

ALLEN & OVERY

# Directors' duties and liabilities in financial distress during Covid-19

July 2020

# Directors' duties and liabilities in financial distress during Covid-19

## A global perspective

Uncertain times give rise to many questions

---

The Covid-19 pandemic and the ensuing economic crisis has a significant impact, both financial and otherwise, on companies around the world. Boards are struggling to ensure survival in the short term and preserve cash, whilst planning for the future, in a world full of uncertainties.

**Many directors are uncertain about their responsibilities and the liability risks in these circumstances. They are facing questions such as:**

- If the company has limited financial means, is it allowed to pay critical suppliers and leave other creditors as yet unpaid? Are there personal liability risks for 'creditor stretching'?
- Can you enter into new contracts if it is increasingly uncertain that the company will be able to meet its obligations?
- Can directors be held liable as 'shadow directors' by influencing the policy of subsidiaries in other jurisdictions?
- What is the 'tipping point' where the board must let creditor interest take precedence over creating and preserving shareholder value?
- What happens to intragroup receivables subordinated in the face of financial difficulties?
- At what stage must the board consult its shareholders in case of financial distress and does it have a duty to file for insolvency protection?
- Do special laws apply in the face of Covid-19 that suspend, mitigate or, to the contrary, aggravate directors' duties and liability risks?



## There are more jurisdictions involved than you think

---

Most directors are generally aware of their duties under the governing laws of the country from which the company is run. However, individuals may also be directors of subsidiaries in other jurisdictions, either personally or indirectly through holding or management entities of which they are directors. And even if they are not, the laws that govern the subsidiaries may classify them as shadow directors of the subsidiary. All this may expose directors to duties and liability risks at local levels.

To complicate matters, liability may not only arise under local company law, but also under tort laws of countries where contracts are entered into that later cannot be performed, causing damages to the company's counterparties. Insolvency proceedings may be opened in yet more jurisdictions where the company or its subsidiaries do business and local insolvency laws may contain specific directors' duties and liability regimes.

## Guidance to navigating these risks

---

We have put together an overview of the main issues facing directors in financially uncertain times in a number of key jurisdictions across the globe. This includes a brief general description of directors' duties and key areas of potential directors' liability in each country, as well as some answers to the questions listed above.

Obviously, the duties and liabilities that may arise will always be dependent on the circumstances. Therefore, this publication should not be used as legal advice when faced with a specific dilemma. However, we hope it may help to alert directors and their in-house advisors to the duties, pitfalls and liability risks that exist in major jurisdictions across the globe.

# Singapore

No.	Question	Answer
<b>Directors' Duties</b>		
1.	Do directors have to act primarily in the interest of their shareholders or do they have to take the interest of other stakeholders (creditors, employees) into account as well? Does that regime change in case of financial distress?	<p>Directors have a duty to act in the interests of the company. When a company is solvent and trading normally, this refers to the interests of the company as a separate commercial entity which in many cases are very readily identified with the interests of its shareholders as a whole.</p> <p>However, when a company is insolvent, or even in a parlous financial position, directors have a fiduciary duty to take into account the interests of the company's creditors when making decisions for the company. While it is common to refer to the 'balance sheet test' or the 'going interest test' when speaking of insolvency in this context, Singapore courts have made clear that there is no bright line which, when crossed by the company, results in directors having to take into account the interests of the company's creditors. Instead, what constitutes the components of a company's interests has been framed as a continuum, where the greater the concern over the company's financial health, the more weight the directors must accord to the interests of creditors over those of the shareholders. In this context, the courts consider the general financial health and solvency of the company in order to ascertain if there was reason to doubt or to be concerned over the financial viability of the company.</p>
2.	What are the key areas of potential liability for directors when a company is in financial difficulties?	<p>There are four main areas of risk: (i) insolvent/wrongful trading; (ii) fraudulent trading; (iii) misfeasance (or breach of duty); and (iv) disqualification and compensation orders. We discuss these four main areas of risk below.</p> <p>It should be noted that the provisions on insolvent/wrongful trading, fraudulent trading and misfeasance discussed below were migrated from the Singapore Companies Act to a new omnibus Insolvency, Restructuring and Dissolution Act with effect from 30 July 2020. Acts taking place prior to 30 July 2020 will be dealt with under the provisions of the Singapore Companies Act and acts taking place on or after 30 July 2020 will be dealt with under the provisions of the Insolvency, Restructuring and Dissolution Act. Except as discussed below, this does not give rise to any substantive difference as the provisions have not changed.</p>



