When a Company is Unable to Pay its Debts:
***Sun Electric Power Pte Ltd v RCMA Asia Pte Ltd* [2021] SGCA 60**

I. Executive Summary

In *Sun Electric Power Pte Ltd v RCMA Asia Pte Ltd* [2021] 2 SLR 478, the Court of Appeal ("**CA**") introduced new legal principles to the areas of insolvency and winding up.

There are two key points which this judgement raises. Firstly, the CA set out two general rules that would apply where a company's directors were controlling the conduct of the company's appeal against a winding-up order. The first rule is that these directors should expect to pay for costs incurred by the company in prosecuting the appeal themselves, instead of using company funds (subject to such funds being reclaimable from the company if the appeal succeeds). The second rule is that they should also expect to be personally responsible for the payment of any party and party costs awarded in favour of the other party if the appeal fails.

Secondly, the CA ruled on the applicable test to be used under section 254(2)(*c*) of the Companies Act (now section 125(2)(*c*) of the IRDA),[1] to determine whether a company was unable to pay its debts, and ultimately whether it could be wound up. The CA determined that the sole applicable test was the cash flow test, which assessed whether the company's current assets exceeded its current liabilities such that it was able to meet all debts as and when they fell due.

II. Material Facts

Sun Electric Power Pte Ltd ("**Sun Electric**") was a licensee and participant in a Forward Sales Contract Scheme ("**FSC Scheme**"). Under this scheme, Sun Electric was required to carry out certain market-making obligations in the electricity futures market in respect of a volume of futures trade,[2] in return for incentive payments by SP Services Ltd.

In 2015, Sun Electric and RCMA Asia Pte Ltd ("**RCMA**") entered into an agreement for RCMA to assume Sun Electric's market-making obligations, in exchange for a 70% share of all incentive payments received by Sun Electric. Sun Electric initially paid RCMA its 70% share, but after January 2018 it stopped all payments.

RCMA filed suit in the High Court ("**HC**") to claim from Sun Electric 70% of all incentive payments that Sun Electric might continue to receive under the FSC Scheme, as well as repayment of an alleged loan that it granted to Sun Electric pursuant to their agreement. RCMA also successfully applied for an interlocutory injunction against Sun Electric, restraining it from dealing with or diminishing the value of (RCMA's) 70% share of the incentive payments ("**RCMA Injunction**"). By July 2018, RCMA had completed its market-making obligations, and by August, Sun Electric had received all remaining incentive payments in its OCBC account.

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[1] At the time RCMA filed the winding up order (18 December 2019), the winding up process was governed by section 254 of the Companies Act (Cap 50, 2006 Rev Ed). However, this section has since been repealed and re-enacted as section 125 of the Insolvency, Restructuring and Dissolution Act 2018 (Act 40 of 2018) ("**IRDA**"). This section sets out a list of situations where the court would have the discretion to wind up a company.

[2] Generally, market-making requires the putting up of a two-way pricing (i.e. both buy and sell) within a pre-determined price spread. A market maker must commit to continuously quoting prices at which it will buy and sell securities. They must also quote the volume in which they are willing to trade along with the frequency of time they will quote at the best bid and best offer prices.

Sun Electric eventually transferred all remaining funds in its OCBC account into its DBS Bank Ltd account, where they were completely garnished, through a separate lawsuit in early 2019, by another of Sun Electric's creditors (a United Arab Emirates-incorporated company, Kashish Worldwide FZE). The DBS account was emptied out around March 2019. RCMA highlighted numerous suspicious circumstances surrounding this garnishment, including the fact that the garnishment was not challenged, no attempt was made to notify the court granting the garnishee order of the RCMA Injunction, and there were inconsistencies regarding the trade between the two companies.

In August 2019, Sun Electric applied for judicial management and interim judicial management; RCMA objected to both applications. The HC agreed and dismissed Sun Electric's applications. The HC further ordered a total of $11,500 in costs to be paid by Sun Electric to RCMA. On 21 November 2019, RCMA's lawyers sent a statutory demand to Sun Electric, demanding payment of the costs and interests ($11,568.88). In December 2019, Sun Electric paid $3,000 into RCMA's lawyers' client account. Thereafter, no further payments were made, and the balance of $8,568.88 remained due, together with additional interest accrued from November 2019 ("**Outstanding Costs**"). RCMA then filed in the HC for Sun Electric to be wound up.

