ong Ker Seng* [2001] 4 SLR 180, which established that the duty of disclosure under s 141(1)(a) is satisfied where disclosure is made

within a reasonable time before the extension of credit. In the circumstances, only the bankrupt himself would be in a position to know to whom he had disclosed his bankruptcy status and the time and context of the notification, and he would be able to prove the fact of disclosure with ease.

14.112 Yong CJ then examined the evidence of the accused and decided that he had not established that he had informed the hotel about his status as an undischarged bankrupt. Accordingly, the learned Chief Justice allowed the Prosecution's appeal, convicted the accused of an offence under s 141(1)(a) and sentenced him to one year's imprisonment.

Vulnerable transactions

Locus standi of a liquidator to invoke avoidance provisions under the Bankruptcy Act

14.113 In *Re Tiong Polestar Engineering Pte Ltd* (para 14.3 *supra*), it was argued that the liquidator of a company was not the proper person to make an application to set aside a payment as the giving of an unfair preference. It was pointed out that, in the case of bankruptcy, s 99 of the Bankruptcy Act states that the Official Assignee may make the application. As the equivalent of the Official Assignee in the case of corporate liquidation is the Official Receiver, it followed that the Official Receiver should be the proper party to make an application when s 99 is applied to corporate liquidation under s 329 of the Companies Act. There was also no express provision in the Companies Act conferring the general powers of the Official Receiver on a liquidator. This point was first raised by this reviewer in an article published just after the relevant legislation had just been enacted ("The Avoidance Provisions of the Bankruptcy Act 1995 and their Application to Companies" [1995] SJLS 597), which was cited in support.

14.114 Woo Bih Li J disagreed with this contention, and was of the view that the intention of the Companies Act is to give a liquidator who is not the Official Receiver as many powers as possible and assist the liquidator to carry out his duties. His Honour further suggested that although various provisions have been enacted to give him such powers, there is nothing in the Companies Act which expressly says that a liquidator has such powers only and no others. With respect, it is not easy to accept that a liquidator has any power which is not expressly or implicitly conferred on him by legislation. A liquidator's office is created solely by statute and the extent of his powers must similarly be prescribed by statute.

14.115 Woo J noted that the problem did not arise in the context of judicial management, as s 227T of the Companies Act, which imported the

application of the relevant bankruptcy provisions into judicial management, expressly states that the transaction in question is “void against the judicial manager”. However, s 329 of the Companies Act, which imports the application of the same bankruptcy provisions into corporate liquidation, does not expressly state that the transaction in question would be void against the liquidator. His Honour rightly attributed this to the problematic process of importing bankruptcy provisions for use in the corporate liquidation regime.

14.116 In any case, his Honour concluded that it is the person appointed as the liquidator who should make the application, be it a private liquidator or the Official Receiver himself. If the only proper applicant is the Official Receiver, it would mean that he has to seek an indemnity for costs and perhaps be consulted as well when he really has nothing to do with the dispute. The learned judge also highlighted the fact that, notwithstanding that this reviewer’s article had been cited in support of the contrary argument, this reviewer had suggested in the article that practical sense would prevail and the likely stand that the court will take is that a liquidator who is not the Official Receiver does possess the necessary *locus standi*. However, the learned judge did not quite agree with this reviewer’s reliance on reg 3(b) of the Companies (Application of Bankruptcy Act Provisions) Regulations (Cap 50, Rg 3, 1995 Ed) (“CABAR”), which provides for such textual and other modifications as may be “necessary” for the application of the bankruptcy provisions to a company under judicial management or liquidation. His Honour felt that any modification to confer on the liquidator the necessary *locus standi* might not satisfy the test of necessity referred to in reg 3(b). Nevertheless, this did not change the learned judge’s view that a liquidator has the required *locus standi*.

Mode of application

14.117 An argument was also made in *Re Tiong Polestar Engineering Pte Ltd* (para 14.3 *supra*) that an application to reverse an unfair preference should be made by way of an originating summons instead of a summons in chambers. Woo J rejected this argument and held that the correct mode of application is by way of a summons in chambers. The learned judge held that the reference in r 7(2) of the Companies (Winding Up) Rules to a “summons” means a summons in chambers and not an originating summons.

