***How Winding Up Proceedings Can Affect A Judgment Creditor's Rights: SCK Serijadi Sdn Bhd v Artison Interior Pte Ltd* [2019] SCGA 05**

I. EXECUTIVE SUMMARY

In *SCK Serijadi Sdn Bhd v Artison Interior Pte Ltd* [2019] SGCA 05, SCK Serijadi Sdn Bhd ("SCK") engaged Artison Interior Pte Ltd ("Artison") to conduct interior decoration works. SCK overpaid Artison and sued Artison for the return of the overpayments. It won an award of $250,000 in the District Court. SCK then attempted to enforce this award by filing two garnishee applications against a third party Shanghai Chong Kee Furniture & Construction Pte Ltd ("Shanghai Chong Kee)", for $155,000 and $57,500. These proceedings would "attach" (or appropriate) any debts that Shanghai Chong Kee owed to Artison. Thus if SCK succeeded in these garnishee applications, effectively Shanghai Chong Kee ("garnishee") would have to directly pay SCK ("judgment creditor") any monies that Shanghai Chong Kee owed Artison ("judgment debtor"), up to the limit of the court-approved amounts.

SCK as judgment creditor was granted two "garnishee orders *nisi*",[1] subject to SCK subsequently attending a "show-cause hearing" where the garnishee Shanghai Chong Kee would have to confirm that it owed money to the judgment debtor Artison, and that there was no good cause (or reason) as to why Shanghai Chong Kee (as garnishee) should not pay the judgment creditor directly, instead of the judgment debtor.

However, a few days before the date of the show-cause hearing, Artison informed SCK that Artison had been placed under a creditor's voluntary winding up, with a liquidator appointed for the process. As such, under section 299(2) of the Companies Act (Cap 50, 2006 Rev Ed) ("the Act"), the garnishee proceedings could not proceed unless the court ordered otherwise. And under section 334(1) of the Act, SCK could not retain the benefit of the attachment as against the liquidator, unless the court also ordered otherwise.

SCK applied to the High Court ("HC") for permission to proceed with the garnishee proceedings, and to retain the benefit of the attachment of Shanghai Chong Kee's debts as against the liquidator. It argued that it had become a secured creditor as it had served the garnishee orders *nisi* before Artison was placed under winding up, and hence was not subject to the winding up regime. The HC dismissed the application and declined to grant SCK leave to continue with the garnishee proceedings. The Court of Appeal ("CA") agreed with the HC.

II. HC DECISION

The HC followed the CA's prior decision in *Transbilt Engineering Pte Ltd (in liquidation) v Finebuild Systems Pte Ltd* [2005] 3 SLR(R) 550 ("*Transbilt*"). There, the judgment creditor had similarly obtained a garnishee order *nisi*, but was prevented from continuing with the garnishee proceedings after the judgment debtor was placed under a winding up. The CA there held that the policy considerations behind section 334(1) of the Act were to provide a clear path for the liquidator to perform his tasks, which was necessary to prevent any disorganised or unfair rush by creditors to put the assets of the company beyond the liquidator's control. Hence, a judgment creditor would not be granted leave to retain the benefit of the attachment unless it was able to show inequitable behaviour by the judgment debtor. The HC found that there was no such inequitable behaviour, and thus no reason to grant the application.

SCK argued that its situation was unlike *Transbilt* because, unlike the judgment creditor in

[1] Generally, an order "*nisi*" means that it only takes effect or becomes valid after certain conditions are met.

Transbilt, it had actually served[2] the garnishee order *nisi* on Artison. SCK claimed this created what it called an "equitable charge" in its favour, thus making SCK a secured creditor[3] and not subject to the winding up regime.

While the HC agreed that service of a garnishee order *nisi* created an equitable charge, it held that mere service did not make SCK a secured creditor. It further noted that it was likely that the garnishee order *nisi* in *Transbilt* had in fact been served, and thus that these two cases were similar. The HC noted that in any case, on the onset of liquidation both secured and unsecured creditors were placed on the same footing, and thus subject to sections 299 and 334 of the Act.

