
CLIENT UPDATE 2015 FEBRUARY

BUSINESS FINANCE & INSOLVENCY

Proof of Debt in Liquidation: Claims for Informal Arrangements

Introduction

Shareholders or directors of a company often enter into informal or private financial arrangements with the company or its members, particularly when the threat of insolvency is looming. However, when it comes to proof of debt after the onset of liquidation, to what extent can claims for such arrangements be made? This was one of the issues considered in *Ong Kian Hoy v Liquidator of HSS Engineering Pte Ltd* [2014] SGHC 262.

In this case, the Plaintiff director and shareholder of an insolvent company sought to challenge the liquidator's rejection of certain claims in his proof of debt. However, the liquidator's decision to reject the three major claims was upheld by the High Court.

The first major claim was for personal loans which the Plaintiff had advanced to the company, which the Court found to have been written off by the Plaintiff to allow the company to borrow further funds. The second major claim was for compensation pursuant to a settlement agreement, which was found to be binding on the shareholders and not the company itself. The third claim was for legal fees and costs incurred by the Plaintiff in appealing against the winding up order made against the company, which the Court held should be borne by the Plaintiff and not the company.

The liquidator was successfully represented by Patrick Ang and Ang Siok Hoon of Rajah & Tann Singapore LLP.

Brief Facts

The Plaintiff was the director and majority shareholder of the Company. The Company eventually entered liquidation, at which point the Plaintiff filed certain proofs of debt.

- (i) One of the major claims was for personal loans from the Plaintiff to the Company amounting to S\$656,393, which he had allegedly made in order to keep the Company in business.
- (ii) The second major claim was pursuant to a Deed of Settlement (the "**Deed**") between the shareholders of the Company, the Company, and a creditor of the Company, under which the shareholders would dispose of their shares in the Company. It was provided under the Deed that upon completion of the sale of shares, the shareholders were to pay the Plaintiff S\$450,000 as compensation for loss of use of part of the Company's factory property (the "**Property**"). The sale of shares never took place.
- (iii) The third major claim was for legal fees and costs incurred by the Plaintiff in appealing against the winding up order made against the Company.

The Liquidator of the Company rejected all three claims. The Plaintiff thus applied to Court to set aside the Liquidator's Notice of Rejection.

Holding of the High Court

The High Court upheld the Liquidator's rejection of the three major claims, finding that there was no basis for the claims.

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With regard to the first claim, the Plaintiff had signed a confirmation that he agreed to waive the loans made to the Company. The Plaintiff submitted that the waiver should not stand as he had received no consideration for this waiver, and that he had only agreed to the waiver to allow the accounts of the Company to be in credit so as to enable further bank loans for the development of the business.

However, the Court held the Plaintiff to his waiver of the loans. It was found that the Plaintiff did in fact benefit from the waiver, as the Company being able to make further bank loans would benefit him as a shareholder. Further, having agreed to the production of documents which would show the Company's accounts to be in credit to third parties, the Plaintiff would be estopped from going back on his waiver. Therefore, he had no claim to recover the S\$656,393 in loans.

With regard to the second claim, the shareholders had actually been unable to sell their shares under the Deed. Nonetheless, the Plaintiff argued that he should be compensated for being deprived of the use of the Property, whether or not it was sold pursuant to the Deed or by reason of liquidation.

The Court held that the Plaintiff was not owed compensation from the Company as the obligation to compensate the Plaintiff was owed by the shareholders, and not the Company itself. In any event, the obligation to compensate the Plaintiff under the Deed had not been triggered, as the Plaintiff was being deprived of the use of the Property due to the liquidation, and not pursuant to the Deed.

With regard to the third claim, the Plaintiff incurred costs in filing an appeal against the winding up order made against the company. On the facts, the Plaintiff eventually withdrew the appeal and as such, was ordered to pay costs of S\$12,000 to the respondent creditor.

The Court found that the Plaintiff had filed the appeal even though he did not dispute the debt that was owed; the Plaintiff had filed the appeal in the hope that he would be able to raise sufficient funds to pay off the respondent creditor. The Court found that there was no merit to the Plaintiff's claim and the costs of the appeal should be borne by the Plaintiff and should not be thrown upon the assets of the company to the prejudice of the creditors.

Concluding Words

Informal financial agreements between directors or shareholders of a company and the company itself may be aimed at providing temporary relief or setting up private arrangements, with no actual intention of enforcement. However, when the company enters insolvency, these agreements will be strictly upheld against the parties.

This was clearly demonstrated in the present case, where the Plaintiff's agreement to waive substantial debts to give a more favourable picture of the Company's accounts was found to be binding against him in the proof of debt process. Further, the Plaintiff's arrangement to be compensated for the Property was held to the strict terms of the contract, meaning that the obligation of the shareholders could not be read as being synonymous with the obligation of the Company.

In addition, not all costs incurred in relation to a winding up order may be reclaimed from the company. Here, the costs incurred by the Plaintiff in resisting the winding up order were held to be properly borne by the Plaintiff himself, even though it was ostensibly to stave off liquidation for long enough to rescue the Company. There must at least be some merit in such an appeal.

Parties wishing to consult on proof of debt or other insolvency matters may contact our team below.

Please feel free to also contact the Knowledge and Risk Management Group at eOASIS@rajahtann.com

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