STEPHENSON HARWOOD
(SINGAPORE) ALLIANCE

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Going Concerns

Restructuring and insolvency

In this issue

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Global Restructuring Review 2019

Introduction

Welcome to the 2nd edition of Going Concerns where we strive to bring you the latest updates on restructuring and insolvency law. In this issue, we maintain our focus on Singapore law and provide:

1. A short commentary on potential pitfalls which directors should look out for when the company they helm begins facing financial difficulties;

2. A case summary on ***Ma Wai Fong Kathryn v Trillion Investment Pte Ltd and others and another appeal*** [2019] SGCA 18, where the Court of Appeal considered when it would order an equitable buyout of shares instead of ordering a winding up; and

3. A case summary on ***Re: Zetta Jet Pte Ltd and others (Asia Aviation Holdings Pte Ltd, intervener)*** [2019] SGHC 53, the first decision where the Singapore court recognised a foreign insolvency proceeding pursuant to the recently adopted UNCITRAL Model Law on Cross Border Insolvency.

This edition further features our Hong Kong team with their insights on cross border restructuring in Hong Kong, in particular, providing a case summary on the first Hong Kong Court decision recognising a Japanese winding up proceeding in ***Re Kaoru Takamatsu*** [2019] HKCFI 802.

We hope you enjoyed this 2nd edition of Going Concerns and we look forward to your continued support in the coming editions of the same. As usual, please feel free to contact us should you like to learn more on any topic.

Companies with financial difficulties: Directors look out!

This article explores the potential pitfalls directors may face when his/her company is on the brink of insolvency. While it is trite that directors have a duty to act in the best interest of the company as a whole, when a company has financial difficulties, the best interest of the company would include its creditors' interests. Further, directors should be aware that they are exposed to civil and criminal sanctions should they engage in fraudulent or insolvent trading. We elaborate below.

The best interest of the company includes the creditors' interests when a company is near insolvency or insolvent

Generally, the best interests of a company are very readily identified with the interests of its shareholders as a whole. However, when a company has financial difficulties, how should the law balance the interests of creditors and the interests of shareholders? This was addressed by the Singapore Court of Appeal in ***Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd*** [2010] 4 SLR 1089 ("***Progen***") and the principles in *Progen* were recently applied by the Singapore Court of Appeal in ***Parakou Investment Holdings Pte Ltd and another v Parakou Shipping Pte Ltd (in liquidation) and other appeals*** [2018] 1 SLR 271.

In *Progen*, the liquidators of Progen Engineering applied to set aside several transactions between Progen Engineering and Progen Holdings on the basis that the transactions were unfair preferences under section 99(2) of the Bankruptcy Act (Cap. 20, 2000 Rev Ed) read with section 329(1) of the Companies Act (Cap. 50) (the "**Act**").

The directors' duties were relevant in the application because the Singapore court considered that whenever it is plainly established that the directors have disregarded their duties, the transactions that appear to undermine the collective procedure of insolvent liquidation (such as unfair preferences or undervalue transactions) should be treated with greater scepticism.

As such, in order to determine whether the directors acted in accordance with their duties, one key question is what constitutes the "best interest of the company as a whole". The answer would depend on the financial position of the company.

The company's solvency status is relevant because the company's directors owe no duties to the company's creditors when the company is solvent. The company need not be technically insolvent (i.e. cash flow or balance sheet insolvent) for the directors to be required to take the creditors' interests into account. It is sufficient if the company is in a state of near insolvency or "*perilously close to being insolvent*".

Essentially, the greater the concern over the company's financial health, the more weight the directors must accord to the interests of the company's creditors over those of the company's shareholders. As such, when a company is insolvent, the interests of the company's creditors are the "*dominant factor*" in determining what

constitutes the best interest of the company as a whole.

> "*when a company is insolvent, or even in a parlous financial position, directors have a fiduciary duty to take into account the interests of the company's creditors when making decisions for the company.*" [48] of *Progen*

The rationale is that, when a company is insolvent, the company is effectively trading and running the company's business with its creditors' money. The Singapore court recognised that the limited liability principle minimised the risks on shareholders as they would, at worst, lose what they had invested in the company. On the other hand, unsecured or partially secured creditors may never recover any monies due to them when the company becomes insolvent. As such, unlike the shareholders who have the most to gain from risky ventures, the creditors (unsecured, in particular) have everything to lose when illegitimate risks are taken.

