JUDICIAL MANAGEMENT IN CORPORATE INSOLVENCY

This article attempts to identify the conditions necessary for the rational assessment of the causes of insolvency and the formulation and implementation of rescue plans. This framework of discussion facilitates a comparative study of existing insolvency practices and a contextual evaluation of the statutory scheme of judicial management.

I. INTRODUCTION

THE purpose of judicial management is to prevent viable companies in financial difficulties from being liquidated. This suggests that the then existing insolvency laws were inadequate for such a purpose. To appreciate these inadequacies and to gauge how far judicial management remedies them, a comparative study of insolvency proceedings such as receivership, liquidation, creditors' schemes of arrangement and compromise and judicial management, seems necessary. This subject area is vast. The results do suggest that the intrinsic value of judicial management is that when invoked its procedures allow economic rationality to prevail in the event of insolvency and pre-empt the economically wasteful and socially ugly self-interested scramble for assets. In this broader context, it becomes apparent that the purpose of rescuing a company is not the sole objective of judicial management.

II. THE BACKGROUND

Upon incorporation, a company is given a legal personality entitling it to trade through its human agents. When a company is insolvent, the company's privilege to continue to trade is restricted. For instance, directors who carry on trading when the company is insolvent[1] may be guilty of the offence of fraudulent trading.[2] The company is also liable to be wound up on the ground that it is unable to pay its debts, and subject to a proviso, a floating charge created within 6 months of a commencement of winding up is invalid.[3] Until recently, the public was generally uninterested in what eventually happen to an insolvent company. The company might have been compulsorily wound up by its creditors.[4] If the company had created a floating charge, the

[1] See section 254(2) of the Companies Act, Cap. 50, Singapore Statutes, 1985 Rev. Ed., which operates as a deeming provision of a company's inability to pay debts.

[2] See sections 339(3) and 340 of the Companies Act, Cap. 50, Singapore Statutes, 1985 Rev. Ed.

[3] See sections 254 and 330, respectively.

[4] Sections 253 and 254 of the Companies Act, Cap. 50, Singapore Statutes, 1985 Rev. Ed., permit application to the Court for an order to wind up a company on various grounds, including, of course, the inability of the company to pay its debts.

debentureholder might have exercised his right to place the company under receivership. If the company was seriously insolvent, it was also possible that a compromise or scheme of arrangement under section 210 of the Companies Act might have been proposed to the creditors.[5] Any of the abovementioned insolvency proceedings or a combination thereof could have materialised.[6] The outcome is hazardous, and it is fair to say that the fate of the company and its management is at the mercy of its creditors. The fate of an insolvent company is necessarily affected by an interplay of creditors' actions and strategies.[7] These actions and strategies are, in the main, assertions of proprietary rights in order to take control of assets by secured creditors on the one hand; and petitions to the Court for a winding-up order by. unsecured creditors on the other. The appointment of a receiver and manager by secured creditors does not prevent the winding up of the company.[8] In petitioning, for a winding-up order, unsecured creditors expect that the liquidator appointed by the Court would challenge the validity of the secured transactions and investigate the affairs of the company.[9] Thus, while the receiver and manager acts in the interest of the debentureholder, the liquidator acts to safeguard the interests of the unsecured creditors and the shareholders. The outcome is that unless exceptional circumstances exist (such as through the active intervention of a powerful agent whether in the form of a major creditor or a bank[10] or the Court[11] or a governmental regulatory institution[12]), most insolvency procedures are unable to reconcile the conflicting interests of the creditors whose main object is to recover the amount owed with least costs and in the shortest possible time. Existing insolvency procedures are unable to promote positive and coherent courses of action, such as rehabilitation or orderly disposition of assets. They are also unable to prevent a self-interested scramble by creditors for the remaining assets. The insolvency, which may well be caused by a temporary cash-flow problem, and the social and economic effects of closure could be totally ignored.

5 The provisions lay down a detailed set of procedures for this purpose.

6 As an example, one could perhaps look at the Emporium Group of companies. There was a combination of insolvency procedures because in respect of one of the companies in the group, Oriental Emporium & Supermarket (People's Park) Pte. Ltd., the same set of insolvency practitioners were appointed as receivers and managers and provisional liquidators of the company at the same time (See the Orders of Court made by Mr. Justice L.P. Thean, File nos. 478 of 1986 & 1356 of 1986, respectively.) In their role as receivers and managers, they were specifically tasked with the carrying out and implementation of the Scheme of Arrangement. In their role as provisional liquidators, they were required to either carry on or close down the businesses of the Company pending the outcome of the scheme of arrangements.

7 For those interested in studying creditors' behaviour, there is an interesting article on this by J.J. Quinn entitled, "Corporate Reorganization and Strategic Behaviour: An Economic Analysis of Canadian Insolvency Law and Recent Proposals for Reform", (1986) Osgoode Hall L.J. 1.

8 See James O'Donovan, "The Interaction of Winding up and Receivership" (1979) 53 Aust. L.J. 264-65.

9 *Ibid.,* 264.

10 A bank may decide to support a rehabilitation plan, agree to a compromise or a scheme of arrangement, or, where necessary, put the company under receivership.

11 See the example provided by the Emporium Holdings case discussed above.

12 The Monetary Authority of Singapore (MAS) which wields considerable influence over banks has the potential to actively intervene in the insolvency of a major company. This is to a certain extent borne out by the role MAS played in the Pan-El crisis.

Introduced by the Companies (Amendment) Act 1987, judicial management came into operation on 15 May 1987. This is in part an outcome of the economic sub-committee's recommendation in January 1986 that "measures should be introduced so that a viable business capable of making a contribution to the economy could be preserved whenever possible for the benefit of the employees, the commercial community and the general public."[13] With 8 petitions for judicial management in a space of 9 months since its inception, out of which 2 final and 2 interim orders were granted, it seems fair to say that the impact of judicial management is beginning to be felt.[14] In terms of concept and statutory language, there is no doubt that the Singapore Act is modelled on the English Insolvency Act 1985. Over in England, where the scheme of administration first came into force on 29 December 1986,[15] reported cases, wherein judges fine-tuned the rules and procedures of administration, are beginning to emerge.[16] In view of these developments, it seems timely to review the concept and the procedures of judicial management as well as to examine its widespread impact on insolvency laws and practice.

III. Concepts And Practices Affecting An Insolvent Company Prior To Judicial Management

To allow for rational assessment of the causes of insolvency and the formulation of plans for a rescue or an orderly realisation of business assets, several prerequisites in the form of minimum paradigmatic conditions should ideally exist. For the purposes of this article, some of these conditions are identified. It might be useful to outline them for the purpose of demonstrating how existing insolvency concepts and practices fall short.

1. *A Neutral Party should take over as Controller of an Insolvent Company*

The handing over of the reins of an insolvent company to an impartial party is necessary to ensure that he acts independently, in good faith,

[13] See page 63.

[14] The first order was made on 14 August 1987 in respect of Lim Seng Huat (S) Pte Ltd by Chan J.C. The rest of the orders in chronological order are as follows:

42/87 — Lim Seng Huat (S) Pte Ltd — Date of Order — 14/8/87
83/87 — Wusang Engineering Pte Ltd — Date of Order — 4/9/87
84/87 — Golden Fortune Development Pte Ltd — Petition later withdrawn
97/87 — DEP International Pte Ltd — Petition dismissed on 23/9/87
104/87 — Eng Guan Huat Construction Co. Pte Ltd
105/87 — Eng Seng Huat Construction Co. Pte Ltd
13/88 — Sane Food Industries Pte Ltd, interim judicial management order granted on 18 March 1988
14/89 — Singapore Animal Husbandry Enterprises Ltd.
Interim judicial management order granted on 18 March 1988.

[15] See Tom Hughes, "Administration — a viable alternative", (1987) May/June, Insolvency Law & Practice, 66.

