STEPHENSON HARWOOD
(SINGAPORE) ALLIANCE

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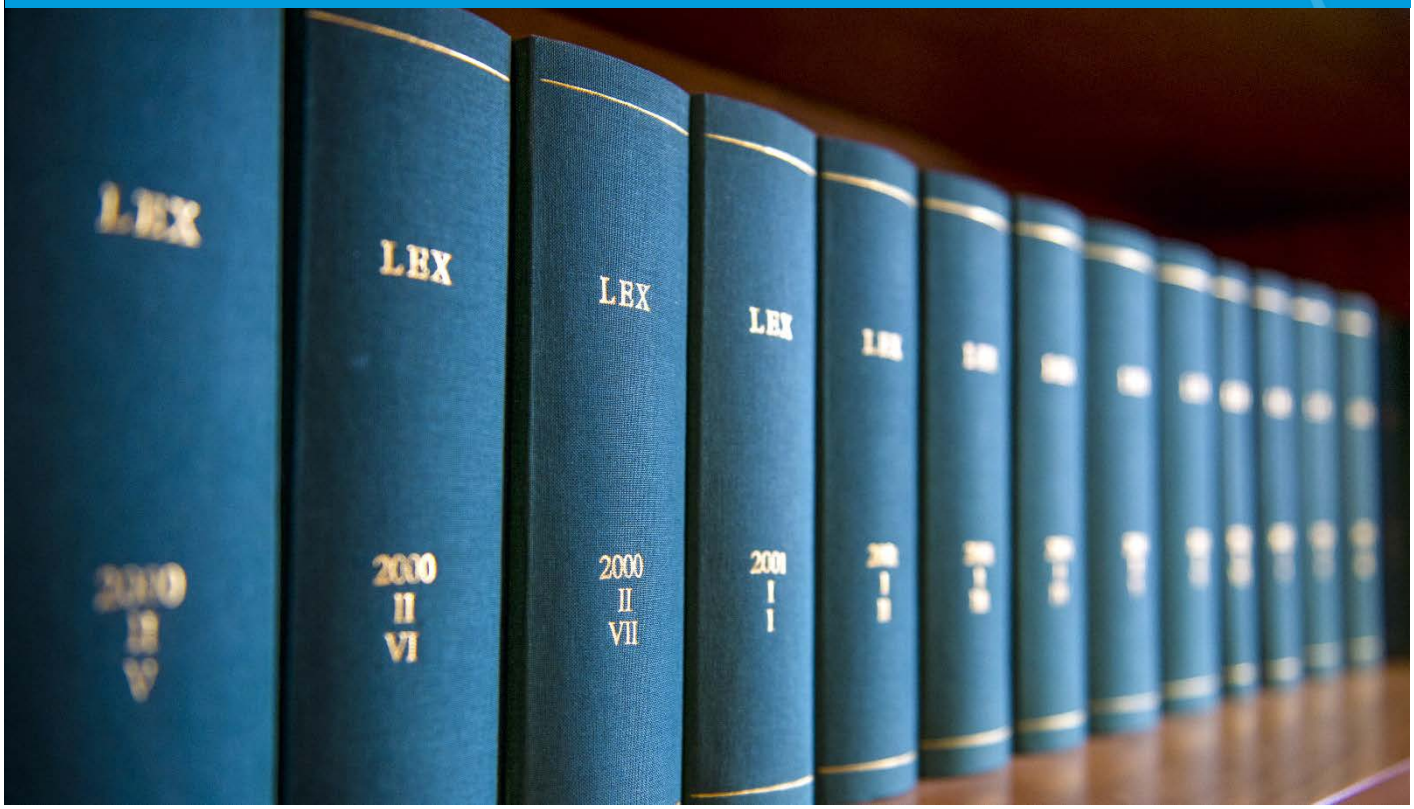
Going concerns

