# SCRAPING THE SARCOPHAGUS OF A COMPANY IN LIQUIDATION: A GUIDE FOR CORPORATE TOMB RAIDERS UNDER THE IRDA IN SINGAPORE

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## I. INTRODUCTION

Warren Buffett famously remarked that "only when the tide goes out do you discover who has been swimming naked". As tidal fortunes ebb under the unrelenting headwinds of the COVID-19 pandemic, countless businesses have failed, and numerous managerial indiscretions have been brought to light. In 2020, we have seen the collapse of many former industry giants in Singapore, among many others: Hin Leong Trading, KS Energy, and Robinsons. Almost certainly, more will follow. [1] Unsecured creditors are usually left with only the bare-bones remains of a company's assets. Hapless but not helpless— this is where the liquidator steps in.

Liquidators are appointed by the court or creditors to realize and distribute the maximum value of assets of an insolvent company. This article aims to canvas the best existing remedies available for liquidators to 'claw back' monies paid out by an insolvent company under the *Insolvency, Restructuring and Dissolution Act 2018*[2] ('*IRDA*') which came into effect on 30 July 2020. The

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[1] Business Times (21 December 2020), "More restructuring, insolvency cases likely in 2021 as reliefs end" online: <https://www.businesstimes.com.sg/companies-markets/more-restructuring-insolvency-cases-likely-in-2021-as-reliefs-end>.

[2] No. 40 of 2018, Sing.

IRDA is an 'omnibus', but admittedly not 'omnipotent', legislation[3] that consolidates corporate and personal insolvency laws formerly found under the *Bankruptcy Act*[4] and the *Companies Act.*[5]

This article shall discuss four available actions available for liquidators under the *IRDA*: 1) to avoid prior transactions made by the insolvent company; 2) to hold the owner-controllers behind-the-scenes responsible for the company's debts, for improper trading; 3) to pursue a common law claim for damages against the directors for the breach of fiduciary duties; and 4) to establish a proprietary claim for a breach of constructive trust.

## II. AVOIDING PRIOR TRANSACTIONS UNDER THE IRDA

By relying on an avoidance claim under the *IRDA*, the liquidator can 'wind back the clock' and avoid prior transactions entered into by the insolvent company that were: (a) undervalue transactions; and/or (b) unfair preferences.

### *A. Undervalue transactions*

The elements of a claim for undervalue transactions are as follows:

a) the transactions were made within the relevant time;[6]

b) the transactions were at an undervalue;[7] and

c) the defence of good faith does not apply.[8]

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[3] *Singapore Parliamentary Debates*: *Official Report* (1 October 2018) vol 94 (Mr Edwin Tong Chun Fai, Second Minister for Law)

[4] Cap 20, 1985 Rev Ed Sing.

[5] Cap 50, 2006 Rev Ed Sing.

[6] *IRDA*, s 226.

[7] *Ibid*, s 224(3).

[8] *Ibid*, s 224(4).

The relevant period for which transactions can be avoided is 3 years prior to the commencement of winding-up proceedings.[9] The period is not relevant unless the company was insolvent or became insolvent in consequence of the undervalue transaction.[10] The company is presumed to be unable to pay its debts or presumed to become unable to pay its debts in consequence of the undervalue transaction, in the case of connected persons.[11]

A company enters into an undervalue transaction if the company enters into a transaction wherein it receives no consideration,[12] or the consideration received by the company thereunder is significantly less than the consideration incurred by the company.[13]

The courts will not make an order that a transaction is undervalued if the company entered the transaction in good faith and to carry on its business,[14] and there were reasonable grounds for believing that the transaction would benefit the company.[15] According to the *Encus International v Tenacious Investment*,[16] the defence of good faith will not apply if it were "*obvious*" that the transaction would not benefit the insolvent company.[17]

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[9] *Ibid*, s 226(1).
[10] *Ibid*, s 226(2).
[11] *Ibid*, s 226(3).
[12] *Ibid*, s 224(3)(a).
[13] *Ibid*, s 224(3)(b).
[14] *Ibid*, s 224(4)(a).
[15] *Ibid*, s 224(4)(b).
[16] [2016] SGHC 50.
[17] *Ibid* at para 65.

