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Insights

COVID-19 AND WRONGFUL TRADING IN HONG KONG SAR AND SINGAPORE

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SUMMARY

As COVID-19 cases continue to span the globe, a significant economic impact is being felt globally. Businesses have been disrupted, cash flows have been interrupted and economies have been thrown into a huge negative shock.

In many countries across the world, governments have amended their insolvency and corporation legislation, or enacted new legislation, in order to provide temporary relief to entities in financial distress as a result of the COVID-19 pandemic. This blog examines the impact of these measures alongside the current position in Hong Kong SAR and Singapore.

Introduction

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In many countries across the world, governments have amended their insolvency and corporation legislation, or enacted new legislation, in order to provide temporary relief to entities in financial distress as a result of the COVID-19 pandemic.

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What we have seen in other countries

In order to provide relief to businesses that are unable to meet their debts due to the impact of COVID-19, the Australian Federal Government has passed temporary amendments to its insolvency and corporation legislation through the *Coronavirus Economic Response Package Omnibus Act 2020* (Cth) that received Royal Assent on 24 March 2020. The changes provide relief to directors

from the risk of personal liability for insolvent trading by allowing businesses to operate during a temporary six month period without having to enter voluntary administration or liquidation. Further, the statutory minimum for the issuing of a statutory demand has been increased from AU$2,000 to AU$20,000 and the period for compliance with such a demand has been extended from twenty-one days to six months.

The German government has passed a bill that contains wide ranging measures to provide individuals and businesses with sufficient liquidity to help them through the COVID-19 pandemic. The legislation provides that the obligation to file for insolvency as well as the payment prohibitions will be suspended until 30 September 2020, unless the insolvency is not due to the effects of the COVID-19 pandemic or there is no prospect of eliminating a payment default that has occurred. The law also relieves managing directors from liability for payments made in the ordinary course of business after the company has become insolvent, in particular, where such payments are made to maintain or resume business operations or to implement a restructuring concept. Further, during a three month transition period, creditors are prohibited from commencing insolvency proceedings against businesses. These measures may be extended by the government until no later than 31 March 2021.

On 28 March 2020 the UK government announced that it will introduce legislation at the earliest opportunity to, among other things, give businesses greater flexibility to help them emerge intact at the end of the pandemic. With the overriding objective of helping companies which need to undergo a financial restructuring or rescue process to continue trading, the proposed measures will give those businesses extra time and space to weather the storm whilst ensuring that creditors get the best return possible in the circumstances.

The government previously consulted on proposed changes to the UK's insolvency framework and is now looking to introduce reforms including:

- a moratorium for companies giving them breathing space from creditors enforcing their debts for a period of time whilst they seek a rescue or restructure,
  - protection of their supplies to enable them to continue trading during the moratorium, and
  - a new restructuring plan, binding creditors to that plan.

In addition to this, the UK government has announced a temporary suspension of the wrongful trading regime, with retrospective effect from 1 March 2020, to remove the threat of personal liability for directors.

The devil will be in the detail on the suspension of wrongful trading to ensure that it is not abused. However, for companies genuinely struggling as a result of the effects of COVID-19 this will provide directors with some valuable reassurance. It was stated that all other checks and balances to

ensure directors fulfil their duties properly will remain in force and, in the zone of insolvency, this means that directors will continue to have regard to the interests of creditors.

Position in Asia

Hong Kong SAR

Hong Kong SAR has no concept of "insolvent trading" or "wrongful trading", although the Financial Services and the Treasury Bureau has indicated that such provisions may be included in a draft corporate rescue bill that will be put to the Legislative Council ("LegCo") in the autumn.

Although rare, individuals may be subject to criminal and civil penalties and disqualification orders if they engage in fraudulent trading. Fraudulent trading is when a business of the company has been carried out with the intent to defraud creditors. If fraudulent trading can be established, the courts may declare that any persons who were knowingly parties to the fraudulent carrying on of the business shall be personally responsible (without any limitation of liability) for the debts or liabilities of the company. The criminal penalty is a fine and/or a prison sentence of up to 5 years. Directors may also be subject to claims on other statutory grounds, such as (a) failure to exercise reasonable care, skill and diligence, (b) misfeasance, (c) breach of duty or (d) breach of trust in relation to the company as found out in the course of winding up of a company.

Companies in financial difficulties are, however, exposed to a variety of formal procedures including the appointment of a receiver, voluntary liquidation, and compulsory liquidation. A financially distressed company (or if the company is being wound up, the liquidator or provisional liquidator) may also restructure its debts through the scheme of arrangement process. Pursuant to sections 668 to 677 of the Companies Ordinance (Cap. 622), the company may apply to the court for an order of an arrangement or a compromise in respect of its debts wherein the creditors will accept repayment of debts less than the amounts originally owed.

Notably, apart from the scheme of arrangement process, Hong Kong SAR lacks any formal corporate rescue procedure such as can be found in some other common law jurisdictions. However, the Financial Services and the Treasury Bureau has indicated that the draft bill that will be put to LegCo in the autumn will include a corporate rescue procedure, including a six month moratorium from hostile acts by creditors. The draft bill is being prepared in an attempt to prevent a huge number of corporate failures following the 2019 protests and the COVID-19 pandemic.

