REFORMING CAPITAL MAINTENANCE LAW: THE COMPANIES (AMENDMENT) ACT 2005

The Companies (Amendment) Act 2005 has reformed the law on capital maintenance substantially. It has, *inter alia*, enabled a company that satisfies the requisite solvency tests to reduce capital, engage in financial assistance and share buyback. This article analyses the salient features of these reforms and their doctrinal implications, in particular the doctrine of capital maintenance and solvency tests. It argues that whilst the reforms have reduced compliance costs, the failure to bring the solvency-based reforms to their logical conclusion has made Singapore law's on capital maintenance incoherent. It recommends that Singapore should follow New Zealand and abolish the capital maintenance doctrine.

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I. Introduction

1 The Companies (Amendment) Act 2005 ("Amendment Act") was passed by Singapore's Parliament on 16 May 2005 and came into operation on 30 January 2006.[1] It gave effect to several recommendations of the Company Legislation and Regulatory Framework Committee ("CLRFC"),[2] which includes abolishing the par value and authorised capital, liberalising the rules of capital maintenance, allowing shares repurchased by companies to be kept as treasury shares and providing for a new method of amalgamation for companies. Those reforms have reduced the costs of running companies in Singapore and made Singapore's company law more competitive and flexible.

* I thank my colleague Professor Hans Tjio for his invaluable comments on an earlier draft of this article. All errors that remain are mine alone.

1 Companies (Amendment) Act (Commencement) Notification 2005 (SL Instrument No 878/2005).

2 The CLRFC was appointed by the Government in December 1999 to undertake a comprehensive review of company law and regulatory framework in Singapore and to recommend a modern company law. Its final report was presented to the Government in October 2002.

2 This article discusses the reforms of the capital maintenance rules and rules related thereto by the Amendment Act. It does not seek to summarise the new statutory provisions. Rather its purpose is to analyse their salient features and those aspects that may cause difficulties in interpretation in future, and the doctrinal implications of the reforms. We should not lose sight of the latter, even as we plough through the very complex and technical provisions in the Amendment Act. The main argument is that the reforms have rendered Singapore's law on capital maintenance doctrinally unsatisfactory. This is not to say that the reforms are unsound. On the contrary, it will be argued that the reforms do not go far enough and that Singapore should follow New Zealand and abolish the capital maintenance doctrine.

II. Par value

3 With a simple statement, "Shares of a company have no par or nominal value",[3] the Amendment Act implemented recommendation 2.18 of the CLRFC report. In so abolishing the par value, long regarded as important by the company laws of the Commonwealth countries, we follow the lead taken by countries such as New Zealand[4] and Australia.[5] In UK, the Company Law Review Steering Group would have recommended abolishing par value shares but for the restrictions imposed by the Second EU Company Law Directive.[6]

4 Any amount in the share premium account and capital redemption reserve before 30 January 2006, the date when par value was abolished, became part of the company's share capital.[7] Authorised capital was also abolished and provisions relating to it in the memorandum of any company are deemed to be deleted.[8] Henceforth, generally there will

3 Section 15 of the Amendment Act. The provision becomes s 62A(1) of the Companies Act (Cap 50, 2006 Rev Ed). Henceforth all references of statutory provisions will be to this Act unless otherwise stated.

4 NZ abolished the par value concept in 1993 by its Companies Act 1993, s 38.

5 It abolished the par value concept from 1 July 1998. See Australian Corporations Law 1998, s 254C.

6 UK Company Law Review Steering Group, Modern Company Law for a Competitive Economy: Completing the Structure, vol 8, [7.2].

7 Section 62B(2).

8 Section 8(1) of the Amendment Act. *Cf*, Lucien Wong & Maisie Ooi, "The Companies (Amendment) Act 2005: Impact on Capital Raising and Capital Maintenance" in *Developments in Singapore Law 2001-2005* (Teo Keang Sood ed), (Singapore Academy of Law, 2006) ch 1 [79] where Dr Maisie Ooi argued that it is

now be only two items of share capital reflected in a company's balance sheet: issued capital and paid-up capital. They will be measured against the amount of capital issued and actually paid up respectively, not the par value of shares.

5 Generally, the above reforms have been well received.[9] One of the benefits of the reforms is to simplify the rules on capital both for professionals and businessmen. At the initial stage, however, accountants and lawyers will have to grapple with the transitional provisions and learn to reason without resorting to the familiar concept of par value. This may prove difficult for some who have become so used to the concept. It is therefore useful to recount briefly the shortcomings of the par value regime, which have been comprehensively and convincingly canvassed elsewhere.[10]

6 Concepts of capital based on par value are outdated and are no longer relied on by investors and creditors in assessing a company's underlying value. In practice, other measures such as earning per share, net tangible asset backing and other financial ratios are used. But par value is not just something that is or has become useless. It may mislead unsophisticated investors into thinking that it has some relevance to the intrinsic value of a company's shares. Next, the rule that a company cannot issue shares at a discount to par value[11] prevents a company from raising new funds when the market value of its shares has fallen below par value. Indeed, the case for the abolition of par value is so overwhelming that even its birthplace for common law jurisdictions was minded to abolish it but for the restraints imposed by the Second EU Company Law Directive.[12]

still open to companies to specify an authorised capital, not in terms of monetary value (since the shares have no par value), but in terms of the number of shares.

9 Lucien Wong & Maisie Ooi, "The Companies (Amendment) Act 2005: Impact on Capital Raising and Capital Maintenance" in *Developments in Singapore Law 2001-2005* (Teo Keang Sood ed) (Singapore Academy of Law, 2006) ch 1, where two different views were espoused. In paras 5-9 Mr Lucien Wong welcomed the move to a mandatory no par regime, while Dr Maisie Ooi in paras 70-72 argued that an optional no par regime has its advantages.

10 See *eg*, Ho Yew Kee & Lan Luh Luh, "The Par Value of Shares: An Irrelevant Concept in Modern Company Law" [1999] Sing JLS 552.

11 *Ooregum Gold Mining Co of India Ltd v Roper* [1892] AC 125 (HL).

12 UK Company Law Review Steering Group, Modern Company Law for a Competitive Economy: Completing the Structure (London, DTI, Nov 2000).

III. Solvency statement

A. Definition

7 At the heart of the reforms to the capital maintenance doctrine is the solvency statement of directors.[13] Put simply, if a solvency statement is made and other relevant requirements are met, a company is allowed to reduce its capital without court sanction,[14] redeem its preference shares out of capital,[15] and give financial assistance without having to comply with the traditional white-wash procedure.[16] For purpose of analysis, it is necessary to set out the definition of the solvency tests, found in s 7A, in some detail.

8 A solvency statement consists of the opinions of the directors on four solvency tests: first, as regards the company's situation at the date of the statement, there is no ground to think that the company could not then pay its debts;[17] secondly, if it is intended to commence winding up of the company within the period of twelve months after the date of the statement, the company will be able to pay its debts in full within the period of twelve months after the commencement of the winding up;[18] thirdly, if it is not intended so to commence winding up, the company will be able to pay its debts as they fall due during the period of twelve months after the date of the statement;[19] and fourthly, the value of the company's assets is not less than that of its liabilities and will remain so after the proposed capital reduction, redemption or giving of financial assistance, whichever is relevant.[20]

9 The second solvency test may seem to be a test on cash flow solvency. That is incorrect. *Prima facie*, what the test requires to be satisfied is that if the company were wound up its assets should exceed its liabilities. This is a test on balance sheet solvency, but it differs from the familiar balance sheet test which if not satisfied would give the court

13 It should be noted that under the old s 73 regime for the reduction of capital (now s 78G), although a formal declaration of solvency is not required, the practice is to produce an affidavit attesting to the company's solvency to overcome the risk of creditor objection.
14 Sections 78B and 76C.
15 Section 76B.
16 Sections 76(9A) and 76(9B).
17 Section 7A(1)(a).
18 Section 7A(1)(b)(i).
19 Section 7A(1)(b)(ii).
20 Section 7A(1)(c).

jurisdiction to make a winding up order on the ground that the company is insolvent.[21] It is rather more similar to the test for a declaration of solvency under s 293(1), which if made by directors will enable the company's liquidation to proceed as a solvent liquidation under the members' control. Commenting on the English equivalent of Singapore's s 293(1),[22] Professor Goode has said that it is "technically possible for the directors properly to file a declaration of solvency"[23] even though at that time the company is unable to pay its debts both on a cash flow and balance sheet basis. Transposing this comment to the second solvency test, the test does not require that the company should be balance sheet solvent at the time when it was wound up; what is required is that the company should be able to pay its debts in full within twelve months after it is wound up. However, in practice it is highly unlikely that a reasonable forecast may be made on the second matter without the first matter being satisfied.[24]

10 In summary, a solvency statement requires directors to state in their opinion that the company is cash flow solvent at the date of the statement and will remain so for twelve months thereafter (first and third solvency tests), that the company will be balance sheet solvent before and after the proposed transaction (fourth solvency test), and that if the company were wound up within twelve months after the date of the statement, it will be balance sheet solvent, at the latest, within a further twelve months after the commencement of winding up (second solvency test). This is a very complicated battery of tests. It is submitted that, in practice, directors would be well advised not to make a solvency statement unless they can be reasonably certain of the following: that the company is cash flow and balance sheet solvent at the date of the statement and will remain so for twelve months thereafter.

11 Although this is still early days, it can be seen that a s 7A solvency statement is not only complex but also imposes onerous demands on directors. It requires the directors to not only assess the company's current financial position, including valuing its assets and estimating its contingent and prospective liabilities, but also a forecast on those matters

21 Section 254(1)(e), 2(c). Cases that have interpreted the provisions include *Malayan Plant v Moscow Narodny Bank* [1980] 2 MLJ 53 (PC); *Re Sunshine Securities (Pte) Ltd* [1978] 1 MLJ 57; *Re Great Eastern Hotel (Pte) Ltd* [1989] 1 MLJ 161; *Re Sanpete Builders (S) Pte Ltd* [1989] 1 MLJ 393.

22 UK Insolvency Act 1986, s 89.

23 Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell, 3rd Ed, 2005)[4-12].

24 Ibid.

for the next twelve months. The amount of work that will be involved in that task will depend on many factors, including the state of the companies' financial records, the state of the economy and industry that the company is in, the nature of its business, assets and liabilities and accounting standards. It can well be anticipated that it may prove difficult for some directors, especially independent directors, to make a solvency statement, especially since negligence may expose them to a criminal charge.[25]

B. Evaluation

12 The doctrinal implications of the introduction of solvency tests into capital maintenance law will be dealt with in a later section. This section is only concerned with the more technical issues in relation to the solvency statement. At the outset, it is necessary to appreciate that solvency tests are used widely in the Companies Act (Cap 50, 2006 Rev. Ed.) ("Companies Act"). In addition to the solvency statement found in s 7A, there is another in relation to two new mechanisms of amalgamation introduced by the Amendment Act.[26] Further, there is the declaration of solvency for solvent liquidation and the solvency test for share buyback.[27] Solvency tests therefore now occupy a central position in the Companies Act. It may be expected that their operation will raise various difficult issues in practice. One needs only to look at the length devoted to discussing the solvency tests in books on corporate insolvency law.[28] Due to space constraints, it is only possible to raise four policy-oriented issues for discussion.