RCMA argued that Sun Electric should be wound up pursuant to section 254(1)(*e*) of the Companies Act as Sun Electric was unable to pay its debt. This argument had two bases: (1) Sun Electric should be deemed to be unable to pay its debts pursuant to section 254(2)(*a*) of the Companies Act as it had not paid the Outstanding Costs in full despite having been served a statutory demand; (2) alternatively, Sun Electric should be deemed to be unable to pay its debts pursuant to section 254(2)(*c*) of the Companies Act as it was cash flow insolvent and balance sheet insolvent. As another alternative argument, RCMA argued that it would be just and equitable to wind up Sun Electric pursuant to section 254(1)(*i*) of the Companies Act since Sun Electric had carried out its business in a fraudulent manner. RCMA claimed (among other matters) that Sun Electric had dissipated the enjoined funds (the value of 70% of incentive payments received) in breach of the RCMA Injunction, by transferring all the funds in the OCBC account to the DBS account and allowing them to be garnished by Kashish in highly suspicious circumstances.

The HC accepted all three grounds for winding up relied on by RCMA. First, Sun Electric was deemed to be unable to repay its debts pursuant to section 254(2)(*a*) of the Companies Act, as it had not repaid the Outstanding Costs in spite of the statutory demand. Although Sun Electric had repaid $3,000 such that the Outstanding Costs fell below $10,000, this was not to the reasonable satisfaction of RCMA. Second, Sun Electric was unable to pay its debts pursuant to section 254(2)(*c*) of the Companies Act as it was cash flow insolvent and balance sheet insolvent. Third, it was just and equitable to wind up Sun Electric. The HC further held that RCMA did not act in abuse of process, or with an ulterior motive in bringing the claim. Sun Electric appealed.

III. Issues

On appeal, the CA considered four main issues:

(a) whether Mr Matthew Peloso (Sun Electric's sole director) and M/s TanLim Partnership (Sun Electric's lawyers) were authorized to act for Sun Electric in the appeal;
(b) whether the HC erred in finding that Sun Electric was deemed to be unable to pay its debts pursuant to section 254(2)(*c*) of the Companies Act;
(c) whether the HC erred in finding that Sun Electric was deemed to be unable to pay its debts pursuant to section 254(2)(*a*) of the Companies Act; and
(d) whether the HC erred in exercising its discretion to wind up Sun Electric pursuant to section 254(1)(*e*) of the Companies Act.

A. Whether Sun Electric's lawyers Mr Peloso and M/s TanLim Partnership were authorized to act for Sun Electric in the appeal

RCMA argued that Mr Peloso could not have the authority to control the conduct of the appeal by Sun Electric unless a stay of the winding up order ("**stay order**") had first been granted, since without the stay order and upon a company's liquidation, its directors were *functus officio* (i.e. no longer had official authority to act for the company). However, the CA rejected this argument. The governing principle was that a company has the right to appeal a winding-up order regardless of whether a stay order is granted. It is a necessary corollary of the company's right to appeal that its directors (rather than the liquidator) be allowed to control the conduct of the appeal.

The CA first explained that decisions of the HC are appealable as of right to the CA except in certain defined cases where leave is required. A company has the right to appeal a winding up order even without leave of court as a winding up order does not fall within the categories of matters which require leave to appeal. If a stay is a necessary requirement in order to appeal, there may be situations where the court could effectively prevent the company from appealing by refusing to grant a stay. This would circumvent the legislative framework which allows a company to appeal as of right and cannot possibly be the law. Further, the CA also noted that not only is a stay not required in order for the company to appeal, it is in fact discouraged in the situation of a winding-up order.

Regarding the director's ability to control the conduct of the company's appeal, the CA stated that it would be illogical to entrust the conduct of the appeal to the liquidator because the very object of the appeal is to revoke the winding up order and discharge the liquidator.

The CA also dealt with the significant question of who should pay the costs of an appeal against a winding-up order. To address the concern that the directors and/or shareholders would whittle down the company's funds to pursue an unmeritorious appeal when these funds should be reserved for payment to the creditors, the CA set out two general rules. First, the directors and/or shareholders controlling the conduct of the appeal should expect to pay any costs incurred by the company in prosecuting the appeal out of their own pockets, instead of using the company's funds. If the appeal succeeds, the directors and/or shareholders can reclaim from the company the funds that they had expended. Second, the directors and/or shareholders controlling the conduct of the appeal should also expect to be personally responsible for the payment of any party and party costs awarded in favour of the respondent if the appeal fails.