14.118 For completeness, it should be noted that, in the later decision of the Court of Appeal in *Mercator & Noordstar NV v Velstra Pte Ltd* (para 14.3 *supra*), an application by the liquidator of a company to set aside a transaction as a transaction at an undervalue had been made by originating summons. The respondent to the application argued that the application should have

been made by writ, and sought the conversion of the originating summons into a writ action. Before the Court of Appeal, the respondent to the application succeeded on a substantive point and the conversion became academic. The Court of Appeal did not comment on whether the application should have been commenced by originating summons or by writ, or that neither mode was correct. In this reviewer's view, the reasoning in *Re Tiong Polestar Engineering Pte Ltd* is correct, and the proper procedure is that a summons in chambers should be used by a liquidator (or judicial manager) to apply to set aside a transaction under the Bankruptcy Act provisions referred to in ss 329(1) and 227T of the Companies Act. It is also pertinent to note that in bankruptcy, an application to reverse a transaction as a transaction at an undervalue, an unfair preference or an extortionate credit transaction is made by summons in chambers (r 11 of the Bankruptcy Rules). There is no reason for the position to be any different where the application is made by a liquidator (or judicial manager).

Associates and connected persons

14.119 It may be recalled that the concepts of associates and connected persons are used to trigger certain important consequences in relation to the Bankruptcy Act provisions on unfair preferences and transactions at an undervalue. An "associate" of a bankrupt is assigned various definitions in s 101 of the Bankruptcy Act. In relation to companies under liquidation or judicial management, ss 227T and 329 of the Companies Act read with the CABAR, replace the concept of "associates" with a wider concept of "persons connected with a company".

14.120 In summary, the significance of whether an unfair preference is given to, or a transaction at an undervalue entered with, an associate or connected person is as follows. Where a recipient of an unfair preference is an "associate" of a bankrupt or a "person connected" with a company under liquidation or judicial management, the statutory vulnerability period is anytime during the two years before the onset of bankruptcy, liquidation or judicial management (see s 100(1) of the Bankruptcy Act), as opposed to the shorter six-month period in cases where no associate or connected person is involved. Further, if an unfair preference is given to an associate (in the case of a bankrupt) or a connected person (in the case of a company under liquidation or judicial management), it is presumed that the bankrupt or company, in deciding to give the unfair preference, was influenced by a desire to produce the effect of an unfair preference (see s 99(5) of the Bankruptcy Act). Thus, the onus is not on the Official Assignee, liquidator or judicial manager (as the case may be) to establish this mental element (as otherwise required by s 99(4) of the Bankruptcy Act). Rather, the recipient of the

purported unfair preference has to rebut the presumption of the existence of such a desire.

14.121 With respect to transactions at an undervalue, the effect of a transaction being entered into with an associate (in the case of a transaction entered into by a bankrupt prior to bankruptcy) or a connected person (in the case of a transaction entered into by a company prior to its liquidation or judicial management) is that it raises the presumption that the bankrupt or company was insolvent at the time of the transaction or became insolvent as a result of the transaction (see s 100(3) of the Bankruptcy Act). The onus then falls on the counter-party to the transaction to rebut the presumption and show that the requirement of insolvency under s 100(2) of the Bankruptcy Act is not satisfied.

14.122 The Court of Appeal's decision in *Show Theatres Pte Ltd v Shaw Theatres Pte Ltd* [2002] 4 SLR 145 ("*Show Theatres*") has done much to establish the correct approach in interpreting the relevant provisions defining the concepts of associates and connected persons, in particular, the confusing and difficult interplay between the provisions of the Bankruptcy Act and the CABAR. However, it would appear that not all the complications have been eradicated. In 2003, both the High Court and the Court of Appeal had to again consider issues arising from the provisions relating to the definitions of associates and connected persons.