13 The first is that there is cause for concern that the law on solvency statement, and more generally, solvency tests is unnecessarily complex and demanding and that this may affect their utility in practice. It has been seen from the prior section that s 7A is very complex and demanding. This is only the tip of the ice berg. Although the purpose of solvency tests is, notwithstanding that they are used in different contexts in the Companies Act, the common one of creditor protection, the rules vary considerably. The added complexity should be avoided unless compelled by one or more good reasons. This may be said of the

25 Section 7A(6).
26 Section 49 of the Amendment Act which becomes s 215A to J of the Act.
27 Section 76F(4).
28 *Eg*, Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell, 3rd Ed, 2005) ch 4.

differences between some of the provisions, but not others. For example, the solvency statement under s 7A imposes more onerous requirements than the declaration of solvency under s 293(1), referred to earlier.[29] It is submitted that as a company is expected to continue to trade after a capital reduction, redemption of preference shares or the giving of financial assistance, unlike liquidation, it is justifiable that the former imposes more onerous requirements than the latter.[30] On the other hand, there seems little justification for the differences between a s 7A solvency statement and the solvency requirement for share buyback. It will be argued later, in the section on share buyback, that in practice the differences are likely to amount to little.[31]

14 Secondly, it is not clear whether a particular jurisdiction's attitude towards the capital maintenance doctrine affects its views on how stringent the solvency statement should be. Singapore, like the UK, has a hybrid system whereby the traditional capital maintenance rules exist alongside exceptions based on the solvency tests. New Zealand, on the other hand, abolished the capital maintenance doctrine in 1993.[32] It is interesting to note that the New Zealand solvency tests are much more relaxed in their requirements compared to that of Singapore and the UK.[33] The New Zealand solvency test merely requires the directors to state that the company will be cash-flow and balance sheet solvent after the transaction. On the one hand, it may be argued that since New Zealand has abolished the capital maintenance doctrine and gone the full length of liberalising its rules on the usage of capital, its solvency tests can afford to be more lenient compared to that of Singapore and UK. This argument is however not fully convincing. Since Singapore has decided to make

29 See text to n 21.

30 Jonathan Rickford, "Legal Approaches to Restricting Distributions to Shareholders: Balance Sheet Tests and Solvency Tests" (2006) 7 European Business Organization Law Review 135, 174.

31 See paras 68-69 of this article.

32 NZ Companies Act 1993. For a detailed account, see *Morison's Company and Securities Law* (Andrew Beck, Andrew Borrowdale *etc*, eds) (LexisNexis, 2006) vol 2, [13.3], [14.1]-[14.2].

33 UK Companies Act 2006 (c 46), s 643. Although *prima facie* this is not as demanding as that of Singapore, as it does not explicitly require the company to be balance sheet solvent for a period of 12 months after the date of the statement if it remains a going concern, in practice it is hard to see how directors can state that a company will have the ability to pay its debts for a period of 12 months after the date of the statement without it being balance sheet solvent over such a long period. See paras 68-69 of this article which discusses the same point in a comparison of the solvency tests for share buyback on the one hand and capital maintenance and financial assistance for the acquisition of shares on the other hand.

substantial qualifications to the capital maintenance rules and use the solvency tests to protect creditors, there is no reason in principle why the New Zealand definition cannot be adopted, unless it is thought that the New Zealand tests are not robust enough to protect the interests of creditors. This is a difficult issue admitting of no easy answer. Arguably a creditor is not entitled, in the absence of an agreement, to more protection than that the company should remain cash-flow and balance sheet solvent immediately after the transaction. An ill-advised reduction of capital or financial assistance can however expose a creditor to greater risks than what it has agreed to bear.[34] At the end, however, leaving aside for the moment the suggestion that the capital maintenance doctrine be replaced by solvency tests, which will be discussed in a later section,[35] this is a rather practical matter. Practical experience of the workability of the solvency tests over the next few years will probably shape general opinion on whether they should be relaxed. Even then, at this stage it may be said that large companies, whose boards consist of independent directors, may find it difficult to use the simpler methods of capital reduction or financial assistance. The independent directors, due to lack of intimate knowledge of the company's financial position and business prospects, may decline to make the solvency statements. These companies may then be compelled to rely on court sanctioned capital reduction or the white wash procedure for financial assistance.

15 Thirdly, there will always be a time lag between the making of the solvency statement and the carrying into effect of the proposed transaction. It is possible that the company's financial condition may deteriorate during that interim period causing the directors to no longer hold the opinion set out in the solvency statements. However, the Amendment Act only deals with this problem directly in the case of financial assistance for the acquisition of shares, where the company is prohibited from giving the assistance if any of its directors no longer has reasonable grounds for any of the opinions expressed in the solvency statement.[36] It is not clear why a similar rule does not apply to the other transactions covered by s 7A, *ie*, the newly introduced out of court capital reduction or redemption of preference shares out of capital; although in

34 J Armour, "Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law" (2000) 63 MLR 355, 367.

35 See para 17 *et seq* of this article.

36 Section 76(9C)(b). For share buybacks, there is a continuous solvency requirement imposed by s 76F(3) and (4), presumably because buybacks can stretch over a long period of time.

the case of the former, the problem is alleviated by the requirement that the solvency statement must be made no earlier than fifteen days (private company) or twenty-two days (public company) before the passing of the special resolution approving the capital reduction.[37] Although in the last resort recourse may always be had to the director's statutory and common law duty to take into account creditors' interests,[38] there seems to be no good reason for not taking a uniform approach here.

16 Fourthly, in forming their opinion that the company will be balance-sheet solvent before and after the proposed transaction, the directors are required to have regard to the most recent financial statements of the company and all other circumstances that the directors know or ought to know affect, or may affect, the value of the company's assets or liabilities, and may rely on valuations of assets or estimates of liabilities that are reasonable in the circumstances.[39] This provision does not apply to the other solvency tests. It is not clear why this should be so. Surely the directors ought to have regard to the same matters and be entitled to rely on reasonable valuations for all the other solvency tests as well?

IV. Doctrinal implications of solvency tests

A. Introduction

17 The Amendment Act has liberalised Singapore's law on capital maintenance significantly. The reforms have enabled companies in Singapore, provided that they satisfy the relevant solvency tests,[40] to reduce their capital without court sanction,[41] buy back their shares[42] and

37 Section 78B(3)(b)(ii) and s 78C(3)(b)(ii).

38 For statutory duties, see s 339(3) (insolvent trading) and s 340(1) (fraudulent trading). Some of the cases on directors' common law duty are: *Kinsela v Russell Kinsela Property Ltd* (1986) 10 ACLR 395 at 401; *Re Genesis Technologies International (S) Pte Ltd* [1994] 3 SLR 390 at 392; *Chip Thye Enterprises Pte Ltd v Phay Gi Mo* [2004] 1 SLR 434 at [12]–[16].

39 Section 7A(4). Failure of the directors properly to inform themselves about the financial situation of the company will invalidate the declaration and hence the whole procedure: *Re In a Flap Envelope Co Ltd* [2003] EWHC 3037, [2004] 1 BCLC 64.

40 Section 7A (capital reduction, financial assistance, redemption of preference shares); s 76F(4) (share buyback).

41 Section 78B (capital reduction by private company); s 78C (capital reduction by public company).

42 Section 76F(1).

give financial assistance for the acquisition of their shares without court sanction.[43] Each of these will be analysed in some detail in subsequent sections. The purpose of this section is to assess the implications of this shift to solvency tests on the coherence of the capital maintenance doctrine.

18 The purpose of the solvency tests is to protect the interests of creditors of a company that proposes to engage in capital or related transactions. That is also a major purpose and in fact the impetus that led to the development of the doctrine of capital maintenance.[44] In the leading case of *Trevor v Whitworth*,[45] Lord Watson explained the rationale of the doctrine as follows:

> Paid-up capital may be diminished or lost in the course of the company's trading; that is a result which no legislation can prevent; but persons who deal with, and give credit to a *limited* company, naturally rely upon the fact that the company is trading with a certain amount of capital already paid, as well as upon the responsibility of its members for the capital remaining at call; and they are entitled to assume that no part of the capital which has been paid into the coffers of the company has been subsequently paid out, except in the legitimate course of its business. [emphasis added].

19 The above quotation shows that whilst both the solvency tests and the rules of capital maintenance are concerned with protecting creditors, their nature is different. Solvency tests envisage that a company may engage in the transactions specified provided that the company is solvent, whereas capital maintenance envisages that the capital of the company, in an abstract sense, constitutes a fund which creditors of the company rely upon when they give credit to the company, and thus capital should not be returned to the shareholders. It will be shown in the next section that the nature of the capital maintenance doctrine is not as absolute as that portrayed by Lord Watson in the quotation cited above. Nonetheless, the starting point of capital maintenance remains that capital should remain intact for the benefit of creditors.

43 Section 76(9A), (9B).

44 Another major purpose of the rules on capital maintenance is to ensure that shareholders are treated fairly: *Carruth v Imperial Chemical Industries Ltd* [1937] AC 707 (HL); *Scottish Insurance Corp v Wilsons & Clyde Coal Co Ltd* [1949] AC 462 (HL) (capital reduction); *Wu Yang Construction Group Ltd v Zhejiang Jinyi Group Co Ltd* [2006] SGHC 152, [2006] 4 SLR 451 (financial assistance).

45 (1887) LR 12 AC 409, 423-424. An unlimited company may reduce capital by special resolution without seeking the court's confirmation: *Re Borough Commercial and Building Society* [1893] 2 Ch 242.

20 The issue thus arises whether solvency tests may exist within a framework of capital maintenance rules without undermining the coherence of the law. It will be argued that the introduction of solvency tests to this framework has indeed caused the law to loose its doctrinal coherence. This should not be taken as a criticism of the move to introduce solvency tests into this area of law. Rather, it is thought that the reforms have not gone far enough; capital maintenance should be abolished in favour of solvency tests. However, before we delve into this contentious point, it is necessary to explain briefly why it is thought that the doctrine of capital maintenance is unsatisfactory on practical and doctrinal grounds.

21 The capital maintenance doctrine has been criticised on the practical ground that it imposes costs and restrictions on company management without countervailing benefit.[46] The UK Company Law Review Steering Group, set up in 1998 to reform British Company Law has noted that in practice, creditors and potential creditors nowadays do not any longer regard the amount of a company's issued share capital as a significant matter when deciding whether or not to extend credit to it.[47] They pay much more regard to the company's financial strength as indicated by its financial ratio, its business prospects and the overall economic environment within which the company operates.