[16] These cases include *Re a Company* No. 00175 of 1987, [1987] 3 BCC 124; *Re Charnley Davies Business Services Ltd & Others.* [1987] 3 BCC 408; *Air Ecosses Ltd. & Ors.* v. *Civil Aviation Authority & Anor.* [1987] 3 BCC 492; *Re St. Ives Windings Ltd.* [1987] 3 BCC 634; and *Re Newport County Association Football Club Ltd.* [1987] 3 BCC 635.

and in the interests of all parties concerned. This condition is vital if one hopes to obtain support from all the creditors for the proposed plan of action. Under existing insolvency laws and practices, such a person is non-existent.

Liquidators are appointed by the Court for the purpose of winding up a company. The liquidator as well as the provisional liquidator appointed by the Court in a compulsory winding-up proceeding act primarily in the interests of unsecured creditors and shareholders. When appointed a liquidator would investigate whether the company's management have been guilty of any misfeasance and whether unfair dispositions have been made and whether secured transactions are valid and intra vires.[17] As such, the appointment of a liquidator is most threatening as far as the secured creditors are concerned.

By definition, liquidators are unsuited for the task of salvaging a company as their main function is to terminate a company's existence. However, it would be unwise to dismiss them from consideration as experience has shown that provisional liquidators who may exercise powers similar to that of liquidators[18] could play a useful role in corporate rescues. The experience of the companies in the Emporium Holdings group demonstrated that, with imagination, provisional liquidators could be appointed with the task of keeping the companies going until the receivers and managers (in this case, also appointed by the Court) came up with a scheme of arrangement and compromise with the creditors. This would also enable the companies in the group to be sold as going concerns.[19] The arrangement is imaginative and represents a legally cumbersome make-shift solution to meet a desperate need.

The problem with a receiver appointed by a floating charge chargee is that he is hardly impartial. He acts only in the interest of the chargee, and is not legally answerable to the rest of the unsecured creditors.[20] Commenting on English law, a writer notes that "the unsatisfactory character of this is highlighted by the fact that the English courts have felt obliged recently to recognize an equitable duty to account to the company on vacation which goes beyond the statutory obligations and a tort duty of care to guarantors in respect of a negligent exercise of the power of sale."[21] A court-appointed receiver would appear neutral but like the provisional liquidators they are

[17] For a discussion of how a liquidator may challenge the validity of the floating charge and the validity of the appointment of the receiver see James O'Donovan, "The Interaction Of Winding Up And Receivership", (1979) 53 Aust. L.J. 264, 265.
[18] See section 267 of the Companies Act, Cap. 50, Singapore Statutes, 1985 Rev. Ed.
[19] See earlier discussion. There might be some questions concerning the legality of such arrangements.
[20] J.H. Farrar, "Company Insolvency and the Cork Recommendations", Vol. 4 No. 1, The Company Lawyer, p. 21.
[21] *Ibid*., p. 21. See also Ivor Benveniste, "Receiverships and the Protection of Unsecured Creditors", Vol. 6, No. 4, The Company Lawyer, 161, 162.

normally appointed for limited and specific purposes.[22] Yet, like the provisional liquidators, it would be wrong to dismiss them because as in the Emporium Holdings example, receivers and managers appointed by the Court were tasked with the proposal and implementation of a scheme of arrangement with the aim of selling the companies in the group as going concerns.[23]

The absence of an impartial party dedicated to the task of corporate rescue might have led to an insolvency practitioner to observe that:

> "The Companies Act, in its existing form, does provide management of companies with opportunities to enter into compromises or arrangements with its creditors; however, such "restructuring exercises" were often unsuccessful, primarily due to the fact that creditors were not provided with reasonably accurate financial data or an impartial and frank report on the affairs of the Company to merit consideration."[24]

2. *A Stay of Enforcement Proceedings*

When directors have exhausted their resources to save the company, the creditors swoop down for the kill. What is urgently required is a "freeze on proceedings or execution against the company or its assets, and therefore provides an opportunity for arrangements to be made with the company's creditors and members for a rescheduling of the company's debts and a restructuring of its ownership and control, as appropriate."[25]

The appointment of a provisional liquidator acts as an automatic stay on proceedings against the company.[26] There is therefore an effective moratorium on payment of debts. Receivers, on the other hand, are disadvantaged in that there is no automatic stay on proceedings against the company. Oftentime, receivers have to take action to adjourn winding-up petitions and be involved in legal disputes with other creditors. In fact, the appointment of a receiver

[22] As has been pointed out by a commentator "the court may appoint a receiver if it 'appears to the Court to be just or convenient to do so, under Civil Law Act (Cap. 30) section 4(8); also Supreme Court Of Judicature Act (Cap. 15) section 18(2), first schedule para 6 empowers the court to appoint a receiver of property the subject of any cause or matter, and see RSC Order 30." See Andrew Hicks, "Reforming Insolvency Law — Company Rescues", (1986) 7 Sing. L.R. 128,131. As noted by another writer the recent Pan-El affairs provided an example of how this power might be exercised. "In the Pan-El case, there is no debenture-holder with a floating charge, hence the creditor banks concerned had to make an application to court to appoint receivers and managers. The reason given by the applicants, I believe (although I have not seen the affidavit) is that there would be a scramble for the assets of the company and that the assets need to be preserved for the benefit of everyone entitled thereto." This observation is made by Helen Yeo in her conference paper entitled "Compulsory Versus Voluntary Liquidation — What are the differences, costs and benefits?". The paper was presented in Singapore on 27 February 1986. This conference was organised by OR management and covered the topic of Singapore company, insolvency and bankruptcy laws.

[23] See earlier discussion.

[24] See letter of P.T. Hong to Select Committee, Report of the Select Committee on the 1987 Companies (Amendment) Bill at p. A3.

[25] See Nick Segal, "The Role of the Administrator" (1986) 4 J. Int'l Bus. L. 236.

[26] See section 262(3) of the Companies Act, Singapore Statutes, Cap. 50, 1985 Rev. Ed.

attracts legal challenges to the rights he might have over the assets. Potential purchasers of an insolvent company are generally deterred by legal proceedings against the company[27] The *Straits Times* has reported that creditors' action against Teck Hock & Co., the debt laden coffee trader placed under receivership, had caused United Industrial Corporation to withdraw its plan to inject $16 million to help the company to recover.[28] The reason is that the uncertainty rendered the rescue plan unworkable. The need for a freeze perhaps explains why in the case of Emporium Holdings receivers and managers appointed by the Court were also appointed provisional liquidators.[29]

3. *The Controller Must be Able to Continue to Trade*

The company must continue to trade if it is to be rescued. Trade creditors would only be willing to supply goods and services if they can be assured of priority in payment. It makes no sense to throw good money after bad. Controllers charged with the responsibility of keeping the company alive would only be willing to trade if they can do so without incurring personal liability or committing the offence of fraudulent trading in the event of failure.[30]

The problems facing a receiver who carries on the business have been well documented.[31] The main legal difficulties posed by the Companies Act are:[32]

> "(i) section 339(3) imposes an offence if an officer, a term defined to include a receiver and manager, contracts a debt without a reasonable or probable expectation that it will be paid;
>
> (ii) section 340 of the Act which deals with fraudulent trading may also be broad enough to catch a receiver and manager who attempts an unsuccessful rescue; and
>
> (iii) section 218 prohibits a receiver from contracting out of his personal liability."

Furthermore, the receiver has no statutory right to indemnity out of the assets charged and has to obtain indemnity from the debenture-holder privately.[33]

It has been noted that "the reason for the unavoidable personal liability of the receiver is presumably to protect unsecured creditors who give credit to the company in receivership while supplying goods to enlarge the chargee's security."[34] Perhaps this explains why in the

27 This is also the view expressed by J.R. Lingard in his book, *Corporate Rescues and Insolvencies,* (1986), p. 151.

28 See the *Straits Times,* Thursday, March 10, 1988.

29 See earlier discussion.

30 See section 339(3) and section 340 of the Companies Act, Singapore Statutes, Cap. 50, 1985 Rev. Ed.

31 See Andrew Hicks, "Reforming Insolvency Law — Company Rescues" (1986) 7 Sing. L.R. 128, 138-42. See also R.J. Hay, "Saving Companies In Difficulty — Alternatives To Liquidation", [1986] 2 M.L.J. clv, clvi.

