Foo Kian Beng v OP3 International Pte Ltd (in liquidation)
[2024] 1 SLR 361; [2024] SGCA 10

I. Executive Summary

A company, being an inanimate legal person, acts through its agents. Typically, this would include its board of directors, the directing minds of the company. However, this can give rise to problems: where a director's personal interest is not aligned with the interests of the company as a whole, the director may pursue his own personal interest at the expense of the whole company. To address this difficulty, directors have a legal fiduciary duty to always act in the "best interests of the company". Briefly, as a fiduciary, the director has a legal obligation to act in the best interests of his/her company.

This is not always a simple task though. Where the company's best interests lie depends on the circumstances. When a company is financially healthy, the interests of creditors are generally sufficiently protected, and the interests of the company's shareholders may be treated as a sufficient proxy for those of the company. When a company is insolvent, however, the interests of the creditors will come to the fore as the directors are effectively trading and running the company's business with the creditors' money.

Foo Kian Beng v OP3 International Pte Ltd (in liquidation) [2024] 1 SLR 361 centres on the difficulty in delineating the point in time at which the interests of creditors should assume significance and even pre-eminence in the mind of the directors. The Court of Appeal ("**CA**") took this opportunity to set out its views on this issue, bearing in mind the UK Supreme Court's then-recent decision on a similar matter in *BTI 2014 LLC v Sequana SA and others* [2022] UKSC 25 ("***Sequana***").

OP3 International Pte Ltd ("**OP3**"), the company in question, filed suit against its sole director and shareholder Mr Foo Kian Beng ("**Mr Foo**"), for authorising the payment of dividends and the repayment of company loans to himself (the "**Payments**"), at a time when the company was facing a suit due to the defective design and construction of a drainage system at one of its clients' premises. Of the Payments, Mr Foo averred that a particular dividend recorded as having been paid to him in 2016 ("**Disputed Dividend**") was in fact paid to him in 2017, as part of one of the loan repayments ("**Disputed Payment**"). The Disputed Dividend and the Disputed Payment will be collectively referred to as the "**Disputed Transactions**".

The High Court ("**HC**") found OP3 to be in a financially parlous state at the time of the payments to Mr Foo. In these circumstances, at the time he authorised those payments to himself Mr Foo was in fact obliged to consider the interests of OP3's creditors, as part of his fiduciary duty to act in the best interests of the company. The HC held that he breached that duty because there was no legitimate reason for him to have paid himself those amounts, in preference to the claims of other creditors. The CA agreed with the HC and dismissed Mr Foo's appeal.

For simplicity's sake, the fiduciary duty owed by a director to the company to consider the interests of creditors in certain circumstances will be referred to as the "**Creditor Duty**". However, there is in fact no distinct duty that directors owe to creditors, or any duty separate from the directors' fiduciary duty to act in the best interests of the company.

II. Material Facts

OP3 is an interior design, decorating consultancy and construction services business. It was ordered to be liquidated in 2020, due to its failure to satisfy a judgment sum it was ordered to pay in what is known as "**Suit 498**". Suit 498 is separate from the current suit and appeal. While Suit 498 was ongoing, Mr Foo transferred sums from OP3 to himself. Subsequently, as part of the liquidation process, OP3's liquidator commenced a new suit ("**Suit 152**") in OP3's name against Mr Foo for the transfer of these sums.

A. Before liquidation: Suit 498, and transactions between OP3 and Mr Foo

OP3 had contracted with Smile Inc Dental Surgeons Pte Ltd ("**Smile Inc**") to provide fitting out works at one of Smile Inc's clinics ("Clinic"). OP3 completed the contract after the contract deadline. A few months later, Smile Inc discovered mould growing on the Clinic's walls. Smile Inc discovered that the mould was the result of a flood in the Clinic ("**First Flood**") and, on the same day, notified OP3 of it. Smile Inc believed that the First Flood was caused by OP3's defective fitting out works.