Restructuring and insolvency



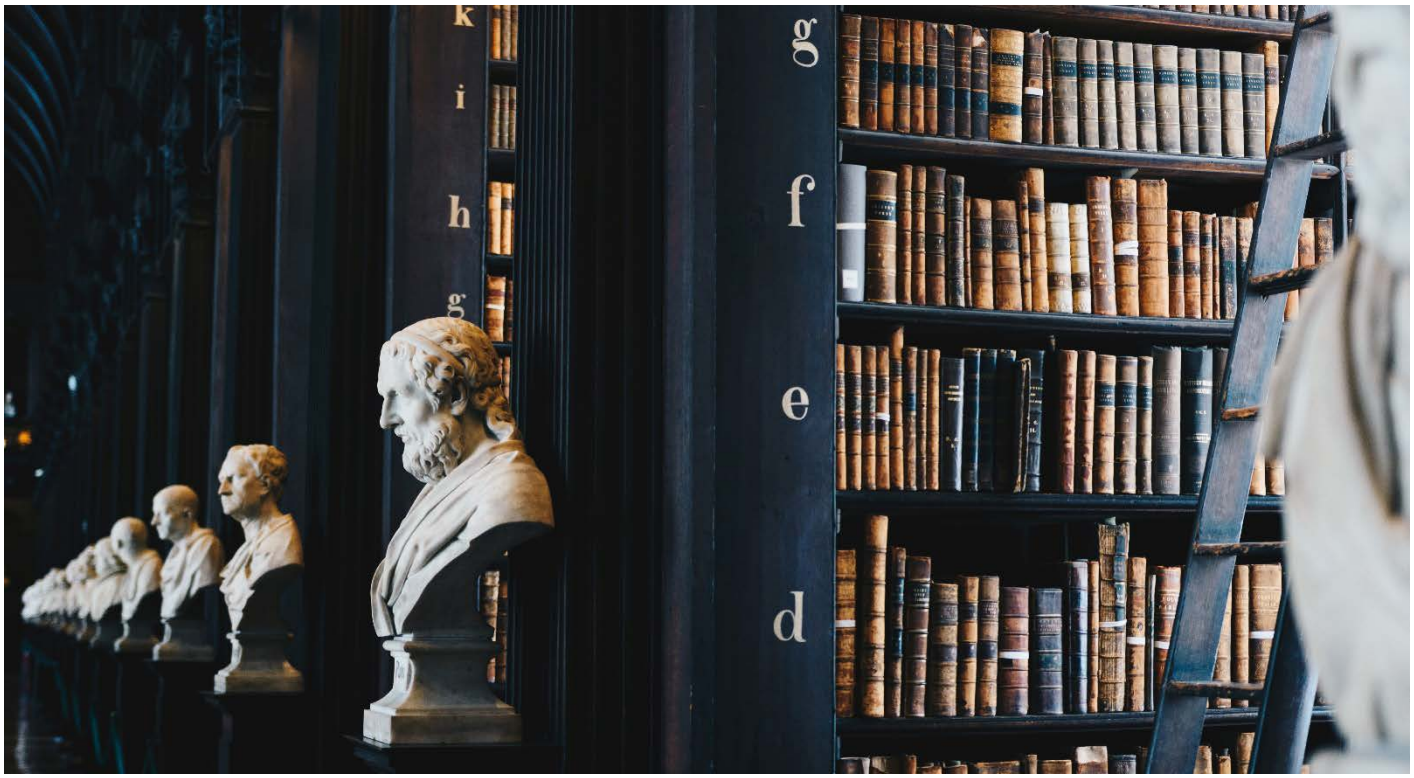
In the latest edition of Going concerns, Stephenson Harwood's Asia restructuring and insolvency team touch on key changes in Singapore brought about by the recent Singapore Insolvency, Restructuring and Dissolution Act 2018 (and where applicable, the impact on the shipping industry), and the positions in Singapore and Hong Kong on winding up petitions vs arbitration clauses.