32 See Hay, *supra,* note 31, at p. clviii.

33 See Hicks, *supra,* note 31, p. 139.

34 *Ibid.*

Emporium Holdings case the Court, having appointed the receivers and managers to one of the companies in the group, also appointed them as provisional liquidators and entrusted to them in their capacities as provisional liquidators the task of carrying on business.[35] Unfortunately, the above arrangement of entrusting the provisional liquidators with the task of carrying on the business created a host of other legal problems with regard to priority in payments for the goods supplied. One of the problems, briefly noted, is that the appointment of a liquidator is for the sole purpose of terminating a company. But, as authorised by section 272, he may, with the authority of the Court or the committee of inspection, carry on the business of the company for the "beneficial winding up of the company." Provisional liquidators may exercise all the functions and powers of a liquidator or as may be prescribed by the Court in the order appointing him.[36] In this legal context, it is difficult for one to argue that the provisional liquidator who was supposed to carry on a holding operation to enable the receivers and managers to come up with a section 210 rescue plan was carrying on business for the "beneficial winding up of the company."[37] The next no less problematic issue is whether the new trading debts incurred in the holding operation could constitute proper costs, charges and expenses 'incidental to the winding up' ranking in priority to all other claims under section 311. It would be outside the scope of this paper for this writer to try to provide tentative answers to these difficult legal issues; the fact that they exist suffice for the purpose of demonstrating the gaps in the then existing insolvency laws.

4. *Simple Procedures Enabling Plans to be Expeditiously Approved by Creditors.*

When a floating charge crystallizes, the debentureholder is entitled to appoint a receiver to take control of the assets and management of the company. The receiver does not require the support and co-operation of the rest of the creditors if his intention is not to carry on trading but in selling off the assets. If the business of the company is basically sound and the debentureholder is willing to provide indemnity or capital to the receiver, he may continue to trade with the aim of effecting a rescue. The forbearance of the other creditors though useful would still not be crucial to the object of the exercise. However, if there is a need to continue trading and a company is seriously in debt so that unless creditors agree to write off part of their debts there is no hope of a rescue, a procedure is needed to enable the other creditors to come to an expeditious decision on whether to collectively agree to waive or to capitalise part of the moneys owing to them. The alternative for the creditors is of course to liquidate the company and receive a small

[35] The order by Mr. Justice Thean provides that the provisional liquidators be indemnified against any liabiliity arising from carrying out the powers and duties from the company's assets in priority to all creditors. See Order of Court for Companies Winding up No. 478 of 1986 and *in the matter of Oriental Emporium & Supermarket (People's Park) Pte. Ltd.*

[36] See section 267 of the Companies Act, Singapore Statutes, Cap. 50, 1985 Rev. Ed.

[37] This writer is grateful to Mr. Leong Keng Kheong for bringing these issues to my attention.

dividend.[38] Under the then existing procedures, great difficulties were involved in any attempt to obtain creditors' approval for a compromise or scheme of arrangement under section 210 of the Companies Act. The word "arrangement" is not defined by the Companies Act. Provided the proposed scheme is not contrary to the general law or ultra vires the company, any kind of reconstruction, compromise or arrangement is possible. An example of such an arrangement is the payment to creditors of less than 100 cents to the dollar on the debts owed to them. Or they may be asked to accept late payment, possibly by instalments. Section 210 gives the court the power to sanction an arrangement proposed by the company and approved by a requisite majority of its creditors and to make that arrangement binding on all creditors. This makes possible the preservation of the company and imposes upon creditors a payment pattern which the company can hopefully afford.[39]

The disadvantage of this alternative is that the section 210 procedure is too formal and complex. The Court becomes too involved and the extensive information required to be given to the creditors can be counter-productive in smaller insolvencies.[40] Section 210 basically lays down a statutory framework for the creditors' collective decision concerning the company's proposal. Notice of creditors' meeting must be given to all the relevant creditors and full details of the scheme must also be circulated. At the meetings, if a majority in number of each class representing three-quarters in value of creditors of these classes vote in favour, then the next step can be taken. This is to petition the court for its approval. Unfortunately, the requisite majority cannot be easily obtained.

The reason is that secured creditors who enjoy distributorial priorities, who are likely to be paid in full if the assets are swiftly seized and realised, could not be expected to support the scheme.[41] Apart from this inter-class conflict between secured and unsecured creditors there is also the possibility of intra-creditor conflict amongst creditors belonging to the same class. This is due to the fact that some creditors, such as trade creditors, have collateral interests in the continuation of a company and are thus more inclined to approve the scheme. This sentiment may not be shared by, for example, a small unsecured creditor with a critical cash-flow situation.

Another difficulty is in the determination of the different classes of creditors. As pointed out "the basic types of secured, preferred, ordinary and subordinated creditors can often be divided into a myriad of sub-classes depending upon consideration offered or rights taken away under the (proposed) scheme."[42] As a result, where a

[38] See Lingard, *supra,* note 27 at p. 5. In the Emporium Holdings case, the *Straits Times* reported on 31 October 1986 that unsecured creditors stand to receive 16 cents more to a dollar if they support the proposed restructuring plan.

[39] Steven A. Frieze, "A Corporate/Client In Financial Difficulties? The Alternatives To Liquidation.", (1983) L.S.G. 1649.

[40] Robert V. Wright, "Corporate Insolvency: An Analysis of English and Canadian Corporate Salvage Reform Proposals" (1985) 34 I.C.L.Q. 25, 35.

[41] See Quinn, *supra,* note 7.

[42] Richard J. Hay, "Saving Companies In Difficulty — Alternatives to Liquidation", [1986] 2 M.L.J. clv, at p. clvi.

scheme is successfully attacked on the ground that classes were wrongly determined, the whole scheme fails.[43]

It can be appreciated that, except in exceptional circumstances,[44] the cumbersome procedures and the difficulty in obtaining creditor approval generally discourage the use of section 210 for the purpose of corporate rescue.

In summary, it can be appreciated that the then existing insolvency laws and practice seriously fall short of the paradigmatic conditions outlined above.

IV. JUDICIAL MANAGEMENT — AN ASSESSMENT OF ITS IMPACT

The introduction of judicial management was for the purpose of filling the gaps outlined above. The judicial manager has the advantage insofar as he cannot be subjected to pressure by creditors and (subject to the directions of the Court) can compel secured creditors to refrain from enforcing their security, and can sell the assets charged with the remainder of the business.[45] In view of the recent experience in the use of the judicial management procedures, it is timely that we review its provisions and assess its impact.

1. *Petitioning for a Judicial Management Order.*

The following persons are entitled under section 227B to apply, by way of petition, for a judicial management order:

(i) a company acting pursuant to a members' resolution;
(ii) directors acting pursuant to a board of directors' resolution;
(iii) a creditor or creditors; and
(iv) contingent or prospective creditors.

When a company is insolvent, creditors are unlikely to savour the prospect of that person falling within any of the abovementioned categories petitioning for a judicial management order. Most creditors would be quite justified in thinking that once the company is insolvent, the shareholders should be deemed to have exhausted all their equity and the right to deal with company's assets should rightly pass over to them.[46] It follows that they alone should decide the fate of the company in the insolvency process and not the board of directors

43 *Ibid.*
44 For those who are familiar with the saga of the Emporium Holding group, the problem there was not so much of obtaining creditors' approval but in finding a buyer willing to inject fresh capital. The case is unique in that the secured creditors such as the banks were willing to agree voluntarily to a moratorium since October 1986.
45 See Lingard, *supra,* note 27, preface.
46 See Quinn, *supra,* note 7, p. 2.

or its majority of the shareholders.[47] This view seems legitimate in cases where the reason why the company is in financial straits was because it has been mismanaged by its directors.

The Act is liberally worded in allowing a petitioner to apply for a judicial management order. The requirements, as imposed by section 227A, are that the petitioners consider that the company is or will be unable to pay its debts[48]; and there is reasonable probability of rehabilitating the company or of preserving all or part of its business as a going concern or that otherwise the interests of the creditors would be better served than by resorting to a winding up.