### *B. Unfair Preferences*

The elements of a claim for unfair preference are as follows:

a) the payments were made within the relevant time;[18]

b) the defendant is a creditor, surety or guarantor of the insolvent company's debts or liabilities;[19]

c) the insolvent company conducted itself in a manner which put the creditor in a more advantageous position during the relevant period;[20] and

d) in giving the preference, the insolvent company was influenced by a desire to improve the creditor's position.[21]

The relevant period for which transactions can be avoided is 2 years prior to the commencement of winding-up proceedings.[22] As with an avoidance claim for undervalue transactions, this 2-year period is only relevant if the insolvent company was insolvent or became insolvent as a consequence of the unfair preference.[23]As is the case for undervalue transaction detailed above, a company is presumed to have been insolvent or have become insolvent as a consequence of the unfair preference, in the case of connected persons.[24]

A company gives an unfair preference to a person if the person is a creditor, surety or guarantor of the company,[25] and the company does anything which puts that person in a more advantageous position than that person would have been ordinarily in the event of the company's winding up.[26] This element of being put in a more advantageous position should be easily satisfied for unsecured

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[18] *IRDA*, *supra* note 2, s 226.
[19] *Ibid*, s 225(3)(a).
[20] *Ibid*, s 225(3)(b).
[21] *Ibid*, s 225(4).
[22] *Ibid*, s 226(1)(b).
[23] *Ibid*, s 226(2).
[24] *Ibid*, s 226(3).
[25] *Ibid*, s 225(3)(a).
[26] *Ibid*, s 225(3)(b).

creditors because but for the preference payments, insolvency law would have taken claimants "exactly as it finds them"[27] according to the *pari passu* principle, which is the default mode of distribution. Without preference payments, unsecured creditors would ordinarily be relegated to scrape the bottom of the barrel and receive the leftover assets (if there are even any remaining) of the company.

The Court will only make an order that payment was preferential if the insolvent company, in making that payment, had a desire to place the creditor in a more advantageous position.[28] This desire is presumed if the preferred creditor is a connected person.[29] To determine whether the insolvent company had a desire to place the creditor in a more advantageous position, the courts will first consider the state of mind of the officers controlling the debtor[30].

Transactions which are actuated only by proper commercial considerations will not constitute a voidable preference.[31] An example of such a proper commercial consideration can be found in *Re MC Bacon*[32]. There, the bank creditor had placed pressure on the debtor company and demanded a debenture. In deciding that the debenture was not an unfair preference, Millett J found that the debtor company's decision to grant the debenture to the bank creditor had been made as part of the director's decision to continue trading in a genuine belief that the company could be salvaged and that they had no choice but to accede to the bank's request for a debenture.[33]

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[27] See e.g. *Re Smith, Knight & Co, ex p Ashbury* (1868) L.R. 5 Eq. 223 at 226: "The Act of Parliament unquestionably says, that everybody shall be paid pari passu, but that means everybody after the winding-up has commenced. [The Act] takes them exactly as it finds them, and divides the assets amongst the creditors, paying them their dividend on their debts as they then exist".

[28] *IRDA*, *supra* note 2, s 225(4).

[29] *Ibid*, s 225(5).

[30] *DBS Bank v Tam Chee Chong and another* [2011] 4 SLR 948 at para 22.

[31] *Ibid.*

[32] [1990] BCLC 324.

[33] *Ibid* at 336F–337E, explained by *DBS Bank v Tam Chee Chong*, supra note 30 at para 23.

If the claim is successful, the court has a wide discretion to make orders under s 227(1) of the *IRDA*. The available orders include, *inter alia*, an order requiring any beneficial recipient to account for benefits received from the company[34], an order requiring any property transferred as part of the transaction to be vested in the company[35] or the release or discharge of any security given by the company.[36]

## III. IMPROPER TRADING

It is trite law that a company, even if effectively managed and owned by one owner, is a separate legal entity from its owner-controllers.[37] However, this does not mean that owners of the company are insulated from all personal liability in the event of any personal wrongdoing. The liquidator can apply to court to hold the owners fully liable for the debts of the company under one of the two categories of "improper trading" under the *IRDA*: (1) wrongful trading; and (2) fraudulent trading. These two variants of "improper trading" shall be addressed in turn below.