22 Practical considerations aside, the doctrine has also been criticised on doctrinal grounds. The leading New Zealand text on company law, *Morison's Company and Securities Law*, states that "the rule was arbitrary (it assumed incorrectly that any distribution of capital prejudiced creditors), riddled with inconsistencies …"[48] The reason why the doctrine does not provide consistent or reliable protection for creditors is because its operation is dependent on various capital

46 See *eg*, R W Dickerson, J L Howard and L Getz, *Proposals for a New Business Corporations Law for Canada* (Ottawa: Information Canada, 1971) vol 1, [97]-[101] which led Canada to abolish its capital maintenance doctrine when it enacted the Canada Business Corporations Act (federal law) in 1975. The relevant section is now found in Canada Business Corporations Act (C-44), s 38.

47 UK Company Law Review Steering Group, Modern Company Law for a Competitive Economy: The Strategic Framework [5.4.3]. See also See Eilis Ferran, "Creditors' Interests and "Core" Company Law" (1999) 20 Co Lawyer 314, 318 where the author criticised the British maintenance-of-capital principle, as it then existed before the UK Companies Act 2006, as an "outmoded and excessive response of an earlier age to the risk that the operators of a company will engage in actions that will undermine the priority position of creditors on winding up".

48 *Morison's Company and Securities Law (*Andrew Beck & Andrew Borrowdale *etc* eds), (LexisNexis, 2006) vol 2, [14.1].

yardsticks in the company's balance sheet and these figures are historical.[49] As explained by David Wishart:[50]

> Almost as soon as a company is incorporated, the fund of capital represented by the share capital of the company does not indicate how much money there is in the company to repay the debt. In many respects future earnings are much more important. Further, if the company has had time to trade, profits and losses will have added to or detracted from the funds available to creditors. To refer back to a historical figure for a measure of the money available in a company was patently useless. Creditors relied on their own assessment of creditworthiness and charged for risk. Once creditors determined exactly how much money in their opinion would be available they became concerned about dissipation of that fund. In this respect the rules derived from the principle of maintenance of capital performed the useful function of preventing other interests, mainly the shareholders, from taking undue priority. However, they were misdirected in protecting the capital fund as an absolute figure.

23 Several Commonwealth jurisdictions have acted to relax the restrictions imposed by the capital maintenance doctrine.[51] In Singapore, a major inroad was made to the capital maintenance doctrine when share buyback was for the first time allowed in 2001,[52] and the Amendment Act has further hastened the retreat of the doctrine.[53] In Australia, a company has the general power to reduce its share capital if three requirements are satisfied: first, the capital reduction is fair and reasonable to the company's shareholders as a whole; secondly, it does not materially prejudice the company's ability to pay its creditors; and thirdly, it is approved by shareholders.[54] New Zealand, as mentioned above, has gone even further and abolished the capital maintenance rules. "Solvency tests now remain as the only restriction on the ability of a company to

49 John Armour, "Legal Capital: An Outdated Concept" (2006) 7 European Business Organization Law Review 5; Jonathan Rickford, "Legal Approaches to Restricting Distributions to Shareholders: Balance Sheet Tests and Solvency Tests" (2006) 7 European Business Organization Law Review 135.

50 David Wishart, *Company Law in Context* (OUP, 1994) p 177.

51 Eilis Ferran, "Creditors' Interests and "Core" Company Law" (1999) 20 Co Lawyer 314 at 318; *Ford's Principles of Corporations Law* (RP Austin & IM Ramsay eds) (LexisNexis Butterworths, 13th Ed, 2007) [24.360]-[24.370].

52 Companies (Amendment) Act 1998, s 5 which introduced new s 76B to s 76G.

53 The Minister, in the second reading of the Companies (Amendment) Bill 2005, stated that "[T]he current amendments will give companies the flexibility to design appropriate capital structures which best suit their needs, at a lower cost …" See Sing Parliamentary Debates vol 80 at col 698 (16 May 2005).

54 Section 256B(1) Corporations Act 2001. See *Ford's Principles of Corporations Law* (RP Austin & IM Ramsay eds) (Lexis Nexis Butterworths, 13th Ed, 2007) [24.520] *et seq.*

distribute money or property to its shareholders, whether of a capital or revenue nature."[55]

24 The next section sets out this writer's arguments on the nature of the capital maintenance doctrine and the solvency tests. *Morison's Company and Securities Law* states that "[T]he capital maintenance rule required a company to retain assets equivalent to the subscribed capital. The solvency test requires a company to retain assets sufficient to enable the company to meet its obligations."[56] The differences between the capital maintenance doctrine and solvency tests are brought out vividly in these propositions. Whilst this writer agrees substantially with them, it is submitted respectfully that the first proposition is an oversimplification. It suggested, similar to the quotation of Lord Watson in *Trevor v Whitworth* cited above,[57] that under the doctrine a company's capital contributed by its members is regarded as notionally constituting a fund that shall be kept inviolate for the benefit of its creditors, *ie,* an "inviolable fund" concept. This writer will argue that this concept does not represent the law accurately and will present a more nuanced exposition of the capital maintenance doctrine. Next, it will be suggested that even on this more nuanced view of the capital maintenance doctrine, the introduction of the solvency tests has made the doctrine largely incoherent. Thirdly, it will be argued that it is preferable to abolish the capital maintenance doctrine and use solvency tests to protect creditors' interests.

B. Capital maintenance doctrine

25 Before 1867 it would be accurate to think of a company's capital as constituting an "inviolable fund" which although may be lost through trading must otherwise be kept for the benefit of the company's creditors. However, since 1867, statute had allowed a company to reduce its capital if it was supported by a special reduction and approved by the court.[58] In substance this procedure has continued until today, though the legislative provisions and their operation have become more flexible.[59] The shape of capital maintenance law hence depends on the creditor protection mechanism set out in the relevant statutory provisions and the manner in

55 *Morison's Company and Securities Law* (Andrew Beck & Andrew Borrowdale *etc* eds) (LexisNexis, 2006) vol 2, [14.2].
56 *Id*, at [14.4].
57 See para 18 of this article.
58 UK Companies Act 1867.
59 UK Company Law Review Steering Group, Modern Company Law for a Competitive Economy: The Strategic Framework paras 5.4.4-5.4.5.

which the courts exercise their discretion to confirm a capital reduction. For example, if a company is allowed to return its capital to its shareholders and they do not come under a liability to return those sums of money to the company, it is impossible to continue to adhere to the "inviolable fund" concept. It will be necessary to provide a more nuanced description of the capital maintenance doctrine.

26 There are many different ways to reduce capital[60] and they contradict the "inviolable fund" concept to different degrees. Stripped of the technicalities it is possible to place a capital reduction into one or more of the following categories: the reduction or extinction of a member's liability to pay the amount unpaid on his shares, the cancellation of any paid-up capital which is lost or unrepresented by available assets, the return of money or assets to the company's members, or the reduction of the capital yardstick in the company's accounts.[61] A capital reduction that involves only the cancellation of any paid-up share capital which is lost or unrepresented by available assets contradicts the "inviolable fund" concept to a lesser extent compared to a return of capital to members. The former (usually called a loss reduction) contradicts the concept in that the company's capital yardstick is reduced,[62] but it does not otherwise prejudice the company's creditors, unless it has hidden value in its balance sheet in the form of undervalued assets or over provision in respect of liabilities.[63] The latter (usually called a repayment reduction), on the other hand, reduces the company's assets and its capital and is potentially prejudicial to creditors of the company. Both forms of capital reduction have been approved, as may be seen from the following two cases.

60 Under ss 78A and 78G, a company may reduce its capital "in any way". There is no limitation of the power of the court to confirm a capital reduction except that it must first be satisfied that all the creditors entitled to object to the reduction have either consented or been paid or secured: *British and American Trustee and Finance Corp v Couper* [1894] AC 399, 403; *Re Credit Assurance and Guarantee Corp* [1902] 2 Ch 601. For a list of the different modes of capital reduction, see *Buckley on the Companies Acts* (Mary Arden, Dan Prentice & Thomas Stockdale eds) (LexisNexis, 15th Ed, 2006) at para 135.9.

61 Section 78A(1). See also Halsbury's Laws of Singapore vol 6, [70.480].

62 This is important in jurisdictions where a company may not pay dividends unless its capital is intact, such as UK (Companies Act 2006, s 830) and HK (Companies Ordinance, s 79B) but is irrelevant to Singapore as dividends may be paid out of trading profits even though the company's capital is not intact: *Lee v Neuchatel Asphalte Co* (1889) 41 Ch D 1 (CA) 26.

63 For the modern approach to loss reductions, see *Re Jupiter House Investments (Cambridge) Ltd* [1985] 1 WLR 975; *Re Grosvenor Press Plc* [1985] 1 WLR 980.

27 In *Re Grosvenor Press Plc*,[64] a company proposed to cancel capital that was lost. As the company could not prove that the loss of capital was permanent, it gave an undertaking to the court that a special reserve would be set up if any of the lost capital was recovered which would not be available for distribution until creditors existing at the date when the reduction became effective have been paid off. Nourse J approved the reduction, stating that the "statutory procedures which allow for its reduction demonstrate that there is no status of inviolability attaching to a company's capital."[65] In *Ex p Westburn Sugar Refineries Ltd*,[66] the company, in anticipation of the nationalisation of its assets, proposed to return to its members part of its paid-up share capital in the form of shares in another company. As the company's financial position was extremely strong, with its current assets far exceeding its current liabilities, the court approved the reduction, noting that the creditors were amply provided for.

28 Therefore, the concern of the courts in approving capital reduction, in so far as creditors' interests are concerned, is how those interests may be protected in an appropriate way. The statutory mechanism under s 78H(1) and (2) requires the court to settle a list of qualifying creditors when a capital reduction is a repayment reduction or involves a reduction of liability in respect of unpaid share capital or where the court so directs. To the extent that the creditors on the list have not been discharged or consented to the reduction, the court will require, until recently,[67] the company to secure the debt or claim by appropriating, in the case of admitted debts (or debts which are not admitted but which the company is willing to provide for) the full amount of the debt or claim and, in the case of other debts (including contingent debts), such amount as the court shall direct. In practice, however, it is extremely rare for the court to settle a list of qualifying creditors. Given the cumbersome nature of this procedure, companies invariably seek to avoid the requirements of s 78H by ensuring that the reduction is structured in a manner not involving any adverse consequences for creditors. The most convenient form of creditor protection to be adopted will generally be

64 [1985] 1 WLR 980.
65 *Id*, 985.
66 [1951] AC 625 (HL).
67 The law has changed as pursuant to the Amendment Act, the court has power to confirm a reduction even though creditors have not consented or their debts paid or secured, provided that the creditors have other "adequate safeguards" for the debts or where the court thinks security or other safeguards unnecessary "in view of the assets the company would have after the reduction": s 78(2).

determined by two main factors, namely the form of the reduction and the nature of the creditors of a company. In practice, protection in one or more of the following forms have been used: consent from creditors, payment, appropriating money in a blocked account to meet creditors' claims, provision of security or bank's guarantee, giving the court an appropriate undertaking or retaining sufficient assets to meet the claims of creditors.[68]

29 The above discussion proves that it is a gloss to state that the doctrine requires a company to retain assets equivalent to its subscribed capital without explaining in close proximity that the statement is subject to qualifications as explained above.[69] It is more accurate to state the doctrine in the following propositions. First, the capital maintenance doctrine relies on the capital subscribed by members of the company to erect a body of rules to protect creditors. Secondly, *prima facie* the company is required to retain assets equivalent to its subscribed capital for the benefit of its creditors. Thirdly, the *prima facie* position is subject to the important qualification that companies' legislation does allow a company to reduce its capital in any way, including returning capital to its members, provided that the interests of creditors are adequately protected.[70] English courts have, in exercising their discretion over the last one hundred plus years, accepted different methods as providing adequate protection. Unfortunately, they have not laid down any general principle in relation to the exercise of the discretion beyond saying that creditors should be safeguarded. This is probably because the fact situations are so diverse that it is difficult to generalise and also because judges have regarded this as a matter of practice.[71] At this stage, the most

68 This reflects the practice in Britain, as discussed in *Gore-Browne on Companies* (Millett & Alcock eds) (Jordans, 45th Ed, 2005) at para 64[18] *et seq*. There seems to be no text that discusses the practice in Singapore, but as Singapore's legislation on capital reduction is very similar to that in Britain, it is surmised that the practice in Singapore would also be similar to the practice in Britain.

