LEGAL UPDATE

Recent Developments in Singapore Relating to Directors

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(with thanks to Tan Jin Yong and Kong Xie Shern)

Introduction

1. This update will summarize 4 recent developments which have an impact on directors, particularly in relation to the duties owed by a director to his/her company.

2. First, the Singapore Court of Appeal in *Dynasty Line Limited (in liquidation) v Sukamto Sia* [2014] SGCA 21 ("*Dynasty Line*") decided that directors have a duty to consider the interest of the company's creditors when there are concerns over the company's financial health.

3. Secondly, the Court of Appeal decided in *Ho Kang Peng v Scintronix Corp Ltd (formerly known as TTL Holdings Ltd)* [2014] SGCA 22 ("*Scintronix*") that directors would be in breach of their duties to the company if they made illegal payments (that amounted to bribes), even if the payments were for the short term financial gain of the company.

4. Thirdly, in *Burgundy Global Exploration Corp v Transocean Offshore International Ventures Ltd* [2014] SGCA 24 ("*Burgundy Global*"), the Court of Appeal decided that Singapore courts have the power to permit service of an examination of judgment debtor ("EJD") order against foreign officers of a company (including directors), even if they are not physically present in Singapore.

5. Finally, ACRA recently issued a practice direction regarding the duties of a director in relation to financial reporting.

Dynasty Line – Directors' duties to creditors when there are concerns over the company's financial health

6. In *Dynasty Line*, the Court of Appeal decided that when there are concerns over the company's financial health, the fiduciary duty of a director to act in the best interest of the company would include taking into consideration the interest of the creditors. The "*best interest of the company*" is not necessarily limited to the benefit of the shareholders. "*As long as there are reasons to be*

concerned that the creditors' interests are or will be at risk because of difficult financial circumstances, the directors ignore those interests at their peril."

Facts

7. Dynasty Line Limited ("Dynasty") was a company incorporated in the BVI and a personal investment vehicle of Sia, the sole shareholder. Sia and Lee were both directors of Dynasty.

8. In 1996, Dynasty completed seven separate sale and purchase agreements to acquire 29,537,367 shares ("the Shares") in China Development Corporation Limited ("CDC").

9. Approximately 28% of the purchase price was paid. The Shares was the *only* asset that Dynasty possessed. The remaining amount was to be paid in different tranches according to the agreements.

10. Subsequently, Dynasty pledged the Shares as security to various financial institutions for loans granted to Sia, Sia's business associate and another company owned by Sia and Lee ("the Borrowers"). The Borrowers defaulted on the loans and the financial institutions sold off the pledged Shares to satisfy the debt.

11. Six years later, Dynasty was wound up in BVI. The liquidators commenced proceedings in Singapore against Sia and Lee for breach of fiduciary duties under BVI law as directors of Dynasty.

Did the director's breach their fiduciary duties as directors?

12. Under both BVI and Singapore law, a director owes fiduciary duties to the company. This entails taking into consideration the company's best interests having regard to the position of its shareholders as well as of its creditors. The weight that the director has to accord either interest will vary according to the financial health of the company. Where there are concerns over the company's financial health, then directors' action will have to take into account creditors' interests.

13. To determine the general financial health of the company, the Court pointed out that a broad based inquiry of the circumstances

has to be adopted. The company does not have to be technically insolvent for the creditors' interests to be taken into consideration by the directors.

14. On the facts of the case, the Court found that Lee and Sia had cause for concern that Dynasty would be approaching or be in a position of insolvency if it went ahead with securitising the Shares for the loan agreements. Dynasty owed liabilities for the shares that were not yet fully paid and had no other assets. It also did not receive any monies under the loan agreements.

15. Hence, the pledging of the Shares greatly compromised Dynasty's ability to pay the purchase price for the Shares and this imperilled its solvency.

16. Sia had full knowledge that the transaction would prejudice Dynasty's ability to repay the loan. By entering into such transaction, his disregard of the interests of the creditors is a breach of his fiduciary duties as director.

Scintronix – Breach of directors' duties occurs when unauthorized and irregular payments amounting to bribes are made by directors.