A corporate rescue procedure is something that has been mooted since 1996, but never implemented. Although it seems like such a procedure is yet again at the forefront of LegCo's mind, it will be several months until such legislation provides the much needed respite from the distress that many businesses are experiencing right now. When compared with the prompt measures implemented by countries such as Australia and Germany in response to the effects of the COVID-19 pandemic, it pales into insignificance and will not provide the relief or protection to businesses that are unable to pay its debts.

Singapore

There is a concept of “wrongful trading” in Singapore and the operative provision is set out in Section 339(3) of the Companies Act (Chapter 50 of Singapore) (“Singapore Companies Act”). When a company is insolvent, any payment or any transaction that it makes may incur civil and criminal liabilities for its directors. This offence is premised on the basis of the director knowingly causing the company to take on a debt obligation when he had no reasonable or probable ground of expectation that the company would be able to repay the debt. It may be sufficient to establish that the director contracted the debts in a reckless or unreasonable manner without having to establish fraud or dishonesty.

Wrongful trading must be established on a criminal standard of proof (i.e. beyond a reasonable doubt) and this is a prerequisite before civil liability, where the standard of proof is based on the balance of probabilities. If criminal liability is made out, such director may be fined up to S$2,000 or imprisoned for a term up to 3 months. Thereafter, such director can also be made personally liable for the whole or part of the debt under section 340(2) the Singapore Companies Act.

Accordingly, directors need to pay extra attention to their obligations not to trade by continuing to incur debts through the course of their daily business, while the company is insolvent. Debts can be incurred whether through the making of orders for supplies or the signing of agreements to leases spaces when the company has insufficient funds to fulfil such payments. This is especially tricky in such stressful times where directors are anxious about their businesses and pressured to make quick decisions.

On 1 April 2020, the Singapore government announced its plan to introduce the COVID-19 (Temporary Measures) Bill in Parliament in the next week to offer temporary relief to businesses and individuals who are unable to fulfil their contractual obligations because of COVID-19. It is noted that the monetary thresholds and time limits for bankruptcy and insolvency will be increased. For companies and partnerships, the monetary threshold for insolvency will be increased from S$10,000 to S$100,000. The time period to satisfy a statutory demand will increase from 21 days to 6 months. Directors will also be temporarily relieved from their obligations to prevent their companies from trading while insolvent if the debts are incurred in the company’s ordinary course of business. However, directors remain criminally liable if the debts are incurred fraudulently. More clarity on the new law is expected in the coming days.

Another interesting issue to consider is how COVID-19 may impact the rolling out of the Insolvency, Restructuring and Dissolution Act 2018 (“IRDA”) in Singapore. The IRDA was passed in Parliament on 1 October 2018 but is currently not in force. It consolidates and reforms Singapore’s corporate insolvency and bankruptcy regimes and includes new wrongful trading provisions. Under the new provisions, a company is considered to have traded wrongfully if it incurs debts or liabilities when insolvent (or becomes insolvent as a result of incurring debts or liabilities) without reasonable prospect of meeting them in full. What is more striking is the flexibility of the new provisions, where

criminal liability is no longer a pre-requisite to civil liability and parties such as employees, contractors or counterparties of the company if they were party to the company trading in that manner (not just directors) can be caught under the new provisions.

Given that many otherwise healthy companies are facing financial difficulties at this point in time and the temporary relief measures under the COVID-19 (Temporary Measures) Bill that will be introduced shortly, it is possible that there may be a further delay in the commencement of the IRDA because the new wrongful trading provisions would make it easier for directors and other stakeholders to incur liability.

Recommendations

Given the financial stresses that many businesses will currently feel, now is an important time to pay attention to obligations not to trade if a company is insolvent (Singapore) and avoid any situation that could be seen to qualify as fraudulent trading (Hong Kong SAR). Such offences are assessed with the benefit of hindsight and it is therefore important for directors to take professional advice and ensure that their decision-making is carefully minuted.

In order to mitigate the risks of insolvency, it is also vitally important to reassess the company's financial position, costs and expenses by, for example:

- doing a review of its financial position and the company's solvency in view of the impact of the COVID-19 outbreak, taking into account the tests for insolvency in the related jurisdiction and monitoring cash flow / balance sheets;
- ensure that contractual requirements and financial obligations are met. The company can do so by reviewing their current contracts and possibly attempting to renegotiate key contracts (e.g. payment and time obligations) where required;
- reviewing cost-cutting measures such as planning labour stand downs or reductions;
- monitor the outbreak as well as evolving economic circumstances and government assistance being put in place (if any) and how this impacts on the business and/or its assets / liabilities;
- engage the necessary advisory (e.g. legal and financial) teams to assist with the process; and
- holding meetings with the various committees and personnel within the company to review the above on a regular basis, and to strike a change in strategy or planning where required.

RELATED CAPABILITIES

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MEET THE TEAM

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