69 With respect, it is submitted that the manner of exposition in most texts may be improved; *eg*, *Farrar's Company Law* (John Farrar & Brenda Hannigan eds) (Butterworths, 4th Ed, 1998) ch 16, Eilis Ferran, *Company Law and Corporate Finance* (OUP, 1999) ch 10; *Walter Woon on Company Law* (Tan Cheng Han ed) (Sweet & Maxwell Asia, 3rd Ed, 2005) [12.6] *et seq*. *Cf. Gower and Davies' Principles of Modern Company Law* (Paul Davies ed) (Sweet & Maxwell, 7th Ed, 2003) ch 11.

70 It may also be added that since 1998 share buybacks were allowed: Companies (Amendment) Act 1998, s 5 which introduced s 76B to s 76G.

71 See *eg*, *Re Jupiter House Investments (Cambridge) Ltd* [1985] 1 WLR 975, 978 (the observations of Lord Macnaghten in *Poole v National Bank of China Ltd* [1907] AC 229, 238-240, do not represent the law as practiced in this court); *Re Grosvenor Press Plc* [1985] 1 WLR 980, 983 ("settled general practice as to the form of undertaking to be required").

that can be said is that in a loss reduction, the court is mostly concerned that subscribed capital should not be returned surreptitiously to the members.[72] In a repayment reduction where creditors have not given their consents, the court is mostly concerned that their interests are safeguarded through the setting aside of assets as security or the retention of sufficient assets in the company to meet the claims of the creditors.[73]

30 The doctrine as described above does not seem to fit the words "capital maintenance" very well. This is particularly so in a repayment reduction which is approved on the basis that the company has sufficient liquid assets to cover the aggregate of any amount of capital proposed to be repaid to members and the total sum due to creditors plus a margin of not less than ten percent.[74] For ease of reference, this method of creditor protection will henceforth be called the "security margin" method. It can be seen that the security margin method stretches the *prima facie* position of the doctrine that the company retains assets equivalent to the capital investment of its members to breaking point.

C. Solvency tests

31 Solvency tests are not concerned at all with protecting the integrity of the subscribed capital of a company. It is submitted that the underlying rationale of the solvency tests is the rule that creditors rank ahead of members in a company's insolvent liquidation.[75] This ranking of claims will be inverted if the company is insolvent when it is proposed to transfer an asset or make a payment to a member, or if the company is made insolvent as a result of the proposal. If however it may be reasonably concluded that the company is solvent and will remain so after the proposal, the proposal will respect the ranking of claims. This does not mean that it makes good business sense for the company to forthwith carry out the proposal or that respect for the ranking of claims is the only rule of law governing the proposal.[76] It does however provide justification for the law to take the position that, in this situation, so far as regards the

72 See *eg*, *Re Jupiter House Investments (Cambridge) Ltd* [1985] 1 WLR 975; *Re Grosvenor Press Plc* [1985] 1 WLR 980 (discussed in text to n 64).

73 See *eg*, *Ex p Westburn Sugar Refineries Ltd* [1951] AC 625 (HL) (discussed in text to n 66).

74 *Gore-Brown on Companies* (Millett and Alcock eds) (Jordans, 45th Ed, 2005) [64[20]].

75 Section 300.

76 *Eg*, the directors should ensure that the proposal is not *ultra vires* the company and that in approving it they have discharged their duties as directors.

company-creditors relationship, the company should not be prohibited from carrying out the proposal. Creditors who require more protection than the law provides should covenant for it in their negotiations with the company.[77]

D. Doctrine is incoherent

32 It is submitted, with respect, that the doctrinal basis of capital maintenance is inconsistent with the solvency tests. Professor Ferran has remarked that the former is "independent of any solvency requirement with the consequence that a company cannot transfer value to shareholders by a capital reduction …"[78] This supports the point made above that the nature of capital maintenance differs from the solvency tests, but to prove the assertion, it is necessary to delve more deeply.

33 The more nuanced exposition of the capital maintenance doctrine above shows that the practices adopted by the courts when approving capital reductions derogate from the *prima facie* position of the doctrine to varying degrees. It may be argued that the security margin method of protecting creditors is quite similar to the solvency tests introduced by the Amendment Act. If so, it may be further argued that the solvency tests under s 7A and s 76F(4) are simply part of the continuing process of liberalising the capital maintenance doctrine and co-exist coherently with court-sanctioned reduction within the overarching structure of the doctrine. It is submitted that these arguments should be rejected for the following reasons.

34 First, the starting position of the capital maintenance doctrine and the solvency tests are different. Whilst the former is concerned to protect the integrity of the capital subscribed by a company's members, the solvency tests are content to allow a company return capital to its members provided that the company remains solvent thereafter. For a statute to say in one breadth that all that is required for a company to reduce its capital is that it should be solvent, and in the next breadth to retain the overarching structure of the capital maintenance doctrine, is, in this writer's opinion, contradictory.

77 It is beyond the scope of this article to discuss whether this approach is efficient or fair. For a discussion of the efficiency issue, see J Armour, "Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law" (2000) 63 MLR 355.

78 Eilis Ferran, "Creditors' Interests and "Core" Company Law" (1999) 20 Co Lawyer 314 at 318.

35 Secondly, it is misconceived to extrapolate from the security margin method and conclude that as the solvency tests are similar to it, they are consistent with the capital maintenance doctrine. In the first place, it is arguable that the security margin method has derogated so fundamentally from the concept of capital maintenance that it cannot be regarded as being consistent with the doctrine. This is not a criticism of the courts that developed the practice; on the contrary, it may be taken as evidence that in practice the doctrine has operated unsatisfactorily. Secondly, in any event, the security margin method is essentially different from the solvency tests. The differences are not only procedural, but also substantive. Solvency tests merely require the company to be in a financial position to pay off its debts in full. There is no question that the company must in addition satisfy a security margin, which is what the security margin method imposes.

E. Proposed way forward

36 Assuming that it is accepted that the solvency tests do not cohere satisfactorily within a framework of capital maintenance, it may still be argued that as a practical matter Singapore's hybrid system has the merit of allowing a company to choose whichever option that meets its requirements better. As pointed out above, court-sanctioned capital reduction may be important to large companies with independent directors who may be unwilling to vouch for the company's solvency due to lack of intimate knowledge.[79] This flexibility would be lost if the capital maintenance doctrine is abolished which would necessarily entail abolishing court-sanctioned capital reduction as well.

37 With respect, these arguments are not convincing. First, a menu approach sacrifices the coherence of law which should be rejected, unless perhaps there is no other practical alternative. Second, it is not a satisfactory solution to hope that the availability of court-sanctioned capital reduction may make up for any deficiencies of the solvency tests. Court-sanctioned capital reduction is a time-consuming and cumbersome process. A far better solution is to face the issue of whether the current solvency tests are unnecessarily too stringent squarely and if necessary to fine-tune them.

79 It is interesting to note that in its capital reduction exercise in 2006, Singapore Telecommunications Ltd still resorted to the court sanction method even though the new option was available to it <http://home.singtel.com/investor_relations/capital_reduction/ default.asp>(accessed 22 May 2007).

38 It is therefore submitted that the reforms introduced by the Amendment Act to the capital maintenance doctrine should be carried to its logical conclusion. The time has come to abolish the capital maintenance doctrine in favour of solvency tests. This is not such a radical suggestion as it may seem. New Zealand abolished the capital maintenance doctrine in 1993,[80] and so far as may be ascertained from the texts,[81] the reform seemed to have worked well. In most US States, legal capital rules have either been abolished outright or simply withered into marcescence.[82] It is also instructive for us to look at the recent European experience. As a result of decisions of the European Court of Justice,[83] it has become possible for companies in the European Union to choose to incorporate in a Member State, even though their businesses are conducted in another Member State, to avoid minimum capital rules.[84] Many continental entrepreneurs have thus chosen to incorporate their businesses in the United Kingdom, where legal capital rules for private companies are relatively permissive. This development has caused the legislatures of various Member States to start questioning their attachment to the rules.

39 The success of a shift to solvency tests depends upon three things:

> Proper accounting rules that allow for the accurate measurement of solvency; suitable sanctions to deter the responsible managers from making false claims about their company's solvency either deliberately or negligently; and effective recovery mechanisms where value is wrongly transferred to shareholders in priority to creditors."[85]

Professor Ferran has noted that English law in these three areas, as it stood before the UK Companies Act 2006, may not be perfect. It is beyond the scope of this article to consider whether the same may be said

80 NZ Companies Act 1993.

81 *Eg*, *Morison's Company and Securities Law* (Andrew Beck & Andrew Borrowdale *etc*, eds), (LexisNexis, 2006) vol 2, ch 14.

82 See *eg*, B Manning, *Legal Capital* (Foundation Press, 2nd Ed, 1982).

83 ECJ, Case C-212/97 *Centros Ltd v Erhvervs-og Selskabssyrelsen* [1999] ECR I-1459, [2000] Ch 446; ECJ, Case C-208/00 *Überseering BV v Nordic Construction Company Baumanagement GmbH* (NCC) [2002] ECR I-9919; ECJ, Case C-167/01 *Kamer van Koophan-del en Fabrieken voor Amsterdam v Inspire Art Ltd* [2003] ECR I-10155.

84 It is not clear whether the capital maintenance rules fall within the reasoning of the ECJ decisions so that companies which find such rules in a Member State to be a hindrance to the exercise of corporate free movement may be able to challenge them. See John Armour "Legal Capital: An Outdated Concept?" (2006) 7 European Business Organization Law Review 5, 24 who argues in the affirmative.

85 Eilis Ferran, "Creditors' Interests and 'Core' Company Law" (1999) 20 Co Lawyer 314 at 318 (commenting on the acceptability of a flexible rule based on solvency tests).

of Singapore law. Nevertheless, it is possible to provide a snapshot of the relevant issues that should be resolved as part of the package if the law is reformed as here suggested.