No.	Question	Answer
		<p><b>(i) Insolvent/wrongful trading</b></p> <p><b><i>Please note that in response to the Covid-19 epidemic, the Singapore government has, in the COVID-19 (Temporary Measures) Act 2020, introduced a provision that provides a limited temporary relief from the offence of insolvent trading. This is discussed in greater detail in section 14 below.</i></b></p> <p>– Insolvent trading (applicable to acts prior to 30 July 2020)</p> <p>Under the offence of insolvent trading, an officer commits an offence if he is knowingly a party to the contracting by the company of a particular debt, having at that time no reasonable or probable ground to expect the company to be able to pay. An ‘officer’ includes not only directors, but also executive employees, privately appointed receivers and managers, and liquidators in members’ voluntary winding up. The test is objective and does not require fraud or dishonesty. Breach of the provision is an offence rendering the officer liable on conviction to a fine not exceeding SGD2,000 or to imprisonment for a term not exceeding three months. A prosecution for the offence may be brought not only during in course of winding up but also in any proceedings against the company. Upon conviction, the liquidator, any creditor or any contributory to the company may apply to court for a declaration that the officer be personally responsible, without any limitation of liability, for the payment of the whole or any part of that debt.</p> <p>– Wrongful trading (applicable to acts on or after 30 July 2020)</p> <p>The offence of insolvent trading has been replaced with a prohibition against wrongful trading. The prohibition, which gives rise to both civil and criminal liability, applies to acts on or after 30 July 2020.</p> <p>Similar to the offence of insolvent trading, wrongful trading occurs if the company, when insolvent, incurs debts or other liabilities without reasonable prospect of meeting them in full. It also occurs if the company, when solvent, incurs debts or other liabilities that it has no reasonable prospect of meeting in full and that result in the company becoming insolvent.</p> <p>However, while the offence of insolvent trading applied only to officers of the company, wrongful trading applies to any person who was a party to the wrongful trading if that person knew that the company was trading wrongfully. In addition, an officer of the company will also be liable if he or she was a party to the wrongful trading and, ought, in all the circumstances, to have known that the company was trading wrongfully. An ‘officer’ includes not only directors, but also executive employees, privately appointed receivers and managers, and liquidators in members’ voluntary winding up.</p> <p>A court may declare any such person to be liable for all or any of the debts or other liabilities of the company as it directs. An application for such a declaration may be brought on its own and, as a civil matter, liability is determined on a balance of probabilities. Separately, that person may also be found criminally liable (and the standard of proof is the higher standard of beyond reasonable doubt). If criminally liable, the person may be liable to a fine not exceeding SGD10,000 or to imprisonment for a term not exceeding three years or to both.</p>



No.	Question	Answer
		<p><b>(ii) Fraudulent Trading</b></p> <p>Fraudulent trading applies if it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose. Where there has been fraudulent trading, the court may declare that any person who was knowingly a party to the carrying on of the business in that manner be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as it directs. The application for such a declaration may be brought at any time in the course of winding up or in any proceedings against the company, and may be brought by the liquidator or any creditor or contributory of the company.</p> <p>In addition to civil liability, fraudulent trading is an offence rendering the persons responsible liable on conviction to a fine not exceeding SGD15,000 or to imprisonment for a term not exceeding seven years or to both.</p> <p>In order to establish the offence of fraudulent trading, it must be shown that the business of the company was carried out with the intention of defrauding the company's creditors or any other person or for any fraudulent purpose. This requires an element of dishonesty which results in an innocent party being deceived. The courts have held that the test is subjective but that they will test the defendant's claim against an objective standard. Accordingly, if a reasonable man would have found the actions dishonest, this will have a bearing on whether the court will accept the defendant's claim of honesty as credible.</p> <p><b>(iii) Misfeasance</b></p> <p>There are two aspects to the law of misfeasance in the zone of insolvency. First, as mentioned above, when a company is insolvent or likely to become insolvent the directors' duty to the company requires that they consider the interests of creditors in addition to, or to the exclusion of, the interests of shareholders. Liability for a breach of fiduciary duty is both civil (redounding in liability for damages to the company) and also, under Singapore law, a criminal offence.</p> <p>Secondly, where a company is in being wound up, the court may assess damages against an officer that has been has misapplied or retained or become liable or accountable for any money or property of the company or been guilty of any misfeasance or breach of trust or duty in relation to the company. This provision does not create any new rights but provides a summary mode of enforcing rights (ie, for the court make an order without a trial) in the winding up of the company. An application may be brought by the liquidator, any creditor or contributory. The court may order the officer responsible to repay or restore the money or property or any part thereof with interest at such rate as it thinks just. It may alternatively order the officer responsible to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust or duty as it thinks just.</p>