Content

Get to know the Insolvency, Restructuring and Dissolution Act 2018

The IRDA recently took effect on 30 July 2020 and consolidated the personal bankruptcy (under the Bankruptcy Act (Cap. 20)) and corporate insolvency regimes (under the Companies Act (Cap. 50)("**CA**")) to create an omnibus act to contain all insolvency and debt restructuring legislation. The IRDA does not merely consolidate the 2 regimes, but also serves to provide a holistic update to the regimes to strengthen Singapore's position as a debt restructuring hub.

This article serves to provide some of the key updates made under the IRDA to the restructuring and insolvency landscape, and where applicable, the impact on the shipping industry.



Ipso Facto clauses

Section 440 of the IRDA is a new provision which prevents parties from exercising their contractual rights by terminating or modifying a right or claiming for an accelerated payment by reason only that the debtor company is insolvent or where the company applies for a scheme of arrangement or judicial management. However, this would only apply where the only reason to terminate / seek an acceleration of payment is the company's insolvency. Where there are other reasons to do so, Section 440 of the IRDA will not restrict said contractual rights.

There are some further exceptions – Section 440 of the IRDA does not apply to, amongst others, any commercial charter of a vessel (this likely includes bareboat charters, time charters and voyage charters).

This exception is wider than the exceptions provided for in Canada, in which the provisions of Section 440 are based upon, and in Australia. One reason could be because Singapore is more dependent on the import and export/shipping industries compared to the other two countries and to place a restriction on ipso facto clauses in contracts involving such industries may have a negative impact for the country. Further, eligible financial contract including but not limited to

Winding up petitions vs arbitration clauses (SG) – The *prima facie* standard of review prevails

The Singapore Court of Appeal ("**CA**") in a series of 2 judgments confirmed the *prima facie* standard of review where a disputed debt or a cross-claim was subject to an arbitration agreement. This is further subject to the abuse of process exception which would displace the debtor's right to refer the dispute to arbitration.

The *prima facie* standard of review prevails

First, the CA in *AnAn Group (Singapore) Pte Ltd v VTB Bank (Public Joint Stock Co)* [2020] SGCA 33 determined that the appropriate standard of review for a disputed debt or a cross-claim that was subject to an arbitration agreement was the *prima facie* standard of review.

This issue was first considered in the English Court of Appeal in the still authoritative decision of *Salford Estates (No 2) Ltd v Altomart Ltd (No 2)* [2015] Ch 589 ("**Salford**"). The English Court of Appeal was concerned that parties could, as a standard tactic, seek to bypass an arbitration agreement by presenting a winding up petition in order to obtain, effectively, a summary judgment type analysis of liability for disputed debt through winding up proceedings.

This issue was in flux in Singapore as the Singapore High Court had adopted 2 different approaches:

1. In *BDG v BDG* [2016] 5 SLR 977 and *BWF v BWG* [2020] 3 SLR 894, the Singapore High Court adopted the *Salford* approach and found that where a dispute between parties was subject to an arbitration clause, the test was whether there was a ***prima facie*** dispute;
2. In *VTB Bank (Public Joint Stock Co) v Anan Group (Singapore) Pte Ltd* [2018] SGHC 250, the Singapore High Court considered itself bound by the Court of Appeal decision of *Metalform* whereby the debtor company needed to establish the existence of a substantial and ***bona fide*** dispute over the debt.

It was therefore very useful for the CA to consider the authorities from various jurisdictions, including the English, Hong Kong, Eastern Caribbean and Malaysian positions, and clarify that

> "*when a court is faced with either a disputed debt or a cross-claim that is subject to an arbitration agreement, the prima facie standard should apply, such that the winding-up proceedings will be stayed or dismissed as long as (a) there is a valid arbitration agreement between the parties; and (b) the dispute falls within the scope of the arbitration agreement, provided that the dispute is not being*

raised by the debtor in abuse of the court's process."

