

Dear IPAS Associates/Fellows,

We are glad to bring you the IPAS Update on the recent trends and developments in the insolvency profession.

Message from Chairman

Dear Associates/Fellows

This is one of a series of technical updates for Associates and Fellows as part of our initiatives to provide relevant technical knowledge in our ongoing Continuing Professional Education.

Members are encouraged to contribute articles of interest and share some of their expertise with colleagues in our profession, which can only be for the good of the profession as a whole.

Yours sincerely,
DON M HO, FIPAS
Chairman

Join IPAS

Invitation to join the Insolvency Practitioners Association of Singapore Limited (IPAS)

Pursuant to the recommendations of the Company Legislation and Regulatory Framework Committee, the Insolvency Practitioners Association of Singapore Limited (IPAS) was incorporated on 12 April 2005 with the support of the

Technical Updates

CONDUCT OF CREDITORS' MEETING / CONVERSION OF CREDITORS' VOLUNTARY LIQUIDATION TO COMPULSORY LIQUIDATION

In *Sysma Construction Pte Ltd v EK Developments [2007] SGHC 36*, the High Court clarified the principles relating to the conduct of a creditors' meeting. In this case, the plaintiff had applied for leave to initiate compulsory winding up proceedings on the defendant while the defendant was already in the process of voluntary winding up. The provisional liquidators were appointed as the company's liquidators. The plaintiff was the largest single creditor of the defendant.

At a creditors' meeting chaired by the provisional liquidator, the plaintiff sought to nominate a candidate for appointment as the company's liquidator. The nomination was rejected by the provisional liquidator for being late, but the provisional liquidator offered to adjourn the meeting so that the nomination could be made in time. He then put the question of adjournment to a vote by asking those who wanted an adjournment to raise their hands. Only 3 of the 31 persons present did. The provisional liquidator did not seek direct confirmation from the other persons at the meeting whether they wanted the meeting to go on.

It was held by the High Court that the provisional liquidator erred when he conducted the voting in the manner that he did. He should have recorded the votes for and in opposition of the adjournment of the meeting and on the appointment of the liquidator. The Court opined that another error had been made even before the meeting started - the meeting should have been for the purpose of appointing liquidators for the company, and not for confirming the appointment of the provisional liquidators as the liquidators of the company as indicated in the agenda of the meeting.

As for the issue on whether voluntary winding up should be replaced by compulsory winding up, the Court stated that regard had to be had to the inevitable duplicity and wastage in time, effort and costs. There had to be a reason before the wishes of applicant were allowed to overrule the wishes of the majority of the creditors. When there were no reasons at all, then the wishes of the majority creditors should prevail. In the present case, there was no evidence of any exceptional mismanagement of the company that called for an examination by a court-appointed liquidator. Further, the Court held that there were no general principles of fairness and

Institute of Certified Public Accountants of Singapore (ICPAS), the Law Society of Singapore (Lawsoc) and the Official Receiver and Official Assignee. The members of IPAS are ICPAS and the Lawsoc.

IPAS cordially invites you to apply to be an Associate or a Fellow of IPAS and participate in our series of CPE courses, seminars and technical discussions on the specialist subjects of insolvency, restructuring and individual & corporate recoveries. Membership has advantages.

For the invitation letter and application form, please visit our website at www.ipas.org.sg

commercial morality that weighed in favour of the plaintiff's insistence that the company be wound up compulsorily to prevail over the majority decision in support of voluntary winding up.

DUTY OF CARE OF STATUTORY AUDITORS AND FORENSIC AUDITORS

Two recent Court of Appeal judgments, *PlanAssure PAC v Gaelic Inns Pte Ltd* [2007] SGCA 41 ("**Gaelic Inns**") and *JSI Shipping (S) Pte Ltd v Teofoongwongcloong* [2007] SGCA 40 ("**JSI Shipping**") are relevant in ascertaining the duty of care required of statutory auditors. The Court in *JSI Shipping* observed that a multitude of factors come into play when assessing the nature and extent of an auditor's professional duties - there is no single all-embracing rule or criterion that consistently or exclusively predominates.

