
Dispute Resolution

Appeals Against a Winding-Up Order: Who Should Control the Appeal and Who Should Pay?

Introduction

In *Sun Electric Power Pte Ltd v RCMA Asia Pte Ltd* [2021] SGCA 60, the Singapore Court of Appeal had the opportunity to consider some vital questions relating to insolvency proceedings. In the context of an appeal against a winding-up order, the Court considered whether the company's directors should be entitled to control the appeal, and who should be responsible for the costs of the appeal.

The Court also examined the test for determining whether a company is deemed unable to pay its debts under sections 254(2)(c) and 254(2)(a) of the Companies Act. While these provisions have been repealed, they are effectively reproduced in the Insolvency, Restructuring and Dissolution Act 2018 ("IRDA"), save for certain amendments in monetary thresholds.

Notably, the Court of Appeal held that the company's director was allowed to control the conduct of the appeal against the winding-up order. However, the Court of Appeal highlighted that directors or shareholders controlling the conduct of the appeal should expect to pay any costs incurred in prosecuting the appeal out of their own pockets, and should expect to be personally responsible for the payment of any party and party costs if the appeal fails.

This Update provides a summary of the case and highlights the key points of the Court of Appeal's decision.

Brief Facts

The Respondent was a creditor of the Appellant company. One Mr Peloso was the sole director of the Appellant, as well as the owner of a majority of the shares of the Appellant's holding company.

The Appellant had unsuccessfully applied for judicial management, having been opposed by the Respondent. As a result of these proceedings, the court ordered the Appellant to pay costs to the Respondent.

On 21 November 2019, the Respondent sent a statutory demand to the Appellant demanding payment of S\$11,568.88, being the amount of the costs awarded plus accrued interest. The Appellant proposed

Dispute Resolution

to make payment in instalments, starting with S\$3,000, but this proposal was rejected by the Respondent. Nevertheless, the Appellant paid S\$3,000 into the Respondent's solicitors' client account on 13 December 2019. Thereafter, no further payments were made by the Appellant and the balance of \$8,568.88 remained due, together with additional interest which had been accruing from 21 November 2019.

On 18 December 2019, the Respondent filed a winding up application against the Appellant. As the application was made before the IRDA came into effect, the winding up application was made pursuant to the relevant provisions in the Companies Act.

The High Court Judge ("**Judge**") accepted the grounds for winding-up relied upon by the Respondent and ordered that the Appellant be wound up. The Appellant appealed against this decision.

The Court of Appeal had to determine, among other issues:

- (a) Whether Mr Peloso and the Appellant's solicitors were authorised to act for the Appellant in the appeal; and
- (b) Whether the Judge had erred in finding that the Appellant was deemed to be unable to pay its debts pursuant to sections 254(2)(c) and 254(2)(a) of the Companies Act.

Holding of the Court of Appeal

The Court of Appeal upheld the order that the Appellant be wound up.

Authorisation and costs in an appeal

The Court of Appeal held that Mr Peloso and the Appellant's solicitors were authorised to act for the Appellant in the appeal, rejecting the Respondent's argument that Mr Peloso could not have the authority to control the conduct of the appeal unless a stay order had been granted.

The Court of Appeal held that a company has the right to appeal a winding up order regardless of whether a stay order is granted, and it is a necessary corollary of the company's right to appeal that its directors be allowed to control the conduct of the appeal.

However, the Court of Appeal highlighted that it is impermissible for the directors or shareholders to whittle down the company's funds to pursue an unmeritorious appeal when these funds should be reserved for payment to the creditors. The Court of Appeal thus set out the following rules regarding who should bear the costs of an appeal against a winding-up order:

Dispute Resolution

- (a) The directors or shareholders controlling the conduct of the appeal should expect to pay the costs of the appeal out of their own pockets, instead of using the funds of the company.
 - i. Where a stay order is not granted, they should be unable to use the funds of the company because the liquidator should have custody and control of all of the company's property.
 - ii. Where a stay order is granted, they may be able to use the funds of the company, but should be prepared to pay it back to the company if the appeal fails.
 - iii. That said, if the appeal succeeds, they can reclaim from the company the funds that they had expended from their own pockets in prosecuting the appeal.

- (b) The directors or shareholders controlling the conduct of the appeal should also expect to be personally responsible for the payment of any party and party costs awarded in favour of the respondent if the appeal fails.

Section 254(2)(c) of the Companies Act

Section 254(2)(c) of the Companies Act provides that a company shall be deemed to be unable to pay its debts if it is proved to the satisfaction of the Court that the company is unable to pay its debts; and in determining whether a company is unable to pay its debts the Court shall take into account the contingent and prospective liabilities of the company. This provision is retained in section 125(2)(c) of the IRDA.

Previously, courts have applied one or more of several tests, depending on the circumstances of each case, in determining if a company is insolvent. In this case, the Judge relied on both the cash flow test and balance sheet test in reaching the conclusion that the Appellant was unable to pay its debts, but did not state that either test was conclusive.

On appeal, the Respondent argued that the cash flow test should be the dominant test and that if this test was satisfied, the company should be deemed as unable to pay its debts regardless of whether the balance sheet test was satisfied. The Appellant argued that it was balance sheet solvent (thus implying that the balance sheet test should apply).

The Court of Appeal clarified that the cash flow test should be the sole and determinative test under section 254(2)(c) of the Companies Act. The cash flow test assesses whether the company's current assets exceed its current liabilities such that it is able to meet all debts as and when they fall due, where "current assets" and "current liabilities" refer to assets which will be realisable and debts which will fall due within a 12-month timeframe.