No.	Question	Answer
		<p><b>(iv) Disqualification orders</b></p> <p>Where a person is a director of a company which was insolvent at the time it went into liquidation and his conduct as a director makes him unfit to be a director of a company, the Minister for Finance or the Official Receiver may apply to court for a disqualification order against that person. A company is insolvent at the time it has gone into liquidation if it was unable to pay its debts at that time. In general, this may be established by showing that the company failed to satisfy a statutory demand for payment of a sum exceeding SGD15,000 (subject to our comments at section 14 below) or that the company was insolvent on the basis of the cashflow test (unable to satisfy its debts as they fall due) or the balance sheet test (its liabilities exceed its assets). It should be noted that these are also the grounds on which a company may be wound up by the court for being unable to pay its debts.</p> <p>In considering whether a person is unfit to be a director, the Singapore Companies Act sets out a list of matters that may be considered by the court. The list is not exhaustive and includes the following matters, among others:</p> <ul style="list-style-type: none"> <li>– whether there has been any misfeasance or breach of any fiduciary or other duty by the director in relation to the company;</li> <li>– whether there has been any misapplication or retention by the director of, or any conduct by the director giving rise to an obligation to account for, any money or other property of the company;</li> <li>– the extent of the director’s responsibility for the causes of the company becoming insolvent;</li> <li>– the extent of the director’s responsibility for any failure by the company to supply any goods or services which have been paid for (in whole or in part); and</li> <li>– whether the causes of the company becoming insolvent are attributable to its carrying on business in a particular industry where the risk of insolvency is generally recognised to be higher.</li> </ul> <p>A disqualification order may also be made against any person who was a director of the company during the three years before it went into liquidation but who was no longer a director of the company when it went into liquidation.</p> <p>If a disqualification order is granted, the person against whom it is made may not act as a director of a company, or be in any way, directly or indirectly, concerned in, or take part in the management of, a company. A court may make an order of disqualification for a period of up to five years from the date of the order. It is an offence to act in contravention of a disqualification order.</p>



No.	Question	Answer
3.	Does director's liability rest only on formally appointed managing directors, or also on others who perform managerial tasks?	<p>The Singapore Companies Act defines a director as any person who occupies the position of director, by whatever name called. This covers more than just formally appointed (<i>de jure</i>) directors and extends to a person who acts as a director (a <b>de facto director</b>) or a person in accordance with whose directions or instructions the directors of a company are accustomed to act (a <b>shadow director</b>). As regards the main liability risks discussed above, the persons who can be held liable are, in summary, as follows:</p> <p>(i) insolvent/wrongful trading:</p> <ul style="list-style-type: none"> <li>– (For acts prior to 30 July 2020) an officer of the company who was knowingly a party to the contracting of the debt may be held liable subject to the additional elements being satisfied (discussed below). The term 'officer' includes any director (whether <i>de jure</i>, <i>de facto</i> or a shadow director). It also includes any person employed in an executive capacity by the company, as well as a receiver and manager and any liquidator of a company appointed in a voluntary winding up.</li> <li>– (For acts on or after 30 July 2020) any person who was a party to the wrongful trading may be held liable subject to the additional elements being satisfied (discussed below).</li> </ul> <p>(ii) fraudulent trading: any person who was knowingly a <i>party</i> to the carrying on of the business for a fraudulent purpose (this will include persons dealing with the company who receive property with knowledge of the fraud);</p> <p>(iii) the duty to consider the interests of creditors applies to all directors (<i>de facto</i>, <i>de jure</i> or shadow directors). The misfeasance remedy is available against any past or present officer; liquidator; and any person involved in the formation, promotion or management of the company; and</p> <p>(iv) disqualification orders: any person occupying the position of director, by whatever name called (including <i>de facto</i> directors and shadow directors).</p>
4.	What are the liability risks for directors if the company borrows new money or enters into new contracts but may not be able to perform the ensuing obligations?	<p>The answer to this across the four main areas of liability risk discussed above at 2. is as follows:</p> <p>(i) Insolvent/wrongful trading:</p> <ul style="list-style-type: none"> <li>– (For acts prior to 30 July 2020) The issue is whether the officer responsible had no reasonable or probable ground to expect the company to be able to pay. While there have been no Singapore cases discussing this, it is generally accepted that the ability to pay must be determined in a realistic way, taking into account the extent and nature of the assets and liabilities of the business, cash available, whether it can be expected to pay by borrowing or realising assets, bearing in mind the possible illegality of any such processes, and any promises of new finance.</li> <li>– (For acts on or after 30 July 2020) For officers, the issue is whether the officer responsible ought, in all the circumstances, to have known that the company was trading wrongfully. The test is one of constructive rather than actual knowledge – what a reasonable man in the position of the officer should have known given the circumstances. The provision is new and there have been no cases on it as yet. For any other person, that person must have known that the company was trading wrongfully. This requires actual knowledge.</li> </ul> <p>(ii) Fraudulent Trading: As noted above, it must be shown that the business of the company was carried out with the intention of defrauding the company's creditors or any other person or for any fraudulent purpose. This requires an element of dishonesty which results in an innocent party being deceived.</p>



