Corporate Insolvency Law In Singapore

The Legal Consequences of Corporate Insolvency

Insolvency is a term generally used to describe a legal person's state of financial affairs. Specifically "insolvency is the inability to pay one's debts". Historically, in the Commonwealth countries at least, the insolvency of individuals came under a separate bankruptcy law whilst the insolvency of companies came under the company law. In some jurisdictions, statutory provisions on insolvency are found in one omnibus Insolvency Act. This took place in England with the Insolvency Act of 1986 as amended to date.

In the United States, the term "insolvency" is not used; rather the Bankruptcy Code encompasses all the statutory provisions on both personal bankruptcy and corporate insolvency. In Singapore, the Bankruptcy Act deals with a natural person's insolvent status. There is as yet no separate Insolvency Act to deal with corporate insolvency. The Singapore Companies Act has all of the statutory provisions on the insolvency of companies. Australia is in a similar position to Singapore.

The primary purpose of insolvency law is to replace the "free for all" pursuit of claims by individual creditors, when the debtor is unable to pay all of his debts, with a statutory regime which is exercised as a collective effort. Creditors' rights and remedies are suspended, wholly or in part, to ensure the orderly realisation of the debtor's assets and the fair and equitable settlement of creditors' claims. Insolvency law is distinct and separate from debt collection law. The latter deals with a claim or a contest between the debtor company and a particular creditor.

This point is clearly illustrated by the provisions in the Singapore Companies Act which make the taxed costs of the petitioning creditor in a winding-up petition a priority payment ranking first together with the costs and expenses of the liquidation as a pre-preferential debt. The liquidator is specifically authorised to reimburse the petitioning creditor out of the assets of the company. These provisions recognise that the petition for a winding-up is a collective petition on behalf of all of the creditors even though it is instituted in the name of one or more creditors.

THE LEGAL CONSEQUENCES OF CORPORATE INSOLVENCY

An act of insolvency, in itself, carries no legal penalties under the statutory provisions of most countries, including Singapore. Professor Goode noted that insolvency as such is not a condition to which legal consequences attach. Rather the legal consequences occur only after the debtor company has become subject to a formal insolvency proceeding.

As one writer puts it succinctly “a state of insolvency does not of itself create legal liability but acts as a trigger for liability”.

The legal liabilities at the point when a company contracts a debt are different as between a company that is solvent and one that is insolvent. Insolvency accelerates the rights of all creditors. Creditors who will normally abide their turn to be paid will now find themselves in a position where the different rights of different creditors make a difference as to who or whether one gets paid and if so by how much.

A state of insolvency sets off far-reaching liabilities for the company and its directors. It is normally one of the “default events” that will give a secured creditor in a debenture or loan agreement the right to put the company into receivership. It crystallizes a security such as a floating charge into a fixed charge. It may be a ground for the termination of a contract.

A director or manager of a company may be personally liable to the creditors of the company if he approves the purchase of the company’s own shares knowing the company is insolvent or will become insolvent as a result of the share buy-back. For the specific protection of creditors, a company is not allowed to pay a dividend otherwise than out of distributable profits.

A state of insolvency is likely to lead to the winding-up of the company. A winding- up sets off legal presumptions on certain transactions of the company effected in its pre-insolvency period. These transactions are then void or voidable. Any property sold or acquired to or from a director of the company within a period of two years from the commencement of the winding-up of the company at other than market value is subject to recovery by the liquidator. Even a secured creditor who created a floating charge within six months of the commencement of the winding-up will lose his security unless it is proved that the company immediately after the creation of the floating charge was solvent.

When a company is insolvent, any payment or any transaction that it makes can incur civil and criminal liabilities for the company and its directors. A simple payment to a creditor at a time when the company is going through a cash flow crunch may later be set aside as a preferential payment. A company needs to avoid the pitfalls of “insolvent trading” exposing the directors and officers to charges of wrongful trading and even fraudulent trading. A director of an insolvent company may, knowingly or unknowingly, be in breach of his fiduciary duties to the company.