40 First, the rules discussed above are not the only rules developed by the law to protect creditors of limited liability companies. The abolishment of the capital maintenance doctrine will provide an excellent opportunity for law reformers to focus on how the rationale underlying the solvency tests interact with the rationales underlying those other rules, for example, the duties on a director of a company that is insolvent or in financial difficulties,[86] insolvent trading[87] and the disqualification of directors on the ground of unfitness,[88] where the insolvency of the company is an important element. An overall review of all the relevant rules used to protect creditors will help to prevent inconsistent treatment and overkill and to improve the coherence of the law.

41 Secondly, as mentioned earlier, our solvency statement is much more stringent than that of New Zealand. The court-based capital reduction method may be necessary as an option for large companies with independent directors. If that is the case, it would be necessary to relax our solvency tests, perhaps adopting the New Zealand approach,[89] since that option will no longer be available with the demise of the capital maintenance doctrine.

86 *Eg*, *Federal Express Pacific Inc v Meglis Airfreight Pte Ltd* [1998] SGHC 417 at [17] (directors of an insolvent company owe a duty to its creditors) with *Yukong Line Ltd of Korea v Rendsburg Investments Corporation of Liberia (No 2)* [1998] 1 WLR 294 at 313 (no such duty is owed). For a recent contribution, see Hans Tjio, "The Rationalisation of Directors' Duties in Singapore" (2005) 17 SAcLJ 52, pp 65-69.

87 Section 339(3). An issue that should be addressed is whether Singapore should introduce something like the UK provision prohibiting wrongful trading (UK Insolvency Act 1986, s 214) or the Australian provision prohibiting insolvent trading (Australian Corporations Act 2001, s 588G).

88 There are various grounds for disqualification in the Companies Act, but s 149 is the provision that disqualifies directors of insolvent companies on the ground of unfitness. This is however rarely used in practice, unlike the case in UK where between 1500 and 2000 directors per year are normally disqualified in Great Britain, the vast majority as directors of insolvent companies found unfit (or admitting this by undertaking. See the Annual Report and Accounts 2005-2006 of the UK Insolvency Service, p 17 available at <http://www.insolvency.gov.uk/pdfs/annual2005-06web.pdf>(accessed 22 May 2007).

89 See Jonathan Rickford "Legal Approaches to Restricting Distributions to Shareholders: Balance Sheet Tests and Solvency Tests" (2006) 7 European Business Organization Law Review 135, 171 (discusses various issues relating to solvency tests used to govern distributions to members).

42 Thirdly, at the periphery the solvency tests are notoriously difficult to apply, as evidenced by the cases on whether a company is insolvent so justifying its winding up.[90] Moreover, as the context is different, the jurisprudence developed in those cases may not be fully applicable. Much effort will have to be expended to flesh out how the solvency tests should be applied in practice.[91]

43 Fourthly, all the detailed rules spawned by the capital maintenance doctrine have to be reformed, where necessary, to be consistent with the adoption of the solvency tests as the sole criterion in this area of law. As an example, our law on dividends still consists largely of judge-made rules,[92] which allow a company to pay dividends even though its capital is not intact.[93] This is unsatisfactory from the perspective of capital maintenance. In 1980, Britain replaced the common law rules by the rule that a company may only pay a dividend if it has distributable profits, which are accumulated realised profits, so far as not previously utilised by distribution or capitalisation, less its accumulated realised losses, so far as not previously written off in a reduction or re-organisation of capital duly made.[94] That reform was undertaken primarily to give effect to the Second Company Law Directive,[95] but it was also seen as remedying the unsatisfactory state of case law.[96] To a company law based on solvency tests, however, the criticisms of the judge-made rules have no force and the British legislation should not be followed. Rather, the rules on dividends would have to be reformed, inter alia, to allow a company to pay dividends provided that it satisfies the solvency

90 The cases are too numerous to include. A sampling may include *Cornhill Insurance plc v Improvement Services Ltd* [1986] 1 WLR 114; *Byblos Bank SA v Al-Khudairy* (1986) 2 BCC 99, 549 (CA); *Re Great Eastern Hotel (Pte) Ltd* [1989] 1 MLJ 161. See also Roy Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell, 3rd Ed, 2005) at [4-15] *et seq*; Andrew Keay, *McPherson's Law of Company Liquidation*, (Sweet & Maxwell, 2001) at [3.23] *et seq*.

91 For the New Zealand jurisprudence on this point, see *Morison's Company and Securities Law* (Andrew Beck & Andrew Borrowdale *etc* ed) (LexisNexis, 2006) vol 2, [14.5]-[14.8].

92 For a summary of the rules, see *Walter Woon on Company Law* (Tan Cheng Han ed) (Sweet & Maxwell Asia, 3rd Ed, 2005) [12.84] *et seq*. The CLRFC had recommended that Singapore follows the UK rules (recommendation 2.20) but this has not been implemented.

93 *Lee v Neuchatel Asphalte Co* (1889) 41 Ch D 1 (CA) 26.

94 UK Companies Act 2006, s 830. An additional restriction applies to public companies: s 831.

95 77/91/EEC, [1977] OJ L26/1, art 15 which restricts distributions by public companies.

96 The opportunity was taken to tighten up the rules governing private companies as well. See *Gower and Davies' Principles of Modern Company Law* (Paul Davies ed) (Sweet & Maxwell, 7th Ed, 2003) ch 13.

tests. Section 403 which stipulates that a company can only pay dividends if it has profits for that purpose would accordingly have to be reformed.

V. Capital reduction

A. Out-of-court capital reduction

44 The Amendment Act, implementing CLRFC recommendation 2.19, introduces an alternative capital reduction process that is based on solvency declaration by directors, not court sanction.[97] The provisions are contained in a new division 3A. Except for some minor differences, the procedure is essentially similar for private and public companies. There are three main elements in the new procedure. First, all the directors are required to make a solvency statement, except where the reduction involves only the cancellation of capital that is lost or unrepresented by profits.[98] Secondly, the members are required to pass a special resolution to approve the proposed reduction.[99] Thirdly, creditors are entitled to apply to court to object to the proposed reduction.[100] The provisions are complex but on the whole do not seem to raise any controversial issues, except for the last element on the right of creditors to object.

45 First, the ground on which to determine whether a creditors' objection should be upheld is still mired in the old thinking of capital maintenance; consequently it is inconsistent with a solvency-based capital reduction. Section 78F(2) stipulates that on a creditor's objection, the court shall cancel the resolution to reduce capital if satisfied that, with regard to any outstanding debt or claim, it has not been secured and other adequate safeguards have not been given for it and it could not be said that these are unnecessary in view of the assets that the company would have after the reduction.[101] These are similar to the measures for creditor protection which the courts have developed when exercising their discretion on whether to approve a capital reduction under the

97 The traditional court-sanctioned reduction of capital is now contained in s 78G; s 73 has been repealed.
98 Sections 78B(3) and 78C(3).
99 Sections 78B(1) and 78C(1).
100 Section 78F.
101 Section 78F(2).

capital maintenance doctrine.[102] With respect, it does not make sense to stipulate that a company is allowed to reduce its capital provided it has satisfied the solvency tests in s 7A, and then to direct that the court shall disallow it unless the company is able to satisfy some other tests. Section 78F is essentially based on clause 56 of the Draft Bill in the UK White Paper on Modernising Company Law – Draft Clauses.[103] The clause is however not to be found in the UK Companies Act 2006; in fact creditors are not given any right to object in that Act. Whilst it is open to debate whether creditors should be given a right to object, this right, if given, must be related to the solvency tests, not notions of capital maintenance.

46 Secondly, the machinery for creditor protection seems half-hearted and at any rate does not reflect the Minister's speech in Parliament on the second reading of the Amendment Act.[104] According to the Minister, to allow for flexibility the detailed rules on publicity will be set out in subsidiary legislation. Nevertheless, he outlined the policy, which is that public companies will be required to publish in advance in a national newspaper a notice of reduction of share capital, while private companies can choose either to publish the notice in a newspaper or send a notice to inform all their creditors. It is doubtful whether publication in the mass media will be an effective means of alerting creditors to a proposed capital reduction. However, subsidiary legislation made thereafter does not even provide for that. The publicity requirement is met by simply lodging certain specified information with the Registrar in a prescribed format and paying the prescribed fees, whereupon the Registrar will upload the information on the Registry's website.[105] There is no mandatory requirement to publish a notice in a newspaper, though the company concerned may choose to do so.[106] Whilst advance notice of a proposed capital reduction is probably not required, the weak publicity requirements do mean that it will be very difficult for creditors to effectively exercise their right of objection,[107] unless the company concerned on its own initiative takes extra steps to inform the creditors.

102 See paras 28-30 of this article. It is interesting to note that the provision giving the court jurisdiction to confirm a court-sanctioned capital reduction, s 78I(2), has been amended so that it is now similar to the relevant parts in s 78F(2).
103 Cm 5553-II.
104 Singapore Parliamentary Debates, Official Report (16 May 2005) vol 80, cols 698708.
105 Companies Regulations, reg 6(1) and (3), introduced by Companies (Amendment) Regulations 2006, reg 2.
106 *Id*, reg 6(1)(2).
107 Section 78D.

B. Amendments to court-sanctioned capital reduction

47 The original court-sanctioned procedure, which now appears as ss 78G-78K, has been amended in three areas. First, whereas previously a company may only reduce its capital if so authorised by its articles,[108] such authorisation is not necessary under the new regime; it is sufficient if the memorandum or articles do not exclude or restrict any power to reduce capital conferred on the company by the new division 3A.[109] Secondly, the court may confirm a reduction even though qualifying creditors, settled in a list of such creditors, have not consented to it and their debts have not been repaid or secured, where the creditors have other "adequate safeguards" for the debts or where the court thinks security or other safeguards unnecessary "in view of the assets the company would have after the reduction."[110] This is an improvement over the original provision which provided only that the court may dispense with the consent of an objecting creditor if the debt is paid or secured,[111] which is unduly restrictive. Thirdly, under the original procedure, where a creditor who was entitled to object to the reduction was not entered on the list of creditors (by reason of his ignorance of the proceedings or of their nature and effect with respect to his claim) and the company subsequently goes into insolvent liquidation, the members' original liability to contribute to the assets of the company in the winding up is preserved.[112] This is now no longer the case, where s 78K declares that after a capital reduction, a member is not liable in respect of any share to any call or contribution beyond the difference (if any) between the issue price of the share and the aggregate of the amount paid up on the share (if any) and the amount reduced on the share.

VI. Financial assistance

A. Two new methods

(1) Introduction

48 Two additional methods authorising financial assistance by a company for acquisition of its shares were introduced, one requiring only

108 Old s 73(1).
109 Section 78A(3).
110 Section 78I(2).
111 Old s 73(2)(c).
112 Old s 73(9).

a directors' resolution while the other requiring both a directors' resolution and approval of the shareholders.[113] The first method is restricted to the giving of financial assistance where the amount of the assistance together with the amount outstanding on any assistance given earlier under the same method does not exceed ten percent of the aggregate of the total paid-up capital of the company and its reserves. No such restriction applies to the second method. For the purpose of this article, the first and second methods shall be called "director approved" and "shareholder approved" methods of financial assistance respectively.

