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Singapore: Trends & Developments

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Trends and Developments

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Duties, Obligations and Potential Liability of Directors and Insolvency Professionals: A Brief Review of Recent Decisions of the Singapore Courts

Introduction

As a distressed company approaches insolvency, its directors must ensure that they remain acutely aware of their duties, particularly the duty to consider the interests of the company's creditors (or the "creditor-regarding duty", for short). Once the company enters into a formal insolvency proceeding like judicial management or liquidation, the insolvency professionals (IPs) who enter the picture must likewise be aware of their duties and obligations, as their conduct will be scrutinised by creditors and the court alike. Any failing may potentially be met by a challenge from the creditors, or the prospect of being removed from office.

In Singapore, recent decisions issued by the High Court and Court of Appeal have shed some light on how the court will likely evaluate the conduct of directors and IPs, in both pre-insolvency and insolvency scenarios. These decisions are examined below.

Pre-insolvency: directors

It is well established in Singapore law that directors have a fiduciary duty as a company approaches insolvency to consider the interests of the company's creditors when making decisions for the company (see Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd ("Progen") at [48]; Lim Oon Kuin v Ocean Tankers (Pte) Ltd [2022] 1 SLR 434 ("OK Lim") at [11]).

In practice, however, there is considerable difficulty in ascertaining exactly when the director's duty to act in the best interests of the company changes in complexion from having regard to the interests of the company's shareholders to having regard to the interests of the company's creditors.

Under Singapore law, this "tipping point" is said to occur when the company is in a state of "near insolvency" or a "parlous financial position" (see Progen at [48] and OK Lim at [11]).

The question of the applicable "tipping point" was recently considered by the UK Supreme Court in BTI 2014 LLC v Sequana SA and others [2022] UKSC 25 ("Sequana"). It was decided that the creditor-regarding duty is triggered when the company is "insolvent or bordering on insolvency", or when an insolvent liquidation or administration is "probable" (see Sequana at [12], [88], [203] and [279]). This is broadly synonymous to the company being "on the verge of insolvency", as these terms all convey a "sense of imminence" (see Sequana at [88]). In contrast, the "tipping point" is not met merely when there is a "real risk of insolvency" or if the company is "likely to become insolvent" (see Sequana at [89], [199] and [297]).

It remains to be seen how the Singapore courts will treat the Sequana decision. Although it is not binding, Sequana is a judgment of the highest court of the United Kingdom, and holds significant persuasive value.

As a starting point, it appears that Sequana sets out a different "tipping point" from the current position under Singapore law. The Singapore High Court has previously held that "on a plain reading of the two terms", "[a] company on the verge of insolvency is clearly in a worse position than a company in a parlous financial situation" (see OP3 International Pte Ltd (in liquidation) v Foo Kian Beng [2022] SGHC 225 at [30]). This suggests that the "verge of insolvency" threshold in Sequana is reached later than the "parlous financial position" threshold under current Singapore law, in that the former connotes a greater sense of imminence and a greater proximity to actual insolvency. Following from this, an adoption of the Sequana position could mean a change in Singapore law, in that the creditor-regarding duty will be triggered at a later point in time.

That being said, any resultant change to the law may be more theoretical than practical. A company that is in a "parlous" (or precarious) financial position is almost certainly one (or a few) steps away from being on the verge of insolvency. In this regard, the definitive test of insolvency is cash-flow insolvency (see Sun Electric Power Pte Ltd v RCMA Asia Pte Ltd [2021] 2 SLR 495 at [56] and [65]), while taking into account near-term collections and liabilities. In coming to the conclusion that a company is in a "parlous financial situation", the directors (and management) would have analysed and dismissed the possibility that the company's cash flow would improve in the near future. Hence, insolvent liquidation or administration will also be probable.

From a practical perspective, directors would still do well to abide by the same set of practical tips to ensure that they do not inadvertently breach the creditor-regarding duty, as follows:

- closely monitor the company's financial position;
- engage in proper documentation, especially when the board makes decisions relating to significant transactions; and
- seek professional advice if necessary.

Insolvency: liquidators and judicial managers

Once a company enters an insolvency proceeding, IPs such as liquidators or judicial managers (JMs) enter the picture and displace the existing directors.