Companies trade with the privilege of limited liability which protects the shareholders and the directors from personal liability for the company’s debts. This protection is breached when the company incurs a debt at a time when there is no reasonable or probable ground of expecting the company to be able to pay the debt. In that situation the director or officer responsible for contracting the debt may be personally liable without any limits for the payment of the debt. It is therefore important to be able to recognise objectively when a company is insolvent. The difficulty is ascertaining the "moment of truth". It is said that at the point when a company is insolvent, the realisable assets of the company become a pool of funds held in trust for the creditors.

S Y N O P S I S

The purpose of this paper is to examine, in the context of the corporate insolvency law in Singapore, the two overriding issues in corporate insolvency law : (a) the statutory and judicial tests of insolvency; and (b) the legal consequences of insolvency for the creditors and for the company, its directors and officers. This paper will not discuss the insolvency of natural persons.

The paper will address the question : when can it be said that a company is insolvent? Because of the serious consequences of insolvency, directors need to recognise when a company is entering a state of insolvency. The paper will discuss the application of the statutory and judicial tests of insolvency to different insolvency proceedings.

The paper will examine the recognition and the ordering of creditors' rights and the protection of creditors under the common law and in the statutes. This is a public policy issue because creditors provide part of the funds to enable the company to continue in business, whether in the form of loans secured against the company's assets or in the form of a deferral of payment as an unsecured creditor.

The paper will consider the liabilities of directors, officers and managers for any acts or transactions that have contributed to the company's insolvency or were executed during the time the company was insolvent. There are also civil and criminal penalties outside the insolvency provisions for acts to defraud creditors. The paper will draw on the legislative experience and common law cases of other countries.

CONCLUSION

Singapore's corporate insolvency regime should be reviewed. Firstly the scattering of the avoidance provisions in separate statutes led even the Singapore Court of Appeal to comment on the "drafting complexity". It can be argued that the avoidance provisions, in particular the relevant time period, in a personal bankruptcy cannot be imported wholesale into a corporate insolvency regime. Secondly the "insolvent trading" provisions are broad and vague. The "wrongful trading" provision in s.339(3) does not provide the statutory defence available to directors under the English Insolvency Act 1986 of "taking every step he ought to have taken to avoid loss to creditors". s.339(3) is applicable only if that director is culpable, he has to be “knowingly a party”.

What if he suspects insolvency or should be aware of the company’s insolvency and fails to prevent his fellow directors from incurring further debts? In Australia, under such circumstances, the director is liable for insolvent trading under s.588G of the Corporations Act. Another area of concern is the incurring of “involuntary debts” such as tax liabilities. The safer course would be for directors to take into account contingent and involuntary liabilities in evaluating the solvency of the company.

The legal consequences of corporate insolvency should be seen against the larger issue of the scope of company law. Whose interests should the company serve? The settled law is that whilst the company is solvent, the interest of the company is the only interest that should prevail. Even so, there are sufficient safeguards at common law and in company legislation to protect creditors.

A voluntary creditor has the freedom to protect his interests by contract such that his claim to payment or to an asset of the company is superior or senior to that of another creditor. As Professor Goode puts it : “ In policy terms, the secured creditor is accorded priority because he bargained for it; other creditors who chose to lend unsecured cannot complain of their subordinated position.”

This statement is not strictly correct since the unsecured creditor is really not lending money to the company. He is merely agreeing to payment at a later date. It is important to reiterate the creditor expects to be paid in the ordinary course of business. For this reason, creditors are ‘protected’ by statutory provisions requiring the company, in varying degree, to obtain their consent, to keep them informed, and to obtain a court order where their interests may be prejudiced.

The one risk that creditors cannot be protected against in legislation or at common law is the risk of the company becoming insolvent through an honest business or management failure. For this reason, an act of insolvency per se cannot attract legal liability. Singapore recognises that the legal framework must be conducive to risk taking and entrepreneurship. This objective is shared by other jurisdictions.

A company and its business that cannot be salvaged will, in the course of events, lead to the liquidation and dissolution of the company. When there is a probability that the business of the company can be saved or revived, the possibility of a corporate rescue or a corporate workout emerges. The creditors have to decide if they will receive a better distribution in any of the corporate rescue structures than they would have done in a liquidation.

This is not the full LLM Paper.
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