(2) Common elements of the two new methods

49 There are three requirements that are common to both methods. First, the directors have to pass a resolution that the company should give the assistance, giving the assistance is in the best interests of the company and the terms and conditions under which the assistance is given are fair and reasonable to the company.[114] Secondly, the resolution must set out in full the grounds for the directors' conclusions.[115] Thirdly, all the directors have to make a solvency statement in relation to the giving of the financial assistance.[116]

(3) Director-approved financial assistance

50 Under this method, the company may proceed to give financial assistance after the board resolution has been passed, and only need to inform the shareholders and lodge documents with the Registrar thereafter.[117] The Amendment Act does not impose any time limit within which the financial assistance must be given after the passing of the board resolution, although no financial assistance may be given if any director who voted in favour of the resolution ceases to be satisfied that the giving of the assistance is in the best interests of the company, or that the terms and conditions under which the assistance is proposed are fair and reasonable to the company, or if any director no longer has reasonable grounds for any of the opinions expressed in the solvency statement.[118] These conditions, which mirror those that must be satisfied when the

113 Sections 76(9A) and (9B).
114 Sections 76(9A)(c) and 76(9B)(a).
115 Sections 76(9A)(d) and 76(9B)(b).
116 Sections 76(9A)(e) and 76(9B)(c). Hence directors who vote against the board resolution are also required to make a solvency statement.
117 Section 76(9A)(f) and (g).
118 Section 76(9C).

directors pass the board resolution approving the giving of financial assistance and make the solvency statement, are thus "evergreen" conditions that continue to apply from the beginning to the time when the financial assistance is given.

51 It is interesting to note there is a requirement that the company receives fair value in connection with the financial assistance which applies only to this method of director approved financial assistance.[119] Since the board is already required to resolve that the terms and conditions under which the assistance is given are fair and reasonable to the company, why is there a need for this additional requirement which *prima facie* seems to duplicate the other requirement? The answer may lie in the fact that no shareholders' resolution is needed in director-approved financial assistance. Although the majority required for the shareholders' resolution to pass is unfortunately not clear, a matter which will be discussed in the next section, this requirement affords minority shareholders some measure of protection from prejudicial conduct of the majority.[120] There is no similar protection for director approved financial assistance. Although the board is required to resolve that the assistance is given under terms that are fair and reasonable, the general approach of the courts is not to question business decisions bona fide arrived at.[121] The provision that the company must receive fair value in connection with the financial assistance can be seen as a direction from Parliament that should a dispute arise on the issue, courts should decide for themselves objectively whether the provision has been satisfied, instead of deferring the decision to the directors, where it cannot be shown that the directors have acted in bad faith. This will give the minority shareholders some protection from prejudicial conduct of the majority.

119 Section 76(9A)(b).

120 They may also be able to rely on s 216.

121 The cases are replete with statements that courts should not act as supervisory boards over a company's business decisions, from the exclamation of Lord Eldon LC in *Carlen v Drury* (1812) 1 Ves & B 154, 158 that "This Court is not to be required on every Occasion to take the Management of every Playhouse and Brewhouse in the Kingdom" to the statement of Lord Wilbeforce in *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821 (PC) 832 that:

> There is no appeal on merits from management decisions to courts of law: nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at.

This statement of Lord Wilberforce was cited with approval in *Re Winpac Paper Products Pte Ltd* [2000] 4 SLR 768 at [9].

(4) Shareholder-approved financial assistance

52 The company has to convene a general meeting to obtain shareholders' approval under this method.[122] It has to send to each member having the right to vote a notice containing particulars of the board resolution and key information on the proposed financial assistance, including such information and explanation as may be necessary to enable a reasonable member to understand the nature and implications for the company and its members of the proposed transaction.[123] After the meeting has passed the resolution, the company must lodge the relevant documents with the Registrar.[124] There is a time limit of twelve months, from the passing of the shareholders' resolution, within which the financial assistance must be given,[125] and the "evergreen" conditions that apply to director approved financial assistance apply similarly here.[126]

53 The majority required for the members to pass the resolution may give rise to controversy. The majority needed is "all the members of the company present and voting either in person or by proxy" where the resolution is passed at a meeting and "all the members of the company" where it is passed by written means.[127] The majority needed thus depends on the method used to pass the resolution. However, the CLRFC recommendation was for unanimous consent of the members, which was also what the Minister said in Parliament during the second reading of the Companies (Amendment) Bill 2005,[128] rather than only the approval of the members present and voting at the meeting. It is not clear why this was departed from in the drafting of the provisions.

54 It is submitted that the provisions may be defended, albeit ultimately whether true unanimity is required is another matter. *Prima facie*, since allowing resolutions to be passed by written means is only meant to improve the efficiency of transacting affairs within the company, whatever majority is required of resolutions at shareholders' meeting

122 Section 76(9B)(e).
123 Section 76(9B)(d). The provisions do not explicitly require that a copy of the solvency statement should be made available to the members. It is arguable that they may rely on the "sweep-up" provision in s 76(9B)(d)(vi) to request for the statement or relevant information contained therein.
124 Section 76(9B)(f).
125 Section 76(9B)(g).
126 Section 76(9C). See discussion two paragraphs above.
127 Sections 76(9B)(e)(i) and 76(9B)(e)(ii). See also s 184A(4A).
128 Singapore Parliamentary Debates vol 80 at col 698 (16 May 2005).

should apply to written resolutions *mutatis mutandis*. However, since there is no meeting for a written resolution, the base against which the majority is measured has to be the total voting rights of the members who are entitled to vote had a meeting been held, rather than members present at the meeting. Generally, a special and ordinary resolution is passed by written means by seventy five percent and fifty percent of the total voting rights of the members who are entitled to vote on the resolution respectively,[129] the same percentage as that required had a meeting been held.[130] It may be argued that the same idea underpins the majority required for this method of financial assistance.

55 The issue of whether the provisions are properly drafted ultimately depends on whether an individual member should be given the right to veto this method of approving the giving of financial assistance. Veto rights have been given in relation to other matters.[131] If the right is given on this matter and exercised, the company can still seek to give financial assistance by recourse to the traditional "whitewash" procedure,[132] which is however a much more cumbersome procedure involving court sanction and the right of various parties, including members and creditors, to object to the giving of the financial assistance.[133]

(5) Liberalising effect of new measures

56 The new measures have made it easier for a company to give financial assistance for the acquisition of its shares in two respects. First, where the amount involved is less than ten percent of the company's total capital, consent of the members is not required. Provided that all the directors are willing to make the solvency statement, a majority of the directors can approve the giving of financial assistance. Secondly, where the amount involved is more than ten percent of the company's total capital, albeit members' consent is required, an application to the court for approval is not necessary, unlike the traditional "whitewash"

129 Section 184A(3) and (4) respectively.
130 Section 184(1).
131 *Eg*, s 26A(2) (entrenching provision can only be amended with the consent of all the members); s 175A(2) (resolution to dispense with annual general meeting has to be passed "by all of such members as, being entitled to do so, vote in person or, where proxies are allowed, by proxy present at the meeting").
132 Section 76(10).
133 Section 76(12).

procedure.[134] The traditional procedure, which requires a special resolution and court approval, will therefore only be used in future where the directors are not able to garner the requisite support[135] from the members for the proposed transaction, or where not all the directors are willing to make a solvency statement. The main attractions of the traditional approach are that directors are not required to make a solvency statement and the financial position of the company does not have to be explicitly stated, although the directors who voted in favour of the resolution are required to express their opinions on the latter.[136]

57 The Amendment Act also states that representations, warranties and indemnities given by an issuer or vendor, in good faith and in the ordinary course of commercial dealings, in the context of an offer to the public to subscribe for its shares, will not be construed as financial assistance.[137] The reason for this is that investors in an initial public offering may require representations, warranties or indemnities from the issuer, which may be construed as the giving of financial assistance by the issuer. It is not clear whether this should be regarded as a clarification of existing law to put the matter beyond doubt, or an amendment, since this author is given to understand that some practitioners think that this has always been the case.[138]

B. Evaluation

(1) Recent developments in some Commonwealth jurisdictions

58 Singapore's reform of the law prohibiting financial assistance is consistent with the recent developments in some Commonwealth jurisdictions, such as UK, Australia and New Zealand. The prohibition, first introduced into the UK legislation in 1929,[139] has been on the retreat in recent years, similar to the fate of the rule prohibiting capital

134 Section 76(10).
135 As explained in paras 53-55 of this article, unanimous support is only required where the resolution is passed by written means: s 76(9B)(e)(ii). Where it is passed at a members' meeting, the consent of all the members present at the meeting suffices: s 76(9B)(e)(i).
136 Section 76(10)(c).
137 Section 76(8)(ga).
138 See also Michael Ewing-Chow and Hans Tjio, "Providing Assistance For Financial Assistance" [2006] SJLS 465.
139 Companies Act 1929, s 45, which was enacted on the recommendation of the Greene Committee (Cmd 2657).

reduction.[140] The current position in UK is that there is no prohibition on the giving of financial assistance by private companies.[141] This reform followed the recommendation of the Company Law Review Steering Group, which had argued that it was inappropriate for companies to continue to carry the cost of complying with the rules on financial assistance.[142] The reason is that abusive transactions could be controlled in other ways, for example, through the provisions on directors' duties or through the wrongful trading and market abuse provisions that have come into force since the enactment of the UK Companies Act 1985. The recommendation was restricted to private companies, as UK is required by the EU Second Directive to maintain a prohibition on financial assistance by public companies, subject to limited exceptions.[143]

59 In Australia, companies are allowed to give financial assistance if any one of the following three conditions is satisfied. First, the giving of the assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors.[144] Secondly, where the assistance is approved by a special resolution of shareholders, whereby the person acquiring the shares and his associates are precluded from voting,[145] or where all ordinary shareholders agree to the assistance at a general meeting. Thirdly, if the assistance is exempted under s 260C.[146]

60 New Zealand, on the other hand, uses a different approach. It allows financial assistance in three situations, provided a board resolution[147] and directors' certificate of solvency[148] have been obtained: firstly, all shareholders have consented in writing to the giving of the assistance;[149] secondly, the board resolves that assistance is of benefit to shareholders not receiving the assistance and the terms and conditions are fair and reasonable to them;[150] and thirdly, less than five percent of the

140 See para 25 *et seq* of this article.
141 UK Companies Act 2006 (c 46), s 682(1)(a). See also UK White Paper on Modernising Company Law, (Cm 5553-1), vol 1, Part II, [6.5]; UK White Paper on Company Law Reform, (Cm 6456) [4.8].
142 UK Company Law Review Steering Group, Completing the Structure [2.14].
143 Article 23 of the Second Directive.
144 Section 260A(1)(a), Australian Corporations Act 2001.
145 *Id*, s 260B(1).
146 *Id*, s 260A(1)(c).
147 Section 76(2), NZ Companies Act 1993.
148 *Id*, s 77(1). Under s 77(2), only the directors who vote in favour of the resolution need to sign a solvency certificate.
149 *Id*, s 76(1)(a).
150 *Id*, s 78(1).