Further, the Singapore court considered that it is only right for the directors to owe fiduciary duties to creditors for the decisions they make. This fiduciary duty will require directors to ensure that the company's assets are not dissipated or exploited for their own benefit "*to the prejudice of creditors' interests*".

For completeness, this fiduciary duty is only owed to the company and directors do not directly owe duties to the company's creditors. This means that individual creditors cannot, without the assistance of liquidators, directly recover from the directors for breaches of duty.

Directors may be personally liable for civil and criminal sanctions

Insolvent Trading

Where debts are contracted by a director for and on behalf of a company when the director had no reasonable or probable expectation that the company would be able to pay the debt, the director may be convicted of an offence under section 339(3) of the Act. The director may be liable to a fine not exceeding $2,000 or to imprisonment for a term not exceeding 3 months.

Further, pursuant to section 340(2) of the Act, a director who has been convicted under section 339(3) of the Act may be made personally liable for the payment of the whole or any part of that debt. An order to this effect may be made by the Singapore court on the application of the liquidator or any creditor or contributory of the company.

Fraudulent Trading

Where the business of a company had been carried out with the intention of defrauding the company's creditors or creditors of any other person or for any fraudulent purpose, and the director was a knowing party to the business being carried out in that manner, the director may be convicted of an offence under section 340(5) of the Act. The director may be liable to a fine not exceeding $15,000 or to imprisonment for a term not exceeding 7 years or to both.

Similarly, pursuant to section 340(1) of the Act, the director may be made personally liable for all or any of the debts or other liabilities of the company. Such an order may be made by the Singapore court on the application of the liquidator or any creditor or contributory of the company. However, unlike in the case of insolvent trading mentioned above, the director need not be convicted before he may be made personally liable.

The Singapore Court of Appeal in ***Tang Yoke Kheng (trading as Niklex Supply Co) v Lek Benedict and others*** [2005] 3 SLR(R) 263 ("***Tang Yoke Kheng***") made it clear that, for fraud to be shown, there must be an element of dishonesty which results in the deception of an innocent party such as a creditor.

Additionally, the standard of proof remains that of a balance of probabilities instead of the criminal standard of proof beyond reasonable doubt despite the infusion of a criminal element (i.e. fraud). Nevertheless, given the severity and potentially serious implications of an allegation of fraud, the Singapore court highlighted that it would expect proof to be higher than that in a civil trial. As such, the more serious the allegation, the more the party on whom the burden of proof fell on has to do in order to establish his case on a balance of probabilities.

Accordingly, in *Tang Yoke Kheng*, the Singapore court upheld the lower court's rejection of the allegation of fraud because the appellant failed to discharge her burden of proof that the key elements of fraud (i.e. dishonesty and deception) were present.

While it is honourable for the captain to go down with the ship, directors should be acutely aware of the fiduciary duties that they owe as well as the potential civil and criminal sanctions they may face when a company is facing distress.

When will it be just and equitable to wind up a company?

While the insolvency regime is traditionally engaged by a debtor's inability to pay its debts as they fall due, there are other mechanisms to wind up a company, one of which is on a just and equitable ground under section 254(1)(i) of the Companies Act (Cap. 50)(the "**Act**"). ***Ma Wai Fong Kathryn v Trillion Investment Pte Ltd and others and another appeal*** [2019] SGCA 18 is a recent judgment from the Court of Appeal discussing this and in particular, is one of the few cases which considered section 254(2A) of the Act wherein the Singapore court has the power to order an equitable buyout of the shares instead of a winding up.

The case concerns Trillion Investment Pte Ltd ("**Trillion**") and Double Ace Trading Company (Private) Limited ("**Double Ace**") (collectively referred to as the "**Companies**"), 2 Singaporean companies within the business empire of Datuk Wong, a highly successful Malaysian businessman whose empire covered an array of businesses including timber logging and harvesting, land development, trading, manufacturing, oil palm plantations, oil milling, hotel businesses and travel services operating in Australia, Liberia, the British Virgin Islands, Papua New Guinea and Singapore. The Appellant's late husband was Wong Kie Nie ("**WKN**") and he was one of 3 sons (the "**Wong Brothers**") of the late Datuk Wong. WKN was a 50% shareholder of Trillion and a 39% shareholder of Double Ace. WKN ran, amongst others, the Companies until March 2011 when he fell ill with cancer and passed away on 11 March 2013.