No.	Question	Answer
		<p>(iii) Misfeasance: directors who are by the relevant time required to think of the interest of creditors, generally, should not be increasing losses by continued trading including incurring further credit without a solution (light at the end of the tunnel) being reasonably likely.</p> <p>Disqualification order: causing the company to enter into contracts it cannot meet/comply with/satisfy may be a part of a picture showing the director is unfit to be concerned in the management of a company and should be disqualified. As noted above, the director's responsibility for the causes of the company becoming insolvent and the extent of the director's responsibility for any failure by the company to supply any goods or services which have been paid for (in whole or in part) are among the matters that the courts will consider in deciding whether a disqualification order should be made.</p>
5.	What are the liability risks in case of 'creditor stretching'?	Absent particular facts (for example, where a director fraudulently or negligently misstates the company's financial position), managing a company's cashflow ('creditor stretching') in times of financial distress is a relatively normal way for a company to seek to find the time to restructure. The critical issue is whether it is reasonable to believe a restructuring can be achieved. Deliberately paying some creditors (particularly connected creditors) ahead of others may render the directors vulnerable to attack.
6.	What are the liability risks in case of selective payments to some but not all creditors in case of liquidity issues? Is there a stage at which directors must treat all creditors equally?	As explained above, the key question here is whether there is a reasonable prospect of restructuring without a formal insolvency process. If there is such a reasonable prospect, and keeping in mind what is in the interests of creditors generally, directors have some flexibility in managing the company's cash. 'Ransom' payments to key creditors may be justifiable in such a scenario although equal treatment of the creditors of the same rank is usually the appropriate approach.
7.	Is there a distinction in this regard between preferential treatment of related entities and of other creditors?	As a general point, many legal rules make it inadvisable to pay connected persons in priority to others.
8.	Is there an obligation in case of financial difficulties to convene a shareholders meeting and if so, at what stage of financial difficulties?	No. As a matter of practice, directors generally do keep shareholders' updated as to the financial status of the company prior to taking any concrete step of action with regards the company. Directors can apply for a moratorium over proceedings as part of a package to restructure the company's debts. There is no specific point at which this can be done but the directors should, at the least, have enough of plan to be able to provide the court with a brief description of the intended compromise or arrangement, containing sufficient particulars to enable the court to assess whether the intended compromise or arrangement is feasible and merits consideration by the company's creditors.



No.	Question	Answer
9.	Is there an obligation at some stage to file for bankruptcy or other statutory insolvency protection regimes?	Singapore insolvency law does not have an express requirement to file at a particular time. The law operates by exposing directors to potential liability where filing is in the best interests of creditors and they do not file. It is therefore prudent for directors to file to avoid personal liability where that is the best outcome for creditors.
10.	Are there special liability risks in regard of certain debts, such as tax debts, social security payments, pension contributions?	No.
11.	Are the liability risks of the directors collective (the whole board is responsible/liable) or individual? On what grounds can a director exculpate himself from other directors' acts or omissions?	<p>Directors owe their duties individually as opposed to the board being collectively responsible. This means that each director has to form his/her own views independently as he/she considers appropriate. Directors may be allocated specific responsibilities and they will have primary responsibility in that area, but that does not absolve the other directors from responsibility for ensuring these duties are being discharged appropriately by the director concerned. This may involve directors challenging each other's actions and views in certain circumstances.</p> <p>As stated above, the minimum standard required of a director is that of a reasonably diligent person having the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as that director. However, the actual standard by which a particular director is judged will be higher if that director's general knowledge, skill and experience are, in fact, greater.</p> <p>In practice, boards will try to reach a unanimous decision on major issues such as whether to file for insolvency. Where, say, one director feels strongly that the company should file and the rest of the board consider it is reasonable to continue trading, that director may feel compelled to resign as director.</p> <p>There is a general defence under section 391, Companies Act to a breach of duty claim where a director has acted honestly and reasonably and, in the circumstances, the court concludes that he or she ought fairly to be excused.</p>
12.	Are there specific actions against directors under bankruptcy law?	Please see risks discussed above. It is worth noting in passing that in English law 'bankruptcy' is a term applied to the insolvency of individuals. 'Insolvency' is the term used for corporates.



