Chip Thye Enterprises Pte Ltd (in liquidation) v Phay Gi Mo and Others
[2003] SGHC 307

Case Number : Suit 103/2002

Decision Date : 09 December 2003

Tribunal/Court : High Court

Coram : Belinda Ang Saw Ean J

Counsel Name(s) : Nicholas Loh and Christopher Yong (Legal21 LLC) for plaintiffs; Ravi Chelliah and Lee Hwai Bin (Chelliah and Kiang) for first to third defendants; Pey Ciew Chang, fourth defendant, in person

Parties : Chip Thye Enterprises Pte Ltd (in liquidation) — Phay Gi Mo; Pey Lim Cheng; Estate of Lee Tiang Chin, Deceased; Pey Ciew Chang

Companies – Directors – Duties – Dividend declaration when company insolvent – Whether constitutes breach of directors' duties

Companies – Directors – Liabilities – Dividends declared in absence or excess of profits

Insolvency Law – Avoidance of transactions – Relevant test for insolvency – Allegation that transactions carried out whilst company solvent

1 This action is brought by the Plaintiff, Chip Thye Enterprises (Pte) Ltd (in Liquidation), acting through its liquidator against the Defendants, some of whom were the shareholders and former directors of the Plaintiff.

History and Dispute

2 The Plaintiff was incorporated on 20 January 1973. It was a family owned company engaged in the building construction business. Phay Gi Mo, the 1st Defendant ("D1") and Pey Lim Cheng, the 2nd Defendant ("D2") are brothers and they managed the business. D2 as the chairman and director was the major shareholder (46.7%) of the company. D1 was the managing director with a 33.3% share in the equity of the company. The 4th Defendant, Pey Ciew Chang ("D4") is the son of D2 and he held a 6.7% interest in the company and was a director from 1982 until 15 April 1994. D1 is the uncle of D4.

3 The estate of Lee Tiang Chin, deceased is the 3rd Defendant ("D3"). Lee Tiang Chin was the wife of D2. D2 is now the personal representative of her estate. Prior to her death, Lee Tiang Chin held a 13.3% stake in the Plaintiff. By Order of Court dated 21 June 2002, the proceeding against D3 was allowed to continue against D2 as personal representative of the estate as if he was substituted as a party.

4 The Plaintiff was the main contractor of a condominium and bungalow development at Tanglin Hill. The owner and developer of the Tanglin Hill project was Capital Realty Pte Ltd ("Capital Realty"). The Plaintiff subcontracted the entire building contract to Articon Construction Pte Ltd ("Articon").

5 It is common ground that the Plaintiff allowed its name to be used by Articon to tender for the Tanglin Hill project as Articon did not have the required CIDB rating to tender for such a large project. For lending its name to secure the contract, Articon was to pay to the Plaintiff what was described by D1 as administrative expenses in the sum of $150,000. Articon's loan facility of $4.7 million being its working capital requirements for the Tanglin Hill project was guaranteed by a corporate guarantee from the Plaintiff. The Plaintiff executed in favour of Overseas Union Bank

("OUB"), a Deed of Assignment whereby the Plaintiff assigned all its rights, title and interest to and in all payments arising out of the Tanglin Hill project. The project was completed at the end of 1997. Articon was wound up by an Order of Court dated 28 May 1999.

6 The close relationship between the Plaintiff and Articon was not denied. The Plaintiff had a 35% shareholding in Articon and another 16.6% were held by D4. D4 was a director of Articon from 1983 to 1999.

7 In Civil Appeal no. 50 of 2000 reported in [2000] 4 SLR 548, the Court of Appeal allowed Capital Realty's appeal for the repayment of an outstanding loan in the sum of $500,000. The appellate court found that the various payments made by Capital Realty were loans to the Plaintiff and judgment was entered against the Plaintiff. The Plaintiff defaulted on the judgment and Capital Realty on 13 February 2001 petitioned for the company to be wound up. The Plaintiff was wound up by Order of Court on 23 March 2001.

8 The Plaintiff was named as main contractor in contemporaneous documents such as letters from the quantity surveyor and the architect. Chao JA delivering the judgment of the Court of Appeal made the following observations at 558: "The documentary evidence further showed that during the course of the [Tanglin Hill] project, the respondents [Chip Thye] and Articon did not draw a clear distinction between themselves. Letters addressed to one would be responded to by the other. Payments for invoices directed at the respondents [Chip Thye] would be settled by Articon and vice versa." It was noted in the report that although D1 was not a director of Articon, nevertheless he was a cheque signatory to the bank account of Articon.

9 The liquidator's contention is that once the Plaintiff was insolvent, D1 and D2 as directors owed a duty to keep its property inviolate in order to pay its creditors. This breach of duty of the directors of the Plaintiff, in failing to act bona fide in the interests of its creditors during the Plaintiff's insolvency, forms the basis for the action against D1 and D2. The complaint against D1 and D2 involved breaches of directors' duties and arising in consequence of the fiduciary character of their duties, obligations as trustee of the Plaintiff's assets in respect of six specific improper transactions ("improper transactions"). Initially the improper transactions numbered in total seven until one allegation concerning audit confirmations to Articon was withdrawn during the course of the trial. The liquidator of the Plaintiff, Khoo Ho Tong ("KHT"), contends that most if not all the improper transactions resulted in the Defendants benefitting exclusively at the expense of the Plaintiff and its creditors and at the time when the Plaintiff was insolvent.

10 D1 and D2 contend that the transactions in question were done or made when the company was solvent. There was nothing improper about the transactions.