Upon learning of the First Flood, OP3 assessed that the flooding occurred at the Clinic's drainage sump area and undertook rectification works. However, about five months later, Smile Inc discovered mould growth on the walls of the Clinic for the second time after a second flood ("**Second Flood**"). This also originated at the Clinic's drainage sump area. Smile Inc notified Mr Foo of the Second Flood and Mr Foo visited the Clinic the next day to investigate the circumstances surrounding the Second Flood.

In the wake of the Second Flood, Smile Inc issued a letter of demand to OP3, claiming that OP3's fitting out works had been tardy and defective, and were the cause of both floods. Smile Inc sought compensation for having to "shut down the operation of the Clinic for an extended period" on two occasions and for ancillary costs of repair. Subsequently, Smile Inc commenced Suit 498. OP3 was represented by Parwani Law LLC ("**Parwani Law**"). The court ultimately found in favour of Smile Inc. As OP3 could not pay the sum ordered by the court under Suit 498, it had to enter liquidation proceedings.

While Suit 498 was ongoing, Mr Foo authorised the payment of the Disputed Dividends to himself and a year later, transferred to himself the Disputed Payment.

B. During and after liquidation

As part of the liquidation process, OP3's liquidator brought Suit 152 in OP3's name against Mr Foo.

(i) OP3's arguments

In Suit 152, OP3 sought to recover the Payments from Mr Foo. OP3 claimed that Mr Foo breached his director's duty to act in the best interests of the company under the common law and/or his duty to act honestly under section 157(1) of the Companies Act (Cap 50, 2006 Rev Ed) ("Companies Act"). Central to OP3's case was its claim that a director is under a duty to consider the interests of the creditors as part of his duty to act in the best interests of the company at a time when the company is "financially parlous". OP3 argued that this describes a state of affairs that is less dire than being on "the verge of insolvency".

OP3 alleged that it was insolvent or, at least, in a financially parlous position during the times when Mr Foo authorised the Payments, due to the following reasons:

(a) Suit 498 gave rise to a contingent liability that was reasonably likely to materialise; and
(b) Even if the lowest quantum at which this contingent liability could be valued had been accounted for, OP3 would be rendered cash flow insolvent, close to balance sheet insolvent, or balance sheet insolvent at the time of the Payments. This would mean that OP3 was "financially parlous".

OP3 argued that in these circumstances Mr Foo was obliged to consider the interests of creditors as part of his duty as a director to act in the best interests of the company. By authorising the Payments to himself, he had breached the Creditor Duty.

(ii) Mr Foo's arguments

Mr Foo countered that the Creditor Duty only arises when the company is in fact insolvent or on the verge of insolvency, and further these are financial states that are more dire than when a company is in a financially parlous position. He argued that OP3 was neither insolvent nor on the verge of

insolvency when he authorised the Payments.

Mr Foo also claimed that OP3's contingent liability in Suit 498 need not have been accounted for. This liability was, according to him, not reasonably likely to materialise because:

- He genuinely believed that OP3 had a strong defence to Suit 498;
- He considered that the First Flood had arisen from failure on Smile Inc's part;
- OP3 conducted two sets of tests, which confirmed that there were no defects in the drainage pipes OP3 installed at the Clinic, after the First Flood and Second Flood; and
- Before making the Payments to himself, he had confirmed with an auditor OP3 previously engaged to prepare its financial accounts that it was proper for Mr Foo to make the Payments.

There was also a report prepared by an independent expert Mr Chee Yan Pong ("**Mr Chee**"), that purportedly found that the causes of the First Flood and Second Flood were not attributable to OP3. Further, Mr Foo submitted that OP3 was solvent at the material time, and he was thus under no duty to consider the interests of creditors when he authorised the Payments to himself.

(iii) The HC's judgment

The HC found in favour of OP3. It held that the Creditor Duty is first engaged when a company is "financially parlous" and that this is a state of affairs less severe than being "on the verge of insolvency". The HC also found that OP3's potential liability in Suit 498 was reasonably likely to materialise when Smile Inc served the statement of claim on OP3. This was because there was little to suggest that Mr Foo was justified in relying on the legal advice he received from Parwani Law. Mr Foo was also not justified in relying on the auditor's advice and Mr Chee's report. Based on the facts and circumstances known to Mr Foo by then, he could not reasonably have believed that OP3 would not face *any* liability in Suit 498.