company's paid-up capital and reserves are involved and the company receives fair value in connection with the assistance.[151]

61 Although the CLRFC did not state so expressly, it is clear that we have adopted the New Zealand approach with some modifications. The CLRFC voiced doubts about the Australian provision which depends on a materiality threshold.[152] It was concerned with the uncertainty surrounding it, as the question of whether there is material prejudice is a question of fact which depends on the facts of each case. "In particular, it will not be possible to determine whether the transaction involves material prejudice merely by reference to arbitrary rules, such as the percentage impact the transaction will have on the company's profit."[153]

(2) Doctrinal foundation

62 There are two views on the doctrinal foundation of the prohibition on financial assistance. On one view it may be seen as closely related to the doctrine of capital maintenance, though "the ban on financial assistance has only a limited overlap with that principle"[154] due mainly to the "broad sweep of the financial assistance provisions".[155] The second view is that despite its traditional link to the doctrine of maintenance of capital, the restriction on giving financial assistance is aimed at a particular kind of abuse of powers by directors.[156] "The improper practice is to allow the company's assets to be used to facilitate an acquisition of its shares (typically though not always an acquisition of a controlling interest) in a manner which confers benefit on the seller or the buyer but no benefit on the corporate entity, its other shareholders and creditors."[157]

63 It has been argued earlier that Singapore should abolish its capital maintenance doctrine.[158] If this is accepted, the first view is

151 *Id*, s 80(1).
152 CLRFC Report, [3.4.5]. See further Y-Y Cho and V Kishore, "The "Material Prejudice" Test and the Financial Assistance Prohibition" (2004) 78 ALJ 194.
153 Explanatory Memorandum to the Company Law Review Bill 1998, [12.77], commenting on s 260A(1)(a) of the Australian Corporations Act 2001.
154 Eilis Ferran, "Creditors' Interests and "Core" Company Law" (1999) 20 Co Lawyer 314 at 319.
155 *Ibid*.
156 *Ford's Principles of Corporations Law* (RP Austin & IM Ramsay eds) (Butterworths, 13th Ed, 2007) [24.670].
157 *Ibid*.
158 See paras 32-33 of this article.

untenable. But regardless of whether the argument is accepted, it is submitted that the second view is preferable for two reasons: first, as a matter of principle, and secondly, the implicit support for the second view in the reforms and *Wu Yang Construction Group Ltd v Zhejiang Jinyi Group Co Ltd*.[159]

64 The rationale of the prohibition on financial assistance does not cohere with the nature of the capital maintenance doctrine. The doctrine stipulates that, subject to qualifications, the capital of the company should not be reduced or returned to shareholders resulting in its depletion.[160] In a financial assistance, while the assets of the company usually finds its way into the pockets of the vendor of shares, this may or may not result in an actual depletion of the company's assets.[161] Nevertheless, the mere fact that an act does not lead to a depletion of the company's assets does not necessarily mean that the act is not objectionable, or in the reverse situation where there has been an actual or potential diminution of assets this does not necessarily mean that unlawful financial assistance has been given, since the company may have entered into the transaction for perfectly good and legitimate commercial reasons rather than to deplete its assets in aid of the intended acquisition of its shares.[162] Therefore, the restriction on financial assistance is better seen as striking at an abusive and improper practice of corporate controllers.

65 There is much to be said for freeing the law on financial assistance from the doctrine of capital maintenance and leaving the problems it seeks to solve to the general law on directors, or if it is thought that the risk of abuse is too great, to view the restriction as an instance where statutory intervention is deemed necessary to reinforce the general law on directors, much like the restriction on loans to directors.[163] This is the logical step to take, since even under the traditional "whitewash" procedure, the passing of a special resolution and court approval do not relieve a director of any duty to the company in

159 [2006] 4 SLR 451, [2006] SGHC 152. See also *PP v Lew Syn Pau* [2006] 4 SLR 210, [2006] SGHC 146. See Wan Wai Yee, "Financial Assistance: The Case for Re-examining Section 76 of the Companies Act" (2007) 19 SAcLJ 80.

160 See text to n 69.

161 In *PP v Lew Syn Pau* [2006] 4 SLR 210 at [107] and [151], [2006] SGHC 146, Menon JC would categorise this as a depletion on the ground that assets of the company have been put at risk, since there is always a possibility that a borrower, however creditworthy, may default.

162 *Id*, at [141], [142] and [151].

163 Sections 162 and 163.

connection with the giving of financial assistance,[164] a provision which finds its parallel in the two new methods of authorised financial assistance.[165]

66 It is submitted that recent developments, statutory and to a greater extent, case law, provide implicit support for the second view. It has been argued earlier that the nature of solvency tests differs from the capital maintenance doctrine.[166] As the two new methods of approving financial assistance introduced by the Amendment Act are based on solvency tests,[167] it means that the prohibition on financial assistance cannot be understood as a response dictated by the doctrine. This point may or may not be taken as support for the second view, but at the very least it shows that the first view is not tenable. Next, clearer support for the second view may be found in *Wu Yang Construction Group Ltd v Zhejiang Jinyi Group Co Ltd*,[168] a valuable contribution from Phang JC (as he then was) on the rationale of the prohibition on financial assistance. In clarifying the Court of Appeal case of *Intraco Ltd v Multi-Pak Singapore Pte Ltd*,[169] the learned judge stated categorically that s 76 was not meant to capture transactions which were "entered into *bona fide* in the commercial interests of the company itself (as opposed to providing, in substance if not form, financial assistance for the purchase of the company's own shares)".[170]

VII. Share buyback

A. Introduction

67 The Amendment Act introduced two major reforms in relation to share buyback. First, it allows a company to engage in share buybacks so long as it is solvent.[171] It does not matter whether it is funded out of a company's capital or profits. Before this reform, a share buyback can only be funded out of a company's distributable profits.[172] Secondly, it allows a company to keep the shares so acquired as treasury shares, unlike the

164 Section 76(15).
165 Section 76(9D).
166 Section IV(B), (C) and (D).
167 Sections 76(9A) and (9B).
168 [2006] 4 SLR 451, [2006] SGHC 152.
169 [1995] 1 SLR 313 (CA).
170 *Id*, at [35].
171 Section 76F(1).
172 Section 76F(1) before the amendments.

prior position where they are deemed to be cancelled immediately upon acquisition.[173]

B. Solvency-backed share buyback

(1) Solvency requirement

68 On paper the solvency requirement for share buyback is more lax in two aspects, procedural and substantive, than the solvency statement for capital reduction and financial assistance for the acquisition of shares as set out in s 7A. It is however not clear whether these differences will mean much in practice. As regards procedure, in a share buyback directors have only to be satisfied that the company is and will remain solvent after the proposed buyback. Although it would be prudent for directors to record in some kind of document that they have considered the financial position of the company and their reasons for concluding that the company is solvent, the law does not formally require them to make a solvency statement,[174] unlike the case in capital reduction and financial assistance for the acquisition of shares.[175]

69 Substantively, the solvency requirement for share buyback, set out in s 76F(4), consists of four tests, *ie*, that the company is able to pay its debts in full at the time of the buyback and for twelve months thereafter and that the value of its assets is not less than its liabilities before and after the buyback. These solvency tests are less stringent compared to that for capital reduction and financial assistance for the acquisition of shares set out in s 7A. That provision is very complex, but as argued earlier,[176] it may be regarded as requiring that the company is cash flow and balance sheet solvent at the date of the statement and will remain so for twelve months thereafter. So far as cash flow solvency is concerned the differences between s 76F(4) and s 7A are minor. On paper, the balance sheet solvency tests in s 7A are more stringent than that for s 76F(4). But that is likely to be on paper only. In practice, it is difficult to envisage that a director, acting with reasonable skill and care, will be willing to predict or be satisfied with a forecast that a company will be cash-flow solvent for

173 Section 76B(5) before the amendments. Paradoxically, this does not apply to shares acquired under s 76DA (contingent purchase contract).

174 Notice that it was said during the second reading of the Companies (Amendment) Bill 2005 that a solvency statement is needed: Sing Parliamentary Debates vol 80 at col 698 (16 May 2005).

175 Section 7A(2).

176 See para 10 of this article.

twelve months after the relevant transaction, without being at the same time predicting or the forecast also forecasting that the company will also be correspondingly balance-sheet solvent. As pointed out by Professor Goode:

> There is a close link between cash flow insolvency and balance sheet insolvency in that where a company is a going concern and its business can be sold as such with its assets in use in the business, those assets will usually have a substantially higher value than if disposed of on a break-up basis, divorced from their previous business activity. So a company which is commercially solvent has a much greater chance of satisfying the balance sheet test of solvency than one which is unable to pay its debts as they fall due.[177]

(2) Capital, profits and solvency

70 Although Singapore, after the Amendment Act, still retains the capital maintenance doctrine as its overarching framework, only traces of the doctrine may be found in the law on share buyback. The basic rule is that a company may buyback its shares provided the solvency requirement is met,[178] although there are temporal restrictions on the number of shares that may be acquired.[179] It is thus no longer meaningful to talk about capital and profits, a distinction which is central to the capital maintenance doctrine. Nevertheless, s 76F(1) stipulates that a company may buyback its shares "out of the company's capital or profits so long as the company is solvent." The juxtaposition of capital, profits and solvency seems to signify the lingering hold of the capital maintenance doctrine on thinking and drafting in this area of law. However, although the drafting of s 76F(1) is unfortunate in this regard, it is not doctrinally incoherent, unlike s 78F(2) which governs a court's decision on whether to uphold a creditors' objection to a solvency-based capital reduction by reference to traditional notions of capital maintenance and is criticised above as being inconsistent with the nature of the capital reduction.

