Azero Investments SA v Velstra Pte Ltd and Another Appeal
[2005] SGCA 44

Case Number : CA 124/2004, 125/2004

Decision Date : 19 September 2005

Tribunal/Court : Court of Appeal

Coram : Chao Hick Tin JA; Kan Ting Chiu J; Yong Pung How CJ

Counsel Name(s) : Conrad Campos (Robert Wang and Woo LLC) for Azero Investments SA; Vinodh Coomaraswamy SC and David Chan (Shook Lin and Bok) for Velstra Pte Ltd

Parties : Azero Investments SA — Velstra Pte Ltd

Insolvency Law – Avoidance of transactions – Unfair preferences – Whether assignment of debt constituting unfair preference – Whether garnishee payments should be reversed on ground of unfair preference – Sections 99, 100 Bankruptcy Act (Cap 20, 2000 Rev Ed), s 329 Companies Act (Cap 50, 1994 Rev Ed)

Trusts – Recipient liability – Company's debt assigned to another creditor – Company's bank accounts subject to garnishee orders – Whether director breaching fiduciary duties owed to company in allowing garnished sums to be paid – Whether recipient receiving garnishee proceeds knowing that they were transferred in breach of trust – Whether recipient liable as constructive trustee

19 September 2005 *Judgment reserved.*

Kan Ting Chiu J (delivering the judgment of the court):

Background

1 Velstra Pte Ltd ("Velstra"), a company incorporated in Singapore, was fully owned by a Belgian company, Language Development Fund ("LDF"). LDF also owned a chain of language development companies (hereinafter referred to as "the LDCs"). A Belgian national, Tony Snauwaert ("Snauwaert"), was a director of Velstra and LDF.

2 LDF and Velstra were closely related to Lernout & Hauspie Speech Products NV ("L&H"), a leading provider of speech recognition software. L&H was founded by three Belgians, Jo Lernout ("Lernout"), Pol Hauspie ("Hauspie") and Nico Willaert ("Willaert").

3 Azero Investments SA ("Azero") was a company incorporated in Luxembourg. A F Veltmeijer ("Veltmeijer") was a director of Azero.

4 Veltmeijer was keen for Azero to invest in L&H, and had discussions with Snauwaert. Snauwaert suggested that Azero invest in Velstra instead, but Veltmeijer preferred to invest in a Belgian company. Snauwaert then proposed that the investment be in the form of a loan to BVBA Language Development Service ("LDS"), a shareholder of LDF, secured by the personal guarantees of Lernout, Hauspie and Willaert (hereinafter referred to collectively as "the sureties"). Snauwaert was also a director of LDS.

5 This proposal was accepted and in November 1999, Azero made a loan of €2m to LDS, secured by a surety agreement executed by the sureties. The loan was to be repaid on 31 May 2001.

6 The €2m was not retained by LDS. Without informing Azero, LDS entered into two sub-loan

agreements to advance €1.5m to Velstra and the balance €500,000 to Four One-One.Com Pte Ltd ("411"), a subsidiary company of LDF.

7 In mid-2000, negative reports about L&H surfaced. Veltmeijer began to make enquiries from LDS about Azero's loan. He was told by Snauwaert of the sub-loans, and he also came to realise that Velstra and the LDCs were just letter-box companies which held licences from L&H. However, Snauwaert represented to Veltmeijer that the LDCs had value, and put up a proposal to Veltmeijer to restructure LDF.

8 In March or April 2001, Azero considered taking over LDF. LDF shares were acquired to obtain access to LDF's financial statements, and the services of accountants and lawyers were engaged. The trial judge accepted that Azero made these efforts in good faith. When the loan to LDS fell due on 31 May 2001, no payment was made. On 1 June 2001, Azero's lawyers, Advocatenassociate Gilkens Panis Vandersanden ("AGPV"), wrote to LDS to demand for payment and for information on any action LDS had taken to recover the sub-loan to Velstra.

