The Coronavirus Disease 2019 (COVID-19) Pandemic: Directors' Duties in Times of Financial Difficulties

The COVID-19 pandemic has placed significant pressure on businesses and the economy. Even fundamentally healthy and viable businesses are seeing their financial resources stretched thin due to factors such as weakening demand, increasing late payments, and disruptions in supply chains.

Directors will play an important role in ensuring that their companies emerge from the COVID-19 pandemic in a strong and sustainable position.

This update discusses the duties of directors in times of financial difficulties and suggests prudent measures directors can take to safeguard the future viability of their companies. The update also analyses the recently enacted COVID-19 (Temporary Measures) Act 2020 which provides directors a "safe harbour" from insolvent trading liability for a period of 6 months commencing from 20 April 2020.

Directors' duties and how they shift in times of financial difficulties

Directors will be familiar with their ordinary duties, such as the duty to act in the best interests of the company, the duty to act honestly and use reasonable diligence, the duty to avoid conflicts of interest, and so on. These duties apply with equal force when companies are facing financial difficulties.

However, when a company is in a dire financial position, directors' duties take on an added dimension. Various obligations are imposed on companies and their directors to ensure the interests of the company's creditors are protected.

Directors should note the following:

(a) **Interests of creditors**: When a company is insolvent or nearing insolvency, directors have a fiduciary duty to take into account the interests of the company's creditors when making decisions for the company.

(b) **Insolvent trading**: Directors cannot knowingly incur debts which the company has no reasonable ground of expectation of being able to repay. This is commonly referred to as "insolvent trading". The directors and officers of the company may be criminally liable for insolvent trading, and may be made personally liable to repay the debts incurred.

(c) **Unfair preferences and undervalue transactions**: Directors may be made personally liable for procuring unfair preferences and undervalue transactions.

An "unfair preference" refers to an action which is motivated by a desire to prefer one creditor over another and which serves to put a creditor in a better position than it would have been in if the company were to be wound up. An example of an unfair preference is a director choosing to repay the debt of a family member ahead of other creditors.

An "undervalue transaction" is a transaction where the company receives significantly less in value than what it is providing under the transaction. An example of an undervalue transaction is

selling an asset at a price far below what the company would have been able to obtain on the open market.

Directors cannot simply take a "business as usual" approach when their companies run into financial difficulties. Directors must carefully assess the risks involved in various transactions which might otherwise have been fine in ordinary circumstances. This includes transactions such as taking on new borrowings, incurring further trade credit with suppliers, declaring dividends, and acquiring and disposing substantial assets.

COVID-19 (Temporary Measures) Act 2020 – "safe harbour" for insolvent trading

In light of the COVID-19 situation, new legislation has been recently passed which provides directors and other officers of companies a "safe harbour" from insolvent trading liability.

A director will not be liable for insolvent trading for debts which are incurred in the ordinary course of business. The safe harbour is intended as a temporary measure for a limited period. The Singapore Government has prescribed a period of 6 months from 20 April 2020 as the effective period of the safe harbour, which may be extended or shortened as determined by it.

There are no prescribed guidelines as to what debts may be considered to be incurred in the "ordinary course of business". On one end of the spectrum, trade debts incurred in the course of day to day business operations (such as buying goods on credit) are likely to be regarded as debts incurred in the ordinary course of business. On the other end of the spectrum, substantial new borrowings to fund new investments or acquisitions will be at risk of being regarded as debts incurred outside the ordinary course of business. As such, even with the implementation of the safe harbour, directors should be prudent and carefully review transactions which involve incurring new debts and liabilities.

Practical measures to safeguard the future viability of companies

In periods of economic and financial uncertainty, directors can take practical measures to safeguard the future viability of their companies. Directors should:

(a) Monitor the financial position and operational situation of the company closely. This necessitates regular and accurate management reporting on the company's cash flow position, collections, expenses and aging accounts receivables and payables.

(b) Develop realistic and conservative cash flow forecasts which account for projected operational and administrative expenses, capital expenditure, and cash inflows. Forecasts should be revised regularly to account for material changes.

(c) Work with customers who are behind on payments to seek a clear and consistent plan for settling outstanding payments. Explore debt re-profiling options where appropriate so that all parties can manage their cash flow in a sustainable manner.

(d) Engage financial and legal turnaround specialists to help the company navigate through challenging financial and operational environments.