14.123 In *Re Tiong Polestar Engineering Pte Ltd* (para 14.3 *supra*), the liquidator of a company applied for the reversal of certain payments of rent and utilities made by the company to its landlord within the period of two years prior to the commencement of liquidation. The extended two-year period prior to commencement of liquidation during which transactions could be impugned as unfair preferences (instead of the usual six-month period) would be applicable only if the landlord was a "person connected" with the company and hence an "associate" of the company. The liquidator submitted that this was necessarily so as the company and the landlord had a common director, relying on the decision of the Court of Appeal in *Show Theatres*. One would have thought that this was an insurmountable argument. However, the landlord made the unexpected submission that *Show Theatres* dealt with the definition of an "associate" in relation to s 101(1)(b) of the Bankruptcy Act, and did not decide on the definition of an "associate" under the CABAR. The landlord then made the contention that the CABAR were *ultra vires*.

14.124 With respect, this reviewer finds the treatment of *Show Theatres* puzzling. It is very clear from the *Show Theatres* decision that the Court of Appeal was dealing with the meaning of an "associate" of and "person

connected” with a company in the context of both s 101 of the Bankruptcy Act and the CABAR. The Court of Appeal took pains to clarify the meaning of an “associate” of a bankrupt and a “person connected with a company” under liquidation or judicial management, as well as the proper interpretational approach to be applied towards the interplay between s 101 of the Bankruptcy Act and the CABAR. Further, the very *ratio decidendi* of the court’s decision was that a company with one or more common directors as the company under liquidation or judicial management is a “person connected” with the latter company, and that the applicable statutory vulnerability period would be two years and not six months. It is therefore difficult to see how a credible argument could have been made that the point was not decided in *Show Theatres*.

14.125 Woo Bih Li J did not consider the landlord’s submission on this point in detail, but proceeded to consider, and dismiss, the main argument of the landlord that the CABAR were *ultra vires*. The first basis for this argument was that s 329(1) of the Companies Act states that the application of the unfair preference provisions in the Bankruptcy Act into the corporate liquidation regime is subject to “such modifications as may be prescribed”. Section 410 of the Companies Act refers to rules “prescribed” by the Rules of Committee, while s 411 refers to regulations to be made by the Minister. The landlord contended that, as such, the CABAR should have been made by the Rules Committee under s 410 instead of having been made by the Minister under s 411. The learned judge rightly rejected this argument, for the simple reason that the term “prescribed” is defined in s 2 of the Companies Act to include “prescribed by this Act”, and the term “Act” is defined in the same section to “include any regulations”. As such, the modifications referred to in s 329(1) would include modifications prescribed by the CABAR.

14.126 The second basis for the argument that the CABAR were *ultra vires* was that they should have been made under the Bankruptcy Act and not under s 411 of the Companies Act. This was also rightly rejected by Woo J. The learned judge was of the view that the CABAR were rightly made under the Companies Act because they are intended to apply certain bankruptcy provisions to companies. Although no authority was cited for this conclusion, it should be noted that a very similar argument was rejected by the High Court in *Show Theatres Pte Ltd v Shaw Theatres Pte Ltd* [2002] 2 SLR 144. On appeal, this argument was not advanced, but the Court of Appeal expressly agreed with the High Court on this point. Again, it is somewhat surprising that the landlord sought to canvass an issue which had already been decided by the Court of Appeal.

14.127 In *Mercator & Noordstar NV v Velstra Pte Ltd* (para 14.3 *supra*), an application to reverse a transaction at an undervalue was taken out by the

liquidator of a company (“Velstra”), which was a wholly-owned subsidiary of LDF, against LDF’s 97% shareholder (“Mercator”). Mercator had subscribed for US\$2m in shares in LDF and had also extended a loan of US\$10m to LDF. Mercator thereby became the largest shareholder in LDF, but was not aware of this. Further, Mercator did not nominate any directors to the board of LDF and allowed LDF to be managed by one Snauwaert (“S”). Subsequently, Velstra itself also borrowed a sum of US\$36m from another investor. Upon the payment of this sum into the Velstra’s bank account, S immediately instructed the bank to pay a sum of US\$5.08m to Mercator. The payment was recorded in the books of Velstra as a payment made on behalf of LDF. Velstra was placed in liquidation by the investor more than two years later and the liquidator applied to reverse the payment of US\$5.08m to Mercator.

