

PROVIDING ASSISTANCE FOR FINANCIAL ASSISTANCE

*Public Prosecutor v. Lew Syn Pau*¹

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I. INTRODUCTION

Rules to preserve corporate assets are a necessary by-product of limited liability, as well as a means of limiting agency costs arising from the separation of ownership and control. Hence, it is axiomatic that the directors of a company are required to act *bona fide* in the best interests of the company, “and not for any collateral purpose”: *Re Smith & Fawcett*.² The weakness of the common law duty is that courts are reluctant to substitute the business judgments of the controllers with their own. According to Lord Wilberforce in *Howard Smith v. Ampol Petroleum*:³

There is no appeal on merits from management decisions to courts of law: nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at.

While Singapore, like England, does not have a formal business judgment rule,⁴ Tay Yong Kwang J. in *ECRC Land Pte Ltd v. Wing On Ho*,⁵ held that courts do not second-guess the commercial decisions of directors acting in the best interests of the company. Support for this approach can be found in the judgment of Rajah J.C. (as he then was) in the later decision in *Vita Health Labs v. Pang Seng Meng*,⁶ where he cites *ECRC Land* with approval. Rajah J.C. similarly thought that a court should be slow to interfere with *bona fide* commercial decisions taken by directors, and it was for the market to punish directors that had honestly made bad commercial decisions. However, while he stressed the importance of judicial restraint in order to facilitate

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¹ [2006] SGHC 146 [*Lew Syn Pau*].

² [1942] Ch. 304 at 306 (C.A.).

³ [1974] A.C. 821 at 832.

⁴ In Malaysia, the Finance Committee on Corporate Governance recommended the introduction of a statutory business judgment rule: see further A.N.M. Sulaiman, “Revising the directors’ duty of care, skill and diligence in Malaysia” (2004) 17 *Australian Journal of Corporate Law* 196 at 198.

⁵ [2004] 1 S.L.R. 105 (H.C.) [*ECRC Land*].

⁶ [2004] 4 S.L.R. 162 (H.C.).

entrepreneurship, he also stated that, “[o]rdinary norms of commercial morality must be observed”,⁷ which suggests that the no-second-guessing rule ends when conflicts of interest are involved.

Outside of self-interested transactions, however, further statutory controls are sometimes needed to protect shareholders and/or creditors. For example, section 76(1)(a)(i) of the *Companies Act*⁸ provides that:

a company shall not whether directly or indirectly, give any financial assistance for the purpose of, or *in connection with* the acquisition by any person, whether before or at the same time as the giving of financial assistance, of shares or units of shares in the company; or shares or units of shares in a holding company of the company [emphasis added].

The section was modelled on Australian and U.K. provisions.⁹ Its present form differs from the present day UK equivalent — section 151 of the UK *Companies Act 1985* — which makes no reference to “connection” and looks only to the purpose of the financial assistance. Section 76 also differs from today’s Australian equivalent — section 260A(1)(a) of the Australian *Corporations Act 2001* — which allows the giving of financial assistance so long as it does not materially prejudice the interests of the company or its shareholders, or the company’s ability to pay its creditors.¹⁰ While the *Companies (Amendment) Act 2005*¹¹ added new exemptions to section 76, pursuant to the recommendations of the Company Legislation and Regulatory Framework Committee that were accepted by the Government in October 2002,¹² these created specific safe harbours, and did not abolish the general prohibition itself.¹³

II. PUBLIC PROSECUTOR V. LEW SYN PAU

In this vein, *P. P. v. Lew Syn Pau*¹⁴ may have provided much needed guidance to practitioners, with its focus on the precise meaning of financial assistance and its

⁷ *Ibid.* at [17].

⁸ Cap. 50 (1994 Rev. Ed.).

⁹ Initially, section 76 was based on section 67 of the Australian *Uniform Companies Act 1961* (Cth.) and section 54 of the UK *Companies Act 1948*. In 1987, substantial amendments were made to bring section 76 in line with section 129 of the Australian *Companies Act 1981* (Cth.) (which became section 205 of the Australian *Corporations Law 1989* (Cth.)).

¹⁰ See further Y-Y. Cho and V. Kishore, “The “Material Prejudice” Test and the Financial Assistance Prohibition” (2004) 78 A.L.J 194.