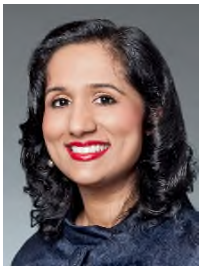
(e) Consider business rehabilitation and rescue mechanisms available under the Companies Act (for more information on Singapore's enhanced restructuring regime, refer to our update Singapore's enhanced debt restructuring mechanisms - One year on).

Directors of listed companies should also ensure that their companies comply with their continuous disclosure obligations and other applicable listing rules. In particular, directors should take note of the Singapore Exchange Regulation's guidance issued on 22 April 2020 regarding disclosures of the effects of Covid-19 on companies' operations, finances and business (see Regulator's Column: What SGX expects of issuers' disclosures during COVID-19) .

An ounce of prevention is worth a pound of cure. Directors who are vigilant and act proactively to address potential issues early can enable their companies to emerge from the COVID-19 pandemic in a position of strength.

If you would like information and/or assistance on the above or any other area of law, you may wish to contact the Partner at WongPartnership whom you normally work with or any of the following Partners:

Manoj Pillay SANDRASEGARA
Head – Restructuring & Insolvency
d: +65 6416 8106
e: manoj.sandra@wongpartnership.com
Click here to view Manoj's CV.



Smitha MENON
Partner – Restructuring & Insolvency
d: +65 6416 8129
e: smitha.menon@wongpartnership.com
Click here to view Smitha's CV.

Annabelle YIP
Senior Consultant;
Joint Head – Corporate Governance & Compliance
d: +65 6416 8249
e: annabelle.yip@wongpartnership.com
Click here to view Annabelle's CV.

Kevin HO
Deputy Head – Corporate Governance & Compliance
d: +65 6416 2555
e: kevin.ho@wongpartnership.com
Click here to view Kevin's CV.

Vivien YUI
Partner – Corporate Governance & Compliance
d: +65 6416 8009
e: vivien.yui@wongpartnership.com
Click here to view Vivien's CV.

Connect with WongPartnership.

WPG MEMBERS AND OFFICES

- contactus@wongpartnership.com

SINGAPORE

-
WongPartnership LLP
12 Marina Boulevard Level 28
Marina Bay Financial Centre Tower 3
Singapore 018982
t +65 6416 8000
f +65 6532 5711/5722

CHINA

-
WongPartnership LLP
Beijing Representative Office
Unit 3111 China World Office 2
1 Jianguomenwai Avenue, Chaoyang District
Beijing 100004, PRC
t +86 10 6505 6900
f +86 10 6505 2562

-
WongPartnership LLP
Shanghai Representative Office
Unit 1015 Corporate Avenue 1
222 Hubin Road
Shanghai 200021, PRC
t +86 21 6340 3131
f +86 21 6340 3315

MYANMAR

-
WongPartnership Myanmar Ltd.
Junction City Tower, #09-03
Bogyoke Aung San Road
Pabedan Township, Yangon
Myanmar
t +95 1 925 3737
f +95 1 925 3742

INDONESIA

-
Makes & Partners Law Firm
Menara Batavia, 7th Floor
Jl. KH. Mas Mansyur Kav. 126
Jakarta 10220, Indonesia
t +62 21 574 7181
f +62 21 574 7180
w makeslaw.com

MALAYSIA

-
Foong & Partners
Advocates & Solicitors
13-1, Menara 1MK, Kompleks 1 Mont' Kiara
No 1 Jalan Kiara, Mont' Kiara
50480 Kuala Lumpur, Malaysia
t +60 3 6419 0822
f +60 3 6419 0823
w foongpartners.com

MIDDLE EAST

-
Al Aidarous International Legal Practice
Abdullah Al Mulla Building, Mezzanine Suite 02
39 Hameem Street (side street of Al Murroor Street)
Al Nahyan Camp Area
P.O. Box No. 71284
Abu Dhabi, UAE
t +971 2 6439 222
f +971 2 6349 229
w aidarous.com

-
Al Aidarous International Legal Practice
Zalfa Building, Suite 101 - 102
Sh. Rashid Road
Garhoud
P.O. Box No. 33299
Dubai, UAE
t +971 4 2828 000
f +971 4 2828 011

PHILIPPINES

-
ZGLaw
27/F 88 Corporate Center
141 Sedeño Street, Salcedo Village
Makati City 1227, Philippines
t +63 2 889 6060
f +63 2 889 6066
w zglaw.com/~zglaw

wongpartnership.com