14.128 The solvency of Velstra at the time of making the payment was disputed, and this raised the issue of whether Mercator was a person connected with Velstra and Mercator therefore had the burden of showing that Velstra was not insolvent. At first instance, Choo Han Teck J held that Mercator was a person connected with Velstra as it was an associate of Velstra under s 101(6) read with s 101(9)(b) of the Bankruptcy Act (*Velstra Pte Ltd v Mercator & Noordstar NV* [2003] SGHC 35). Section 101(6) states, *inter alia*, that a company is an associate of an individual if that individual has control of it, while s 101(9)(b) states that an individual shall be taken to have control of a company if he is entitled to exercise, or control the exercise of, one-third or more of the voting power at any general meeting of the company or of another company which has control of it. It was therefore not necessary that Mercator should have *de facto* control over Velstra.

14.129 This was challenged unsuccessfully by Mercator on appeal. The Court of Appeal, citing *Show Theatres* (para 14.122 *supra*), held that the reference to “individual” in ss 101(6) and 101(9) must be read to refer to “company”, as this is a necessary modification contemplated by reg 3 of the CABAR. Mercator had control of Velstra because it was a 97% shareholder; it was immaterial that Mercator did not know it was the 97% shareholder of Velstra’s parent company and that Mercator left the running of LDF to its directors. The fact of the matter was that Mercator did own 97% of the shares in LDF and could have exercised control.

14.130 Relying on *Show Theatres*, Mercator had also contended that there must have been a common person in charge of both Mercator and Velstra before they could be considered as associates or connected persons. The court dismissed this contention, clarifying that *Show Theatres* was an illustration of when two companies were considered to be associated. That case does not mean that two companies which do not have a common person in charge may

not be regarded as associated, if they otherwise satisfy the other criteria laid out in s 101 and the CABAR.

Transactions at an undervalue

14.131 *Mercator & Noordstar NV v Velstra Pte Ltd* (paras 14.3 and 14.127–14.130 *supra*) is the first opportunity for the Court of Appeal to consider whether to allow a liquidator’s application to reverse a transaction as being entered at an undervalue, pursuant to s 98 of the Bankruptcy Act read with s 329 of the Companies Act. The facts of this case have been set out above. The liquidator of Velstra had succeeded against Mercator at first instance before Choo Han Teck J (*Velstra Pte Ltd v Mercator & Noordstar NV* (para 14.128 *supra*)). However, Mercator’s appeal to the Court of Appeal was allowed.

14.132 The Court of Appeal was of the view that the payment made by Velstra to Mercator amounted to a “transaction” within the meaning of that term in s 98 of the Bankruptcy Act. The court disapproved of the English decision in *Re Taylor Sinclair (Capital) Ltd* [2001] 2 BCLC 176 where Robert Englehart QC sitting as a Deputy High Court Judge held that a transaction must involve at least some element of dealing between the parties to the transaction, and that the mere transmission and receipt of money did not amount to a transaction. The court pointed out that a “transaction” is expressly defined in s 2(1) of the Bankruptcy Act as including a gift and held that there is no reason why a simple payment should not fall within the meaning of the word “transaction”. Neither did the phrase “enter into a transaction” necessarily connote that there should be mutuality. The court also noted the decision in *Re Taylor Sinclair (Capital) Ltd* could be justified on the ground that the company making the payment received no consideration at all for the payment.

14.133 Further, the court stated that the aim of s 98 of the Bankruptcy Act would be seriously undermined if a simple payment were construed not to be a “transaction”. The court stated that the policy objective of s 98 was to protect the interest of the general body of creditors against a diminution of assets brought about by a transaction which conferred an unfair or improper advantage on a particular creditor of a company. With respect, this is not entirely accurate. Section 98 has nothing to do with the conferring of an advantage on a particular creditor of a company; its objective is to recover any assets transferred away by an insolvent person, within a certain time prior to that person’s bankruptcy, liquidation or judicial management, without receiving commensurate valuable consideration for the transfer. There is no requirement in s 98 that the transaction in question must have been entered into with a “particular creditor”. The reversal of the conferment of an unfair

or improper advantage by a person on a particular creditor is the objective of s 99, that is, the reversal of unfair preferences.