9 That set off a series of developments. On 11 June 2001, LDS's lawyers, Advocatenkantoor Mattijs, Van Roy, Voet & Co ("AMVRV & Co"), replied that LDS was unable to repay the loan and proposed that LDS assign to Azero the sub-loans to Velstra and 411. On 13 June 2001, AMVRV & Co sent to AGPV a printout of the bank balances of the LDCs, Velstra and 411. On 14 June 2001, the sub-loans of Velstra and 411 were formally assigned to Azero, and LDS's debt to Azero was discharged and the sureties were released.

10 On 22 June 2001, notice of assignment was given to Velstra. On 3 July 2001, Azero commenced proceedings against Velstra, and obtained judgment in default of appearance on 12 July 2001 for US$1,872,240, interest and costs.

11 On 20 July 2001, Azero applied to garnish Velstra's two bank accounts with the Development Bank of Singapore ("DBS") and KBC Bank NV ("KBC"), and garnishee orders absolute were made against the DBS account for US$91,546.48 and the KBC account for US$204,543.98. On 10 August 2001, KBC paid US$204,457.98 to Velstra and on 21 August 2001, DBS paid US$91,347.04, making a total of US$295,805.02.

12 After the amounts were garnished, Velstra deposited various sums into the DBS account. On 9 November 2001 the amount in the account stood at US$250,346.98. Azero took further garnishee proceedings and received payment of US$250,145.08 (with a deduction of S$140 for the costs of DBS) on 18 December 2001.

13 The total amount Azero received through the garnishee proceedings was US$546,152.

14 On 12 April 2002, Velstra was wound up on a petition filed on 22 March 2002 by a creditor, Harout Khatchadourian, who had loaned Velstra US$36m. After Velstra was wound up, he funded Velstra's liquidators in this action as well as other actions to recover Velstra's assets. Velstra's liquidators were the effective plaintiff in the action below.

The plaintiff's action

15 The plaintiff commenced action against Azero to claim the three sums Azero received through the garnishee proceedings.

16 The plaintiff's claims were founded on two grounds:

(a) that the garnishment of Velstra's accounts were tainted by an unfair preference given to Azero; and

(b) Azero held the garnishee proceeds as a constructive trustee for Velstra because Azero received them with actual or constructive notice that Snauwaert had acted in breach of his fiduciary duties as a director of Velstra in allowing those sums to be paid to Azero.

Unfair preference

17 This claim is founded on s 329 of the Companies Act (Cap 50, 1994 Rev Ed) ("CA") read with ss 99 and 100 of the Bankruptcy Act (Cap 20, 2000 Rev Ed) ("BA").

18 Sections 329(1) and 329(2) of the CA read:

> (1) Subject to this Act and such modifications as may be prescribed, any transfer, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company which, had it been made or done by or against an individual, would in his bankruptcy be void or voidable under section 98, 99 or 103 of the Bankruptcy Act 1995 (read with sections 100, 101 and 102 thereof) shall in the event of the company being wound up be void or voidable in like manner.
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> (2) For the purposes of this section, the date which corresponds with the date of presentation of the bankruptcy petition in the case of an individual shall be —
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> (*a*) in the case of a winding up by the Court —
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> (i) the date of the presentation of the petition; or
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> (ii) where before the presentation of the petition a resolution has been passed by the company for voluntary winding up, the date upon which the resolution to wind up the company voluntarily is passed,
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> whichever is the earlier; and
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> (*b*) in the case of a voluntary winding up, the date upon which the winding up is deemed by this Act to have commenced.