No.	Question	Answer
13.	Are there specific duties of (or consequences for) shareholders or other group companies at some stage of the financial difficulties, such as an automatic subordination or conversion into equity of debt to parent companies?	<p>Singapore law does not have a general law of shareholder duties nor do we have thin capitalisation rules or a law of equitable subordination of shareholder loans. In an insolvency, for example, intercompany loans are not subordinated or converted into equity. There is a law of 'piercing the corporate veil' such that a parent company, say, may be made liable for the debts of its subsidiary but its scope is narrow and often involves other concepts such as fraud, agency, or sham transactions.</p> <p>A few specific points to note in the context of group companies:</p> <ul style="list-style-type: none"> <li>(i) If a director is on the board of a number of companies in a group, he/she must wear his or her hat as director of each company in turn, individually, and consider the financial position of <b>that</b> company alone when making decisions for each company.</li> <li>(ii) There is also a positive obligation for directors to avoid potential conflicts of interest. For example, a director should ensure that the financial difficulties have not caused a potential conflict of interest with their position as director of other companies within a group. Where there is a potential conflict of interest, consideration should be given to whether the relevant director might resign from one or more of his or her positions or recuse himself or herself and take no part in the board discussions or decision-making at one company or the other.</li> <li>(iii) A common director of two companies (for example, a director of a parent and its subsidiary) with confidential information at parent level which concerns the financial position of the subsidiary may be placed in an awkward position as there is an issue of conflict of interest.</li> <li>(iv) Where a parent company or the directors of such a parent operate a "hands on" approach to running the group and interfere persistently in the management of the subsidiary companies, the parent company (or, exceptionally, its directors) may be a shadow or <i>de facto</i> director of the subsidiary and accordingly the attendant duties and potential liabilities set out in the sections above will attach to them.</li> </ul>
14.	Is there special legislation mitigating the liability risks of directors specifically in view of the Covid-19 crisis?	<p>The COVID-19 (Temporary Measures) Act 2020 (<b>Covid-19 Act</b>) modifies the offence of insolvent / wrongful trading in respect of debts incurred during the period 20 April to 19 October 2020. The act states that where a debt is incurred during the period from 20 April to 19 October 2020, the officer is not to be treated as having no reasonable or probable ground of expectation that the company would be able to repay the debt if the debt was incurred in the ordinary course of business and before the appointment of a judicial manager or liquidator. A similar modification has been made to the offence of insolvent trading by officers of limited liability partnerships and trustee-managers of business trusts. Directors will continue to be liable where debts are incurred fraudulently.</p> <p>The Covid-19 Act also changes the threshold and time period for statutory demands (a precursor to a creditor winding-up), requiring that the demand be for a minimum of SGD100,000 and allowing a company up to 6 months to pay.</p>



## Contacts

---



**Prakash Segaran**  
Partner  
Tel +65 6671 6060  
prakash.segaran@allenoverly.com



**Rishi Hindocha**  
Counsel  
Tel +65 6671 6274  
rishi.hindocha@allenoverly.com



**Shuhui Kwok**  
Counsel  
Tel +65 6671 6065  
shuhui.kwok@allenoverly.com



For more information, please contact:

## London

Allen & Overy LLP  
One Bishops Square  
London  
E1 6AD  
United Kingdom

Tel +44 20 3088 0000  
Fax +44 20 3088 0088

---

## GLOBAL PRESENCE

---

Allen & Overy is an international legal practice with approximately 5,500 people, including some 550 partners, working in over 40 offices worldwide.

**Allen & Overy** means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales.

The term **partner** is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings.

A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.