In reaching this conclusion, the CA thought the *prima facie* standard should be preferred so that winding-up proceedings could not be used to get around the *prima facie* standard adopted for stay applications under section 6 of both the Arbitration Act (Cap. 10) and the International Arbitration Act (Cap. 143A).

Further, to apply a triable issues standard would offend against the principle of party autonomy which is the cornerstone underlying judicial non-intervention in arbitration. To undercut the parties' pre-dispute agreement to refer the matter to arbitration and deciding that there are no triable issues and winding up the debtor may lead to irreparable harm to the debtor's stakeholders. This is as the debtor may lose its right to initiate arbitration proceedings given that the directors of the company become *functus officio* upon winding up and only the liquidator can decide to arbitrate the debt. This leads to greater uncertainty and unnecessary costs for parties. This may also lead to the unnecessary winding up of companies since it could lead to the situation where the liquidator rejects the debt claimed by the petitioner-creditor with the result that the basis for having wound up the debtor falls away. Yet as the winding up order is irreversible, the Court can only order a permanent stay of the winding up order with the net result being irreparable harm to the debtor company's stakeholders.

The abuse of process exception

To qualify the *prima facie* standard of review, the CA added that it would not grant a stay if the application for a stay amounted to an abuse of process. An abuse of the Court's process can manifest itself in a multitude of scenarios. The CA helpfully provided 3 such examples:

1. Where the debt was admitted as regards both liability and quantum;
2. Where the debtor waived or may be estopped from asserting his rights to insist on arbitration such as where parties agreed subsequently that the disputes may be resolved by litigation; or
3. Where the debtor company is seeking to stave off substantiated concerns which justify invocation of the insolvency regime (for example, assets have gone missing and there is an urgent need to appoint independent persons to investigate the company's affairs).

The CA in *BWG v BWF* [2020] 1 SLR 1296 provided a very useful clarification on the doctrine of abuse of process where it was alleged that the debtor had taken inconsistent positions in different proceedings. In *BWG v BWF*, the dispute related to a chain of contracts whereby the Appellant ("**A**") would purchase cargo from company X ("**X**") ("**X-A Contract**"). A thereafter sold the cargo to Respondent ("**R**") ("**A-R Contract**") whereby the A-R Contract had an arbitration clause. Thereafter, R sold the cargo back to X ("**R-X Contract**") without knowing, at the time of contracting, that X would be the ultimate buyer and the ultimate seller of the Cargo.

Under the R-X Contract, X was due to pay R by 10 July 2018 but failed to do so. R in turn failed to pay A by 11 July 2018 as required under the A-R Contract, alleging that payment was only due after it received payment from X under the R-X Contract. In the meantime, R and X entered into a settlement agreement whereby the sums owing under the R-X Contract would be repaid by X over 4 instalments and X's CEO personally guaranteed such a payment ("**Settlement Agreement**"). However, X defaulted on the 1st instalment and R commenced proceedings against X and X's CEO for breach of the settlement agreement.

After X's default under the settlement agreement, A served a statutory demand on R for payment under the A-R Contract and R disputed said debt and made an application to set aside the statutory demand and to restrain A's pending winding up proceedings. R had 4 defences, but for brevity, we will only discuss 3 of the said defences:

1. A had never passed title or delivered the cargo to R ("**Title Defence**").
2. A did not deliver certain shipping documents pursuant to the A-R Contract ("**Non-Receipt of Documents Defence**").
3. The transactions were a sham or tainted by illegality, rendering them unenforceable. Given that X was both the ultimate seller and buyer of the cargo, R alleged that the entire series of transactions had been a disguised loan arrangement between X and A involving "phantom" goods which the Court agreed with ("**Illegality Defence**").

As is common in back-to-back contract disputes, the party that is caught in the middle typically is forced to take inconsistent positions in the "up and down" proceedings. In this regard, A capitalised on this and argued that R's first 3 defences ("**Price Defences**")

were inconsistent with the positions it had taken in R's proceedings against X and therefore were abuses of process.

