Directors' duties in the context of pending insolvency

Running a business in times of a crisis like the current COVID-19 pandemic is not easy. Not only is revenue affected, companies still have to pay their employees, rent, loan instalments, and other overheads. At times, it may feel like your business is scraping the bottom and you are close to insolvency.

In such a scenario, directors have a duty to start taking into account the interests of creditors as a company starts nearing insolvency, or is already there. Although the law does not impose a duty on directors that is directly owed to individual creditors (ie, creditors cannot sue the directors for failing to take into account their interests), the law requires directors to take into account the interests of creditors as a general body and 'to ensure that the company's assets are not dissipated or exploited for their own benefit to the prejudice of creditors' interests.'[1]

What this means is that the actions and transactions undertaken by the directors of a company prior to its winding up may be scrutinised by the liquidators. Some of these transactions may be voided for being an undue preference to a particular creditor[2] or where an asset was sold at an undervalue.

In addition to this general duty, directors of companies nearing insolvency are also prohibited by statute from incurring a debt when there was no reasonable belief that the company could have been able to pay the debt. The penalties for flouting this rule are criminal and may result in a fine not exceeding S$2,000 or to imprisonment for a maximum of 3 months.[3]

As such, directors may be concerned about contracting a loan during this period to tide the company through, or continuing to contract with suppliers for the supply of goods and services when there is a possibility that the cash flow may be insufficient to repay the bank or the suppliers.

However, in these trying times, the COVID-19 (Temporary Measures) Act (the '**Act**') now varies this position and grants directors of companies some measure of relief as they try to steer their companies out of this crisis.

Section 22(2) of the Act provides:

> 2) For the purpose of section 339(3) of the Companies Act (including that provision as applied by the Variable Capital Companies Act 2018), an officer of the company or (as the case may be) an officer, the manager or the custodian of the variable capital company is not to be treated as having no reasonable or probable ground of expectation of the company or variable capital company being able to pay a debt if the debt is incurred –
>
> a) in the ordinary course of the company's or variable capital company's business;
> b) during the prescribed period; and
> c) before the appointment of a judicial manager or liquidator of the company or variable capital company.
>
> [Emphasis added]

[1] *Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd* [2010] SGCA 31, [2010] 4 SLR 1089 at [48].

[2] See generally *DBS Bank Ltd v Tam Chee Chong and another (judicial managers of Jurong Hi-Tech Industries Pte Ltd (under judicial management))* [2011] SGCA 47, [2011] 4 SLR 948.

[3] Section 339(3) of the Companies Act (Cap 50).

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What this means is that as long as directors incur a debt in the ordinary course of the company's business during the prescribed period of 6 months commencing from 20 April 2020, the directors will not risk being liable for incurring a debt under section 339(3) of the Companies Act.

However, the debt must be incurred 'in the ordinary course of the company's … business'. It would not behove to a director to incur debts which are not justifiable as being within the ordinary course of the company's business.

For example, a director of a restaurant business would be justified in contracting with suppliers for the supply of fresh produce. However, that director would not be justified in purchasing a car on hire-purchase for that director's personal use as this would not be in the ordinary course of the company's business.

Section 22(2) of the Act should provide some comfort to directors to continue doing their best to stay afloat and to keep their business operations running, without running the risk of incurring criminal liability for contracting a debt for which, at the time, there was little expectation that it could have been paid.

These are difficult times. To quote Minister for Law K Shanmugam during the Second Reading Speech on the COVID-19 (Temporary Measures) Bill, '[t]he bottom of the market has literally fallen off, and the normal assumptions of business are gone.'

These drastic times call for drastic measures.

In light of the constantly changing circumstances, this is a general overview and should not be treated as legal advice. The information presented is correct to the date of its publication.

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