Although the grounds for petition seem wide, and are susceptible to abuse, section 227B provides that the Court may make a judicial management order if and only if it is satisfied that the company is or will be unable to pay its debts (this requirement serves as a check against abuse), and that it considers that the making of the order would be likely to achieve one or more of the following purposes:

1. preserve the company whether in whole or in part as a going concern;[49] or
2. facilitate a section 210 arrangement; or
3. ensure a more advantageous realisation of the company's assets.

Apart from the strict proof of insolvency, the bases for which a judicial management order could be granted are indeed general. To obtain an order, a petitioner is not even required to establish the likelihood of a successful rescue. The bottomline is simply a more advantageous realisation of the assets and this is easily substantiated if

[47] In South Africa, its relevant provisions in specifying who, and on what grounds, may petition for a judicial management order interestingly specify that if the application is made by a shareholder or a creditor of the company, the petition must establish mismanagement or some similar cause and the court will only grant a judicial management order on such grounds if it is satisfied that the company cannot by itself through its own machinery overcome its difficulties. (See David Shrand, *The Practice Of Insolvency, Winding up of Companies and Judicial Management* (1977), 327). This is useful because it affords unsecured creditors and minority shareholders with genuine cause a remedy not as drastic as a winding-up petition or as full of procedural thicket as a minority action. The requirement that mismanagement be established also prevents abuse by the minority shareholders and unsecured creditors with small claims against the company. The necessary implication of an application by the shareholders and creditors is that the incumbent management is inefficient and incompetent to manage the company. It is a common law principle that directors owe only subjective duty of skill and care and a very relaxed duty of diligence. This right to apply for a judicial management order will no doubt raise the standard. From the larger socio-economic perspective, this will contribute to a more efficient utilisation of economic resources. It has been noted that take-over threats keep the management on their toes; the effect is not too dissimilar here. In Singapore, the right of shareholders and creditors to petition for a judicial management order is to a certain extent unrestricted; this should be even more threatening from the management's point of view.

[48] In the petition it must plead that the company is likely to pay its debts as they fall due. By section 227B(12) the definition in section 254(2) of "inability to pay debts" shall apply for the purposes of this section. This section provides, *inter alia,* that a company shall be deemed to be unable to pay its debts if a creditor has served a demand and the company has for 3 weeks thereafter neglected to pay the sum or to secure of compound for it the reasonable satisfaction of the creditor.

[49] It is apparent that the rescue and preservation of a company in whole is not the only object of judicial management.

more time can be obtained for the sale of the assets. In fact, the first successful petition and order was made on 14 August 1987 in respect of Lim Seng Huat (S) Pte Ltd by Chan J.C. on the basis that the petitioners were able to show that an orderly disposition of assets would allow a higher dividend per dollar to be paid to the unsecured creditors.[50] This contrasts sharply with the Australian concept of official management and South Africa's judicial management. In the South African concept, it was necessary for an applicant to show that there was a reasonable probability that by the granting of a judicial management order the company would be enabled to meet its obligations and to remove the occasion for liquidation. This has been held to imply that a judicial management order should not be granted unless the probability went so far as to show that the company, if the order were granted, would become a successful concern within a reasonable time.[51] The Australian official management is similarly based on a much narrower concept as it only allows creditors to appoint an official manager for the purpose of reviving the company. The narrowness in its concept, amongst other factors, probably accounts for its unpopularity in practice.

The Singapore concept of judicial management is admittedly much broader in its scope and freer in its availability, and there is a legitimate concern that unscrupulous directors, disgruntled shareholders and panicky small and unsecured creditors may abuse the procedures. It is quite clear from studying some of the cases of petition that the main motives in petitioning for a judicial management order were to stave off irate creditors' petitions for winding-up orders and/or to prevent judgement creditors from enforcing their judgement debts.[52] Such petitions were either dismissed or withdrawn because they failed to persuade the judge concerned that there was a likelihood that the company could be rehabilitated or that an order would lead to a more advantageous realisation of the assets.[53] In a particular petition, two related companies who were main and core contractors for HDB projects also had to withdraw their petitions due to the withdrawal of HDB in support of its petition for judicial management. A number of interesting comments could be made on this case. First, the director of a creditor company which filed the petition was also a director of the insolvent company. This fact was noted by one of the other creditors and was presented as a ground of objection to the petition. Second, the managing director of the insolvent company, Eng Seng Huat Construction Co. Pte. Ltd., expressly cited in his affidavit the breakdown in co-operation amongst directors in the board as a ground to support the petition. The implication is that the presence of a judicial manager would be useful to resolve the management deadlock. This is interesting as it was reported in a case in England

50 See Supreme Court file no. 42/87 and *In the Matter of Lim Seng Huat (S) Pte Ltd.*

51 See *Henochsberg oh Companies Act* (1975, 3rd Ed.; edited by Milne *et. al)p.* 746.

52 See, for example, Supreme Court OP No. 84/87, *In the Matter of Golden Fortune Development (Pte) Ltd*; OP No. 97/87, *In the Matter of DEP International Pte Ltd.*; OP No. 104/87, *In the Matter of Eng Guan Huat Construction Co. Pte. Ltd.* and OP No. 105/87, *In the Matter of Eng Seng Huat Construction Co. Pte. Ltd.*

53 *Ibid.* In the case *of DEP International Pte Ltd*., the petition was dismissed with costs because the petitioner failed to convince the Court that the company could be rescued, as the possibility of a rehabilitation put forward to the Court rested on some uncertain business negotiations for the supply of heavy equipment to a new market.

that one of the reasons for appointing an interim quasi-receiver was that the directors were too infirm to act in a debt crisis.[54]

Fears of abuse could be allayed as the Courts have shown that they are capable of ensuring that only meritorious petitions are successful. Further, section 227B(9) does provide that the costs and expenses of any unsuccessful petition shall, unless the Court otherwise orders, be borne by the petitioner and, if the Court considers that the petition is frivolous or vexatious, it may make such orders as it thinks just and equitable to redress any injustice that may have resulted.

In view of the wide scope and availability of judicial management, some safeguards for the creditors have been incorporated in the Act. Section 227B(3)(C) allows a majority in number and value of the creditors to oppose the nomination of a judicial manager by the company. If the Court is satisfied as to the grounds of objection, it invites the creditors to nominate another judicial manager. This right is, however, restricted as the creditors entitled to object have to be a majority in number as well as in value of the debts owed.

The Act also recognises the special rights and interests of a secured creditor, especially that of a creditor who is entitled to appoint a receiver and manager of the whole (or substantially the whole) of a company's property under the terms of a debenture secured by a floating charge or a floating charge and one or more fixed charges. Section 227B(4) requires that when a petition is presented to the court, notice of petition be given to above described person. Sub-section (5) further provides that the Court shall dismiss a petition if it is satisfied that a receiver and manager has been or will be appointed or that the making of the order is opposed by a person who has appointed or is entitled to appoint such a receiver and manager. This means that the holder of a valid floating charge who is entitled to appoint a receiver and manager can veto the making of the order. There is no right of veto if the floating charge is invalid, if, for example, it was created at a time when the company was insolvent.[55] This suggests that the concept of judicial management is introduced on a fairly conservative basis. Realising that financing in Singapore is very much "asset based", legislators have conceded that the rights of a floating charge holder should not be made uncertain.