19 Sections 99(1) and 99(3) of the BA provide that:

> (1) Subject to this section and sections 100 and 102, where an individual is adjudged bankrupt and he has, at the relevant time (as defined in section 100), given an unfair preference to any person, the Official Assignee may apply to the court for an order under this section.
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> …
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> (3) For the purposes of this section and sections 100 and 102, an individual gives an unfair preference to a person if —
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> (*a*) that person is one of the individual's creditors or a surety or guarantor for any of his debts or other liabilities; and

(*b*) the individual does anything or suffers anything to be done which (in either case) has the effect of putting that person into a position which, in the event of the individual's bankruptcy, will be better than the position he would have been in if that thing had not been done.

and s 100(1) of the BA provides that:

Subject to this section, the time at which an individual enters into a transaction at an undervalue or gives an unfair preference shall be a relevant time if the transaction is entered into or the preference given —

(*a*) in the case of a transaction at an undervalue, within the period of 5 years ending with the day of the presentation of the bankruptcy petition on which the individual is adjudged bankrupt;

(*b*) in the case of an unfair preference which is not a transaction at an undervalue and is given to a person who is an associate of the individual (otherwise than by reason only of being his employee), within the period of 2 years ending with that day; and

(*c*) in any other case of an unfair preference which is not a transaction at an undervalue, within the period of 6 months ending with that day.

20 The trial judge found that Velstra was insolvent, but rejected the plaintiff's contentions that Azero was an associate of or a person connected with Velstra. In her judgment, [2004] SGHC 251, the judge stated that:

94 The plaintiff had pleaded that Snauwaert owed and breached his fiduciary duties as a director. This was not denied by the defendant and hence is not in issue. …

95 [I]t cannot be disputed that were it not for the Assignment, the defendant would have had to sue the original debtor, LDS, under Belgian law when the loan remained unpaid after 31 May 2001. It would not have sued LDS in Singapore. Had the defendant obtained judgment in Belgium against LDS, it could not have garnished the plaintiff's debt to LDS under Singapore law. Different jurisdictions would be involved and the defendant would not have been a judgment creditor under Singapore law. *Snauwaert's act*, in his capacity as a common director of LDS and the plaintiff, *in giving the Assignment* undoubtedly overcame the defendant's legal difficulties and I reject the defendant's arguments to the contrary.

96 Based on the scenario in [95], it is my view that *Snauwaert's conduct fell squarely within s 99(1)(b)* [correctly s 99(3)(b)] of the Bankruptcy Act [which deals with the giving of unfair preference]. I had observed earlier at [81] that *Snauwaert went out of his way to make the Assignment an effective instrument for the defendant to recover the loan (in part).* In its closing submissions, the defendant argued that as the execution of the Assignment by Snauwaert on behalf of LDS was in discharge of his duties owed to the defendant as a creditor, it was not influenced by a desire to put the defendant in a better position than other creditors. I disagree. The fiduciary duty owed by Snauwaert to act in the plaintiff's best interests took precedence over any duty he owed to third party creditors, let alone to a particular creditor.

[emphasis added]

These passages indicated that the judge found that unfair preference was given to Azero when LDS assigned the two sub-loans to Azero on 14 June 2001.

21 Azero's counsel pointed out that the judge's statement at [94] that Azero had not denied that Snauwaert had breached his fiduciary duties as director was not consistent with another statement in the judgment at [43]:

> The defendant denied that the execution of the Assignment was a breach of the fiduciary duties Snauwaert owed to the plaintiff.

22 At the conclusion of the judgment, the judge found in favour of the plaintiff on the third sum garnished and paid on 18 December 2001, apparently because the first two amounts received on 10 August 2001 and 21 August 2001 were received more than six months prior to the presentation of the winding-up petition on 22 March 2002, whereas the third payment received on 18 December 2001 came within the six-month period prescribed in s 100(1)(*c*) of the BA. This finding is at variance with [96] of the judgment set out in [20] above that it was the assignment that constituted unfair preference, as distinct from the receipt of the garnishee proceeds. On the basis that the assignment was the act which gave rise to unfair preference then 14 June 2001 should be the operative date. Section 100(1)(*c*) of the BA makes it clear that in this case, the relevant period is the six months from 14 June 2001. As the winding-up petition was not presented until 22 March 2002, the assignment did not come within the relevant period.