14.134 Having decided that the payment amounted to a “transaction”, the Court of Appeal proceeded to consider whether the transaction had been entered into at an undervalue. The court concluded that the liquidators of Velstra had failed to show this. The audited accounts of Velstra showed that the consideration for the payment was that LDF would owe an equivalent sum to Velstra as an unsecured and interest-free loan with no fixed terms of repayment. The payment was made by Velstra with the knowledge and agreement of LDF, and LDF would be liable to repay the sum to Velstra. The court also dismissed the liquidators’ argument that, even if LDF was liable to repay Velstra, such liability was worthless or worth significantly less than the sum of US\$5.08m paid by Velstra to Mercator. The evidence showed that, at the time the payment was made, the entire corporate group was in excellent shape; there was nothing to suggest that the obligation of LDF to repay Velstra was not worth its full value. The court refused to take into account the fact that LDF was subsequently placed under liquidation. The court was of the view that, generally and in the absence of exceptional circumstances, it would be wrong to refer to subsequent events to determine the value of the consideration supporting a transaction. The efficacy of business would be affected detrimentally if a recipient of a payment from a third party has to anticipate future events before he could be assured of the security of his receipt.

14.135 It is submitted that the reasoning and decision of the court is correct, in particular, the emphasis on commercial certainty and the need for security of receipts in business transactions. In addition, reference may be made to s 102(2) of the Bankruptcy Act which provides that the court should not make any order to reverse a transaction at an undervalue which would prejudice a person who had acquired property or received a benefit from the transaction in good faith, for value and without notice of the relevant circumstances. Further, reg 6 of the CABAR provides that no order in respect of a transaction at an undervalue shall be made if the court is satisfied that the company which entered into the transaction did so in good faith and for the purpose of carrying on its business and that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company.

14.136 It is important to note that, on the facts, it appeared that Mercator had no knowledge of any circumstances which might suggest that the payment by Velstra on behalf of LDF was improper or liable to be impugned. In today’s commercial world, the mere fact that the payment of a company’s debt is made with funds from its subsidiary’s bank account must, without more, be insufficient to fix the payee with notice of any impropriety or

possible breach of fiduciary duty by the company's directors. However, if the payee has actual or constructive notice that the payment was being made out of funds belonging to the subsidiary and that the subsidiary was insolvent or would become insolvent as a result of the payment, this may amount to constructive notice of a breach of fiduciary duty on the part of the directors of the subsidiary and the payment may be set aside accordingly (*Banque Bruxelles Lambert v Puvaria Packaging Industries (Pte) Ltd* [1994] 2 SLR 35). It should be highlighted that this would be an action under common law and not a statutory action to reverse a transaction at an undervalue.

Unfair preferences

14.137 In the case of *Re Tiong Polestar Engineering Pte Ltd* (paras 14.3 and 14.123–14.126 *supra*), the liquidator of a company applied for the reversal of certain payments of rent and utilities made by the company to its landlord on the ground that they constituted the giving of unfair preferences. It was not disputed that the company was insolvent at the time of the payments and that the onus lay on the landlord to rebut the presumption that the payments had been influenced by a desire on the part of the company to confer the effect of an unfair preference on the landlord. This presumption had been triggered, pursuant to s 99(5) of the Bankruptcy Act, by virtue of the landlord being a person connected with the company.