2. *Instances of Successful Petitions — Some Observations*

As already noted, the first successful order was made on 14 August, 198? in respect of Lim Seng Huat (S) Pte. Ltd. by Chan J.C.[56] In this case, the ground for the petition and the basis of the order was for an orderly disposition of the assets rather than a forced sale. The petitioners were able to show that an orderly disposition of assets would allow a higher dividend per dollar be paid to the unsecured creditors. The insolvent company had operated as the buying agent of the Emporium Holdings group of companies. The assets were not subject

54 For further details of the case see *Re A Company* (No. 00175 of 1987) [1987] BCLC 467.

55 See section 330 of the Companies Act.

56 See High Court file no. 42/87 of the Supreme Court.

to any floating charge and the rest of the secured creditors probably did not object to the petition because the company had ceased to trade. When it is clear that a judicial management order helps to achieve a more advantageous realisation of the company's assets a floating charge chargee would not object especially if it is clear that he would be paid in full. This is also borne out by a Scottish example which issued its first administration order on 19 January 1987. The Order was made with the co-operation of the Royal Bank of Scotland plc. who held a floating charge. Although the definitive purpose of the Order under section 8(3)(d) of the 1986 Insolvency Act was a "more advantageous realisation of the company's assets than would be effected on a winding-up", the administration procedure was felt advisable for these other following reasons:

"a. The company was a fifth generation family business in Paisley with long-standing connections with the bank and creditors.

b. It was clear that the bank and preferred creditors would be paid in full.

c. It was clear that unsecured creditors would get a substantial dividend.

d. The view was taken that administration would minimise disruption to the business and maximise asset realisations."[57]

The second order in Singapore was made in respect of Wusang Engineering (Pte) Ltd. on 4 September, 1987 by Mr. Justice Thean. In this case, the company had not issued any debenture secured by a floating charge over the company's assets. The company undertook engineering projects and therefore possessed few real assets. The assets of the company were in fact the projects which were in progress. In this regard, the petitioner could convincingly show that it would not be of any advantage to the creditors to have the company wound up. If the company were allowed to complete the projects which were in progress, the payments received would have enabled the company to pay its creditors in full.

On March 11, 1988, the *Straits Times* reported that SAHE (Singapore Animal Husbandry Enterprises) and its subsidiary SAHE Food Industries Pte Ltd was put under interim judicial management.[58] It reported that the parent company was seeking shelter under judicial management to enable its subsidiary to be sold because it was "facing temporary liquidity problems". The reason was that more time was needed for SAHE and its lawyers to come up with information that would assist the judge in his decision.[59]

The above examples of fully or partially successful petitions serve to state the policy of judicial management, namely, that companies should avoid compulsory winding up if there is a more beneficial alternative of managing the insolvency. One could also quite easily agree

[57] See a note by the Editor, "The First Scottish Administration Order — John McMillan (Gleniffer Bakery) Ltd", (May/June 1987) Vol. 3 No. 3, Insolvency Law & Practice, 65, 66.

[58] The *Straits Times,* Saturday, March 11, 1988.

[59] *Ibid.* The companies were subsequently put under judicial management.

with a commentator who went as far saying that "even if the position of the company is hopeless, the management could petition for an administration (judicial management) order on the ground that this would secure a more advantageous realisation of the company's assets."[60] This observation is confirmed in practice, as judicial management orders in Singapore and administration orders in England are often granted either for the purpose of survival of the company or, in the alternative, for a more advantageous realisation of its assets.[61]

3. *A Judicial Management Order to Help Achieve the Approval under Section 210 of a Compromise or Arrangement.*

There have been, thus far, no instances of a judicial management order being granted on the ground that it is likely to achieve the approval under section 210 of a compromise or arrangement between the company and any such persons as are mentioned in that section. It is noted that this provision is worded in exactly the same manner as in section 8(3)(c) of the English Insolvency Act 1986.[62] The main problems with a section 210 scheme of arrangement, as already noted, are that the procedures are too cumbersome and that it is difficult to harness the support of the creditors as they are divided into different classes. In this regard, there is some doubt as to how a petitioner is going to convince the Court that the appointment of a judicial manager "would be likely to achieve the approval under section 210 of a compromise or arrangement between the company and any such persons as are mentioned in that section".[63] Perhaps, the granting of a judicial management order has the advantage of, first, imposing a moratorium and, second, suspending the rights of secured creditors. This would to a certain extent narrow the gap between secured and unsecured creditors as the control of the assets passes to the judicial manager. The proposed compromise or scheme of arrangement can now be incorporated into the judicial manager's proposal and be simply submitted before a meeting of creditors who shall then decide whether to approve the proposals. The important difference here is that creditors are not divided into different classes and a majority in number and value of creditors, present and voting either in person or by proxy, whose claims have been accepted by the judicial manager, may approve the proposals.[64] The other advantage is, of course, that the judicial manager can dispose of any property of the company which is charged if the court is satisfied that this would promote the purpose of the judicial management order.[65] The presence of an

60 See Lingard, *supra,* note 27, at p. 107.

61 See for example the cases of *Re St. Ives Windings Ltd* (1987) 3 BCLC 634 and *Re Charnley Davies Business Services Ltd & Ors.* (1987) 3 BCC 408.

62 C. 45.

63 See section 227B (1)(b)(11).

64 The procedures are so altered by section 227X (3).

65 See Lingard, *supra,* note 27, p. 65. In England there is such a thing as a voluntary arrangement which also facilitates arrangement or composition without class meetings. This scheme applies not only if the company is being wound up or subject to an administration order but also if the directors intend to make proposals to creditors for a composition of the company's debts, or for a scheme of arrangement. But the court has no power to stay proceedings where a scheme is proposed by the directors. The other constraint is that directors who proposed must accept supervision by an insolvency practitioner. See Lingard, *supra,* note 27, pp. 64-5.

independent and impartial party appointed and supervised by the Court would also be helpful.

4. *The Period between Application and Order.*

It has already been noted that the Act permits liberal application for judicial management orders. There is nothing in the Act to suggest that a petition cannot be filed if the company is under receivership or affected by winding up proceedings. The only certain restriction is that a petition should not be filed if the company is already in liquidation since section 227B(7) clearly states that a judicial management order shall not be made in relation to the company after it has gone into liquidation. It is therefore entirely legitimate to file a petition for a judicial management order in order to forestall a petition to wind up a company or to prevent a judgment creditor from enforcing his judgment debt.

Following the petition, the company will cease to pay its debts as they fall due and this will trigger any properly drawn default clause in a floating charge. Accordingly, the debentureholder may oppose the application and appoint a receiver and manager. In judicial management, there is also a temporary moratorium that comes into force as soon as a petition for a judicial management order is presented.

Section 227C provides that during the period beginning with the presentation of a petition for a judicial management order and ending with the making of such an order or the dismissal of the petition:

(a) no resolution shall be passed or order made for the winding up of the company;

(b) no steps shall be taken to enforce any charge on or security over the company's property or to repossess any goods in the company's possession under any hire-purchase agreement, chattels leasing agreement or retention of title of agreement, except with leave of the Court and subject to such terms as the Court may impose; and

(c) no other proceedings and no execution or other legal process shall be commenced or continued and no distress may be levied against the company or its property except with leave of the Court and subject to such terms as the Court may impose.

The impact of a filed petition is understandably great as it stops all legal proceedings and enforcement actions in their tracks. The petition has excellent nuisance value and affects all secured and unsecured creditors alike.

The right of a floating charge chargee is secured in that under section 227B(5) the Court is required to dismiss a petition if it is satisfied that a receiver and manager has or will be appointed or is opposed by the chargee. However, in the event that the chargee requires time to consider whether to oppose or support the appointment of a judicial manager, and is unable to make up his mind before or at the date of hearing, the Court seems entitled to appoint what may be regarded as an interim quasi-receiver for the period until the date of the next

hearing. The power to do so is found in section 227B(6) which provides that on hearing a petition, the Court may dismiss the petition or adjourn the hearing conditionally or unconditionally or make an interim order or any other order that it thinks fit. Such a possibility was shown by Vinelott J. in a recent English case[66] interpreting an almost identical statutory provision,[67] even though such an order would interfere with the right of the debentureholder to subsequently appoint a receiver and manager in order to take control of the company's assets. However, Vinelott J. observed that the Court's power could only be exercised in exceptional circumstances where the assets or business of the company are in jeopardy.[68] Once the Court has appointed an interim quasi-receiver in these circumstances, a chargee who wishes to reassert his right is required to appoint a receiver and manager and, while the interim order is still in force, apply to court to accelerate the hearing and dismiss the petition.[69]

Another provision which threatens the right of a floating charge chargee is section 227B(10)(a) which allows the Court to override the wishes of a person entitled to appoint a receiver and manager if it considers the public interests so require. Finally, it should be noted that the security rights of a chargee can be disregarded if the Court considers that the public interests require the appointment of a judicial manager. In France, the concept of public interest is similarly used to justify the suspension of the rights of secured creditors. There, relevant factors to be considered are the size of the business enterprise, the interests of suppliers, customers, consumers and the social consequences of a stoppage.[70]

In the absence of objection by a floating charge chargee to a petition, unsecured creditors should also feel threatened by the statutory provision found in section 227B(10)(b) which permits the Court to appoint an interim judicial manager pending the appointment of a judicial manager. This power was exercised by the judge in the petition by SAHE to enable the petitioners and his lawyers to gather more information necessary to help the court to make a decision.