11 D2 did not testify at the trial. D1 and D4 said that he is old and suffers from ill health. Their approach was that whatever D1 had to say, it would equally apply to D2. It was also the Defendants' stance towards the alleged improper transactions that D1 and D2 acted on the advice of the auditors. The difficulty with the argument is that without calling the auditors the truth of what was said is not proven. The Defendants are left with their bare assertion which, at best, is hearsay evidence and is not admissible.

The Law on Directors' Duties

12 The three broad categories of director's duties are: fiduciary, duties of skill, care and diligence, and statutory duties. The general principle is that directors have a duty to act in the best interest of the company as a whole. The directors owe fiduciary duties to the company, not to the

individual shareholders.

13 When a company is insolvent, the interests of the creditors become the dominant factor in what constitutes the "benefit of the company as a whole." See *West Mercia Safetywear Limited (In Liq.) v Dodd* [1988] BCLC 250 which was followed and applied by Tay Yong Kwang JC (as he then was) in *Tong Tien See Construction Pte Ltd (in liquidation) v Tong Tien See & Ors* [2002] 3 SLR 76.

14 Dillon LJ in *West Mercia* approved the speech of Street CJ in *Kinsela v Russell Kinsela Pty Ltd (in liq)* [1986] ACLR 395 at 401, where Street CJ said:

> "In a solvent company the propriety interests of the shareholders entitle them as a general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the directors, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense their assets and not the shareholder's assets that, through the medium of the company, are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration."

15 The duty is owed to creditors present or future: *Winkworth v Edward Baron Development Co Ltd & Ors* [1986] 1WLR 1512 at 1516.

16 Lai Siu Chiu J in *Federal Express Pacific Inc. & Another v Meglis Airfreight Pte Ltd and 5 Ors*, Suit No. 96 of 1998, 20 February 1998 (unreported) at paragraph 17 of her Grounds of Decision after reviewing some of the cases referred to above including *Nicolson v Permakraft* [1985] 1 NZLR 242 (3 ACLC 453) and *Brady v Brady* [1988] 2 All ER 617 said:

> "Whatever is the scope of the directors' fiduciary duties towards creditors, it is clear from the authorities above that they do owe such duties to the company's creditors when the company, through their actions, is insolvent, potentially insolvent or put in a situation where its creditors will be prejudiced and the company is or likely to be unable to satisfy its debts with these creditors."

Test of Insolvency

17 There is support in the cases for the view that the test for putting a company into liquidation under s254(1)(e) read with subsection (2)(c) of the Companies Act (Cap.50) is one of fact to be decided in the light of all the circumstances of the case: *Re Sanpete Builders (S) Pte Ltd* [1989] 1 MLJ 393. Insolvency is established as a fact in a number of ways: *Societe General v Statoil Asia Pacific Pte Ltd*, Suit no. 786 of 1999, 20 April 2000, decision of Rajendran J (unreported). The court would look, for instance, at the accumulated losses to see if it were in excess of its capital; nature of the assets of company or were they book debts; current liabilities over current assets; prospect of fresh capital or financial support from shareholders and incoming payments from any source to discharge the debts including credit resources. See Chao JC (as he then was) in *Re Sanpete Builders (S) Pte Ltd* at 400.

18 These cases expanded the tests of insolvency enunciated by Grimberg JC in *Re Great Eastern Hotel (Pte) Ltd* [1998] SLR 841. The tests of insolvency applied were termed by the learned Judicial Commissioner as the practical and theoretical tests. The practical test answers the question "Has the company failed to meet a current demand for a debt already due?" and the theoretical test looks at

whether there is a deficit after balancing overall liabilities against assets.

19 The question to ask is "when was the company unable to pay its debts as they fell due?". It is to be answered by focusing on the company's financial position taken as a whole by reference to whether a person would expect that at some point the company would be unable to meet a liability. The various tests such as quick assets test, balance sheet test or cash flow test are all different measures of solvency and depending on the facts of the case, one test or a combination of tests may or may not be found to be appropriate. A surplus or deficiency of net assets is indicative but not necessarily determinative in establishing whether or not an entity is able to pay all its debts as and when they become due and payable. The "Quick Assets" test (sometimes known as Liquid test or Acid test), which was referred to in *Re Great Eastern Hotel*, is where quick assets are compared to current liabilities. "Quick" assets are those which can be readily converted into cash. The comparison gives an indication of the ability of an entity to meet current liabilities from the assets that are most readily convertible into cash.

20 In my judgment, it is neither helpful nor necessary to lean in favour of one or the other test. There is no single test for insolvency. Ultimately, as the cases decided by the High Court since *Re Great Eastern Hotel* illustrate, regard is given to all of the evidence that appears relevant to the question of insolvency. This approach is all the more applicable to a company (like the Plaintiff) that has already been wound up under s254(1)(e) of the Act and the liquidator of the company seeks to attack various transactions entered into or made before the liquidation but at the time the company was insolvent or of doubtful solvency.

The solvency of the Plaintiff- in the financial years ended 28 February 1999 to 2001

The liquidator's indicia for insolvency

21 KHT who has had access to the financial and accounting records of the Plaintiff testified as to the true financial position of the company for the financial years 1999 to 2001. He testified that the company was insolvent since the financial year ended 28 February 1999 in that its current liabilities exceeded its current assets and there was a net deficiency in assets in the balance sheet. KHT restated the balance sheets of the company for the three successive year-ends. In the restated balance sheets (PB6, PB8 and PB11), KHT took into account debts owing by a subsidiary and related company and contingent liabilities. Both items have a significant impact on the financial position of the company.

Debts owing by subsidiary and related company

22 For the three financial years ended 28 February 1999, 2000 and 2001, a significant portion of the net assets of the company as can be seen from Table 1 below is comprised of debts owed by a subsidiary company, Centrad Engineering Pte Limited ("CE") and Centrad Technology Pte Limited ("CT"), an associated company of CE. It is therefore appropriate to scrutinize these on their recoverability.