14.138 After considering the evidence, Woo Bih Li J decided that the landlord had failed to rebut the presumption. The learned judge did not accept the evidence of the landlord that it had made verbal threats to evict the company. The landlord was a shareholder of the company and had a common director with the company, and it was not in the interests of the landlord for the company to have to relocate. Substantial payments were made after a notice to quit was served by the landlord on the company, but the notice was not withdrawn even after these payments were made. Further, the sums owed to other creditors of the company increased during the material period but the sums owed to the landlord were reduced. However, in the opinion of the learned judge, a small part of the payments of rent made during the material period were fair, taking into account the fact that other creditors also received some payments during that period, and would not be reversed.

14.139 In *ECRC Land Pte Ltd v Ho Wing On Christopher* (para 14.3 *supra*), a company in liquidation alleged that certain payments made to one of the defendants in respect of administrative, legal and secretarial charges and operating expenses, during the period less than two years prior to the commencement of its liquidation, amounted to the giving of unfair preferences under s 99 of the Bankruptcy Act. On the evidence, Tay Yong Kwang J found that the defendant was treated like all the other creditors of the

company, and that the company was neither insolvent at the material time nor did it become insolvent as a result of the payments. The learned judge also decided that the making of the payments were influenced by proper commercial considerations and not by any desire to improve the defendant's position in the event of the company's insolvency (as required by s 99(4)).

14.140 Further, Tay J followed *Re Libra Industries Pte Ltd* [2000] 1 SLR 84 and held that an established practice of payments would indicate that there was no desire to put the creditor at an advantage. With respect, as pointed out by this reviewer in (2000) SAL Ann Rev 201 at 210, it seems difficult to accept that a practice of making certain payments should in itself be evidence that the company did not intend to confer the effect of an unfair preference on the recipient of the payments. It is submitted that the relevant inquiry should be whether the practice is, in the first place, a proper commercial practice. If so, this absolves all payments made pursuant to the practice. If not, the payments should be impugned notwithstanding that there was a very entrenched practice of making such payments.

Conveyances of property with intent to defraud creditors

14.141 In *Soh Lai Chan v Kuah Peng Hock* [2003] SGHC 144, the first defendant was the husband of the plaintiff and a decree *nisi* for divorce had been obtained by the plaintiff against the first defendant. The plaintiff sought a declaration against the first defendant and his brother, the second defendant, that the transfer of certain shares in a company by the first defendant to the second defendant was void. Reliance was placed on s 73B(1) of the Conveyancing and Law of Property Act (Cap 61, 1994 Rev Ed), which states that every conveyance of property made with intent to defraud creditors shall be voidable at the instance of any person thereby prejudiced. The plaintiff claimed that the transfer of the shares had been made by the first defendant with the intention of defrauding his creditors who had given loans and/or banking facilities to the first defendant either solely or jointly with the plaintiff, or for which the plaintiff was a guarantor, and/or with the intention of denying the plaintiff any interest in the shares.

14.142 The plaintiff's application for dismissed by Rajendran J. On the evidence, the learned judge found that the transfer of the shares was part of a distribution exercise amongst the members of the first defendant's family which had been embarked upon by the patriarch of the family in good faith. There was no intention on the part of the patriarch to defraud any creditors of his children or to deprive the plaintiff of any rights she might have in respect of the matrimonial assets. Further, the plaintiff herself was a practical and worldly-wise person who was a willing participant in the distribution exercise.

Directors' common law duty to have regard to creditors' interests

14.143 In *Chip Thye Enterprises Pte Ltd v Phay Gi Mo* (para 14.4 *supra*), the liquidator of a company sued the defendants, who were some of the directors and the shareholders of the company, in respect of certain transactions they had entered into with the company at a time when the company was insolvent. These transactions comprised the writing off of debts owed to the company by certain of the defendants or parties related to them, payments made to certain of the defendants, investing in a foreign partnership, the payment of dividends and allowing one of the defendants to transfer his liability for a debt owed to the company to another insolvent company. The defence of the defendants was that the company was not insolvent at the material time and, in any event, there was nothing improper about the transactions.

14.144 Referring to several English and local cases, Belinda Ang Saw Ean J first stated the principles governing the duties of directors of an insolvent company. Ang J agreed with the orthodox view that, while the general duty of the directors is to act in the best interest of the company as a whole, the interests of the creditors become the dominant factor in what constitutes the interest of the company as a whole when the company is insolvent.