23 While Velstra agreed with the view of the judge, Azero contended that the approach was erroneous. Azero submitted:

> On the facts of the present case, the Learned Judge failed to take into account the fact that at the time of the Assignment, Azero was not a creditor of Velstra. It was a creditor of LDS. Azero became a creditor of Velstra by reason of the notice of assignment on 25 June 2001 or at the earliest, at the date of Assignment on 14 June 2001. The Assignment of 14 June 2001 was the transaction that made Azero a creditor of Velstra and therefore, it could not at the same time be the act that put Azero in a better position as a creditor of Velstra. Thus, the Assignment does not qualify as an act of preference for the purpose of Section 99 of the Bankruptcy Act.

24 The combined effect of ss 329(1) and 329(2) of the CA and ss 99(1) and 99(3)(*b*) of the BA (see [18] and [19] above) is that a company gives an unfair preference to a creditor when it does something or suffers something to be done which would place the creditor in a better position in the event the company is wound up. However, in the situation here, it cannot be said that Velstra had given an unfair preference to Azero. Azero was not a creditor of Velstra. Azero was a creditor of LDS which was in turn a creditor of Velstra. Velstra did not assign anything to Azero. It was LDS which assigned the debt due from Velstra to Azero. On 14 June 2001 Velstra did not have anything to do with Azero. All that the assignment entailed was that instead of Velstra owing the sum of €1.5m to LDS, Velstra thereafter owed it to Azero. There was no change to Velstra's position. Its obligation remained the same, namely, to repay the €1.5m it borrowed.

25 Accordingly, the effect of the assignment was to transform Azero, which was hitherto not a creditor, into a creditor of Velstra.

26 In the course of the appeal, a question was brought up as to whether there could be unfair preference as the assignment did not improve Azero's position. Azero was an unsecured creditor of LDS. When LDS assigned Velstra's debt to Azero, Azero remained an unsecured creditor. Therefore, it was argued that the assignment did not place Azero in a better position.

27 This argument may not be valid. An unfair preference may be obtained even if the debt remained as an unsecured debt. A creditor is placed in a better position when it is able to get at a debtor's assets which it otherwise could not. Without the assignment, Azero could not garnish Velstra's bank accounts. The difficulty the plaintiff faced was that the advantage was not conferred by Velstra; it was given to Azero as a creditor of LDS.

Constructive trust

28 The plaintiff's case on constructive trust stemmed from its case that when Snauwaert breached his fiduciary duties in connection with the assignment, he also committed a breach of trust of Velstra's funds that were assigned.

29 The judge found in [95] and [96] of the judgment set out in [20] hereof that Snauwaert owed a duty to Velstra when he assigned Velstra's debt to LDS to Azero. The judge went on to state at [97] to [99]:

> 97 As the defendant's [Azero's] closing submissions conceded that the moneys in the KBC and DBS accounts totalling US$546,152 constituted trust property, the only question that needs to be determined is whether the defendant [Azero] is liable to account for the last sum garnished, as constructive trustee of the plaintiff.
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> 98 Both sides agreed that the following requirements founded a constructive trusts, *viz*:
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> (a) a particular property was subject to a trust;
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> (b) there was a transfer of that property by a fiduciary;
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> (c) the transfer was in breach of the fiduciary's duties;
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> (d) the defendant received the property or its traceable proceeds;
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> (e) the receipt was for the defendant's benefit;
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> (f) the defendant received the property with knowledge that it was trust property and that it had been transferred in breach of trust.
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> In this case, items (a) to (e) are clearly satisfied; the only issue is item (f). Did Veltmeijer know in relation to the sum of US$250,346.98 that the defendant was receiving trust property and that it had been transferred in breach of trust?
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> 99 To answer that question, it is necessary to go back to the time of the Assignment. Whatever may have been the motives of Snauwaert in revealing the bank balances of the various LDCs by the 13 June letter, there is no doubt in my mind that Veltmeijer was persuaded by the healthy balances of the LDCs to accept the Assignment on the following day, as a viable alternative for the defendant to recover the loan. Consequently, he knew or must have known that Snauwaert's act of assigning the debt of the plaintiff was instrumental in the defendant's obtaining US$546,152, at a time when Veltmeijer had been told personally that LDS could not repay the loan due to the plaintiff's default on the loan. Moneys to repay the loan had to come from other sources of the plaintiff, which sources were revealed to Veltmeijer in the 13 June letter. It is not an insignificant fact that Veltmeijer and Snauwaert even agreed that the defendant would not garnish *all* the moneys in the KBC account but would leave US$5,000 for the