Table 1: Debts owing by subsidiary and related company

As at 28 February	1998	1999	2000	2001
	$	$	$	$

Owing by CE	443,387	449,440	465,800	471,500
Owing by CT	72,146	409,934	424,766	424,766
	_____	_____	_____	_____
	515,533	859,374	890,566	896,266
	======	======	======	======
Net Assets of Chip Thye Enterprise	1,467,721	1,404,969	976,866	1,073,992
	=======	=======	======	=======
As a percentage of Net Assets of Chip Thye Enterprises	35.1%	61.2%	91.2%	83.5%

23 The debts owing by both CE and CT have been highlighted by the Plaintiff's auditors in their audit report for the audited financial statements for years ended 28 February 1997, 1998 and 1999. Because of the material amounts and the fact that the two companies sustained significant losses, the auditors were of the view that provisions against the debts may be necessary and in the event no provisions were made against the debts, they were unable to form a true and fair opinion on the company's accounts for those years.

24 The Plaintiff's investment in CE amounted to $600,000 and provision for diminution in value was already made against it as early as in the financial statements for the year ended 28 February 1996. In a directors' resolution dated 15 September 2000 following an EGM held on 15 September 1999 to dispose of CE to D1 and D2, mention was made that CE had net liabilities of $936,000 or $1.56 per CE share as at 28 February 1998.

25 CT's audited accounts for the financial year ended 30 June 1997 was signed by the directors and auditors on 14 August 1999. CT's balance sheet showed a net deficiency of assets of $871,667 and the auditors in their report raised doubts on the company's ability to continue as a going concern without the support of the directors and shareholders.

26 In the Plaintiff's audited financial statements for the financial year 1999, the subsidiary and related company debts increased to $859,374 from $515,533 the previous year. This was because $317,000 which had been in the past booked as a debt owing by D4 to the Plaintiff was claimed to be an erroneous entry and the sum was reflected as owing by CT instead of D4. CT itself required financial support from its directors and shareholders since 1996 and D4 who was a director of CT admits that no fresh capital was injected into the company.

27 Given the state of affairs of the Plaintiff and with what was known at the relevant times, D1 and D2 ought to have made provisions against those debts. The debts owing by CE and CT were subsequently confirmed as bad debts in the Statement of Affairs dated 23 March 2001, signed by D1.

28 Accordingly, I agree with KHT that the Plaintiff's net assets for the respective financial years ended 28 February 1999, 2000 and 2001 are to be reduced by provisions against the debts owing by CE and CT at the time.

Contingent liabilities

29 In determining balance sheet insolvency, due regard must be given to contingent liabilities. In the Plaintiff's situation, the contingent liabilities were those of their nominated subcontractors of the Tanglin Hill project and they arose as a result of a business arrangement with an associated company, Articon. The project was completed sometime towards the end of 1997. The arrangement it had with Articon for the latter to pay nominated subcontractors would, if not earlier, have came to an end when Articon was wound up. The winding up of Articon on 28 May 1999 would nonetheless crystallised the claims from the nominated subcontractors.

30 The period from 28 May 1999 to 5 June 2000 is significant as the nominated subcontractors would have filed their claims with the Plaintiff and that would have allowed the directors of the Plaintiff to ascertain such contingent liabilities. The directors and auditors signed the financial statements for the year ended 28 February 1999 on 5 June 2000. No mention of such contingent liabilities were made in the notes to the accounts. In my view, the directors would have been aware of the claims of the nominated subcontractors at the latest around the time Articon was wound up. I would add that they could have been aware much earlier as D1 testified that as at March 1998, the alleged claims against Capital Realty totalling $3.8m were known. D1 has admitted whilst the Plaintiff had contracted with the nominated subcontractors, the Plaintiff were only inclined to pay them out of the Plaintiff's claims against Capital Realty.

31 Accordingly, adjustments for the contingent liabilities as collated by the liquidator and unchallenged by D1 and D2 are to be made to the Plaintiff's net assets for the respective financial years ended 28 February 1999, 2000 and 2001.

32 With the restated balance sheets, the financial position of the company as set out by KHT is as follows.

33 As at 28 February 1999, the Plaintiff's audited accounts showed that the cumulative losses amounted to $95,031 as compared to the KHT's assessment of true losses of $1,729,237. In the Balance Sheet presented by the directors for the year ended 28 February 1999, current liabilities exceeded current assets by $506,952. The audited net assets of the Plaintiff as at 28 February 1999 stood at $1,404,969. After taking into account of KHT's adjustments of $1,634,206, it changed to a net deficiency of assets of $229,237. In effect, as at 28 February 1999, all that remained of the Plaintiff's paid up capital of $1.5 million was gone.

34 From then on, successive management accounts of financial years 2000 and 2001 showed excess of current liabilities over current assets of $835,824 and $9,919 respectively. The net assets of the Plaintiff as at 29 February 2000 stood at $976,866. After taking into account KHT's adjustments, the net asset stood at a negative figure of $688,532. The net assets of the Plaintiff as at 28 February 2001 stood at $1,073,992. After taking into account KHT's adjustments, the net assets stood at a negative figure of $883,503. In effect, as at 29 February 2000 and 28 February 2001, all that remained of the Plaintiff's paid up capital of $1.5 million was gone.

35 KHT's view is that the Plaintiff was therefore insolvent during the relevant financial years and the company's paid up capital of $1.5million had all but disappeared. Its history of losses and deficiencies of working capital and net assets all point to that conclusion.