The HC thus held that OP3's contingent liability to Smile Inc in Suit 498 rendered it balance-sheet insolvent, such that Mr Foo was obliged to consider the interests of creditors in making decisions for OP3 at the times of the Disputed Transactions. Mr Foo appealed.

III. Issues on Appeal

On appeal, the CA addressed the following key issues:

A. When is the Creditor Duty first engaged?
B. Was the Creditor Duty engaged at the time Mr Foo authorised the Disputed Transactions?
C. If the Creditor Duty was engaged at the relevant times, did Mr Foo breach this duty by allowing the payment of the Disputed Transactions to himself?

A. When is the Creditor Duty first engaged?

(i) Nature, scope and content of the Creditor Duty

The CA took the opportunity to clarify the nature, scope, and content of the Creditor Duty. This was also timely in view of the UK Supreme Court's discussion of the Creditor Duty in *Sequana*, and the fact that local caselaw contained several differing descriptions of the circumstances that trigger the Creditor Duty.

General principles. The CA first reiterated that the Creditor Duty is a duty owed by directors to the company, rather than to creditors; this also echoed the position taken in *Sequana*. Creditors cannot sue directors for the breach of such duty. Instead, the proper claimant in such a situation would be the company itself. Further, any financial award from a successful action for such breach inures for the benefit of the company, though it may in practical terms be subsequently distributable among the company's creditors. However, the CA left open, for future consideration, the question of the precise circumstances in which a claim for breach of the Creditor Duty may be brought against a director.

The CA then stated that the Creditor Duty modifies how the *company's* interests ought to be understood when a director considers his duty to act in the best interests of the whole company. The Creditor Duty underscores the fact that the interests of creditors acquire discrete significance and require separate consideration at a certain stage in a company's life cycle.

Creditors vs shareholders. The CA stressed that directors must have regard to the interests of different stakeholders, including creditors, at all times. However, when a company is financially healthy, the interests of shareholders can be treated as a proxy for the company's interests. Commensurately less or even no discrete weight can be accorded to the interests of creditors. This is because a solvent company, by definition, has sufficient assets to pay off creditors.

Creditors also indirectly benefit from directors according principal regard to the interests of shareholders in taking decisions for a solvent company. After all, it is in the shareholders' interest – and therefore the company's interests – to pay the company's debts so that it may carry on its business in a way that preserves its reputation for creditworthiness and its access to future credit.

By extension, it is possible for a director to breach his duty to act in the best interests of the company when the company is solvent, by undertaking acts that unjustifiably prejudice the interests of creditors – for instance when acting with the intent of defrauding creditors. While such a director may not need to accord significant weight to the creditors' interests in taking decisions for the company given the company's financial health, acting in *complete disregard* of creditor interests or in a way that is directly adverse to those interests shows a failure to act in the best interests of the company.

Shift in concerns in insolvency. The rationale underlying the Creditor Duty is based on the shift in the main economic stakeholder, as the company approaches insolvency and the asymmetry in corporate governance. When the company is solvent, shareholders are the primary risk bearers. When the company is insolvent, however, creditors displace them from this position because an insolvent company effectively trades and conducts its business with its creditors' money. The law responds to the misalignment of incentives between those running the company and those bearing the consequences of actions undertaken by a financially distressed company by enjoining directors of such firms to take corporate decisions with the interests of creditors in mind. Further, creditors ought to be understood as a class for the purpose of the Creditor Duty. This was consistent with the underlying aim of the Creditor Duty in that the duty seeks to redress the fact that the risks of continued trading of the company has shifted from the shoulders of one stakeholder (namely, the shareholders) to another (namely, the creditors).