14.145 On the test of insolvency, Ang J was of the view that there is no single test for insolvency, and regard must be given to all of the relevant evidence before the court. The learned judge then proceeded to consider all the evidence and concluded that the insolvency of the company at the material time had been established.

14.146 This approach is clearly correct in the context of the duties of the directors of an insolvent company. There is no definite threshold at which the directors are suddenly imposed with a duty to have regard to creditors' interests. The duty does not suddenly kick in upon the company reaching a theoretical level of insolvency. In this reviewer's view, a "sliding scale" approach must be used. The more insolvent a company, the more weight a director has to place on creditors' interests. If a company is hopelessly insolvent, a director should have regard to creditors' interests exclusively. On the other hand, if a company is insolvent but has a reasonable prospect of returning to solvency, it must be permissible for a director to place some weight on the collective interests of the shareholders. Conversely, if a company is not yet insolvent, but the directors are considering whether to enter into a transaction that carries a risk of causing the company to become insolvent, the directors must also consider the creditors' interests to a certain extent. As such, there is no single yardstick for all cases. The first inquiry in every case is whether, in the circumstances of the case, the directors have a

duty to have regard to the interests of creditors at all. If this is answered in the affirmative, the next question is what the duty requires the directors to do, bearing in mind the level of solvency of the company, the extent of the interests of the creditors, the nature and risks of the transaction being contemplated by the directors, and any other relevant circumstances. The final question is then whether the directors have complied with the duty in the particular circumstances of the case.

14.147 However, with respect, this reviewer does not agree with the learned judge's reference to cases on the meaning of insolvency under ss 254(1)(e) and 254(2)(c) of the Companies Act. The meaning of insolvency under these provisions is quite distinct from the meaning of insolvency for the purpose of determining whether the directors of a company have discharged their duty to have regard to the interests of creditors. The former concept of insolvency is used to determine whether a company should be wound up, and generally stipulates that a company is insolvent unless it passes both the cash flow and the balance sheet tests of solvency. Theoretically, there is a fixed meaning assigned to insolvency in this context. In contrast, in the context of the duty of directors to have regard to the interests of the company's creditors, there is no precise level of insolvency, whether in theory or practice. As explained above, in that context, one has to work with a spectrum of the states of insolvency or near-insolvency.

14.148 A simple example may be used to illustrate the difference. It is trite that a company which is wealthy in assets but does not have the cash flow to pay its debts as they fall due may be wound up as an insolvent company, as it fails the cash flow test (*Re Sunshine Securities (Pte) Ltd* [1975–1977] SLR 282). A creditor is entitled to seek the winding up of the company as long as his debt is due and payable but not paid; he is not obliged to give the company time to realise its assets and use the proceeds of realisation to discharge its debts. However, these considerations are wholly inappropriate in the context of directors' duties to have regard to the interests of creditors. If a company has more assets than liabilities, and the contemplated transaction carries little risk of the company becoming insolvent on its balance sheet, it is difficult to see why the directors should have a duty to place any significant weight on the interests of the creditors. Substantively, the creditors' interests will not be affected by the transaction, as the company has enough assets to pay off its creditors in full.

14.149 Returning to Ang J's judgment in *Chip Thye Enterprises Pte Ltd v Phay Gi Mo*, the learned judge, after finding that the insolvency of the company at the relevant time had been established, considered each of the allegations against the defendants. The allegations with respect to the misapplication of funds, namely, the writing off of debts, the making of

payments to certain of the defendants, and the investment in a foreign partnership, were upheld by Ang J. In her Honour's opinion, these transactions were not in the interests of the company's creditors as they had the effect of reducing the assets of the company that should have been available for the discharge of its liabilities to creditors. Similarly, the Ang J found that the payment of dividends were in breach of s 403 of the Companies Act as they were paid out of capital and not profits. However, with respect to the allegation that there had been a transfer of liability for a debt owed to the company, Ang J found that this was based on mistaken book entries and dismissed the liquidator's claim.