The CA ultimately did not find that the Price Defences were abuses of process. The CA found that the doctrine of abuse of process is ultimately a discretionary one where the Court must balance factors and determine which position carries the greater risk of injustice. Instances of inconsistent positions may lead to a finding of abuse of process but where by reason of policy considerations and in exceptional circumstances, the Court may decline to hold a party is in abuse of process if there is a risk of even greater injustice in barring that party from taking such an inconsistent position. Further, where multiple defences were raised, the Court is required to take a granular approach and consider each defence separately to see whether they amounted to an abuse of process. In this regard, the Court found that:

1. Title Defence – the downstream proceedings (i.e. the R-X dispute) was based on the Settlement Agreement instead of the R-X Contract, and therefore no inconsistent position was taken.
2. Non-Receipt of Documents Defence – X did not in the R-X dispute raise this issue. Further, the Court found that when R commenced the proceedings against X, it was not aware of what position X would adopt in response. The fact that X did not subsequently take steps to raise these defences which R could raise as against A, cannot amount to an abuse of process.
3. Illegality Defence – the CA found that it was inappropriate to prevent R from relying on the illegality defence on the basis of the abuse of process doctrine.
    a. First, R was not seeking to profit from an illegal transaction after mounting the inconsistent positions.
    b. Next, R had found itself between a rock and a hard place when X had failed to make the first instalment under the Settlement Agreement and had no choice but to take all reasonable defences to resist A's claim while seeking to recover from X.
    c. Finally, to prevent R from raising the illegality defence, would mean that A is allowed to potentially rely on an illegal contract to wind up R. In seeking to prevent R from obtaining an injunction, A is attempting to enforce the potentially illegal A-R Contract, despite being privy to the alleged fraud involved in the matter. There is a clash between on the one hand public interest to prevent a party from relying on inconsistent positions and public interest against the Court to lend aid to enforce an illegal contract or a fraudulent dealing on the other. The Court found that the risk of injustice would be indubitably greater for the latter situation.
    d. For completeness, the Court also considered that R could potentially gain a windfall if R successfully recovered the outstanding sums from X and resisted A's application. However, the Court was assured on the evidence that the likely outcome would be that R would pay A upon receiving payment from X.