When Creditor Duty is breached. In assessing whether the Creditor Duty was breached, the court will consider whether the director exercised his discretion in good faith in what *he* (not the court) considered to be in the best interests of the company, as understood with reference to the company's financial state at the time. Although the duty is a subjective one in that sense, the court will assess a director's claim objectively, by asking whether the view the director claims to have formed was credible or reasonably open to him, given the information available at the time. The court may infer that a director was not acting honestly where the transaction is objectively not one in the company's interests. The court will be slow to interfere with commercial decisions made honestly but which, *on hindsight*, were financially detrimental to a company. This is because it is not the court's role to condemn directors who, in good faith, have made commercial decisions which turn out to be incorrect.

At the same time, however, a director is also subject to a separate duty to act with reasonable diligence in the discharge of his office under section 157(1) of the Companies Act. This encapsulates the director's common law duty to exercise due care, skill, and diligence. The court will, when faced with a claim for breach of either duty (under section 157(1) or common law), assess whether the director had fallen foul of the objective standard of care and diligence expected of a director.

This difference in duties is significant. Because an action for breach of the Creditor Duty focuses on the subjective intentions of a director, a director may have honestly believed that he had acted in the best interests of the company and be found to have complied with the Creditor Duty, even though his actions fall below the objective standard of care and diligence expected of a director (under section 157(1) or common law). In this situation, compliance with the Creditor Duty does not immunise a director from breaches of other directors' duties which may be engaged on the same set of facts.

(ii) Distinction between whether Creditor Duty has arisen, and breach of such duty

The CA maintained the doctrinal distinction between the issue of whether the Creditor Duty has *arisen,* and the issue of whether a director has acted in *breach* of this duty. Regarding the first issue: when the court examines the financial state of a company, it is essentially assessing where the economic interests of the company lay. This involves an *objective* examination of a company's solvency at the material time, and considers the surrounding circumstances of the case. However, the second issue concerns whether a director *subjectively* believed that his acts were performed in the company's best interests, which was a different inquiry. On this issue, the court is examining the director's business judgment. As such, the court will not substitute its own decisions in place of those made by directors in the honest and reasonable belief that they were for the best interests of the company, even if those decisions turned out subsequently to be wrong ones.

The CA further noted (in line with *Sequana*) that insolvency is not uncommon in the life of viable companies. Directors may, depending on the circumstances, in good faith perceive that there is a reasonable prospect that the company will be able to trade itself out of insolvency for the benefit of both creditors and shareholders. If done in such belief, such a course of action will be consistent with the directors' performance of the Creditor Duty.

When faced with a claim for a breach of the Creditor Duty, the court should objectively ascertain the financial state of the company that was prevailing at the time the transaction sought to be impugned was entered into or that was likely to arise as a result of the company entering into the said transaction. The court is not concerned with whether the company was technically insolvent or whether it would have been appropriate to liquidate the company. Instead, the court will engage in a "broader assessment of the surrounding circumstances", which would include a consideration of all claims, debts, liabilities and obligations of a company, rather than strictly applying the "going concern" test and the "balance sheet" test which remain, at best, useful indicia of the financial health of the company.

(iii) Inquiries for each issue

Having regard to the above indicia, the CA noted the appropriate inquiries for each issue.

1. **Existence of Creditor Duty: Financial Stages of the Company**

The CA held that the court should objectively determine which of three financial stages the company was in at the time the transaction was entered into or that was likely to arise as a result of the company entering into the said transaction. The three stages are:

(a) **Category one**: Where all things including the contemplated transaction having been considered, the company is solvent and able to discharge its debts.

(b) **Category two**: Where a company is imminently likely to be unable to discharge its debts. This category encompasses cases where a director ought reasonably to apprehend that the contemplated transaction is going to render it imminently likely that the company will not be able to discharge its debts. It is no excuse for a director to claim that he did not appreciate how dire the company's financial state was if he ought reasonably to have done so.

(c) **Category three**: Where corporate insolvency proceedings are inevitable. A clear shift in the economic interests in the company (from the shareholders to the creditors as the main economic stakeholders of the company) would occur where insolvent liquidation or

administration (or judicial management under Singapore law) is inevitable. (The CA did note that this was not the position taken by Lord Briggs in *Sequana*, where he held that it is only the onset of the liquidation process itself that converts creditors into the main economic stakeholders of the company.)