B. Whether the HC erred in finding that Sun Electric was deemed to be unable to pay its debts pursuant to section 254(2)(c) of the Companies Act

Section 254(2)(*c*) of the Companies Act (now section 125(2)(*c*) of the IRDA) provides that a company shall be deemed unable to pay its debts if "it is proved to the satisfaction of the [High] Court that the company is unable to pay its debts". In determining whether a company is unable to pay its debts, "the [High] Court shall take into account the contingent and prospective liabilities of the company". If the HC finds that the company is unable to pay its debts, then under section 254(1)(*e*), it may order the winding up of that company.

In a departure from prior cases where several different tests had been used, the CA instead held that the cash flow test should be the sole and determinative test under section 254(2)(*c*) of the Companies Act for whether a company was unable to pay its debts. This test assesses whether the company's current assets exceed its current liabilities such that it is able to meet all debts as and when they fall due. "Current assets" and "current liabilities" referred to assets which would be realisable and debts which would fall due within a 12-month timeframe.

The CA also set out a non-exhaustive list of factors which should be considered under the cash flow test:

(a) the quantum of all debts which were due or would be due in the reasonably near future;
(b) whether payment was being demanded or was likely to be demanded for those debts;
(c) whether the company had failed to pay any of its debts, the quantum of such debt, and for how long the company had failed to pay it;
(d) the length of time which had passed since the commencement of the winding-up proceedings;
(e) the value of the company's current assets and assets which would be realisable in the reasonably near future;
(f) the state of the company's business, in order to determine its expected net cash flow from the business by deducting from projected future sales the cash expenses which would be necessary to generate those sales;
(g) any other income or payment which the company might receive in the reasonably near future; and
(h) arrangements between the company and prospective lenders, such as its bankers and shareholders, in order to determine whether any shortfall in liquid and realisable assets and cash flow could be made up by borrowings which would be repayable at a time later than the debts.

The CA gave several reasons for its departure from prior cases. *First*, it held that Parliament must have intended only a single test for section 254(2)(*c*), implied from the plain words of the provision. In contrast, where Parliament intended to have separate insolvency tests, it has explicitly stated so in the statute. *Second*, its interpretation was supported by United Kingdom ("**UK**") case law, which applied a single test when the UK equivalent of section 254(2)(*c*) (section 518(*e*) of the Companies Act 1985 (c 6) (UK)) was *in pari materia*[3] with section 254(2)(*c*) of the Companies Act; the UK only applied two separate insolvency tests after its legislation was amended to expressly include two tests. *Third*, the single test intended by section 254(2)(*c*) of the Companies Act is not the balance sheet test. This test compares a company's total assets with its total liabilities. However, this ratio has no direct correlation with whether a company "*is* unable to pay its debts". It is not the total asset to total liability ratio which determines a company's present ability to pay its debts. Instead, this is determined by the liquidity of the assets and when the debts fall due. Thus, the CA held that Parliament could not have intended the balance sheet test as the test for section 254(2)(*c*) as it is not a good indicator of the company's present ability to pay its debts.

Applying the cash flow test, the CA agreed with the HC that Sun Electric was "cash flow insolvent". Its current liabilities ($1,702,982) exceeded its current assets ($377,342) by about $1.33m, while its total liabilities exceeded its total assets by at least $1.64m. These deficiencies were likely to have continued up till the date of the winding-up hearing for the following reasons. First, the projected profit from September 2019 to April 2020 was sorely insufficient to cover the deficiency. Secondly, Sun Electric had been loss-making for seven months leading up to 31 July 2019 and no credible evidence was provided to show that this position had changed. Even though the winding-up application was brought for a "meagre confirmed debt of around $9,000" which Sun Electric claimed it could pay immediately, the fact remained that it was not paid up to the hearing of the appeal. The CA found that Sun Electric's current liabilities exceeded its current assets, and this was sufficient to make the finding of insolvency. The burden was on Sun Electric to refute this, but it failed to do so.

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[3] Generally, where two provisions are similarly worded and pertain to the same subject or matter.

Thus, the CA agreed with the HC that Sun Electric was deemed to be unable to pay its debts pursuant to section 254(2)(*c*) of the Companies Act.

C. Whether the HC had erred in finding that Sun Electric was deemed to be unable to pay its debts pursuant to section 254(2)(a) of the Companies Act

Based on the above findings, it was not strictly necessary for the CA to decide whether the alternative ground under section 254(2)(*a*) of the Companies Act was also made out. However, as this raised a novel question of law, for completeness the CA provided its (non-binding) observations regarding this point as well.

