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Director's Duties and COVID-19

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I. Director's duties when company nearing insolvency

Directors in a company owe a myriad of duties to the company's stakeholders. Some duties include the duty to avoid conflicts of interest, to act honestly and to act in a manner that best serves the interests of the company. In a COVID-19 era, many SMEs or smaller businesses may be facing a protracted financial crunch leading to near insolvency or insolvency. This means that the financial position of many companies may be materially impacted. During such times, directors have to consider whether there may be additional duties placed upon them when their company faces severe financial difficulty.

II. Protecting the interests of creditors

In the ordinary course of business, the primary duty of a director is to act in the best interests of the company. This means acting in ways which benefits the shareholders as a whole. However, additional duties arise when creditors—particularly unsecured creditors—are put in a vulnerable situation when a company becomes insolvent. Under Singapore law, directors must take into consideration the interest of creditors when carrying out their directorship in an insolvency or near insolvency context. This duty is triggered when the company is insolvent on a cash-flow or balance sheet basis. An example of a situation where this duty arises would be when a director authorises a transaction which they know or ought to have known is a undervalued transaction under Section 224 of the Insolvency, Restructuring and Dissolution Act 2018.

However, an exception applies if the directors are acting in good faith or had reasonable grounds to act in a way which may have prejudiced creditor interests. An example of such an exception is when there is genuine economic pressure placed on a company which led to the director authorising a sale of an asset at an undervalue which is reasonable in the circumstances. Another exception may be when there is genuine economic pressure placed by creditors which led the director to give additional security to the creditors (e.g higher interest rate or more favourable terms for the creditors) to appease them. In such situations, it may be possible to argue that the company entered into the transaction in good faith.

Directors must note that there are several provisions under the Insolvency, Restructuring and Dissolution Act 2018 which may land the director in legal trouble if breached. These include:

- Wrongful trading under Section 239 of the Insolvency, Restructuring and Dissolution Act 2018: Directors may be fully responsible for any or all of the debts or other liabilities of the company if they knew or ought to have known that the company was trading wrongfully (which causes the company to become insolvent through incurring of debts or liabilities). Directors may also be guilty of an offence which is punishable with a fine not exceeding

$10,000 or imprisonment for a term not exceeding 3 years or both. Example: Directors are obliged not to trade in a manner which incurs debts or liabilities for which the company has insufficient funds to fulfil through the course of their daily business such as by ordering more supplies, signing new lease agreements and so forth.

- Fraudulent trading under Section 238 of the Insolvency, Restructuring and Dissolution Act 2018: Directors may be fully responsible for any or all of the debts or obligations due from the company if they knowingly carried on the business of the company with the intent to defraud creditors of the company or any other person or for any fraudulent purpose. Directors may also be guilty of an offence punishable with a fine not exceeding $15,000 or to imprisonment for a term not exceeding 7 years or both. Fraudulent trading involves the director having the intent to deceive and defraud the creditors or customers. Example: A director continuing to take payments from customers despite knowing that the company will not be able to fulfil the orders or deliberately avoiding payment of company debts whilst still continuing to trade.

- Undervalued transactions under Section 224 of the Insolvency, Restructuring and Dissolution Act 2018: Directors must not enter into transactions with any person at an undervalue. Example: Such a situation arises when a company makes a gift to a person or otherwise enters into a transaction with that person on terms that provide for the company to receive no consideration. A transaction is likely to be deemed undervalued if it is an out-right gift or if the value received by the company is significantly less than what was provided by the company.

- Unfair preferences under Section 225 of the Insolvency, Restructuring and Dissolution Act 2018: Directors must not give an unfair preference to any of the company's creditors or a surety or guarantor for any of the company's debts or other liabilities. Essentially, directors should not show preference in paying off any creditor or relevant person over another. Example: Director authorises payment to a creditor over another creditor in times of insolvency.

Under the COVID-19 (Temporary Measures) Act ("COVID-19 Act"), directors are temporarily relieved from preventing their companies from trading while insolvent if such debts are incurred in the ordinary course of the company's business. An example of this situation is where a director authorises taking on new finance obligations such as purchasing of supplies from third parties which incurs debt even though the company is nearing insolvency. Without this new exception, a director may be liable for wrongful trading because the director is still trading even though he is not supposed to. With the new provision in the COVID-19 Act, the director is relieved from liability for wrongful trading, but they remain criminally liable for debts incurred fraudulently.

III. Practical tips for directors

- Directors should consider the impact of COVID-19 on their company’s businesses.
- Directors should make financial forecasts to cover a broad range of possible outcomes.
- Directors should consider ways to mitigate the impact of business disruptions caused by COVID-19.
- Directors should minute and note every unusual business transaction in greater detail.
- Directors should consider ways to reduce operational costs by exploring possible headroom under current circumstances and other potential sources of liquidity.
- Directors should consider whether any governmental assistance such as rental waivers may apply.
- Directors should consider taking professional advice.

The information in this article is correct as of July 2020.

This Article was authored by Reuben Teng