(3) Sanction on directors

71 Before the Amendment Act, a director who approves a purchase knowing that the company is insolvent or will become insolvent as a

177 See also discussion in n 33 where it was argued that the different solvency tests for capital reduction in Singapore and UK will probably mean little in practice.
178 Section 76F(1).
179 Section 76B(3), (4).

result of the purchase, or who wilfully authorises a payment out of what he knows are not distributable profits is guilty of an offence and is liable to creditors.[180] This provision has been amended in two aspects: first, criminal liability is only triggered by reference to solvency tests ("knowing that the company is not solvent"), and secondly, civil liability is abolished.[181] The former is necessary since solvency tests have replaced the availability of profits as the financial condition that must be satisfied in a share buyback. It is not clear what has prompted the latter. The CLRFC did not advert to this issue in its recommendation to adopt a broader approach to share buyback.[182]

72 There is no definition of the words "knowing that the company is not solvent". Actual knowledge will obviously suffice, but what about a case of wilfully closing one's eyes to the obvious or other shades of constructive knowledge? It is submitted that for the protection offered to creditors by the solvency test to be effective, the words must at least cover a case of "Nelsonian" knowledge, or preferably where a director or manager similarly situated ought reasonably to know that the company is not solvent. This would be covered if something similar to the UK provision on wrongful trading or the Australian provision on insolvent trading is adopted.[183]

(4) Share buyback as informal capital reduction

73 An aspect of the reforms that may not have attracted so much attention is that share buyback can now be used as another method to reduce a company's share capital. Before the Amendment Act, shares were deemed to be cancelled immediately on buyback.[184] But the amount by which the company's share capital was diminished was required to be transferred to a reserve called the "capital redemption reserve",[185] and the rules on capital reduction applied to this reserve as if it was paid-up capital of the company, except that it may be applied to pay up unissued shares to be allotted to members of the company as fully paid bonus

180 Section 76F(3) before the amendments.
181 Section 76F(3).
182 Report of the CLRFC, [3.5].
183 UK Insolvency Act 1986, s 214 (wrongful trading); Australian Corporations Act 2001, s 588G (insolvent trading).
184 Section 76B(5) before the amendments. Treasury shares are introduced for the first time by the Act.
185 Section 76G(1) before the amendments.

shares.[186] After the Amendment Act, shares that are repurchased may be kept as treasury shares,[187] but if they are not, they will be deemed to be cancelled immediately on purchase or acquisition.[188] If the cancelled shares were acquired fully or partially out of the capital of the company, the company is required to reduce the amount of its capital correspondingly.[189] The significance of this is that it is not mandatory on a company to use its profits to acquire shares before it may resort to its capital. A company may therefore choose to use share buyback as a method to effect capital reduction since it involves less formalities compared to a formal capital reduction, notwithstanding that the Amendment Act has introduced a new method of capital reduction that dispenses with court sanction.[190] The reasons are as follows.

74 First, directors need only to be satisfied that the company is solvent for share buyback without having to make a solvency statement, on solvency tests that are less stringent, albeit probably only on paper which may not mean much in practice.[191] Secondly, there is no publicity requirement for share buyback, unlike capital reduction, albeit this requirement is not onerous to meet.[192] Thirdly, creditors are given standing to apply to court to object to a capital reduction,[193] which is not available to them in a share buyback. Fourthly, certain types of share buyback, *viz*, off-market purchase on an equal access scheme and purchase in the market require only an ordinary resolution,[194] while a capital reduction requires a special resolution, be it court-sanctioned or not.[195] But notwithstanding these procedural advantages, a company will still have to resort to a formal reduction of capital where it wants to reduce its ordinary share capital by more than ten percent or other percentage as the Minister may prescribe, as this is the cap on the amount of ordinary shares that may be acquired on a share buyback during a relevant period.[196]

186 Section 76G(2) before the amendments.
187 Section 76H(1).
188 Section 76B(5)
189 Section 76G.
190 See para 44 of this article.
191 See paras 68-69 of this article.
192 Section 78B(1)(c). See text to n 104.
193 Section 78D.
194 Sections 76C and 76E.
195 Sections 78B(1), 78C(1) and 78G(1).
196 Section 76B(3). The relevant period means the period commencing from the date the company's last annual general meeting was held or the date it was required by law to

B. Treasury shares

75 This reform implements CLRFC recommendation 2.23. The CLRFC stated that "treasury shares are useful and cost effective, and would provide companies with greater flexibility to use share buy-backs as a form of capital restructuring",[197] though it is arguable whether the alleged benefit is more apparent than real, since the process of cancelling and issuing new shares can be done very quickly nowadays.

76 A treasury share is defined in s 4(1) as a share which was (or is treated as having been) purchased by a company in circumstances in which s 76H applies, and has been held by the company continuously since the treasury share was so purchased. Section 76H allows a company to hold ordinary shares it acquires in treasury and deals with them in accordance with s 76K. This provision does not prescribe any particular type of overt act that must be done before a repurchased share will be regarded as a treasury share. Nevertheless, some such act is probably necessary, because repurchased shares that are not held as treasury shares are deemed to be cancelled immediately on purchase,[198] and the company is required to reduce the amount of its share capital if the purchase was funded out of capital.[199] The definition of treasury shares in s 4(1) by its choice of grammar seems to allow the act to be manifested after the acquisition of the shares, presumably within a reasonable period of time.

77 The amount of treasury shares a company may hold is limited to ten percent of the aggregate number of shares in that class of shares at that time, or if the company has only one class of shares, ten percent of the total number of shares of the company at that time.[200] If this cap is contravened, the company has to dispose or cancel the excess shares within a period of 6 months after the contravention or such further period as the registrar may allow so as to comply with the cap.[201]

78 A company is prohibited by s 76J(2) from exercising any right in respect of the treasury shares and any purported exercise of such a right is void.[202] The premise is therefore that the rights attaching to treasury

be held, and ending on the date the next annual general meeting is held or is required by law to be held, whichever is the earlier: s 76B(4).

197 CLRFC Report, [3.5.6].

198 Section 76B(5).

199 Section 76G(a), (c).

200 Section 76I(1) and (2).

201 Section 76I(3) and (4).

202 Section 76J(2).

shares continue to exist, but the company is not entitled to exercise them. Perhaps to preclude any argument, it is specifically mentioned in s 76J(3) that the rights to which the prohibition applies include any right to attend or vote at meetings. It is however not clear why it is thought necessary to provide further in that provision that for the purposes of the Companies Act, the company shall be treated as having no right to vote and the treasury shares shall be treated as having no voting rights, which runs counter to the premise that the rights continue to exist though not exercisable.[203]

79 There are two exceptions, one substantive and the other technical, to the above freeze on the rights attaching to treasury shares. The first, under s 76J(5)(a), is that the company may keep any bonus shares allotted in respect of the treasury shares. It has been said that, in relation to the UK regime which contains a similar exception,[204] the rationale for this is that "it does not actually involve the exercise of any rights" and, if not permitted, could otherwise dilute the holding of treasury shares.[205] Presumably the same rationale applies here. Bonus shares that are allotted in respect of treasury shares are treated as if they were purchased by the company at the time they were allotted and held by the company as treasury shares.[206] The second exception is that the company may subdivide or consolidate any treasury share into treasury shares of a smaller amount, if the total value of the treasury shares is unchanged by the exercise. It is probably not needed as it does not seem to involve the exercise of any rights attached to the treasury shares. The purpose of this exception is not clear, nor the omission of consolidation of the shares into shares of greater amount.

80 The uses to which the treasury shares may be put are rather tightly controlled. The company may sell them for cash, transfer them for the purposes of an employees" share scheme or as consideration for shares or assets, cancel them or deal with them for such other purposes as

203 It is interesting to compare our provision with that of the UK, which is contained in UK Companies Act 2006 (c 46), s 726(2) (previously Companies Act 1985, s 162C(2) and (3)) (inserted by Companies (Acquisition of Own Shares) (Treasury Shares) Regulations 2003 (SI 2003/1116) reg 3). It is almost identical to our s 76J(2) and (3), but without the last part, *viz*, "the company shall be treated as having no right to vote and the treasury shares shall be treated as having no voting rights.

204 UK Companies Act 2006 (c 46), s 726(4)(a).

205 Geoffrey Morse, "The Introduction of Treasury Shares into English Law and Practice" [2004] JBL 303, 314.

206 Section 76J(6).

the Minister may by order prescribe.[207] The last option provides flexibility if it is thought in future that treasury shares may be put to other uses beyond those enumerated aforesaid. The sale or transfer option is curtailed in one situation. Where there has been a takeover offer for the shares of the company which included treasury shares and the offeror has received acceptances of at least ninety percent in value of the targeted shares and serve a notice under s 215 of the Companies Act to compulsorily acquire the remaining shares of the company, the company is bound to sell or transfer the treasury shares to the offeror.[208]

VIII. Redemption of preference shares

81 It is established law that a company may issue preference shares which are liable to be redeemed by the company.[209] But until recently, redemption can only be funded out of profits which would otherwise be available for paying dividends, or out of the proceeds of a fresh issue of shares made for the purposes of the redemption.[210] The changes introduced in Companies (Amendment) Act 2000 enabled a company to buyback its preference shares out of distributable profits[211] under one of the share buyback schemes.[212] The Amendment Act has liberalised the law by allowing a company to redeem its preference shares out of its capital, provided all the directors have made a solvency statement in relation to such redemption,[213] and the statement is lodged with the Registrar.[214]

IX. Conclusion

82 The clearest theme of the Amendment Act is the objective of reducing regulation and improving the flexibility of conducting the affairs of a company, which is the predominant mode of carrying on business in Singapore. Seen in this light, the abolition of the par value, substantial reforms of the capital maintenance doctrine and the introduction of more efficient methods of amalgamation are to be welcome. Those reforms should enhance the competitiveness of our

207 Section 76K(1).
208 Section 76K(3).
209 Section 70(1).
210 Section 70(3)(a) before the amendments.
211 Section 76B(2).
212 Sections 76B to 76E.
213 Section 70(4)(a).
214 Section 70(4)(b).

company law in the global economy. Their other impact on law and practice will however probably take a few years to be fully appreciated. In fact, it is arguable that the full implications of the reforms extend beyond the realm of company law. For example, the ease with which capital may be returned to shareholders lessens the need for alternative vehicles like limited liability partnerships[215] and business trusts,[216] which were thought to be needed partly because of the cumbersome capital maintenance rules of company law.

83 This article has analysed the salient features of the reforms of the rules of capital maintenance, in particular those provisions that may cause difficulties in interpretation or application in future, and their doctrinal implication. Two matters in particular stood out in the analysis. The first is the important position occupied by solvency tests in company law after the Amendment Act. Their uses are not confined to capital maintenance. Some of the solvency tests are very technical and complex. To compound the difficulties of comprehension, a plethora of different solvency tests are used, even though it is not clear that in practice all the different types of tests are warranted. It is to be hoped that an in depth study of all the solvency tests used in the Act would be carried out as soon as possible. This is necessary to ensure that the tests balance the conflicting needs of ensuring adequate protection of creditors and of not imposing impossible or unwarranted demands on a director who has the burden of ensuring that the tests are satisfied and faces the prospect of criminal liability if he is negligent. The second matter that stood out in the analysis is that the reforms have made Singapore's law on capital maintenance incoherent. This is because the solvency based reforms of the Amendment Act have not been brought to their logical conclusion. That it is hard to discard a doctrine as venerated as capital maintenance can be seen from its lingering hold even on the reforms in the Amendment Act that are meant to be governed solely by solvency tests. Nevertheless, this is a process that should be continued until the capital maintenance doctrine is well and truly abolished in favour of solvency tests as a means to protect creditors.

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215 Limited liability partnerships may now be set up under the *Limited Liability Partnerships Act* (Cap 163A, 2006 Rev Ed) which came into operation on 11 April 2005.

216 The relevant legislation is the Business Trusts Act (Cap 31A, 2005 Rev Ed) which became operational on 12 October 2004.