¹¹ Act 21 of 2005, which came into force on 30 January 2006.

¹² Sing. Ministry of Finance Company Legislation and Regulatory Framework Committee, *Final Report* (October 2002), online: http://www.agc.gov.sg/publications/docs/CLRFC_Oct_2002.pdf.

¹³ These new provisions were added to the existing exemptions in section 76(9) by the *Companies (Amendment) Act 2005*, and permits financial assistance:

- (a) where less than 10% of the company’s paid up capital and reserves is involved;
- (b) where it is approved by a unanimous resolution of shareholders; and
- (c) for representations, warranties and indemnities by an issuer or vendor in the context of a public offering.

A declaration of solvency is required in the case of (a) and (b). All the directors must also resolve that assistance is in the best interests of the company and is given on terms that are fair and reasonable to the company. It is arguable if (c) is necessary – see the text accompanying *infra* note 67.

¹⁴ [2006] SGHC 146 [*Lew Syn Pau*]. The prosecution decided not to appeal against Menon J.C.’s decision.

link to the improper depletion of corporate assets, sensibly understood. The legal propositions extended by Menon J.C. in this case should be of greater general application than most other financial assistance cases as the facts here were quite simple and not really in dispute. It should also be noted that the prosecution decided not to appeal against the decision, which was in favour of the accused.

The first accused, Lew Syn Pau ('Lew'), was accused of abetting the second, Wong Sheung Sze ('Wong'), who was the executive chairman and director of Broadway Industrial Group Ltd ('BIGL'), an investment holding company listed on the main-board of the Singapore Exchange, to provide financial assistance to a third party, Dick Tan Beng Phiau ("Tan"), for the purchase of shares in BIGL. Both accused were directors of a group of subsidiary companies called the Compart Group, which was the most profitable segment of BIGL's stable of investments, and contributed most to the consolidated financial results of BIGL. However, BIGL's other businesses were not doing as well — it had a weak balance sheet, and faced a large redemption obligation on certain redeemable preference shares it had previously issued. Indeed, in its financial statements for 2002, BIGL's auditors expressed concerns over its viability. Lew was thus engaged to find prospective equity investors on a success fee basis.

Lew approached Tan to invest in BIGL, with the proceeds to be used to redeem the outstanding preference shares early, which, with the preference shareholder agreeing to waive its interest entitlement, saved BIGL the interest payable had the preference shares been redeemed on maturity. Tan set up a private limited company for the purpose of holding the BIGL shares. Unfortunately, the transaction began to unravel when Tan informed BIGL that he had difficulties funding the share purchase. As BIGL was listed, the Singapore Exchange's approval had to be sought to delay the share placement, and while some extension of time was given, the Singapore Exchange required the share placement to be completed by the end of the extended deadline. This is when Wong suggested a way to assist Tan in his purchase of BIGL shares.

The financial assistance was provided in an obvious but roundabout way. First, the board of Compart Asia Pacific Ltd, which was incorporated in Mauritius for valid tax reasons, authorised a director's loan to Lew.¹⁵ From there, Lew advanced a slightly smaller sum to Tan to complete the purchase (through his wholly owned private company). The prosecution did not challenge the defence's assertion that, under Mauritian law, a subsidiary could lawfully provide financial assistance for the acquisition of shares in the holding company. It was also clear to Menon J.C. that the foreign subsidiary did not fall within the ambit of section 76, which covered only local companies, and recourse to the presumption against the extra-territorial application of Singapore law suggested by defence counsel was unnecessary. The English authority that is quite unequivocal on the point that foreign companies do not generally fall under the prohibition is *Arab Bank plc v. Mercantile Holdings Ltd*.¹⁶ Millett J. listed

¹⁵ Menon J.C. found that even if the loan was not authorized, it had been ratified: see [41] and [224]-[231].