Since WKN's passing, the Appellant and the rest of Datuk Wong's family have been embroiled in litigation across multiple jurisdictions and it was alleged that, as at 30 August 2017, a total of 69 legal proceedings had been filed by parties in Malaysia, the British Virgin Islands and Singapore.

It was in this context that the Appellant sought to wind up, amongst others, the Companies. The application ultimately failed for Trillion, but succeeded for Double Ace on the ground that there had been a loss of substratum.

Whether there had been a loss of substratum

The Singapore court could not accept the lower court's decision that the loss of substratum can only be relied upon by a non-founding shareholder if the shareholder took up shares on an assumption that the company would continue to run a particular business. This is because the company's substratum is the main object which it was formed to achieve and when it is no longer able to carry out that object, any member may petition for a winding up order on the just and equitable ground.

This is only fair because in situations where the main objective of the company can no longer be achieved through no fault on the part of the parties, the unfairness lies in holding the parties to the association despite the loss of substratum and a winding up order under section 254(1)(i) of the Act is often justified. The Singapore court also found that a company which is

effectively dormant has lost its substratum. The question to be considered is whether there is unfairness in keeping the aggrieved shareholder locked into a company which is no longer carrying out and/or can no longer carry out the business it set out to do.

The Singapore court could not find that Trillion had lost its substratum as it could carry out its business – i.e. the lease of a unit to Double Ace.

In relation to Double Ace, there was good evidence based on Double Ace's declining or stagnant revenue that no business was transacted after WKN's passing and the Singapore court was therefore satisfied that Double Ace had lost its substratum after WKN fell ill. The Singapore court therefore found that there was basis to wind up Double Ace on the just and equitable ground under section 254(1)(i).

Share Buyout issue

The Singapore court went on to consider whether the Appellant ought to have utilised the exit mechanisms in Double Ace's articles of association to negate the unfairness of being locked into a company that had lost its substratum and if the exit mechanism was unable to negate the unfairness, whether an order should be made for the remaining shareholders to buy over the Appellant's shares in Double Ace. Pursuant to section 254(2A) of the Act (which was only recently added in 2015):

"On an application for winding up on the ground specified in subsection (1)(f) or (i), instead of making an order for the winding up, the Court may if it is of the opinion that it is just and equitable to do so, make an order for the interests in shares of one or more members to be purchased by the company or one or more other members on terms to the satisfaction of the Court."

Prior to this case, there was little guidance as to how "just and equitable" should be interpreted and its threshold. The Singapore court ultimately found that while there was insufficient support to find a lack of probity on the part of the directors, there were some aspects of Double Ace's financial affairs which were unclear due to inconsistent explanations. This led to the Singapore court finding that it was unlikely that a fair and proper evaluation of Double Ace could be carried out without a thorough investigation into Double Ace's financial records and a liquidator with the appropriate powers under the Act could achieve this.

The above therefore suggests that the threshold to show it would be "just and equitable" to order a winding up (to appoint a liquidator to investigate into the company's affairs) is not high – a mere suspicion that the directors would not conduct a fair and proper evaluation, not amounting to a finding of lack of probity, may be sufficient.

Cross border restructuring in Singapore – what constitutes the Centre of Main Interests?

The Singapore court recognised, for the first time, a foreign insolvency proceeding pursuant to section 354B of the Companies Act (Cap. 50) (the "**Act**") and Article 15 of the UNCITRAL Model Law on Cross-Border Insolvency ("**Singapore Model Law**").

Such proceedings will be recognised as a "foreign main proceeding" if it is taking place in the foreign state where the debtor has its centre of main interests ("**COMI**"). What then constitutes the COMI? This is addressed in ***Re: Zetta Jet Pte Ltd and others (Asia Aviation Holdings Pte Ltd, intervener)*** [2019] SGHC 53 ("***Zetta Jet***").

Background

The brief facts of *Zetta Jet* are as follows. In 2017, voluntary Chapter 11 bankruptcy proceedings were filed against Zetta Jet Pte Ltd ("**Zetta Jet Singapore**") and Zetta Jet USA, Inc ("**Zetta Jet USA**") (collectively, the "**Zetta Jet Entities**") in the US. Shortly thereafter, some shareholders of Zetta Jet Singapore applied for and obtained an injunction ("**Injunction**") to prevent Zetta Jet Singapore from taking further steps in relation to the bankruptcy filings in the US Bankruptcy Court. Notwithstanding the Injunction, the US bankruptcy proceedings continued and were eventually converted to Chapter 7 proceedings and Jonathan D. King (the "**Trustee**") was appointed as the bankruptcy trustee of the Zetta Jet Entities. The Trustee thereafter applied to recognise the Chapter 7 proceedings in Singapore but this was denied, save for limited recognition for the purposes of allowing the Trustee to apply to set aside the Singapore injunction. Zetta Jet Singapore did eventually discharge the Injunction by consent of the parties involved. The Trustee thereafter applied to the Singapore court for full recognition of US bankruptcy proceedings.