Thus, the rights of creditors are rendered uncertain for the period between the date of petition and the making of a judicial management order or its dismissal. This period of time may be several weeks. The leave of court is required if the creditors concerned intend to either enforce their security rights or petition for a winding-up order within this period.

5. *The Consequences of A Judicial Management Order.*

(i) *Moratorium*

Upon the making of a judicial management order, the same temporary moratorium would now persist to cover the entire period of

66 See *Re A Company* [1987] BCLC ChD 467.
67 See section 9(4) of the Insolvency Act 1986 (c. 45).
68 *Supra,* note 66, at p. 470. And see also, *supra,* note 27.
69 *Supra,* note 66, at p. 470.
70 J.H. Farrar, "Corporate Insolvency And The Law", (1976) J.B.L. 214, 218.

judicial management. However, the moratorium is now governed by section 227D(4) which, in addition, provides that the order extinguish the right of a debentureholder to appoint a receiver or receiver and manager. Further, it also provides that creditors may obtain the consent of the judicial manager or leave of the Court to bring proceedings or to enforce their security rights. As suggested by a commentator, presumably the court will allow enforcement against assets charged which are not essential to the administrator's proposals.[71] Section 227D(1) provides that on the making of a judicial management order any receiver or receiver and manager shall vacate office and any petition for the winding up of the company shall be dismissed.

(ii) *The Powers of a Judicial Manager.*

For creditors, and especially the secured creditors, the precise scope of the powers of a judicial manager to deal with the company's assets is an important factor to consider when deciding whether to support or object to the petition for a judicial management order. Basically, once an order has been made, the judicial manager takes control of all the property to which the company is or appears to be entitled and all powers conferred and duties imposed on directors are now exercisable by the judicial manager.[72] Section 227G(3) appears to confer wide powers as it provides that the judicial manager shall do all such things as are necessary for the management of the affairs, business and property of the company, and read in conjunction with subsection (4), his powers include those specified in the Eleventh Schedule of the Act, which authorizes the judicial manager to sell or grant security over the property of the company. However, in reality, the powers of a judicial manager to deal with property already subject to security are restricted. Section 227(H), in substance, divides such property, according to how they have been secured, into two categories. Subsection (3) of section 227(H) provides that subsection (1) applies to a floating charge and subsection (2) applies to any other security.

a. *Floating Charge*:[73] There are two reasons why floating charge chargees are given the right to veto the appointment of a judicial manager. First, to avoid the awkward uncrystallisation of a floating charge as a result of the appointment of a judicial manager.[74] Second, in deference to the fact that a floating charge is an important security arrangement, especially for the bank. If the chargee chooses not to exercise his right of veto, section 227H(1) permits the judicial manager to freely "dispose of or otherwise exercise his powers in relation to any property of the company … as if the property were not subject to the security". However, subsection (4) does provide that where such assets are disposed of, the holder of the security shall have the same priority in respect of any property of the company directly or

71 See J.R. Lingard, *supra,* note 27, p. 148.

72 See section 227G of the Companies Act.

73 The English Insolvency Act 1986 schedule 11 para. 1 makes the presentation of a position for an administration order one of the events conferring the right to appoint an administrative receiver under a debenture. See J.R. Lingard, "Administrators and Banks", (1986) Insolvency Law & Practice 134.

74 See p. A14 Select Committee Report.

indirectly representing the property disposed of as he would have had in respect of the property subject to the security. The provision offers little concrete protection to the holder of a floating charge and, as such, he is unlikely to be comforted by this provision. There is nothing to prevent a judicial manager from creating a second floating charge over the charged assets expressed to rank in priority to the first charge. There is also nothing in the Act to prevent the judicial manager from dissipating the proceeds derived from the sale of the assets in the form of business expenses. This apparently cavaliar treatment of the interests of holders of floating charges is more out of necessity than choice. Since assets subject to a floating charge are likely to be stock-in-trade or book debts, it was thought that it might be useful for the judicial manager to be able to deal with them freely in order to raise funds necessary for the continued survival of the company. As such, except in special circumstances, it is unlikely that a chargee of a floating charge would support the petition for a judicial management order.

b. *"Any Other Security"*: The judicial manager's powers to deal with the other secured assets such as assets subject to a fixed charge, hire-purchase agreement, leasing agreement or retention of title agreement are, however, more restricted. To dispose of the assets he needs to apply to the Court for approval which would be granted only if it is satisfied that the proposed disposal would be likely to promote one or more of the purposes specified in the judicial management order. And if the Court is so satisfied, the Court may by order authorise the judicial manager to dispose of the property as if it were not subject to the security or to dispose of the goods as if all rights of the owner under the hire-purchase agreement, chattels leasing agreement or retention of title agreement were vested in the company. Section 227H(5) further stipulates that it shall be a condition that the net proceeds of the disposal authorized by the Court shall be applied towards discharging the sums secured by the security or payable under the relevant agreement. Finally, notice of such an application must be given to the holder of the security or the owner of the goods who is entitled under section 227H(7)(b) to oppose the proposed disposal. Looking at the sum of these provisions, the objective is to prevent secured creditors and legal owners of goods and equipment from forcing a closure of the business by withdrawing their items so that a judicial manager is able to preserve the business as a going concern and achieve a more advantageous realisation of the company's assets. This is one of the key advantages of judicial management. The proceeds realised from the sale of the business as a going concern whether as a whole or in part could then be used to pay off the secured creditors or the owners of the goods or equipment. These provisions adequately safeguard the interests of the abovementioned categories of persons even though the control of the assets now rests in the hands of the judicial manager. However, the drawbacks suffered by them are that they can be prevented from disposing of their assets for a reasonable length of time and they may also find themselves becoming unwilling participants to a sale of a business that included their assets.

However, the position of a creditor such as a bank which has a fixed charge over book debts is less certain. The reason is that it cannot.

enforce such a charge once a petition for a judicial management order has been presented.[75] It is the judicial manager who will collect the debts under his general duty as prescribed by section 227G to take into custody or under his control all the property to which the company appears to be entitled.[76] The issue here raised is whether the collected receivables can be used to finance his trading activities without the approval of the Court and without regard to the rights of the fixed charge holder. As pointed out by a commentator, since the judicial manager is collecting the receivables as a matter of his duty he may also be entitled to use them as finances to keep the company going in the course of his duties to manage the affairs of the company.[77] In fact, there are two possible sources of authority for him to do so. First, paragraph (m) of the Eleventh Schedule of the Act confers power on the judicial manager to make any payment which is necessary or incidental to the performance of his functions. Second, under section 227G(3), the judicial manager is required to do all such things as may be necessary for the management of the affairs, business and property of the company. However, a prudent judicial manager is well advised to protect himself by applying to the Court in accordance with the procedures laid down in subsection (5) of section 227G for directions in relation to any particular matter arising in connection with the carrying out of his functions. There is nothing to suggest that in applying to the Court one has to do so via the procedure laid down in subsection (2) of section 227H which deals with "disposal" of assets subject to a security to which the subsection applies. If an application is made under this subsection, it would be a condition of the Court's order under subsection (5) that the net proceeds of the disposal shall be applied towards discharging the sums secured by the security.

c. *Creditors with Right of Set-Off*: Once a petition has been filed, or when a judicial management order has been granted, the relevant part of the Act provides that "no steps shall be taken to enforce any charge or security over the company's property … etc., except with the leave of the Court."[78] An interesting question for the banks is whether their contractual rights to effect a set-off between two or more accounts are prejudiced by the above. Bank balances or deposits in favour of a company are rightly considered company's property. The determinative question is whether in effecting a set-off one is enforcing a charge or security which is prohibited by section 227C(b). In modern banking practice, banks often look upon cash or credit balances in bank accounts standing in favour of a customer as a means of reducing bank's risk in extending credit facilities. Cash money deposited by customers with a bank or credit balances in accounts standing in favour of customers are ideal securities because of the ease with which they can be realised. There are three distinctive and yet related ways in obtaining rights over the cash deposits or credit balances. First, by way of creating a charge over the bank deposits. Second, by entering into a

[75] See Lingard, *supra,* note 27, p. 135. The writer was commenting on equivalent English provisions.
[76] *Ibid.*
[77] *Ibid.*
[78] See sections 227C(b) and 227D(4)(d) (In the case where a judicial management order has been granted, with the consent of the judicial manager or with the leave of the Court).

contractual set-off arrangement.[79] The third approach is to limit the depositor's right of withdrawal by way of a contract (what is commonly referred to as the 'flawed asset' arrangement).