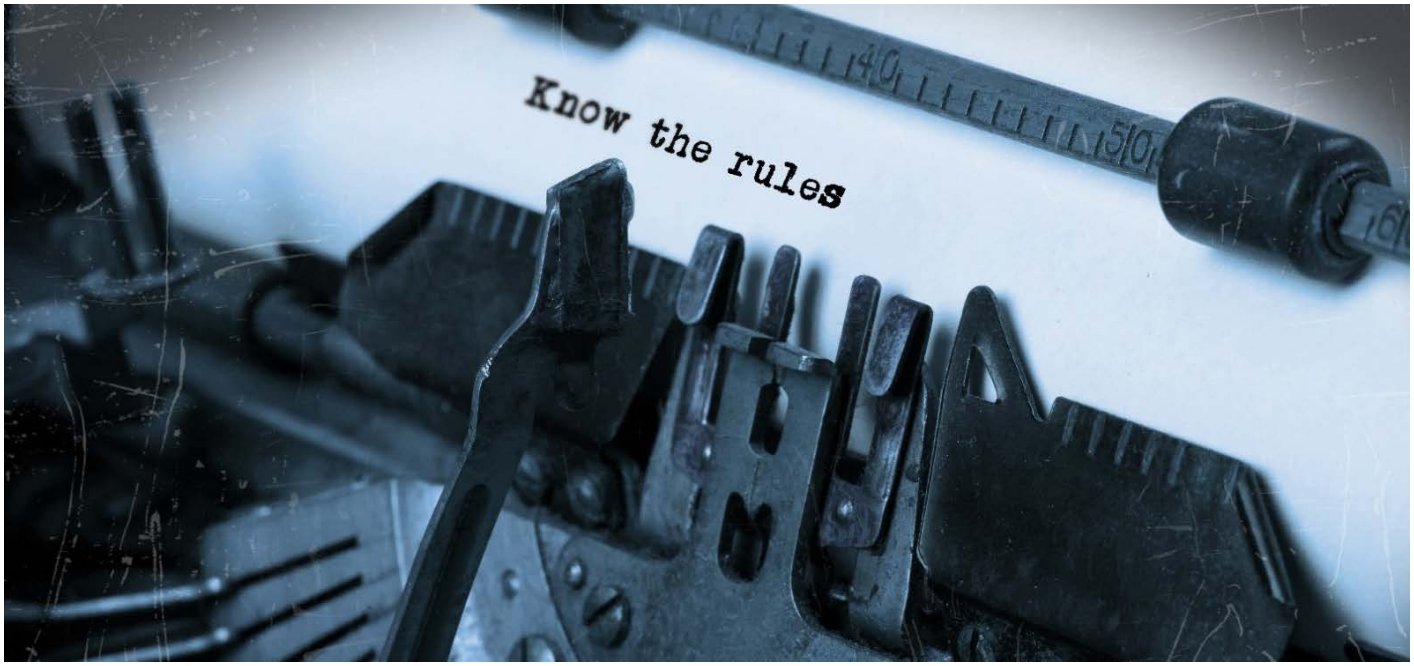
Conclusion

The above cases are a much-welcomed addition to Singapore's jurisprudence and provides much needed certainty in this area of law.

Practically speaking, companies should now consider whether it is in their interest to include an arbitration dispute resolution clause in their contracts, particularly, when dealing with a counterparty which is of suspect financial standing. This is as any dispute would have to go through a potentially lengthy arbitration before winding up the debtor company. In the meantime, significant legal costs would be incurred by both parties, and which would also lead to the counterparty's resources being drained to satisfy any award that may be obtained. This is as opposed to the situation where the creditor may directly issue a statutory demand and proceed to prove its claim to a *prima facie* standard of review at the winding up hearing (subject to the creditor proving that the debt is disputed to a triable issues standard), which is likely to be a lot quicker and less costly.

Winding up petitions vs arbitration clauses – back to the Pre-Lasmos Approach?

In the recent Hong Kong case of Dayang (HK) Marine Shipping Co, Ltd v. Asia Master Logistics Ltd [2020] HKCFI 311 ("**Dayang Case**"), the Court gave its obiter comments that a bona fide dispute on substantial grounds must be established by the debtor in order to dismiss or stay a winding up petition even where the debt is covered by a valid arbitration clause. Similar comments were made by the Court of Appeal in two earlier cases.



The Traditional Approach[1]

Prior to the Lasmos case, in order to successfully challenge the winding up or bankruptcy proceedings, the debtor must establish that there is a bona fide dispute of the debt on substantial grounds.

The test is the same whether or not the debt arises out of a transaction which contains an arbitration agreement.

The Lasmos Approach

In *Lasmos Limited v Southwest Pacific Bauxite (HK) Limited* [2018] HKCFI 426 ("**Lasmos case**"), the Companies Judge Mr Justice Harris held that save for exceptional circumstances, a winding-up petition should generally be dismissed if:

1. A company disputes the debt relied on by the petition;
2. The contract under which the debt is alleged to arise contains an arbitration clause that covers any dispute relating to the debt; and
3. The company takes the steps required under the arbitration clause to commence the contractually mandated dispute resolution process (which might include preliminary stages such as mediation) and files an affirmation in accordance with r 32 of the Companies (Winding-Up) Rules (Cap 32H).

Click here to see our previous article on the Lasmos case.