For wrongful trading, a company liable if it, *inter alia*, incurs debts or other liabilities without reasonable prospect of meeting them in full.[38] The provision captures every person who was a party to the company trading in that manner who knew that the company traded wrongfully or ought to have known about the wrongful trading as an officer.

Fraudulent trading, on the other hand, is satisfied if in the course of winding up of a company, it appears that the business of the company has been carried on with intent to defraud creditors of the company.

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[34] *IRDA*, *supra* note 2, s 227(1)(d).

[35] *Ibid*, s 227(1)(a).

[36] *Ibid*, s 227(1)(s).

[37] *Salomon v A Salomon & Co Ltd* [1896] UKHL 1.

[38] *IRDA*, *supra* note 2, s 239(12).

In either case of "improper trading", the liquidator may apply to the Court to hold knowing parties or officers who ought to have known about the company trading in that manner personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company.[39]

## IV. BREACH OF DIRECTORS' COMMON LAW FIDUCIARY DUTIES

The liquidator may also have a common law claim against the directors of company for breach of fiduciary duties. This includes: (a) the duty to act *bona fide* in the company's interests; (b) the duty to act for proper purpose; and (c) the duty to not be found in a position of conflict-of-interest without proper disclosure.[40] In addition, if a director procures a payment to be made by the company in breach of his fiduciary duty while the company is on the brink of insolvency, the liquidator may sue him personally to recover the money.[41]

### *A. Duty to act bona fide in the company's interest*

The duty to act *bona fide* in the company's interests is theoretically a subjective test, based on what the director himself had honestly believed[42]. However, as a matter of evidence, courts have verged on an objective test based what an "an honest and intelligent man in the directors' position, taking an objective view, could reasonably have concluded".[43] If an act committed by a director is not in the objective interests of the company, the court may draw an inference that the director was not acting *bona fide* in the interests of the company.[44] In a modern setting, this rule may be

[39] *Ibid*, ss 238(1) and 239(1).

[40] Walter Woon, *Walter Woon on Company Law*, 3rd Ed (Singapore: Sweet & Maxwell, 2005) at paras 8.09 to 8.12.

[41] *Singapore Swimming Club v Koh Sin Chong Freddie* [2016] SGCA 28 (CA). While the case was not strictly about a company (it involved a club), it was found that the management committee was a fiduciary of the club, and the fiduciary duties owed by the management committee to the club in that case could be analogized to the duties of a director of a company.

[42] *Goh Chan Peng v Beyonics Technology Ltd* [2017] SGCA 40 at para 36 [*Beyonics*].

[43] *Intraco Ltd v Multipak* [1994] SGCA 142 at para 29.

[44] *Beyonics*, *supra* note 42.

better reframed as a duty to ensure that whatever transactions are authorised by the board must be commercially justifiable from the company's point of view.[45]

### *B. Duty to act for proper purposes*

If the main consideration for a director's act or resolution was to benefit an individual and not the company, then the action is taken for an improper purpose.[46] An example of a breach of the duty to act for proper purposes is the use of a power to forestall one take-over bid in preference over another.[47] The general principle is that an exercise of a fiduciary power can be set aside if its exercise was actuated by an improper purpose.[48]

### *C. Duty to disclose conflicts of interests*

The no-conflict rule obliges a director to avoid situations where his personal interest may conflict with those of the company.[49] In particular, when a director makes his own interests paramount, he will invariably not be acting in the interests of the company. This is a strict duty and applies even where the company itself could not have profited from the corporate opportunity that was diverted to the directors.[50] The fact that the director has acted *bona fide* does not preclude the court from imposing liability—the liability arises from the mere fact of a profit having, in the stated circumstances, been made.[51]

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[45] Walter Woon, *Walter Woon on Company Law*, 3rd Ed (Singapore: Sweet & Maxwell, 2005) at para 8.20.
[46] *Goh Kim Hai Edward v Pacific Can Investment Holdings Ltd* at 1 SLR(R) 540 at para 98 [*Pacific Can*].
[47] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] 2 WLR 689 (Privy Council on appeal from New South Wales),
[48] *Pacific Can*, *supra* note 46.
[49] *Beyonics*, *supra* note 42 at para 47.
[50] See *Regal (Hastings) v Ltd v Gulliver* [1967] 2 AC 134.
[51] *Ibid* at 145.