III. CA DECISION

The CA first agreed with the HC that SCK was not a secured creditor, and that the situation in this case was similar to the situation in *Transbilt*. It further noted that it had previously held in *Transbilt* that a judgment creditor who had obtained a garnishee order *nisi* was to be treated as an unsecured creditor. And once winding up proceedings commenced, such creditors were not, absent exceptional circumstances, entitled to proceed with the garnishee proceedings.

The CA then discussed the rationale behind why SCK wanted to characterise itself as a secured creditor, by claiming to have an equitable charge in its favour. Though sections 299(2) and 334(1) applied to all creditors, the courts were more willing to allow secured creditors to proceed with enforcing their security, as their security was regarded as standing apart from the pool of assets available for distribution amongst unsecured creditors. However, such security had to be created prior to the winding up of the judgment debtor. The question here was whether SCK had, through serving the garnishee order *nisi*, become a secured creditor.

(i) Equitable Charge

It was accepted that the service of a garnishee order *nisi* created an "equitable charge"[4] on the debt which was the subject of the garnishee proceedings. The CA stated that the classic definition of an equitable charge was an interest created when property was "expressly or constructively made liable, or specially appropriated, to the discharge of a debt or some other obligation." Since the service of a garnishee order *nisi* does attach (or appropriate), as between the judgment creditor and debtor, the asset stated in the order to satisfy the underlying debt of the judgment debtor, the CA noted that the effect of the garnishee order *nisi* appeared to conform to this classic definition.

The classic method of creating an equitable charge over a debt is by attaching a third party's debt to the underlying debt in question. This creates a "proprietary interest" (or right) by way of a security (or interest) in the underlying debt, and gives priority to such judgment creditor's claim to have his debt paid out before all other claims. However, the CA noted that the use of the term "equitable charge" in this context was confusing in two respects.

First, it was unclear whether, and in what sense, such an equitable charge created a proprietary interest in the underlying debt. The term "proprietary interest" could have two definitions. Under what the CA called the "Broad Definition," a proprietary interest could refer to an

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[2] Service is the delivery of a legal document that notifies the recipient of the commencement of a legal action or other proceeding in which he is involved.

[3] In general, when a company becomes insolvent and its assets are sold to pay off the company's debts, the debts of secured creditors are repaid before the debts of unsecured creditors.

[4] Generally, a "charge" is a method through which a lender protects money it lends to a borrower, by creating what is known as a security interest or right over the asset that is bought with the money. If the borrower fails to pay back the money on time, the lender can enforce the charge and take that asset.

absolute right to have a particular property applied for the sole benefit and purpose of the rightholder, and which the rightholder could assert against all third parties. But under what the CA called the "Narrow Definition," it could refer to a much less extensive right to prevent the owner of the property from exercising his "full, unfettered right" to "deal" with that property in a manner that was inconsistent with the rightholder's interest.

The CA held that it would only be correct to say that a garnishee order *nisi* creates a proprietary interest according to the Narrow Definition (and not the Broad Definition), as a garnishee order *nisi* merely creates an obligation on the garnishee not to pay the moneys attached to the judgment debtor in breach of the order *nisi*. If the garnishee pays the sum to the judgment debtor in breach of the order *nisi*, he does so at his own peril, and runs the risk of having to pay the same amount to the judgment creditor. The Broad Definition could not apply, as the judgment creditor's rights remained subject to the garnishee order *nisi* being made absolute at the subsequent show-cause hearing.

Second, the use of the term "equitable charge" suggests that the holder of an equitable charge created through service of a garnishee order *nisi* is similar to a person who holds an equitable charge as security for repayment of a debt. However, the equitable charge created through service of a garnishee order *nisi* is different from an equitable charge which creates security for the repayment of a debt.