Under section 254(2)(*a*) of the Companies Act, where a creditor has served on the company a statutory demand for a debt exceeding $10,000, the company will be deemed as unable to pay its debts if it ***neglects to***: (a) pay the sum; (b) secure the sum; or (c) compound the sum (to the reasonable satisfaction of the creditor), within three weeks from the service of the demand ("**the prescribed period**"). The CA opined that regarding the drafting of the provision, it was plain that the intention was that the three limbs be considered *conjunctively* so that the company will not be deemed to be unable to pay its debts as long as it has been able to satisfy one of the limbs. Further, the qualifier "to the reasonable satisfaction of the creditor" would apply to the second and third limbs (secure the sum; compound the sum) but not to the first limb, as it would be a more natural reading of the provision. Thus, the CA observed that the test for the first limb is not whether the debtor pays an amount to the reasonable satisfaction of the creditor, but whether the debtor pays an amount such that the debt falls below the stipulated threshold figure of $10,000.

In the present case, Sun Electric had paid the debt in part such that the Outstanding Costs fell below $10,000. The question was then whether a company which pays the statutory demand in part, such that the remaining sum falls below the stated limit, can be considered to have 'neglected to pay the sum'. This question was further divided into two situations: first, where the partial payment was made within the prescribed period; and second, where the partial payment was made only after that period. For the first situation, the CA opined that a company that pays the debt demanded in a statutory demand in part within the prescribed period such that the remaining amount payable falls below $10,000 should *not* be deemed to be unable to pay its debts pursuant to section 254(2)(*a*) of the Companies Act.

For the second situation, which encompassed the case before the court, the CA observed that once the prescribed period has passed without satisfaction of any of the three limbs by the debtor company, the creditor would have acquired the right to apply for the winding up of the company on the basis that it is unable to pay its debts due to the "deeming effect" of section 254(2)(*a*) of the Companies Act.[4] There were conflicting case authorities on the issue of the effect of the deeming provision after the prescribed period. The *first* category of cases holds that the effect of the deeming provision is only to deem the company to be unable to pay its debts at the point of the expiry of the prescribed period, and not at the time of the winding-up hearing.

The *second* category of cases holds that the effect of the deeming provision is to deem the company to be unable to pay its debts at the point of the expiry of the prescribed period, but this would continue until the winding-up hearing unless payment is made. The *third* category of cases holds that the effect

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[4] This deeming effect refers to the fact that section 254(2)(*a*) of the Companies Act deems a company as unable to pay its debts if it has been served a statutory demand for a debt exceeding $10,000, and the company neglects to pay, secure or compound the sum within three weeks from the service of the demand.

of the deeming provision is to deem the company to be unable to pay its debts at the time of the winding-up hearing, regardless of whether the debt had been paid off subsequent to the expiry of the prescribed period. However, the CA did not make a decision on which was the right position to adopt, reserving its decision to another case where this point would be fully explored.

D. Whether the HC had erred in exercising its discretion to wind up Sun Electric

The CA held that the HC did not err in exercising its discretion to wind up Sun Electric. According to section 254(1)(*e*) of the Companies Act, the HC has such a discretion and is not mandated to order a winding up even if the company is unable to pay its debts. The general rule was that where a company is unable or deemed to be unable to pay its debts, the creditor is *prima facie* (i.e. on first impression) entitled to a winding-up order *ex debito justitiae* (i.e. the applicant has a remedy as of right). However, the HC still has discretion not to order a winding up of the company, as this rule is not absolute, and there are exceptions to it.

In exercising its discretion, the HC should consider factors such as the viability of the company, and the economic and social interests of the company's employees, suppliers, shareholders, non-petitioning creditors, customers and other companies in the group enterprise. As to the present case, the CA found that there were no strong countervailing factors. For instance, there were no creditors who filed applications to oppose a winding up. Winding up Sun Electric would not cause any adverse consequences on the broader energy retail market. Thus, the CA agreed with the HC that Sun Electric should be wound up.

IV. Conclusion

The CA dismissed Sun Electric's appeal on the basis that it was cash flow insolvent, and that the HC did not err in winding it up pursuant to section 254(1)(*e*) read with section 254(2)(*c*) of the Companies Act.

V. Lessons Learnt

Two important points from this judgement are: (i) the CA's setting out of general rules to the effect that directors/shareholders would bear the costs of appealing a winding up order, and (ii) the cash flow test would be the sole determinative test for whether a company is deemed unable to pay its debts under section 254(2)(*c*) of the Companies Act.

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