The Singapore court had to consider where the COMI of Zetta Jet Singapore was located and in this regard, dealt with two issues:-

a. The date at which the assessment of the COMI is to be made; and

b. The approach to be taken in assessing what constitutes the COMI of a particular debtor company.

The date of assessment of a debtor's COMI should be the date of the application for recognition

The Singapore court held that the assessment of a debtor's COMI should be made as at the date of the application to the Singapore court for recognition.

After considering the parties' submissions and the analyses of the approaches in the various jurisdictions, the Singapore court concluded that determining a debtor's COMI as at the date the recognition application is filed (i.e. the US position) "*provide[d] greater certainty and better accord[ed] with commercial realities and the language of the provisions of the Model Law*".

a. First, the Singapore court considered that the usage of the present tense in the definitions in Article 2(f) and 2(g) of the Singapore Model Law indicated that *"what matters is the situation at the point of the application for recognition".*

b. Secondly, the Singapore court noted that postponing the determination of a debtor's COMI until the application for recognition is made accepts that, in contemporary practice, various entirely legitimate measures may be taken to shift a debtor's COMI to another jurisdiction. The Singapore court should take a *"neutral stance as to any purported changes in COMI so as to recognise the applicant's autonomy and to give effect to any preference exercised by the applicant, subject to any public policy concerns."* However, such autonomy and flexibility is subject to limits. For example, if a COMI shift was opportunistically pursued to evade the criminal laws of the recognising court or to cause prejudice to creditors, the Singapore court may deny the application for recognition of the foreign proceeding.

c. Lastly, the Singapore court considered that the Australian approach (i.e. determining a debtor's COMI at the point the court is required to give the decision on recognition, but regard may be had to historical facts which led to the position at the time) leaves the date of the ascertainment of a debtor's COMI uncertain, whereas a bright-line rule would be preferable. The US position which garnered greater certainty and would not, in practice, result in much difference from the Australian approach was therefore preferred.

Singapore's approach in assessing a debtor's COMI

The Singapore court considered that the following principles would be applicable in determining a debtor's COMI under the Singapore Model Law:

a. First, the Singapore court would presume that the place of the debtor company's registered office is its COMI. This presumption would be displaced if it is shown that the place of the company's central administration and other factors point the COMI away from the place of registration to some other location.

b. The COMI factors should be those that are objectively ascertainable by third parties generally, with a focus on creditors and potential creditors in particular.

c. In determining which factors to take into consideration for the COMI determination, it is material to consider how likely it is that a creditor would weigh a particular factor in his mind. The Singapore court would focus on factors that a creditor would take into account in his deliberations as to whether to afford credit to the applicant company. For example, if a company is clearly involved in cross border activities, a creditor may not regard the location of assets as being significant if it is expected that the assets in question (such as vessels or planes) would move around as part of the company's operations. Consequently, the location of the company's fixed assets would be given greater weight.

d. There should be an element of settled permanence or intended permanence in the factors considered which would assist creditors in their weighing of the relevant factors and the risks entailed in granting credit.

e. Where the scale does not clearly tip either way after balancing all the relevant factors, the location of the registered office will be taken to be the debtor's COMI by default.

f. There is no need to maintain strictly the distinction between different entities within a group – it is possible for the analysis to be made of the activities of an entire group of companies as opposed to a specific debtor company.

The Singapore court then assessed the following factors raised by the parties, including the location from which control and direction was administered; the location of clients; the location of creditors; the location of employees; the location of operations; dealings with third parties; and the governing law. There is no indication that the above factors are meant to be exhaustive. On an overall assessment, the Singapore court concluded that the following significant factors displaced the presumption that the place of Zetta Jet Singapore's registered office (i.e. Singapore) was its COMI:

a. Zetta Jet Singapore's central management and direction was conducted from the US at all relevant times.

b. Corporate representations indicated Zetta Jet Singapore operated from the US.

c. A substantial portion of Zetta Jet Singapore's creditors were located in the US.