Where an equitable charge over property is used to create security for repayment of a debt, the secured creditor has the right to resort to the property (to satisfy the debt) if the debt is unpaid. However, where an equitable charge arises from a garnishee order *nisi*, the judgment creditor is only given a *contingent* right to resort to the property, which is dependent on whether some "good cause" may be shown otherwise. As such "good cause" can only be shown at the subsequent show-cause hearing, it is a *future* contingency. And if the judgment debtor is placed under winding up before the show-cause hearing, this future contingency is thwarted.

Thus, a judgment creditor is not in the same position as a secured creditor. At the time of winding up proceedings, the secured creditor has *already* accrued an entitlement to have the company's charged property made available due to the company's default in repayment, whereas the judgment creditor under a garnishee order *nisi* has not accrued any such right.

The CA thus held that the true effect of a garnishee order *nisi* is merely that it prevents the garnishee, upon service of the garnishee order *nisi,* from dealing with the specified debt in a way that is inconsistent with the order. It does not create any proprietary rights or substantive interest which would make the judgment creditor a secured creditor. The CA further noted that the use of the term "equitable charge" in the context of a garnishee order *nisi* was anomalous and unhelpful, and ought to be jettisoned.

(ii) Grant of Leave

The CA then held that since SCK was not a secured creditor, its position was no different from that of other unsecured creditors upon Artison's winding up. As such, the court had to return to the starting point and consider whether SCK's position justified the court granting leave to continue with the garnishee proceedings under sections 299(2) and 334(1) of the Act. The court's discretion in this regard must be exercised judiciously, to satisfy the purpose of these provisions, i.e. to ensure that the liquidator can perform his or her tasks and prevent any creditor from gaining an unfair advantage over other creditors.

The CA stated that the mere service of the garnishee order *nisi* did not justify the granting of such leave to continue with the garnishee proceedings. To hold otherwise would be contrary to

section 334 of the Act. Section 334(1)(*c*) states that a creditor can keep the benefit of an attachment of a debt due to a company which is subsequently wound up (in this case, the right to Shanghai Chong Kee's debt to Artison), only if the attachment was completed before the company was placed under such winding up. And section 334(2)(*b*) states that the attachment is only considered complete when the debt is actually received, which was not the case here. If the court were to set aside the liquidator's rights under section 334(1)(*c*) in every case where the process of attachment had progressed to the service of the garnishee order *nisi* on the garnishee, but was not considered complete as the debt had yet to be received, then section 334(2)(*b*) would be rendered inoperative.

The question was not whether the judgment creditor did anything wrong or not; it was whether the attachment was complete or not. And where the attachment was not complete and the court was asked to grant leave to continue with the garnishee proceedings, the CA agreed with the HC that a judgment creditor would typically need to show some form of "inequity" to justify such granting of leave.

The CA also noted that the threshold of inequity for granting leave was quite high. Though it declined to spell out what exactly amounted to such inequity, the CA noted that it would be inequitable if a judgment debtor made certain representations to a judgment creditor to stall the execution of a garnishee order against the debtor's assets. Conversely, a mere delay in receiving payments caused by a third party bank, which was unrelated to the parties, did not meet such threshold.

In this case, the fact that SCK had commenced garnishee proceedings prior to Artison's winding up, and was taken by surprise by the winding up proceedings, did not meet the high threshold that would change the balance of equities.

IV. LESSONS LEARNT

This case will have a practical impact on judgment creditors who wish to pursue garnishee applications. Lawyers should be clear that the mere service of a garnishee order *nisi* does not elevate the judgment creditor to the status of a secured creditor. Thus until such time as the attachment of the debt is complete (under section 334(2)(*b*) of the Act), the judgment creditor runs the risk of the judgment debtor commencing winding up proceedings, and hence losing the benefit of the garnishee order *nisi*.

Lawyers should therefore try to ensure that any garnishee order is made absolute as soon as possible. They should also inform judgment creditor clients of the problems that potential winding up proceedings by the judgment debtor can impose on garnishee proceedings.

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