17. The Court of Appeal in *Scintronix* decided that directors who allow a company to pay bribes will be in breach of their duties as directors, even if the bribes were made for purposes of profit maximization for the company.

Facts

18. Ho Kang Peng ("Ho") was the Chief Executive Officer ("CEO") of TTL Holdings ("TTL Holdings") at the relevant time. He signed an agreement on behalf of the company to pay Bontech Entreprise Co Ltd ("Bontech") for consultation services. However, this was a sham agreement as no such services were rendered.

19. The Court found that the agreement was used to channel money to a Chinese man as bribes to procure business for TTL Holdings. The Court also found that only Ho and two other directors had knowledge of the unauthorized payments.

Do such payments made in the interests of profit maximization constitute a breach of directors' duties?

20. The Court found that a director who creates a sham contract and makes unauthorized and irregular payments out of the company's funds for the purpose of securing business for the company cannot be said to be acting in good faith in the interests of the company. Even if the director claims that such payments were for profit maximization, he would not be considered to be acting honestly.

21. The Court stated that the interests of a company do not only entail profit maximization. Such payments are in effect gratuities and run the unjustified risk of subjecting the company to criminal liability. As this was a risk which "*no director could honestly believe to be taken in the interests of the company*", the making of such payments constituted a breach of directors' duties to act in good faith in the interest of the company.

22. On the facts, Ho had breached his directors' duties as he facilitated the payment through concealment and deception through a sham agreement without proper authorization.

Did the company implicitly authorized Ho's actions?

23. Ho's first defense was that as two other directors had knowledge of the Bontech Agreement, such knowledge could be attributed to the company and hence the company implicitly authorized Ho's actions. The Court rejected this defense.

24. The Court applied the primary rules of attribution to determine if an act of a director had been authorized by the company. One such rule is that there is a need for collective action of the board of directors of the company which can be done either by a board resolution or the informal assent of all the directors.

25. On the facts, the Court did not find evidence of any such action by the board that authorized Ho's actions. There was also no evidence that *all* the other directors (apart from two) knew of the illegal payments.

Does the principle of illegality apply?

26. Ho also argued that as TTL Holdings was implicated in the in Ho's improper act and, as such, it cannot sue him. The Court also rejected this argument.

27. For the defence to be successful, Ho had to rely on special rules of attribution to attribute the knowledge of three directors, who knew about the payments, to the company. The primary rule of attribution does not apply as there was no evidence that the company's constitution provides for this, and general company law does not allow the knowledge of a few directors to constitute that of the company's.

28. In cases where an innocent third party brings an action against the company for the improper acts of the directors, the company should be bound by the improper acts as the acts of the wrongdoer director(s) would be attributed to that of the company.

29. In cases where the company brings a claim against its directors' for improper acts, the Court stated that special rules of attribution should not apply. The company in such cases is seen as a victim and the "*law will not allow the enforcement of that duty to be compromised by the director's reliance on his own wrongdoing*."

30. On the facts, as the special rules of attribution do not apply, TTL Holdings was not found to have been attributed with the knowledge and actions of Ho and thus the defense failed.

Burgundy Global – Singapore courts have the power to serve an EJD order against foreign officers that are non-parties to the proceedings

31. Two related appeals were before the Court of Appeal in *Burgundy Global*. In the second appeal, the directors of Burgundy Global Exploration Corporation ("Burgundy") appealed against the High Court's refusal to set aside an order for substituted service of EJD orders issued against them.

Facts

32. Due to Burgundy's (a Philippines company) breach of agreement with Transocean Offshore International Ventures Limited ("Transocean"), a Singapore company, Transocean obtained and entered judgment against Burgundy in Singapore.

33. Transocean then applied for and obtained EJD orders against the foreign directors as officers of Burgundy. Transocean failed to serve these orders successfully on the directors in the Philippines.

34. Transocean then obtained leave to effect substituted service by serving on Burgundy's Singapore lawyers. To resist this, the directors applied to set aside the order allowing substituted service.