As such, the Singapore court held that, on the evidence, Zetta Jet Singapore's COMI was, at the material time, located in the US.

The Singapore court can refuse recognition on the ground of public policy

The public policy exception under Article 6 of the Singapore Model Law was considered in light of the argument that a continued breach of an injunction ordered by the Singapore court would constitute a ground for refusal of recognition.

In the earlier proceedings of ***Re Zetta Jet Pte Ltd and Others*** [2018] SGHC 16, recognition was refused because the Trustee flouted the Injunction by pursuing the US bankruptcy proceedings, which undermined the administration of justice in Singapore. It was therefore crucial to the Singapore court that the Injunction was first discharged, and recognition would no longer undermine the administration of justice in Singapore. The Singapore court considered that while the Trustee's breach of the injunction remains a wrong after its discharge and may be pursued as contempt, it did not follow that this failure to comply remained a ground for the continued refusal of recognition under the Singapore Model Law.

"*Those breaching orders issued by Singaporean courts may not need to come to Singapore and may feel that they can thumb their noses with safety from foreign shores. But should they ever need to look to assets or information in Singapore, they will have to answer for their conduct. In the present case, the consensual discharge resolved the issue for the Trustee. The same result may not arise in other cases*" [125] of *Zetta Jet*

Cross border restructuring in Hong Kong – first recognition of Japanese winding up

For the first time, the Hong Kong court in ***Re Kaoru Takamatsu*** [2019] HKCFI 802 has recognised a Japanese winding up proceeding and granted assistance to a bankruptcy trustee appointed by the Japanese court.

Background

On 1 March 2018, the District Court of Tokyo, Twentieth Civil Division ordered Japan Life Co, Ltd ("**Japan Life**") to be wound up and appointed Mr Kaoru Takamatsu as trustee in bankruptcy.

Mr Takamatsu required access to Japan Life's bank accounts records held by the Hong Kong branches of Mizuho Bank and HSBC. Mr Takamatsu sought recognition and assistance from the Hong Kong court to enable him to obtain copies of the account records and deal with Japan Life's affairs in Hong Kong.

Principles for recognising foreign insolvency proceedings

Justice Harris recognised the Japanese winding up proceedings and granted Mr Takamatsu the powers in the standard recognition order (set out in **Re Joint and Several Liquidators of Pacific Andes Enterprises (BVI) Ltd HCMP 3560/2016**), which includes the power to apply for an examination of a person or to seek documents from a third party concerning the affairs of the company.

Harris J summarised the principles of recognising foreign insolvency proceedings and providing assistance to foreign officeholders as follows

- The Hong Kong court will recognise foreign insolvency proceedings which are:
  - collective in nature; and
  - opened in the company's country of incorporation.
- Upon the foreign insolvency proceedings being recognised the Hong Kong court will grant assistance to foreign officeholders. In the case of liquidators appointed in jurisdictions with similar insolvency regimes, the assistance may extend to granting orders that give the foreign insolvency officeholders substantially similar powers to liquidators in Hong Kong.

Despite Japan having a civil law system, Harris J held that the winding up proceedings in Japan were collective in nature and the powers of a trustee under the Japanese winding up proceeding are similar (though not identical) to the rights of a liquidator in a Hong Kong.

In respect of the right to apply to the court for disclosure orders and ancillary relief, Harris J emphasised that this right was a right to apply only. The foreign officeholder must show that a similar right is available in the jurisdiction in which they have been appointed.

What hasn't been answered?

This case does not touch on whether a Japanese corporate reorganization or civil rehabilitation would be recognised in Hong Kong. We anticipate that recognition of such proceedings is unlikely as this would go beyond the scope of what is available in Hong Kong. This follows the reasoning in ***Joint Administrators of African Minerals Ltd v Madison Pacific Trust Ltd*** [2015] HKEC 641, where the Hong Kong court refused to recognise English administration proceedings because there was no equivalent mechanism to administration in Hong Kong.

Takeaway points

The Hong Kong court is willing to recognise and provide assistance in support of foreign insolvency regimes if the applicant is able to demonstrate that the foreign proceedings are collective in nature and the assistance sought does not go beyond what is available under Hong Kong law.

We expect to see more cases where insolvency officeholders from non-Common Law jurisdictions seek recognition and assistance from the Hong Kong court.

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