The Court of Appeal held that although it is not contemplated that an auditor must detect each and every material misstatement or instance of fraud in the discharge of his duties, there is an affirmative duty on the part of the statutory auditor to detect and prevent readily apparent and/or easily detectable types of fraud. Although the auditor is not required to undertake a full-fledge inquiry into the veracity of the account in all cases, the onus is on him to perform his duties with an attitude of professional scepticism and remain alive to the possibility of fraud. He must approach his task with an inquiring mind and remain constantly alert to the fact that a mistake or oversight could actually be the thin end of a wedge. An auditor would thus be obliged to pursue the matter and make further inquiries where reasonable suspicion would typically have been excited.

Forensic auditors should also note that the dicta in *Gaelic Inns* and *JSI Shipping* places a higher duty of care on them as compared to statutory auditors. The Court in *Gaelic Inns* suggests that an auditor conducting a special audit has to perform a 100% audit of all transactions:

"Admittedly, the scope of a statutory audit is comparatively limited in comparison to a forensic audit. A statutory audit need only comply with less onerous obligation, and may use on a test basis instead of performing a 100% audit of all transactions."

Similarly, the Court of Appeal in *JSI Shipping* also hinted on a higher standard of care for auditors conducting special investigative audits. The Court stated:

"...we have to bear in mind the fact that the audits in question were statutory audits (as opposed to special investigative audits commissioned for a special purpose) involving the audit of samples on a test basis".

SCHEME OF ARRANGEMENTS

In *The Oriental Insurance Co Ltd v Reliance National Asia Re Pte Ltd* [2008] SGCA 8, the Court of Appeal overturned the decision of the High Court on 14 January 2008, and allowed a creditor of a company to submit its proof of debt after the deadline set out in a scheme of arrangement. The brief facts are as follows: Oriental Insurance was a creditor of Reliance. Reliance subsequently entered into a scheme of arrangement with its creditors pursuant to section 210 of the Companies Act. After the Scheme was sanctioned, several reminders were sent to Oriental Insurance to submit its Proof of Debt. Oriental Insurance did not submit its Proof of Debt by the deadline set out in the scheme of arrangement. Oriental Insurance subsequently applied for an extension of time to do so.

At the High Court, the judge rejected Oriental Insurance's application and followed the Privy Council case of *Kempe and Another (Joint Liquidators of Mentor Insurance Ltd) v Ambassador Insurance Co (in Liquidation)* [1998] 1 WLR 271 in holding that the Court could not extend the deadline set out in a scheme for submitting a Proof of Debt and that the Court could only amend the Scheme if consent had been obtained by fraud or where there was an obvious mistake in the documents.

The Court of Appeal reversed the decision of the High Court and held that a scheme of arrangement, when approved by the Court takes effect as an order of court, and like any other court order, can be varied, but only in deserving circumstances. The Court took the view that an extension of time to submit a proof of debt in respect of a court-approved scheme was a matter of procedure, rather than as a matter going to the substance or materiality of the commercial dimension of the scheme. Hence, an extension of time could be allowed under Order 3 Rule 4 of the Rules of Court. A further consideration that was taken into account by the Court of Appeal was that there was no prejudice caused to the parties / creditors. The Court stated that the factors that the Court would take into account in deciding whether there is any prejudice to the parties include:

1. Whether any distribution has been made under the scheme;
2. Whether allowing the application for extension of time will inconvenience the other creditors or substantially affect the dividends that they can expect to receive;
3. Whether the order for extension of time can be framed to avoid any potential prejudice to other creditors; and
4. How much the creditor seeking the extension of time stands to lose if no extension is granted.

On a separate note, the Court of Appeal was also of the view that section 392(4)(d) of the Companies Act could also be used to extend the time to submit a proof of debt if it could be shown that

there was no “substantial injustice” to the parties.