36 Lee Yuen Chin ("LYC"), a certified public accountant with ten years of experience as an auditor, testified on behalf of the Defendants. LYC gave evidence as the Defendants' expert only on the declaration of interim dividend on 29 December 1999. He was not asked to testify on the question of the company's solvency during the relevant years and in the light of the alleged improper transactions. Having said that and as an aside, I note that the Quick Assets test ratio based on his computation for financial years ended 28 February 1999, 2000 and 2001 of 0.29, 0.49 and 1.07 respectively did not reveal a healthy picture of the company. A ratio of under 1 means that there are insufficient quick assets to pay immediate creditors. I would add that given the state of affairs of the Plaintiff in those three financial years there being no sales or turnover and therefore no cash inflow generated, the Quick Assets test ratio is not an entirely appropriate test.

37 I am equally perplexed by D1's allegation that the company's cash flow was healthy until 23 March 2001 especially when no cash flow statements were produced to support his contention and in the light of the Plaintiff's business inactivity during the relevant financial years.

The Defendants' contention on insolvency

38 The Defendants deny that the Plaintiff was insolvent. D1 and D2 contend that KHT had considered the contingent liabilities without adequately considering the contingent assets of the company. The contingent assets are the claim against Capital Realty for non-payment of the amount of $1,841,602.53 for architect's certificate nos. C25 to C27 read with C28 and a further $2,000,000 for the final accounts on the Tanglin Hill project. These are relevant and if correct would result in an increase in net assets of the Plaintiff. In addition, D1 said that the sum of $150,000 due from Articon has not been paid. The Defendants therefore contend that from the financial year 1999 to 2000, there was a surplus of assets over the liabilities.

39 The company on 17 July 2000 commenced proceedings in the High Court in Suit no.500 of 2000/M against Capital Realty for non-payment of the amount of $1,841,602.53 due under architect's certificate nos. C25, C26 and C27 read with C28 in respect of the Tanglin Hill project. The proceedings were stayed for arbitration.

40 D1 agreed that the sum of $1,841,602.53 was also due to Articon as a result of the business arrangement. Pursuant to the Deed of Assignment, the money would be paid direct to Articon's bank account. The only basis for the Defendants saying that the Plaintiff has a claim for this sum of money is that contrary to the arrangement, the payment to Articon was not against the Plaintiff's official receipts. In my view, the action commenced on 17 July 2000 was simply the Plaintiff's counter-offensive against Capital Realty's claim for $500,000 initiated after Articon was wound up. In July 2000, the claim for $500,000 was pending appeal to the Court of Appeal. The proceedings for $1,841,602.53 also did not strike me as a genuine claim for other reasons.

41 D1 in his evidence confirmed that the company was only to receive an amount of $150,000 from the Tanglin Hill project. Counsel for D1, D2 and D3, Mr. Ravi Chelliah, submits that the company had no responsibility to carry out any works or arrange for payments to the nominated subcontractors or take on liabilities in the Tanglin Hill Project. Articon was to carry out the responsibility of ensuring that the project was run smoothly. When the Plaintiff was saddled with liabilities incurred by Articon for the Tanglin Hill project, D1 adopted the position that the company must be entitled to the monies from the project to enable payments to be made to the nominated subcontractors.

42 KHT's evidence is that there was no such claim for $1,841,602.53 as he had seen the

accounts of Articon which showed that architect's certificate nos. C25, C26 and C27 had been paid. Although the accounts were not produced, his testimony is corroborated by objective facts. C25 to C27 amounting to $1,903,471.73 were issued and addressed to the Plaintiff in the period December 1996 to April 1997. There was overpayment of C25 to C27 and hence C28 was issued on 1 July 2000 for the overpayment by Capital Realty in the sum of $61,869.20. Besides, if the certificates have been outstanding for such a long period, it would have been reasonable to see evidence of correspondence between the parties over the alleged non-payment or dispute. None was presented by D1 and D2 to substantiate their contention. D1 has said that no demand was ever made against the corporate guarantee. This is consistent with KHT's evidence that Articon has been paid.

43 Moreover, the sum of $1,841,602.53 was not reflected in the 1998 and 1999 audited financial statements nor in the management accounts for 2000 and 2001. By virtue of the Deed of Assignment, the Plaintiff's rights, title and interests in and to payment under the contract with Capital Realty had been assigned to OUB. Legally, until reassigned by OUB, the Plaintiff did not have any right to payment of progress claims. See also clause 1.02 of the Deed of Assignment.

44 I am unable to understand how a breach of the arrangement with Capital Realty for making payments without official receipts from the Plaintiff would translate into a loss of $1,841,602.53 when the Plaintiff had assigned its right, title and interest in and to the payments under the contract. At best, damages would be nominal.

45 D1 said that there is a claim for $2 million in respect of final accounts. This sum includes a retention sum of $670,292.32. KHT did not consider it recoverable because of the Deed of Assignment. D1 had also regarded it as not realisable in the Statement of Affairs. KHT also said that looking at the architect's certificates, the $2 million was never there. The Defendants' counter argument is that as the $2 million represents the final accounts, it would not be found in any of the architect's certificates. D1 during cross-examination stated that the claim of $2 million on final accounts would have arisen as at March 1998. If there was indeed any contingent assets due to the Plaintiff, the directors should but did not mention this by way of notes to the 1999 audited financial statements. The directors also did not adduce any documentary evidence to make good their argument. KHT was informed by D1 (and the evidence was not disputed) that as he had moved office, he had no documents to give to him.

46 Finally, on the sum of $150,000, D1 and D2 contend that it is a contingent asset, as it has not been paid by Articon. KHT's evidence is that it has been paid as shown in Articon's bank account. It bears noting that D1 did not include this sum of $150,000 in the Statement of Affairs which lends credence to KHT's testimony. In any event, this money should be discounted since Articon has been wound up.