plaintiff's operating expenses. The action to recover the loan by way of the Assignment was pre-planned. Accordingly, I answer the question posed in [98] above in the affirmative.

To put it simply in the context of this issue, what was said was that Snauwaert had breached his fiduciary duties to Velstra, and Azero had knowledge of it.

30 In the judgment, the sums recovered under the first and second garnishee proceedings were treated differently from the sum recovered from the third garnishee proceedings. Although the plaintiff was found to have proved its case on constructive trust, judgment was entered only for the US$250,346.98 recovered in the third proceedings. As the breach of fiduciary duties was found to arise from the assignment of Velstra's debt to Azero, the whole amount recovered pursuant to the assignment should be affected. The six-month period that applied to unfair preferences has no application to constructive trusts.

31 This part of the judgment did not satisfy either party. The plaintiff appealed to recover the full US$546,152 on the ground of constructive trust, and Azero appealed to set aside the judgment for the US$250,346.98.

32 As was noted at [21] hereof, there was actually no admission by Azero that the assignment of Velstra's debt to Azero was made in breach of Snauwaert's fiduciary duties as a director of Velstra.

33 It bears repeating that Velstra was not a party to the assignment agreement; the parties were LDS which was the assignor, and Azero was the assignee. In this light, the last sentence of [96] of the judgment below raised two questions: (a) Did Snauwaert owe Velstra any duty in connection with the assignment? and (b) What was the duty that was referred to?

34 When LDS assigned Velstra's debt to Azero, Snauwaert was not acting in his capacity as a director of Velstra. He executed the assignment as a director of LDS. If there were a breach of his fiduciary duties as a director of Velstra, it would have been a breach by omission, by failing to act. However there was no finding that Snauwaert had a duty as a director of Velstra to prevent LDS from making the assignment.

35 The judge stated that a director of a debtor company like Velstra owed a duty to the company above his duties to the company's creditors. That may be so, but clearly whether an admission and payment of a debt is a breach of the duty must be viewed in its context.

36 Take two situations. In one situation, a company is indebted to a creditor, but there are no legal proceedings taken and no demands for payment. At the same time, the company needs to make a deposit on a factory that it requires for its extended operations, and funds sufficient to meet the debt are expected to come in shortly. It can be argued that the directors would have failed in their duties if they used the company's funds to pay the creditor, and cause the company to lose the opportunity to secure the factory. In another situation, a company is facing a creditor which has obtained judgment and is threatening to wind it up if the debt is not paid, and no fresh funds are forthcoming. The directors of the company decide to use the funds of the company to pay off the creditor and avert the threat, and forgo its plans on the factory. In this situation, it would be more difficult to make out a case that the directors have failed in their duties.

37 In the present case, if Velstra had a say in the assignment, it is arguable that the directors should consider whether the assignment was against Velstra's interest by putting it in the position of having to face a vigorous and demanding creditor rather than the original passive creditor. But as Velstra did not have a say on the assignment, Velstra's directors could not have breached their

fiduciary duties because of it. Following from that, Azero could not have received the money with knowledge or deemed knowledge that it was transferred in breach of trust.

Conclusion

38 On the foregoing examination of the case, there was no unfair preference conferred by Velstra to Azero and the garnished proceeds were not transferred from Velstra to Azero in breach of trust. Consequently, Azero's appeal is allowed with costs, and Velstra's appeal is dismissed with costs.