TRACING OF PAYMENT TO COMPANY THAT GOES INTO LIQUIDATION

In *Simon Cooper v PRG Powerhouse Ltd (in creditors' voluntary liquidation) & Ors* [2008] EWHC 498, the English High Court held that where it had clearly to be implied into an arrangement between the applicant and a company that subsequently went into liquidation that the applicant had made a payment to the company to enable it to discharge the applicant's debt to a third party, that sum had not formed part of the company's assets at its free disposal and had been paid subject to a purpose trust. The applicant was therefore entitled to trace his payment to its full amount.

UNFAIR PREFERENCE

In *Hawkes Hill Publishing Co* (High Court, 24 May 2007), the claimant liquidator made claims against the secretary and director (the “**Defendants**”) of a company alleging that they had caused the company to give them a preference and that they were guilty of wrongful trading. The company had been incorporated for the business of publishing a free golfing magazine whose profitability had been dependent on advertising revenue generated. A bank loaned the company £20,000 secured by a debenture over all the company's assets. The Defendants guaranteed the company's liability to the bank. The company subsequently began publication of a second free title. However, the company did not prosper, having experienced cash flow problems and a trading loss. The company subsequently sold both titles for £20,000, but in order to persuade the bank to release the titles from the debenture, the whole of the purchase price was paid on to the bank. The repayment of that original loan reduced the potential liabilities of the company, and affected the guarantees given by the Defendants. Once the company had sold the titles, it had no remaining business and went into voluntary liquidation.

The liquidator contended that (1) the payment of the £20,000 to the bank had been a preference, under because it had had the effect of discharging or reducing the Defendants' liabilities as guarantors and the company had been influenced by a desire to improve their position in the event of an insolvent liquidation; and (2) the Defendants were guilty of wrongful trading, because they had allowed the company to continue to trade after they had known that there was no reasonable prospect that the company would avoid going into insolvent liquidation.

It was held by Justice Lewison that since the Defendants had been guarantors of all of the company's liabilities to the bank it had been an inevitable consequence of a payment to the bank in reduction of the company's liability that their liability under the guarantee would be reduced. However, if the company had gone into insolvent liquidation at that time, the bank would have relied on its security to

realise the company's assets. Whatever the purchase price of the titles, that price would have been applied in reduction of the company's debt to the bank, and to the extent that the bank had recovered its loan, the Defendants' liability under the guarantee would have been similarly reduced.

Therefore, unless the sale of the titles had been at an undervalue, and there was no evidence that they had been, the Defendants' position had been no different from what it would have been if the company had gone into liquidation. The transaction had not, accordingly, amounted to a preference at all. In any event, in entering into the transaction, the company had not been influenced by a desire to improve the position of the Defendants. The Defendants had done the best deal possible at the time, which had been a better one than could have been achieved on a realisation either by a secured creditor or by a liquidator. There had, therefore, been no preference on that ground either.

In addition the Court held that whilst an insolvent liquidation would almost always result from one or more mistakes, picking over the bones of a dead company in a courtroom was not always fair to those who had struggled to keep going in the reasonable, but ultimately misplaced, hope that things would get better. In the instant case, the Defendants had not known or concluded that there was no reasonable prospect that the company could have avoided going into insolvent liquidation. The Defendants had thought that the company could trade its way out of difficulties. There had, therefore, been no wrongful trading on their part.

Disclaimer: This email is intended for the use of the addressee. If you are not the intended recipient of this message, kindly notify us at technical@icpas.org.sg. While all reasonable care has been taken in the preparation of information contained in this update, IPAS takes no responsibility for any action (s) taken on the basis of information contained herein or for any errors or omissions in that information.

Insolvency Practitioners Association of Singapore Limited (IPAS)

Company Registration Number 200504856G
20 Aljunied Road, #06-02 CPA House, Singapore 389805
Telephone: +(65) 6749 8060, Fax: +(65) 6749 8061,
email: technical@icpas.org.sg, website: www.ipas.org.sg