47 I find on the balance of probabilities that D1 and D2 have not established that at the three successive year-ends under discussion, there were contingent assets worth a total of $3.8 million recoverable against Capital Realty. Neither was the sum of $150,000, which was not mentioned as outstanding in the Statement of Affairs nor the accounting records of the Plaintiff, a contingent asset.

48 The value of the company's CLOB shares was written down in the 1998 audited financial statements and the position remained the same in the books of the company for the subsequent years. The Defendants argue that KHT in assessing the solvency of the company should have given a proper value to the CLOB shares. The Defendants' argument is rhetorical. D1 and D2 as directors of the company had accepted the written down value in the accounts. D1 and D2 led no evidence to show what the value of the CLOB shares for the relevant financial years were.

Other evidence on and relating to insolvency

49 The financial statements of the Plaintiff before me are for the five financial years ended 28 February 1997 to 2001. The first three financial statements for years ended 28 February 1997, 1998 and 1999 were audited whilst the remaining two later financial statements for years ended 29 February 2000 and 28 February 2001 were unaudited management accounts.

50 A salient feature that can be gleaned immediately from the Plaintiff's financial statements is that turnover or sales declined sharply from $10,570,503 for the year ended 28 February 1997 to $803,209 for the year ended 28 February 1998. Thereafter no turnover or sales were generated or recorded by the company for the financial years ended 1999, 2000 and 2001. This suggests that the company had curtailed its business activities and in fact had not been engaged in its business of building contractors in the last three financial years. D1 also confirmed that the company was phasing down its construction activities and was exploring new businesses.

51 Under the circumstances, how then would the company settle its existing obligations and liabilities. KHT's restated balance sheets have not been successfully challenged. Looking at the financial situation of the company as a whole for these three successive year-ends, the picture that unfolds is that losses and accumulated losses have eroded the company's capital thereby reducing its capacity to pay its debts. Its financial position deteriorated with each passing year. It is clear that no assistance was available from financial institutions, investors or shareholders for funds. It is highly unlikely that financial institutions would advance monies to the company to pay existing obligations and creditors without getting assurances that any monies loaned would be repaid. The picture is exacerbated by an existing bank overdraft of $505,435 as at 28 February 1998 and no prospects that the company could generate sufficient income to repay since it began to wind down its core business activity. Given the company's performance of no sales or turnover for the financial years ended 28 February 1999, 2000 and 2001 it is again unlikely that funds would be forthcoming from new investors. The existing shareholders may provide funds to support the company but this was not the case here.

52 It would appear that the only course of action left then is for the company to internally generate monies through the disposal and realisation of its assets in order to settle the company's obligations and liabilities.

53 Given the existing state of affairs, it is therefore critical that the directors should act with prudence in the discharge of their duties. This would include ascertaining that the company's assets could be realised at the values that they are recorded in the books and that all its liabilities are marshalled. The purpose therefore is to determine whether there is any shortfall of assets over liabilities and hence further measures that the directors should take to right the situation.

54 It is appropriate to look at what happened on 5 June 2000 with respect to the solvency of the company for the year ended 28 February 1999. That was the date when the accounts were signed by both the directors and auditors. It was also the date when the adjustments to the 1999 accounts were approved. There was a directors' resolution passed on 5 June 1999 to forgive and write off the debt of $196,757.14 owed to the company by D2. The other debt that was written off was for the sum of $44,270.30 owed by related parties to the Plaintiff. The write off of these two debts would reduce the current assets of the company available to pay creditors. On 5 June 2000, the directors agreed to sell the Joo Chiat property and granted an option to a purchaser of the property at $1.07 million. The option was exercised on 9 June 2000 and the sale was completed on 12 July 2000.

55 D1 was asked during cross-examination why he did not use the surplus sale proceeds to pay

the nominated subcontractors. His reply reflected the attitude the directors had towards the unsecured creditors:

"Q: Couldn't you have used [the] sale proceeds to pay nominated

subcontractors?

A: Didn't pay. Why should we use [our] own money to pay them."

[NE155]

56 This piece of evidence is highly significant. It is in my judgment the *raison d'être* for the various transactions the liquidator has identified as improper transactions. I take judicial notice of the fact that CLOB shares were first suspended from trading in September 1998 by the Malaysian government and remained so until 3 July 2002. The non-current asset i.e. the Joo Chiat property was the only resource the company had with which it could use to pay creditors. What transpired was that D1 and D2 sold the property at Joo Chiat and used the surplus to pay out dividends declared on 29 December 1999, pay to D1 and D2 the sum of $27,666.15 and for an investment in Thailand. They did not keep the surplus proceeds to pay its unsecured creditors.

57 In my judgment, the overall evidence established insolvency. The Plaintiff could not pay its creditors without disposing its assets. It did dispose of its assets, the Joo Chiat property, but not to pay its unsecured creditors. The attitude of the directors was that they would not use their own money to pay their nominated subcontractors from the Tanglin Hill project. The facts above, taken in totality, show that the Plaintiff was clearly insolvent since the financial year ended 28 February 1999 and remained so until it was wound up on 23 March 2001. The six transactions that are the subject matter of this action happened during the time the company was insolvent.

Specific Breaches of Directors' Duties - D1 and D2

(i) Misapplication of Plaintiff's funds

58 I have grouped under this heading four transactions (a) write off of $196,757.14 owed by D2, (b) write off of $44,270.30 owed by related parties (c) payment of $27,666.15 to D1 and D2 and (d) remittance of $130,000 to Patinya Exin Limited.

59 I have found that the company was insolvent since the financial year ended 28 February 1999. It follows that D1 and D2 should not have allowed or approved these four transactions because they have the effect of reducing the assets of the company that should have been available for the discharge of its liabilities to creditors. I find that these four transactions were not in the interests of the creditors and D1 and D2 had acted in breach of their duty as directors to keep the property of the company inviolate in order to pay its creditors. D1 had not satisfactorily explained the transactions. The best people to assist him are the auditors of the company. They were not called as witnesses for D1 and D2. I have drawn the necessary adverse inference in this regard.