The first method of creating a charge over bank deposits has been judicially considered and a recent English case, *Re Charge Card Services Ltd,* has decided that it cannot be done.[80] The reasons were, *inter alia,* that the law treats deposits or credit balances standing in favour of a customer as debts owed by the bank or a financial institution to the customer. It is therefore conceptually impossible for a banker to obtain a security interest in any form over his own indebtedness.[81] Another objection is that to obtain a security interest in the deposits or credit balances, the proprietary interests in these debts must be assigned to the assignee and, upon default, the assignee can then sue the debtor to recover the money. Professor Goode felt that "it is the essence of assignment of a debt that the assignee becomes entitled to recover the debt. But here the debtor is the bank, which cannot legally sue itself. It follows that the customer's assignment to the bank is a nullity, for it transfers nothing."[82] Millet J. in *Re Charge Card Services Ltd.* also observed that the right to sue a debtor cannot be made available to the original debtor, just as it cannot be conveyed or assigned to him, because the result is the same — the debtor cannot sue himself upon default of the chargor.[83] Prior to the *Charge Card* decision, it was often argued that the second method by way of a contractual set-off constituted a charge over a book debt requiring registration under section 131 of the Companies Act in order to be valid as against creditors and liquidator. In view of the *Charge Card* decision, it seems less plausible to so argue. The remaining question is whether a contractual set-off arrangement, though not a charge, constitutes a security over the deposits so that its enforcement is also prohibited by sections 227C and 227D. In the opinion of a writer, the right (in equity) to set-off one debt against another does not constitute an equitable security interest or, indeed, confer any right in rem over the claim; it is merely a right to set up one claim against another.[84] This is actually referring to a right of set-off which a bank enjoys in equity. But banks usually would not be content to rely on their equitable rights to combine accounts or to set off; in most cases a contractual set-off arrangement is resorted to improve the bank's position. In this regard, the question would be whether a contractual set-off right resulted in something different. On this point, the considered opinion of a writer is that:

> "… a right of set-off, even if given by contract, is a purely personal right to set one obligation against another. The party asserting it never acquires rights in the other's monetary claim at all; he merely asserts a countervailing claim which operates in *pro*

79 Though under general laws banks are entitled to a right of set-off in equity, they often enter into contractual set-off agreements in order to better protect their interests.

80 *Re Charge Card Services Ltd. [*\986] 3 W.L.R. 679.

81 See *Halesowen Presswork & Assemblies Ltd.* v *Wesminster Bank Ltd.* [1971] 1 Q.B. 1, 46 per Buckley L.J. and the House Of Lords' judgement reported in [1972] A.C. 785.

82 R.M. Goode, *Legal Problems of Credit and Security* (1982), p. 87.

83 In *Re Charge Card Services Ltd* [1986] 3 W.L.R. 697, 721.

84 See R.M. Goode, *Legal Problems of Credit and Security,* (1982), 103-4.

tanto extinction of his monetary liability. It follows that a contractual set-off does not create a security interest."[85]

This view is shared by another writer commenting on the equivalent English provisions.[86] In his opinion, he noted that although the provisions[87] prohibit the enforcement of security, they do not prejudice the chargee's right of set-off.[88]

The 'flawed asset' arrangement "involves writing into the contract of deposit an express provision that it is not repayable until specified events have occurred, or that if a specified event occurs, the obligation to repay is suspended until the bank's debts are repaid".[89] In imposing a condition on the customer's right to withdraw its deposit, this does not by itself give the bank rights over that customer's credit balance; nor does it even amount to a contractual set-off, for the credit balance remains throughout the property of the customer. ° As such, the prevailing view is that the 'flawed asset' arrangement is not a security of any kind,[91] and its enforcement is not prohibited by the Act.

If the above views prevail, then credit balances or cash deposits subject to contractual set-off arrangements or 'flawed assets' arrangement should be useful if banks and other financial institutions are keen to avoid the possibility of their security being made subject to an imposed moratorium under the judicial management provisions.

d. *Book Debts*: One of the possible impacts of judicial management is that from now on, and not considering the legal controversies of how a fixed charge over future book debts may be secured,[92] it may be difficult for a bank or financial concern to decide whether to have a fixed or floating charge over book debts. To take a floating charge would give the bank the right to veto the appointment of a judicial manager. On the other hand, they are postponed to the preferential creditors. The validity of a floating charge can also be challenged under certain specified circumstances in a winding up.[93] The alternative is to take a fixed charge but this would result in a loss of the right of veto and would also cause the bank to face the uncertainty of the right of a judicial manager to collect and dissipate the receivables. After appointment of judicial manager and if cash from book debts is required to meet wages and other essential expenses, there is nothing to stop the manager from exploiting the current uncertainty as to whether a fixed charge over future book debts is possible and applying

85 See R.M. Goode, *ibid*., p. 113.
86 See sections 10 and 11 of the English Insolvency Act 1986. See also J.R. Lingard, *Corporate Rescues And Insolvencies,* (1986), p. 148.
87 See Lingard, *supra,* note 27, p. 148.
88 *Ibid.*
89 See F.W. Neate, "Set-Off", (1981) Int'l Bus. L. 247, 248. See also Philip Wood, *Encyclopedia of Banking Law* (1985) at E. (2451).
90 See Goode, *supra,* note 84, p. 83.
91 *Ibid.*
92 For a discussion of the nature of the legal controversies see J.R. Lingard, *Bank Security Documents* (1985), 98-102.
93 See earlier discussion.
94 See earlier discussion.

to court for a declaration that such a charge is in reality a floating charge.[95]

The above discussions outlined some of the problems faced by secured creditors upon the imposition of judicial management on a company. It is unfortunate that legal uncertainties plague the consideration of the secured creditors' positions. Some of these legal uncertainties are easily forseen and could be reduced by clearer and more specific legislation.

V. THE JUDICIAL MANAGER'S ABILITY To CONTINUE To TRADE

It is crucial that an insolvent company must continue to trade if it is to maintain its chances of being revived or to ensure a more profitable realisation of its assets. In this regard, we have already noted the powers given to a judicial manager to deal with the assets of the company. The wide powers given to deal with assets subject to a floating charge is confirmed by section 227J(3) which provides that whenever a judicial manager ceases to hold his office whether "by virtue of this section or by reason of his death any sums payable in respect of any debts or liabilities incurred while he was a judicial manager under contracts entered into by him in the carrying out of his functions; and any remuneration and expenses properly incurred by him, shall be charged on and paid out of the property of the company in his custody or under his control in priority to all other debts, except those subject to a security to which section 227H(2) applies." A floating charge is of course not a security to which section 227H(2) applies. This will make it possible for a judicial manager to, for instance, secure working capital facility from a bank, possibly by a charge over any unsecured assets or a second floating charge expressed to be in priority to the first charge. Trade creditors would also be willing to continue to supply goods and services if they can be assured of priority in payment. However, even if this condition can be met, trade creditors who dealt with the company prior to its insolvency may feel indignant with regard to the fact that their own money is being used to pay them. The purpose of noting the feelings of trade creditors here is to highlight the difficulties involved in keeping a company afloat. Finally, controllers, such as a newly appointed judicial manager, would only be willing to trade if they can do so without incurring personal liability and be free of liability for fraudulent trading in the event of a failed rescue attempt.