The Court of Appeal made obiter comments in two decisions[2] that it has reservations about the Lasmos

[1] *Hollmet AG v Meridian Success Metal Supplies Ltd* [1997] 4 HKC 343

[2] *But Ka Chon v Interactive Brokers LLC* [2019] 4 HKLRD 85 and *Sit Kwong Lam v Petrolimex Singapore Pte. Ltd* [2019] HKCA 1220 Click here to see our previous article on these two cases

Approach. Click here to see our previous article on these two cases.

Facts in the Dayang case

Dayang chartered its vessel to Asia Master. The fixture note set out the obligations of Dayang including the payment of hire costs. It also contained an arbitration clause which provides for disputes to be arbitrated in Hong Kong but governed by English law. Asia Master failed to pay a number of instalments of hire costs. As a result, Dayang served a statutory demand and subsequently presented a petition for the unpaid debts of approximately US$360,000.

Asia Master did not deny that the debt was due, but instead raised a counterclaim against Dayang alleging breach of duties under the fixture note and submitted that the dispute should be dealt with by arbitration.

Deputy High Court Judge William Wong SC made a winding-up order because (1) Asia Master was unable to establish a bona fide dispute on substantial grounds as the counterclaim was unsupported by factual evidence; and (2) even if the Lasmos Approach was applicable, it did not assist Asia Master as arbitration proceedings had not been commenced.

The Court's further analysis on the Lasmos Approach

The Judge identified two potential justifications for the Lasmos Approach but rejected both of them:

1. **Contractual justification**: This concerns the protection of contractual bargains and freedom to contract. The Court concluded that the presentation of a winding up petition *per se* would not amount to a breach of an agreement to resolve disputes by way of arbitration, since the court proceeding of hearing a winding-up proceeding does not have the effect of determining or resolving the dispute.
2. **Comparative justification**: This concerns consistency of the approach with other jurisdictions. The Judge pointed out that the Lasmos Approach was far from settled under English[3] and Singapore[4] case laws. Also, there were substantial variance amongst Singapore cases in what needs to be shown beyond a bare denial or non-admission of debt.

The Judge concluded that the Court's flexible discretion to make a winding-up order should not be fettered by the Lasmos Approach, and gave his views on the present state of law[5]:

1. For a debtor to dispute the existence of a debt, he must show that there is a bona fide dispute on substantial grounds. Simply denying the debt is not sufficient, regardless whether the underlying contract has an arbitration clause;
2. The existence of an arbitration agreement should be regarded as irrelevant to the exercise of discretion by the court;
3. The commencement of arbitration proceedings may be relevant to prove a bona fide dispute, but itself is not a sufficient proof; and
4. If a creditor petitions where it knows there to be a bona fide dispute over the debt on substantial grounds, it bears the risk of being liable to pay the debtor-petitioner's costs on an indemnity basis and the liability under the tort of malicious prosecution.

Takeaway points

- The Court's comments in this case echo with the obiter comments of the Court of Appeal in two earlier cases, all of which support the Traditional Approach.
- This area of law is still in a state of flux in Hong Kong and an appellate Court decision is required to resolve the debate as to the approach to be adopted.
- With a number of obiter decisions which are contrary to the Lasmos Approach, in future it may not be easy for a debtor company to resist a winding up petition by simply relying on the procedural steps under the Lasmos Approach.

[3] *Salford Estates (No 2) Ltd v Altomart Ltd (No 2)* [2015] Ch 589, *Revenue and Customs Commissioners v Changtel Solutions UK Ltd(formerly ENTA Technologies Ltd)* [2015] 1 WLR 3911 ("*Changtel Solutions*") and *Eco Measure Market Exchange Ltd v Quantum Climate Services Ltd* [2015] BCC 877

[4] *BDG v BDH* [2016] 5 SLR 977, *VTB Bank v Anan Group* [2018] SGHC 250 and *BWF v BWG* [2019] SGHC 81

[5] At paragraph 136 of Dayang case

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