60 D1 and D2 gave approval for the sum of $196,757.14 to be written off. The directors' resolution dated 5 June 2000 justifying the forgiveness of the debt was in recognition of D2's twenty-five years of service as director and chairman of the company. This reason is different from that found in the pleadings and D1's testimony. In the pleadings, the write off was to set off expenses made by D2. On the other hand, D1 testified that imbalances in the Plaintiff's accounts were booked into D2's account. There is no reliable thus evidence in the face of the conflicting evidence. What is

obvious is that the timing of the write off and the sale of the Joo Chiat property was more than a coincidence and the forgiveness of the debt was undoubtedly for the personal benefit of D2 without regard to the interests of the unsecured creditors.

61 Again D1 was not able to substantiate the directors' decision to write off the sum of $44,270.30. Out of this amount, $26,025.11 was owed by Pro-8 Media Advertising Pte Ltd and P.G.M. Investment Pte Ltd. Both are companies owned by D1, D2 and D4. The balance sum of $18,245.89 has not been accounted for. The forgiveness of the debt was indirectly for the personal benefit of D1, D2 and D4 without regard to the interests of the unsecured creditors.

62 Included in investments in the balance sheet as at 28 February 2001 is an amount of $130,000 for an investment in a Thai partnership that specialised in household products. On 5 September 2000, the directors invested $130,000 and payment was made on 3 October 2000 to Patinya Exin Limited Partnership. According to D1, the Plaintiffs in June 2000 agreed to enter into a partnership with Patinya Exin. The company was to invest $150,000.

63 The investment came to an end within a month of the remittance of $130,000. No convincing reason was offered on why instruction to stop operation was given. There were no attempts made to recover the investment and no adequate explanations were offered as to the recoverability of the money.

64 In any case, the investment was entered into whilst the company was insolvent. In my judgement, the investment was made not with the unsecured creditors' interests in mind. D1 had already said that the directors were not going to use the company's money to pay the contingent creditors. This is also consistent with their decision to place the investment in D4's name. I reject the explanation of D1 and D4 that D4's name was used out of convenience.

65 As for the payment of $27,666.15 to D1 and D2, again there are no supporting documents in respect of this payment. Out of this sum, an amount of $20,914.88 attributable to D2 was allegedly due to his firm Hiap Hwa twenty-six years ago. Counsel for the Plainitff, Mr. Nicholas Ng, pointed out a duplication of this claim with the debt of $196,757.14 that was written off. These two debts have antecedents which are, to say the least, obscure. There was no persuasive explanation as to how the compensation of $6,790 to D2 arose. In any case, the payments were made from the sale proceeds without the interests of the creditors in mind. Moreover, D1 had already said that the directors were not going to use the company's money to pay the contingent creditors.

(ii) Interim Dividends of $ 321,900

66 I have found that the company was insolvent since the financial year ended 28 February 1999. It follows that it should not have declared the interim dividend because any dividend would further reduce the capital of the company that should have been available for the discharge of liabilities to its creditors. The dividend was clearly for the personal benefit of D1 to D4.

67 McPherson J in *ANZ Executors and Trustee Company Ltd v Quintex Australia Ltd* [1991] 2 Qd R 360 at 367 referred to the decision of *Mackie v Clough* [1891] 17 VLR 493. In the latter case, the company was confronted by insolvency and the court there held that the distribution ostensibly by way of dividends of the proceeds of the only remaining corporate asset available to pay its creditors was held to be a breach of duty, which the directors had to make good.

68 For payment of dividends made after the financial year of 1999, it is irrelevant whether or not there were or could have been profits of a capital nature out of which dividends could have been

paid. The dividends should not have been made when the company was insolvent. In my judgment, D1 and D2 would have to make good to the Plaintiff the sum of $321,900.

69 Given my findings above, it is strictly not necessary to deal with Mr. Loh's alternative plea. As much ground was covered by the parties, I should deal with it and the report of LYC. I would at the outset point out that even if I have found that the Plaintiff was solvent at all material times, in my judgment D1 and D2 would still have to refund the sum of $321,900. A director who allows a dividend to be paid when there are no profits commits a breach of his fiduciary duty by misapplying the company's funds. Such a director may be made liable to replace the money paid out. Article 115 of the Plaintiff's Article of Association reads:

> "Save as hereinbefore provided no dividend shall be payable except out of the profits of the company and no dividend shall carry interest as against the company. The declaration of the directors as to the amount of the profits of the company shall be conclusive."

Further, a director who wilfully pays or permits a dividend to be paid in breach of s403(1) of the Companies Act is liable to the creditors of the company for the amount of the debts due by the company to them to the extent by which the dividends so paid have exceeded the profits. Neither cause of action is dependent on the insolvency of the company.