2. Breach of Creditor Duty: Subjective intentions of the Director

The CA noted that the financial state of the company provides a useful analytical yardstick against which the subjective *bona fides* of the director may be tested, leading to the following developments of the above categories:

(a) **Category one**: Where a company is, all things considered, financially solvent and able to discharge its debts, a director typically does not need to do anything more than act in the best interests of the shareholders to comply with his fiduciary duty to act in the best interests of the company.

(b) **Category two**: In this intermediate zone, the court will scrutinise the subjective *bona fides* of the director with reference to the potential benefits and risks that the relevant transaction might bring to the company. The court will be slow to second-guess the honest, good faith commercial decisions made by a director to afford the company the best possible chances of revitalising its fortunes. However, transactions undertaken which appear to exclusively benefit shareholders or directors will attract heightened scrutiny.

(c) **Category three**: Where corporate insolvency proceedings are inevitable, there is a clear shift in the economic interests in the company: from the shareholders to the creditors as the main economic stakeholders of the company. This is because the assets of the company at this stage would be insufficient to satisfy the claims of creditors, and in the context of liquidation, shareholders as residual claimants will stand to recover little or nothing. The Creditor Duty operates during this interval to prohibit directors from authorising corporate transactions that have the exclusive effect of benefiting shareholders or themselves at the expense of the company's creditors, such as the payment of dividends.

B. The Creditor Duty was engaged at the time Mr Foo authorised the Disputed Transactions

The CA held that the Creditor Duty was indeed engaged at the time Mr Foo authorised the payment of the Disputed Transactions to himself. In so authorising the transactions, Mr Foo was obliged to have regard to the interests of OP3's creditors.

OP3's contingent liability in Suit 498 was one reasonably likely to materialise and thus had to be taken into account in assessing its solvency at the material times the Disputed Transactions were paid out to Mr Foo. In this case, the legal advice Mr Foo received from Parwani Law on the merits of Smile Inc's claim in Suit 498 did not justify his breach of the Creditor Duty. The evidence showed that the legal advice that Parwani Law provided Mr Foo was extremely cursory and/or was inadmissible hearsay evidence. The mere fact that legal advice was taken does not mean that a defendant-director will inevitably be found to have acted *bona fide* in undertaking a certain course of action. The court must be provided sufficient information about the circumstances under which such advice was provided, so as to be able to evaluate the extent to which an individual can fairly rely on the fact of legal advice.

OP3 had overlooked the need to install an access panel at the Clinic, which was the root cause of the First Flood. The CA also noted that there was little to substantiate Mr Foo's purported belief *at the material time* that OP3 was *not* liable in respect of the Second Flood. For much the same reasons, Mr Chee's Report could not have helped Mr Foo. Neither Mr Foo nor his lawyers provided cogent evidence to show that Mr Foo honestly believed or could honestly have believed that OP3would face no liability in respect of the First and Second Floods.

The contingent liability in Suit 498 was of an amount that made it clear that OP3 was imminently

likely to be unable to discharge its debts. The Creditor Duty was therefore engaged at the times Mr Foo authorised the payment of the Disputed Transactions to himself.

C. Mr Foo breached the Creditor Duty by authorising the payment of the Disputed Transactions to himself

Finally, the CA held that Mr Foo failed to consider the interests of OP3's creditors and acted in breach of the Creditor Duty by authorising the payment of the Disputed Transactions to himself.

The CA stressed that this was not a case where Mr Foo took a strategic commercial decision to revitalise the fortunes of the company and under which OP3's creditors could potentially enjoy some upside if Mr Foo's commercial judgment paid off. Rather, the Disputed Transactions enriched Mr Foo at the expense of OP3's creditors.

IV. Conclusion

The CA held that the Creditor Duty was engaged at the time Mr Foo authorised the payment of the Disputed Transactions to himself; further, that Mr Foo failed to consider the interests of OP3's creditors in breach of this duty by so authorising the transactions. Thus, the appeal was dismissed.

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