A liquidator's core duty is to realise the assets of the company to their best advantage, and to pursue any claims with due diligence. A judicial manager's duty is to ensure that one or more of the following purposes of judicial management is achieved:

- the survival of the company or part thereof as a going concern;
- approval of a scheme of arrangement; or

- a more advantageous realisation of the company's assets than in a winding-up.

Generally speaking, the commercial decisions of IPs are granted a significant amount of deference, in that the court will normally not second-guess such decisions. However, IPs are still held to a high standard when it comes to performing their duties diligently. The following sections explore recent Singapore decisions germane to this issue.

Liquidators

The supervision of liquidators is achieved through, inter alia, the threat or prospect of their being removed. In the context of a compulsory (or court-ordered) winding-up, Section 139(1) of the Insolvency, Restructuring and Dissolution Act 2018 (IRDA) provides for the removal of liquidators: "A liquidator appointed by the Court may resign or on cause shown be removed by the Court."

The High Court has recently opined that showing cause under Section 139(1) involves a two-stage test (see DB International Trust (Singapore) Ltd v Medora Xerxes Jamshid and another [2023] SGHC 83 ("Medora Xerxes") at [13]):

- first, the court assesses the purpose for which the liquidator was appointed (ie, the purpose of the liquidation); and
- second, the court assesses whether the removal of the liquidator is in the "real, substantial and honest interest of the liquidation", bearing in mind the purpose determined at the first stage.

At the second stage, some relevant considerations include the following.

- First, whether the liquidator had failed to display "sufficient vigour" in carrying out their duties. However, this does not require proving that the liquidator is at fault or that they have acted wrongfully or ineptly (see Medora Xerxes at [20]–[21]). For instance, in Medora Xerxes, the liquidator had allowed an unauthorised party (a former director of the company) to act on behalf of the company in Indonesia, causing loss to the company. The liquidator had also failed to personally undertake certain investigations into the affairs of the company, but instead relied on another party to do so. The court held that these reasons alone were sufficient to justify removal of the liquidator in question (see Medora Xerxes at [28]–[33] and [37]–[42]).
- Second, whether the liquidator had failed to comply with their statutory obligations. Whether this suffices as a reason for removal depends on the nature of such failure(s) and the cumulative effect of multiple failures (see Medora Xerxes at [43]).
- Third, whether the creditors have lost confidence in the liquidator. In this regard, the court noted that the presence of considerable creditor opposition is a valid factor for determining whether the liquidator should be removed, as that would affect the efficiency of the liquidation process (see Medora Xerxes at [75]). That being said, the loss of confidence must be justified – this is to guard against creditors acting in concert to remove a liquidator solely at their own whim and fancy, and for no justifiable reason (see Medora Xerxes at [78]).

The above considerations were not stated to be exhaustive, and the court can take other factors into account, such as whether there is a conflict of interest in the continued appointment of the liquidator. The key inquiry at the second stage is simply whether the removal would be in the interest of the liquidation.

It is also important to bear in mind the trite principle that when the liquidator ascertains and discharges the liabilities of the insolvency company (ie, assesses proofs of debt), they act in a quasi-judicial capacity. This means that they cannot act unjudicially, capriciously or arbitrarily (see Feima International (Hongkong) Ltd (in liquidation) v Kyen Resources Pte Ltd (in liquidation) and others [2022] SGHC 304 ("Feima International") at [48]–[50]). Accordingly, it would very likely be the case that if the liquidator acts in a manner contrary to this quasi-judicial capacity, it would constitute grounds for removal under the Medora Xerxes test.

Overall, the decision of Medora Xerxes provides welcome clarification on how the removal of a liquidator pursuant to Section 139(1) should be approached. This raises the question of whether the same two-stage test should apply in the context of a voluntary winding-up. The removal of liquidators in the context of a voluntary winding-up is governed by Section 174 of the IRDA, which reads: "The Court may, on cause shown, remove a liquidator and appoint another liquidator."

It is very likely that the two-stage test would apply. The wording of Section 174 is very similar to that of Section 139(1), as both call for cause to be shown before a liquidator is removed from office. Indeed, the "broad similarity in wording" between the two provisions was noted by the High Court in Medora Xerxes (at [10]–[11]) and was the very basis for the court taking principles developed in the voluntary winding-up context into consideration, although Medora Xerxes itself concerned compulsory winding-up.