70 It is trite law that directors are not allowed to pay dividends out of capital. Dividends may be based upon realised or unrealised capital profits provided the subscribed capital of the company is preserved and there must have been an accretion to the capital of the company. See *Marra Development Ltd v B.W. Rofe Pty Ltd* [1977] 2 NSWLR 616; *QBE Insurance Group Ltd v Australian Securities Commission* (1992) 110 ALR 301 at 317 and 318; *Walter Woon on Company Law* (2nd Ed) at 617. In *Australasian Oil Exploration Ltd v Lachberg & Ors* (1958) 101 CLR 119, the court referred to

> "the fundamental principle of company law that the whole of the subscribed capital of a company with limited liability, unless diminished by expenditure upon the company's objects..shall remain available for the discharge of its liabilities." [p132]
>
> …..
>
> " ..A company has no capital profits available for dividend purposes unless on a balance of account it appears there has been an accretion to the paid up capital…" [p133]

71 Whilst unrealised profits may be used to base a dividend, the revaluation of capital must be in good faith by competent valuers and it is clear that the accretion in value is of a permanent character in the sense that it is not likely to be subject to short-term fluctuations. See *Dimbula Valley (Ceylon) Tea Co Ltd v Laurie* [1961] Ch 353. Before any declaration of dividend is made, the directors should have a detailed list of the company's assets and investments prepared for their information and should not rely on estimates based merely on the opinion of the chairman or auditors: see *Per Romer J in Re City Equitable Fire Insurance Co Ltd* [1924] 19 Lloyd's List Law Reports 93 at 94.

72 D1 said he telephoned an estate agent and was told that the Joo Chiat property was worth $1.8 million. Even on D1's evidence, it could hardly be said that the accounts were properly prepared for the directors to determine whether the declaration would be lawful. In fact, D1 admitted that he and D2 declared the interim dividend on 29 December 1999 without looking at the accounts. In any case, I would not consider a telephone call to an estate agent a bona fide attempt to revalue the non-current asset of the company to ascertain the unrealised gain of capital. Telling strongly against

the suggestion that a valuation was done is the absence of any entry in the accounts to reflect the revaluation of the property. In my judgment, I find that D1 and D2 declared interim dividend on 29 December 1999 without proper investigations and without a bona fide valuation of the property by a competent valuer. LYC testified that if he were instructed then, he would have prepared some accounts. This would have enabled the directors to properly exercise their judgment.

73 D1 confirmed that as at 29 December 1999, he and D2 intended to sell the Joo Chiat property to pay for the interim dividend declared. D1 said thrice during cross-examination that the interim dividend was declared in respect of the financial year 1999. The dividend tax vouchers given to the Plaintiff's shareholders although undated clearly indicated that the interim dividend was for the year ended 28 February 1999 and was paid on 29 December 1999. In addition, the various payment vouchers all dated 14 July 2000 for the cheque payment of dividend to each shareholder also indicated that the dividend was for the year 1999. A Section 44 statement as at 31 December 1999 was submitted to the IRAS showing tax deducted from dividend paid on 29 December 1999 and was signed by D1 on 13 April 2000.

74 D1 has explained that the objective for the declaration of the interim dividend was to utilize the huge tax credit chalked up by the Plaintiff of $1,457,530.25 for the benefit of the shareholders. How shareholders benefit from this depends on the tax bracket of the individual. In the case of an individual paying little or no tax, he will be able to claim a tax refund from the IRAS of the tax paid on the dividend, provided he has received the dividend in the relevant Year of Assessment.

75 Thus for the shareholders to benefit in the Year of Assessment 2000, the dividend tax voucher must be given to the shareholder and the dividend paid in the year 1999. This would enable the shareholder to submit the dividend tax voucher to the IRAS together with his tax return. The company would also have to submit to the IRAS, a Section 44 statement to inform the IRAS that it has made a dividend payment and have utilised the Section 44 tax paid to frank the dividend payment. It is therefore no coincidence that 13 April 2000, the date of submission of the Section 44 statement to the IRAS is just a few days away from 15 April 2000, the last day of submission of tax returns by an individual.

76 By so doing, the directors have intentionally and deliberately issued untruthful dividend tax vouchers as well as declared and submitted an untruthful Section 44 Statement as at 31 December 1999 to the IRAS by stating that the dividend was paid on 29 December 1999 when in fact it was paid on 14 July 2000. The effect of this is that they have accelerated the tax refund by the IRAS on the tax paid on the dividend to the shareholders by a year earlier, rather than in the Year of Assessment 2001.

77 To this extent, D4's denial of any knowledge that the dividend was paid out of the sale proceeds of the Joo Chiat property cannot be believed. Not only was he not paid dividend on 29 December 1999, the accounts for 1999 were laid before the shareholders in general meeting on 30 June 2000 from which D4 would have seen clearly from the Plaintiff's audited accounts that the source of funds to pay the interim dividend could only come from a disposal of the Joo Chiat property.

78 Mr. Chelliah, in his Closing Submissions submit that the directors had made an error in the dividend tax vouchers and that the interim dividend was actually for the financial year ended 29 February 2000. There was no elaboration beyond this bald assertion. The interim dividend vouchers were prepared by the company secretary of the company but he was not called by the Defendants to explain how the alleged mistake arose. I have drawn the necessary adverse inference in this regard.

79 On the evidence detailed above, I find on a balance of probabilities that the interim dividend

was made for the financial year ended 28 February 1999. KHT and LYC are in agreement that the company did not have sufficient profits for the financial year ended 28 February 1999 to enable them to properly declare the interim dividend.

80 It would not assist D1 and D2 even if the declaration of interim dividend was for the financial year ended 29 February 2000. The management accounts clearly showed that there was a loss of $106,203 and hence no profits were available for distribution.

81 This did not stop the directors' insistence that there were profits available for distribution at 29 December 1999, the date of declaration of the interim dividend, for the financial year ended 29 February 2000. To justify their stance, they commissioned LYC to do just that.

82 The rationale on which LYC based his restated profit and loss account and balance sheet to support the interim dividend declaration is that dividends could be paid out of unrealised capital gains and that there was an accretion to capital. He achieved this by making two significant adjustments to the restated profit and loss account, namely the restatement of provisions of $494,428 made against the Plaintiff's investment in CLOB shares in the financial year ended 28 February 1998 and an unrealised capital gain of $675,000 on the Joo Chiat property.