The Court of Appeal also set out a non-exhaustive list of factors which should be considered under the cash flow test:

Dispute Resolution

- (a) the quantum of all debts which are due or will be due in the reasonably near future;
- (b) whether payment is being demanded or is likely to be demanded for those debts;
- (c) whether the company has failed to pay any of its debts, the quantum of such debt, and for how long the company has failed to pay it;
- (d) the length of time which has passed since the commencement of the winding up proceeding;
- (e) the value of the company's current assets and assets which will be realisable in the reasonably near future;
- (f) the state of the company's business, in order to determine its expected net cash flow from the business by deducting from projected future sales the cash expenses which would be necessary to generate those sales;
- (g) any other income or payment which the company may receive in the reasonably near future; and
- (h) arrangements between the company and prospective lenders, such as its bankers and shareholders, in order to determine whether any shortfall in liquid and realisable assets and cash flow could be made up by borrowings which would be repayable at a time later than the debts.

On an application of the cash flow test, the Court of Appeal agreed with the Judge that the Appellant was cash flow insolvent, and that section 254(2)(c) of the Companies Act had been satisfied. The Court of Appeal also found that the Judge had not erred in exercising his discretion to wind up the Appellant.

Section 254(2)(a) of the Companies Act

Section 254(2)(a) of the Companies Act provides that where a creditor has served on the company a statutory demand for a debt exceeding S\$10,000, the company will be deemed as unable to pay its debts if it neglects to: (a) pay the sum; (b) secure the sum; or (c) compound the sum, within the period of three weeks from the service of the demand.

Under section 125(2)(a) of the IRDA, the threshold sum has been increased to S\$15,000, but the provision otherwise remains intact.

In view of the above findings, it was not strictly necessary for the Court of Appeal to decide whether the alternative ground for winding up under section 254(2)(a) of the Companies Act was made out. However, as it was argued by parties, the Court of Appeal expressed its opinion that a company would not be deemed to be unable to pay its debts pursuant to section 254(2)(a) of the Companies Act if it paid part of the debt demanded *within the prescribed period* such that the remaining amount payable fell below S\$10,000. The Court of Appeal declined to decide conclusively on whether the same would apply if the company paid the debt in part *after the expiry of the prescribed period but before the winding up hearing*, and stated that it would reserve its decision on this issue for a subsequent case.

Dispute Resolution

Concluding Words

This decision is important as it establishes the cash flow test as the sole applicable test to determine insolvency for purposes of winding up under section 254(2)(c) of the Companies Act.

Further, it highlights the cost implications of appealing against a winding up order and places the responsibility for the costs of an unmeritorious appeal squarely at the feet of the directors or shareholders who decide to pursue such an appeal. The relevant decision makers should thus comprehensively consider their options and the merits of their case before making any appeal.

For further queries, please feel free to contact our team below.

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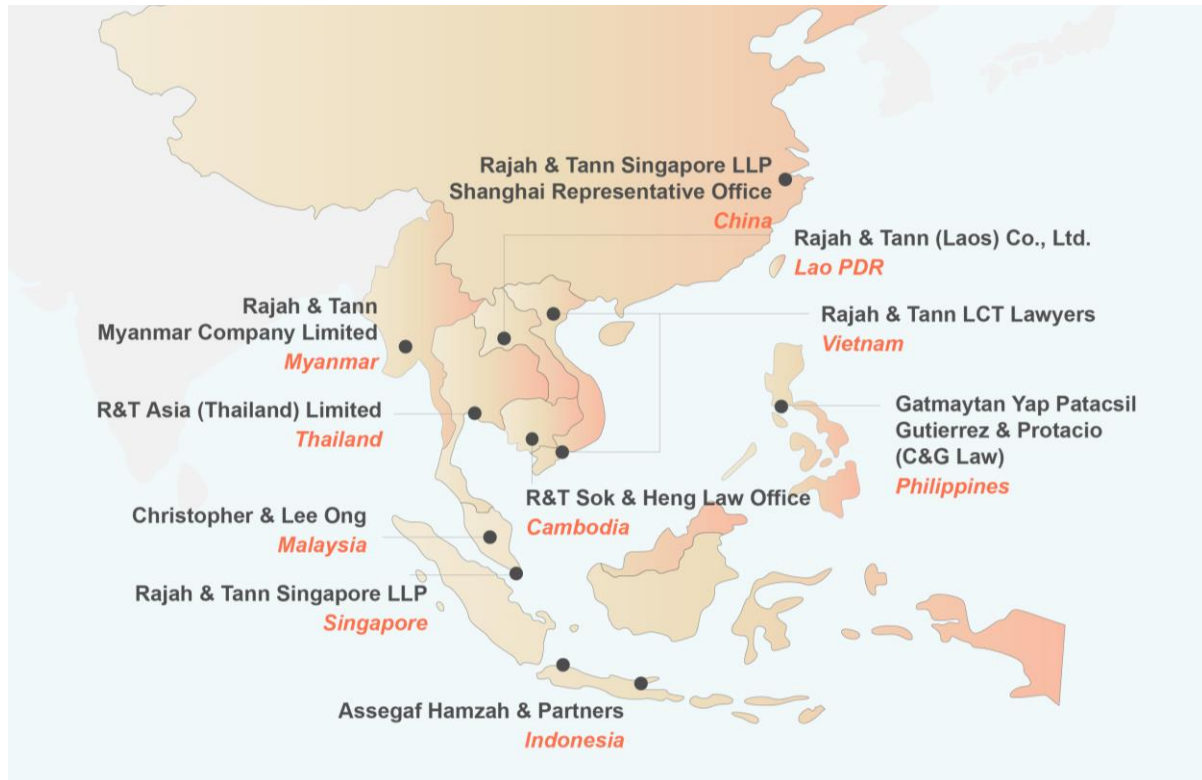
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