Any differences would likely only arise in the application of the test, rather than its formulation. For instance, the purpose of solvent liquidation may differ from the purpose of insolvent liquidation, and so the answer to the first stage inquiry would differ. Flowing from this, the consideration of whether the removal of the liquidator is "in the real, substantial and honest interest of the liquidation" at the second stage may differ.

Judicial managers

The supervision of JMs is achieved through, inter alia, the ability of creditors and members to challenge actions and decisions taken by the JM. The relevant provision is Section 115 of the IRDA, the title of which – "protection of interests of creditors and members" – aptly summarises the purpose of this procedure.

Under Section 115, any creditor or member may apply to the court for an order that the JM has managed the company's affairs, business and property in a manner that is "unfairly prejudicial", or that the JM has acted or proposed to act in a manner that is "unfairly prejudicial", among others.

While there is presently no reported decision on Section 115 of the IRDA, the Court of Appeal decision of Yihua Lifestyle Technology Co, Ltd and another v HTL International Holdings Pte Ltd and others [2021] 2 SLR 1141 ("Yihua Lifestyle") provides useful guidance as it concerned the predecessor provision, Section 227R(1) of the Companies Act 1967.

In Yihua Lifestyle, the Court of Appeal opined that a two-stage test applies to determine whether a JM had acted or proposed to act in a manner that would unfairly harm the interests of the applicant (at [17]):

- first, it must be shown that the action complained of has caused or will cause the applicant to suffer in their capacity as a member or creditor; and
- second, it must be shown that the harm caused by the action is unfair.

As regards the second stage, unfairness may stem from the following.

- Conspicuously unfair or differential treatment to the disadvantage of the applicant (or applicant class), which cannot be justified by reference to the objective of the judicial management or the interests of the members or creditors as a whole.
- A lack of legal or commercial justification for a decision that causes harm to the members or creditors as a whole. This might include, for example, a decision to sell the company's assets at an undervalue, or to embark on a course of action that is based on a wrong appreciation of the law. However, in such cases, the court will not interfere with the JM's decision unless it is perverse (ie, unable to withstand logical analysis).

The two-stage test in Yihua Lifestyle has been applied in at least one unreported decision concerning Section 115 of the IRDA. In its brief remarks for Abuthahir s/o Abdul Gafoor & Anor v Energetix Pte Ltd & 2 Ors & Another Matter (HC/OA 638/2023 and HC/OS 445/2021 – HC/SUM 1814/2023) (8 September 2023), the High Court observed – citing Yihua Lifestyle – that in a Section 115 application, the applicant needed to show that the JM's decision was not commercially justifiable and harmful, and was thus perverse (at [4]).

The same test also extends to the interim judicial management context, as the Section 115 procedure is likewise available vis-à-vis acts of an interim judicial manager (IJM). This was confirmed by the recent High Court decision of PT Bank Negara Indonesia (Persero) TBK, Singapore Branch v Farooq Ahmad Mann (in his capacity as judicial manager) and another and other matters [2023] SGHC 249 ("PT Bank Negara Indonesia") (at [27]).

Interestingly, the High Court in PT Bank Negara Indonesia caveated that the standard by which the court is to assess the decisions taken by the IJM would depend on the context. The court held that a "less exacting standard" should apply when the IJM is adjudicating a creditor's proof of debt for the limited purpose of voting at a pre-appointment meeting, in contrast to the adjudication of a proof of debt in other situations. However, that does not mean that the IJM can do as they please – they must still be satisfied that there is a prima facie claim against the company in order to admit a proof of debt for this limited purpose (see PT Bank Negara Indonesia [35]–[39]).

PT Bank Negara Indonesia thus illustrates that the test in Yihua Lifestyle can be applied in a fact-sensitive manner, as the precise context in which the JM's or IJM's impugned act or decision took place matters.

Conclusion

The grey area when a company is approaching insolvency is a dangerous zone for directors, who must tread carefully to ensure that they comply with all relevant duties. This tension does not let up even after the company enters into a formal insolvency process, as the IPs who come into the picture – although generally trusted to properly discharge their duties and obligations – are nonetheless subject to creditor scrutiny and the overall supervision of the court. This is an integral component of Singapore's insolvency and restructuring regime, which ensures an effective and efficient system, ultimately for the benefit and protection of creditors.

Directors and IPs alike would do well to take note of the slew of recent decisions issued by the Singapore High Court and the Court of Appeal as described above, and ensure that their decisions made and actions taken are defensible, and do not open them up for criticism and scrutiny.

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