We have earlier noted the difficulties confronting a receiver and manager if he attempts to continue to trade. The main problem is that he is not allowed to contract out of his personal liability.[96] In this context, it would be useful to compare his position with that of a judicial manager. In England, under section 14(5) of the Insolvency Act 1986, the administrator in exercising his powers is deemed to be agent of the company. Applying agency law principles, this means that he will not be personally liable unless this is expressly agreed. In Singapore, the treatment is the same and reflects the overriding concern of the legislators here to make the position as clear as possible. While section 227I(1) provides that the judicial manager of a company shall be

[95] See Lingard, *supra,* note 27, p. 132. See also Lingard, *supra,* note 92, at p. 100.
[96] See earlier discussion.

deemed to be the agent of the company, it further states that he shall be personally liable on any contract entered into or adopted by him in the carrying out of his functions except where the contract otherwise provides and where notice of disclaimer has been given to the other party in the adoption of a contract. He is also entitled to be indemnified in respect of his liability out of unencumbered assets and assets subject to a floating charge.[97]

There are several other provisions which are intended to affect a judicial manager's ability to carry on trade. Section 227I(3) provides that the judicial manager is not to be taken to have adopted a contract entered into by the company by reason of anything done or omitted to be done within 28 days after the making of the judicial management order. This provision is evidently designed to give the receiver 28 days during which he is to make up his mind as to his attitude to outstanding contracts, such as a contract of employment. Within this period of time, he is not bound by what he has done or omitted to do.[98] This removes, for a period of time, uncertainty as to whether the contract has been "adopted" by the judicial manager by his conduct. The reason for such a provision is that adoption in the context of receivership has a special meaning and it has been suggested that "what is meant by saying that a receiver has power to adopt a pre-receivership contract is that he may refrain from repudiating it."[99] The position is therefore less clear after the 28 day period. Since a judicial manager is personally liable on a contract "adopted" by him unless he has by notice given to the other party a disclaimer, there is every incentive for him to make his position clear with regard to outstanding contracts after the period.

VI. THE RIGHTS OF CREDITORS IN JUDICIAL MANAGEMENT

It is difficult to sketch a general profile of the various types of creditors as they have conflicting interests. Generally, one might say that the lowest common denominator amongst the creditors is still to recover the maximum of the debt owed at the shortest time. Most creditors, with the exception of a debentureholder entitled to appoint a receiver and manager, have neither the time nor resources to analyse the causes of failure and attempt any revival of a valued corporate customer. The easy way out is to petition the court for a court supervised compulsory liquidation or simply to exercise their rights to recover goods or assets. A receiver and manager appointed by a debentureholder is also unlikely to trade in view of the risks involved.[1] Judicial management has made things somewhat different; it is now possible for any creditor to petition and nominate an approved company auditor to be appointed judicial manager, the expense of which will be paid out of the company's assets, to manage a company in the event of a debt crisis.[2] The rights of creditors now proposed to be examined in judicial

97 See section 227I(1)(c).

98 In England an administrator is allowed only 14 days to make up his mind. See the proviso to section 19(5) of the English Insolvency Act 1986.

99 See the discussion in Lightman and Moss, *The Law of Receivers of Companies* (1986), pp. 204-205.

1 See earlier discussion.

2 See section 277B(1).

management pertain to their rights within the process of judicial management and not their proprietary rights over the assets in the company's possession. Two of such rights have already been mentioned, that is, their right to petition for an order and their right to nominate a judicial manager. In the event that the company has nominated a judicial manager, section 227A(3)(c) provides that a majority in number and value of the creditors (including contingent and prospective creditors) may be heard in opposition to the nomination and the Court may, if satisfied as to the value of the creditors' claim and as to the grounds of opposition, invite the creditors to nominate a person and adopt their nomination.

The other important rights of creditors are rights to notice of petition. However, this right is restricted and notice is to be given only to holders of debentures that are secured by a floating charge.[3] However, in accordance with section 227K(l)(c), where a judicial management order has been made all creditors must be informed within 28 days. And within 60 days of his appointment, section 227M(1) requires a judicial manager to send to all creditors a statement of his proposals and lay a copy of his statement of proposals before a meeting of the company's creditors summoned for the purpose on not less than 14 days notice. In accordance with section 227N, this meeting of creditors shall then decide whether to approve the judicial manager's proposals. At such a meeting, the majority in number and value of creditors, present and voting either in person or by proxy, whose claims have been accepted by the judicial manager, may approve the proposals. However, the right of the creditors to modify the proposals is limited in that the judicial manager has to consent to each modification. In the event that the creditors refuse to approve the plan, the Court is given wide powers (under section 227N(4)) to make consequential provision, to adjourn hearings, and make appropriate orders including an order to discharge the judicial management order. As such, after the creditors have approved of the proposals, they are entitled under section 227O to establish a committee of creditors to monitor the manner in which the judicial manager is discharging his functions. The committee is given the power by subsection (2) to require the judicial manager to attend before it and furnish it with such information relating to the carrying out by him of his functions as it may reasonably require. In this regard, it should be noted that where the judicial manager's proposals have been approved by the creditors, it shall be the duty of the judicial manager to manage the affairs, business and property of the company in accordance with the proposals as from time to time revised by him. However, if substantial revisions are contemplated, the judicial manager is required to seek the approval of the creditors in the same manner as approval was obtained for the original proposals.

Finally, section 227R(1) confers upon a creditor or a member the right to complain to the Court that the company's affairs, business and property are being or have been managed by the judicial manager in a manner in which is or was unfairly prejudicial to the interests of its creditors or of a single creditor that represents one quarter in value of the claims against the company. They may also complain of a

[3] See 227B(4)(b).

particular act or omission as subsection (1)(b) provides that any actual or proposed act or omission of the judicial manager is or would be so prejudicial.

Having thus lost control of the assets for the duration of the period between petition and a grant of order and 60 days thereafter to the judicial manager, the creditors are given a chance to assert indirect control in that the proposals whether for rehabilitation purposes or for a more advantageous realisation of assets require their participation and support. The process of judicial management represents a transition in insolvency proceedings where creditor control is reduced to that of creditor participation. To sum up, the procedures permit the creditors to approve or disapprove of proposals, monitor the performance of the judicial manager and complain to the Court if there is any unfairness.

VII. CONCLUSION — CAN JUDICIAL MANAGEMENT WORK?

The availability of a judicial management scheme suggests that company directors who find that the company is in trading difficulty should hand over control to a judicial manager. This is the way to minimise the potential loss to the company and also help the directors to avoid personal liability for fraudulent trading and possible disqualification. The English example as provided by the case of *Re A Company*[4] showed that the directors, who were too old and infirm to face a debt crisis caused partly by poor business and bad weather causing damage to goods, handed over control to an interim quasi-receiver appointed under English insolvency legislation to keep the business in operation. However, it has been argued that this is unrealistic thinking. The right and natural course for a board to follow in most cases would be to soldier on, and not hand over the reins of office to a stranger whose experience and skills will all too often be those of the corporate undertaker rather than the company doctor.[5] Drawing from the experience of judicial management in South Africa and of official management in Australia, Professor Sealy argues that "the appointment of an administrator will, at the very least, be a most expensive and time-consuming exercise whose ultimate victims in the event that the salvage attempt is unsuccessful will be the creditors themselves".[6] Professor Sealy's views may well be right simply because in the event of a failure to revive a company, its assets must have been further dissipated in trading. With respect to Professor Sealy, however, he has in a sense missed what this author perceives to be the most important contribution of judicial management and that is that it provides a mechanism whereby the future of an insolvent company could be objectively considered and professionally assessed in the interests of all parties concerned. Directors may like to soldier on but may be prevented from so doing simply because creditors would not give them a chance to so. All it takes is for a company to be deemed unable to pay its debts before it is liable to be compulsorily wound up.

[4] *Supra,* note 55.
[5] L.S. Sealy, "The New Administration Procedure — Some Overseas Comparisons", May/June 1986, Insolvency Law & Practice 70.
[6] *Ibid.*

One other point is that a rescue is only one out of several purposes which could form the basis of an order. As I have mentioned earlier on, it is that element of enforced rationality injected through the judicial management mechanism that serves the public interests.

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