### *D. Duty to take into account interests of creditors when company is insolvent/approaching insolvency*

There is a separate doctrine which states that, if a company is on brink of insolvency, its directors cannot dissipate the company's assets unless there is a legitimate reason to do so.[52] In *Chip Thye Enterprises Pte Ltd (in liquidation) v Phay Gi Mo and Others*[53], the High Court held that certain transactions entered by the directors in the name of the company were not in the interest of the creditors, as they reduced the assets of the company, which should have been preserved for the benefit of its creditors. Therefore, the directors in *Chip Thye* were held personally liable to compensate the company. The underlying rationale is that when a company is insolvent, the interests of the creditors become the dominant factor in what constitutes as benefit to the company.[54] Simply put, in a company approaching insolvency, its creditors displace its shareholders as the primary stakeholder.[55]

## V. BREACH OF CONSTRUCTIVE TRUST

The liquidator can also seek to establish a proprietary claim against an insolvent company for breach of a constructive trust.[56] In such a cause of action, the liquidator can pursue monies

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[52] *Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd* [2010] SGCA 31; *Parakou Investment Holdings Pte Ltd v Parakou Shipping Pte Ltd* [2018] SGCA 3 (CA) [*Parakou*]; *Chip Thye Enterprises Pte Ltd (in liquidation) v Phay Gi Mo and Others* [2004] 1 SLR 434 [*Chip Thye*]; Cheng Wai Yuen, "Corporate Director's Common Law Duty to Creditors? - A Revelation of the Present State of Law" [2002] 22 SingLRev 104 at 106: "in light of recent judicial trends in the common law jurisdictions, as well as the unanimous recognition of such a duty by academics and jurists, this duty is so firmly entrenched in the common law that any attempt to dispute its existence would be futile".

[53] *Chip Thye*, *supra* note 52.

[54] *Ibid* at para 13.

[55] Lee Eng Beng S.C, "The Duty to Maintain Equality in Collective Creditor Actions" (2008) 20 SAcLJ 369 at 371.

[56] This was successfully attempted in the recent Court of Appeal case of *Parakou*—see *Parakou*, *supra* note 52.

transferred out of the company's accounts on the basis of knowing receipt and/or dishonest assistance.

The elements of a claim in dishonest assistance are: (a) the existence of a trust; (b) a breach of that trust; (c) assistance rendered by third party towards the breach; and (d) a finding that the assistance rendered by the third party was dishonest.[57]

The elements required to establish knowing receipt are: (a) a disposal of the plaintiff's assets in breach of fiduciary duty; (b) the beneficial receipt by the defendant of assets which are traceable as representing the assets of the plaintiff; and (c) knowledge on the part of the defendant that the assets received are traceable to a breach of fiduciary duty.[58] As with dishonest assistance, one particular difficulty that remains is in determining precisely the degree of knowledge that is required for recipients of trust property to be fixed with liability.

## VI. CONCLUSION

The commencement of winding-up proceedings is only the beginning of the end. Where their own actions are questionable, controllers of insolvent companies will not simply be able to wash their hands off the debts of the company once it fails. Liquidators, as the representative of all 'corporate tomb raiders', still have an extensive range of options to enrich an insolvent company's depleted pool of assets, as outlined above. This will prevent one's pound of flesh from being entombed in the sarcophagus of the company and lost forever.

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[57] *George Raymond Zage III v Ho Chi Kwong* [2010] 2 SLR 589 at para 20.

[58] *El Ajou v Dollar Land Holdings plc and another* [1994] 2 All ER 685 at 700, affirmed by the Singapore Court of Appeal in *George Raymond Zage III v Ho Chi Kwong* [2010] 2 SLR 589.