Whether Singapore courts have the jurisdiction to issue an EJD order against company officers who are ordinarily resident overseas?

35. The Court of Appeal analyzed extensive English authorities and came to the conclusion that Singapore courts have the power to issue EJD orders against foreign officers (whether in Singapore or otherwise).

36. Companies can only act through individuals and the only way a court can exert control over companies would be to issue orders against individuals that act on the companies' behalf and who are able to effect the corporate litigant's compliance with any court orders.

37. There is also little doubt that the underlying purpose of an EJD order, which is to enable judgment creditors to obtain information about a corporate judgment debtor's finances, would be served by extending it to foreign officers.

38. However, to serve an EJD order on a director outside of Singapore, permission from the Singapore Courts to effect service of the order out of Singapore had to be first obtained.

39. The discretion to grant leave to serve an EJD order out of jurisdiction must be exercised sparingly. "*The fundamental question is whether the foreign officer is so closely connected to*

the substantive claim that the Singapore court is justified in taking jurisdiction over him."

40. The Court would take into account the following factors in deciding whether to grant leave for service of the EJD order to be effected overseas: – (1) the extent of the foreign officer's knowledge of his company's financial affairs; and (2) something more than having relevant financial information – for example – the extent of the foreign officers' involvement in the matters relating to the relevant claim before the court.

41. On the facts, Transocean had to apply for leave in order to serve the EJD orders and they could not circumvent this requirement simply by applying for leave to effect substituted service on Burgundy's lawyers in Singapore. In fact, the Court voiced its reservations on this "*novel mode of substituted service*".

42. Since there was not enough material before the Court as to whether the Philippines directors had the relevant financial information and if so, whether the directors had been intimately involved in the claim, the Court refused to grant leave.

ACRA'S Practice Direction No. 2 of 2014

43. The recently published practice direction from ACRA sets out:
    (a) The directors' duties in relation to financial reporting; and
    (b) The review and sanction process of the Financial Reporting Surveillance Programme (FRSP) administered by the ACRA.

Directors' duties in relation to financial reporting

44. Directors of a company incorporated in Singapore have to present financial statements at the company's AGMs. The statements must comply with Accounting Standards issued by the Accounting Standards Council. These statements must also give a true and fair view of the profit and loss, as well as reflect the state of affairs of the company (Section 201(1A), 201(3) and 201(3A) of the Companies Act).

45. Both executive and non-executive directors are responsible for ensuring that the financial statements are true and fair and compliant with the requisite Accounting Standards. They have to

read and understand the statements and ensure the statements are presented according to their understanding of the company. Directors have a duty to raise questions if there are certain contradictions in the statement.

46. Directors are expected to have sufficient and up to date knowledge of the accounting principles and practices to perform review of the financial statements.

47. Directors can obtain professional accounting advice(s) and/or outsource to professional accounting service for preparation of financial statements. However, the directors *remain responsible* for the final statement produced which must be a true and precise reflection of the company's finances.

Review and sanction process of the FRSP administered by the ACRA

48. The FRSP was established by ACRA in 2011 to review selected financial statements to determine compliance. When a breach is found, sanctions will be imposed on directors.

49. ACRA adopts a risk-based approach in prioritizing the financial statements for review. Emphasis will be placed on public and large private companies with indication of potential non-compliance with Accounting Standards or has significant public interest risk. Companies with changes in listing and trading status or significant changes of key stakeholders will also be prioritized.

50. When there are additional information required by ACRA upon review of financial statements, ACRA will raise formal enquiry letters to each individual director who authorized the financial statements to request for explanation and supporting documents if necessary.

51. The Companies Act provides for fines and imprisonment for breaches in financial reporting. However, for less severe technical breaches and first time offenders, ACRA may employ other sanctions such as a warning letters.

52. Where significant corrections are made in the next set of annual financial statements as a result of ACRA's review, the company may be required to disclose the fact that the correction arises

from ACRA's review in the notes to the financial statements explaining the correction.

53. In cases of *severe* reporting breach(es), the company may also be required to rectify the deficient financial statements, have the restated financial statements re-audited and refiled with ACRA.