83 Given the position the directors had on the recoverability of debts owed by the subsidiary and related company in previous years, it was curious that LYC made a further adjustment of writing off the $409,934 debt owed by CT against the gains above. The net effect of these adjustments was to add $759,494 gains to the profit and loss account for the year ended 29 February 2000, thereby supporting the interim dividend declaration.

84 With his adjustments, LYC's restated balance sheet as at 29 December 1999 showed an increase in net assets of $342,563 (capital accretion) to $1,842,563 even after taking into account the dividend.

85 LYC's reason for the write back of the 1998 provision for the diminution in value of CLOB shares is that the provision was too conservative an approach. Not only is his opinion without any basis, he also did not furnish evidence to support his contention. I therefore reject this adjustment.

86 I turn next to the debts owed by CT and CE. LYC has agreed to a provision for the CT debt. As for the $449,440 debt owed by CE, LYC was given to understand that CE is a live company and still operating. He has not explained how such a company with its capital gone and with liabilities in excess of $900,000 would be in a position to repay the debt. For the reasons stated earlier in my judgment on its recoverability, a provision against the debt owed by CE is in order.

87 In the case of the capital gain arising from the revaluation of the Joo Chiat property, the valuation must be a bona fide valuation made by a competent property valuer. A valuation was carried out on 17 January 2000 by CKS Property Consultants Pte Ltd, after the declaration date of the interim dividend. This leads one to believe that the exercise was carried out on hindsight. Moreover, I note that the capital gain had not been put through in the management accounts. These are indeed grounds for rejecting this part of the exercise by LYC.

88 However, even allowing for the sake of argument this gain from the Joo Chiat revaluation, the directors' contention that there were profits available for the declaration of dividend in the financial year ended 29 February 2000 is not founded. Taking LYC's adjusted gains of $759,494, and removing the reinstated 1998 provision for CLOB shares of $494,428 and deducting a further provision of $449,440 for the debt owed by CE, there is an adjusted loss of $184,374. This means that there is

in fact no unrealised capital gains from which the dividend could be declared.

89 Similarly, taking the adjusted net asset of $1,842,563 (which includes a deduction for the dividend) from LYC's restated balance sheet as at 29 December 1999 and making the above adjustments, an adjusted net asset of $898,695 is arrived at. It is clear that there is no capital accretion but a further diminution in capital.

90 In the circumstances, the declared dividend of $321,900 was in breach of director's duty as the dividend was paid out of capital. In addition, it was in contravention of section 403(1) of Companies Act. On the evidence, I am satisfied that the directors had acted wilfully (i.e. deliberately and intentionally) in declaring the interim dividend. Accordingly, in my judgment, D1 and D2 are jointly and severally liable for the amount of the dividend so paid out, namely $321,900.

91 D2 is the personal representative of D3 and the estate is fixed with his knowledge that the declaration of the interim dividend was unlawful. D2 as the personal representative of the estate of D3 and D4 both received their share of the dividend in the knowledge that that there were no profits out of which the company could pay them. However, I agree with Mr. Chelliah that the Plaintiff's pleadings as they stood do not support a cause of action against D3 and D4 as constructive trustees on the ground of knowing receipt of part of trust fund. There was also no pleaded claim based on undue preference. Consequently, the Plaintiff's claim against D3 and D4 for return of their respective share of the dividend must fail.

(iii) Transfer of debt due from D4 to Centrad Technology

92 D1 and D4 said that the debt of $317,000 was in fact owed by CT and not D4. The entries in the books of both companies were wrong and the journal entry in the accounts and ledger books of the Plaintiffs were to reflect the true position. The sum of $317,000 was an amount owed to the Plaintiff as loans for part of its contribution to the working capital and research funds of CT. The money was paid through D4 from 1993 to 1997.

93 The liquidator's contention that the transfer of the debt to CT was deliberate and improper in that the debt was transferred to an insolvent company and D1 and D2 knew that CT had no means to meet this payment. At the time of the transfer D2 and D4 were directors of CT. There were no documents to support D1's assertion that the money was owed by CT from the outset. The liquidator commenced proceedings against CT to recover this debt and judgment in default was entered against CT. KHT explained that he sued CT to prove that the transfer was to a company that could not repay the loan. He therefore seeks recovery of this money from D1, D2 or D4.

94 In my view, the liquidator on this claim of $317,000 has taken an inconsistent position. He has in my judgment accepted that the entries of this debt in the books of both companies were a mistake having relied on the entire amount of $409,934 owed by CT to the Plaintiff in his restated balance sheets. Therefore, the liquidator's claim for $317,000 against D1, D2 and D4 fails.

Result

95 Having substantially succeeded on the merits of the action against D1 and D2, the Plaintiff is entitled to judgment against D1 and D2 with costs as follows. As against D1 and D2, I make the following orders. D1 and D2 are:

(i) Jointly and severally liable to refund the dividend payment of $321,900.

(ii) To pay damages for breaches of directors' duties quantified at $398,693.59.

(iii) Interest at the rate of 6% per annum from the date of the writ to date of payment.

96 For the reasons earlier stated, the Plaintiff fails in its respective claims against D3 and D4. However, I make no costs order insofar as D3 and D4 are concerned. The claim against D3 overlapped with the defence of D2. The difference is in the relief sought which is minimal. The circumstances thus warrant a departure from the usual order that costs follow the event. I also departed from the usual order that costs follow the event where D4 is concerned. A fair order is for the Plaintiff and D4 to bear their own costs. The successful outcome in his favour is to be counterbalanced by the wasted costs occasioned by him. Even after taking into consideration that D4 acted in person, the fact remains that a huge amount of time was spent on totally unnecessary, excessive and incessant arguments going over aspects of the defences of D1 and D2 that do not concern him at all. He spent very little time on his own case preferring to take on the fight for D1 and D2.