¹⁶ [1994] Ch. 71 [*Arab Bank*]. In this case, however, Millett J. (at 82) thought, purely *obiter*, that the U.K. Act proscribed an English subsidiary from giving financial assistance for the purchase of shares in a foreign parent. However, this interpretation, which in any case is legislation specific, has been questioned by C. Roberts, *Financial Assistance for the Acquisition of Shares* (Oxford; New York: Oxford University Press, 2005) at para 7.69.

ten reasons why a foreign subsidiary of an English parent company is not caught by section 151 of the U.K. *Companies Act 1985*. While the English section 151 is worded differently from Singapore's section 76, Menon J.C. held that the reference to "company", in Singapore's section 76,¹⁷ which is by definition limited to companies incorporated under Singapore law, instead of "corporation", which is defined as any body corporate incorporated in Singapore or outside Singapore including foreign companies,¹⁸ also suggested the same conclusion.

Consequently, the issue before the court was whether BIGL's roundabout way of providing financial assistance to Tan for the purchase of its own shares constituted 'indirect' financial assistance within the meaning of section 76. Millett J. put it slightly differently in a further question addressed in the *Arab Bank* case:¹⁹ "(d)oes the mere giving of financial assistance by a subsidiary *ipso facto* also constitute the giving of such assistance by the parent company?" As a preliminary point, Menon J.C. clarified that, while a holding company might control the subsidiary, whatever assistance the holding company renders in getting the subsidiary itself to provide financial assistance, even if it requests or applies strong pressure on the latter to do so,²⁰ was not *per se* financial in nature.²¹

Having cited *Salomon v. Salomon*²² and the importance of corporate legal personality in the very first paragraph of his judgment, it was perhaps unsurprising that Menon J.C. then agreed with Millett J. that the veil should usually be respected, given that the legislature had separately provided for the provision of financial assistance for the acquisition of the shares of a company by the company itself as well as by its subsidiary.²³ But, again on the authority of the *Arab Bank* case,²⁴ Menon J.C. stated that a holding company might be liable if it procured the subsidiary to be in breach of the relevant financial assistance prohibition applicable to it, or if the Singapore company hived off assets to the foreign subsidiary to enable it to finance the relevant acquisition.²⁵ Menon J.C. thought, however, that Millett J's illustrations in *Arab Bank* were not exhaustive, and that it would be possible to pierce the veil in a wider range of situations, such as perhaps where the subsidiary was set up specifically to avoid section 76.²⁶ In such situations, such an arrangement could be seen as a device to circumvent the statutory prohibition and the courts should be minded to lift the corporate veil.²⁷ If the corporate veil is so lifted, then the foreign "assisting company" would be held to be in reality the local parent company.²⁸ However, Menon J.C. expressly dismissed a wide-ranging group or single economic entity rationale

¹⁷ See *Lew Syn Pau*, *supra* note 14 at [181].

¹⁸ *Companies Act* (Cap. 50, 1994 Rev. Ed. Sing.), s. 4

¹⁹ *Supra* note 16 at 80. Millett J. actually addressed this second question first in his judgment.

²⁰ See *Lew Syn Pau*, *supra* note 14 at [221].

²¹ *Ibid.* at [166]-[167].

²² [1897] A.C. 22 (H.L.).

²³ *Lew Syn Pau*, *supra* note 14 at [183] *et al.*

²⁴ *Arab Bank*, *supra* note 16 at 81.

²⁵ *Lew Syn Pau*, *supra* note 14 at [186].

²⁶ This is suggested by C. Roberts, *supra* n 16, at para. 7.67-8.

²⁷ See, for example, *Gilford Motor Co v. Horne* [1933] Ch. 935 (C.A.), *Acatos & Hutcheson plc v. Watson* [1995] 1 B.C.L.C. 218 (Ch.), *Gerhard Hendrik Gispem & Ors v. Ling Lee Soon Alex & Anor* [2001] SGHC 350 and *New Line Productions, Inc and Anor v. Aglow Video Pte Ltd* [2005] 3 S.L.R. 660 (H.C.).

²⁸ Roberts, *supra* note 16 at para 7.67.

for lifting the corporate veil put forward by the prosecution,²⁹ even though he had noted earlier the contribution of the Compart Group to the consolidated financial statements of the BIGL.³⁰

Given the potential for abuse, however, it is submitted that, even if the subsidiary had not been set up specifically to avoid section 76 and the transaction was one which used a validly and previously set up subsidiary to avoid the limitations of section 76, that that transaction still could be scrutinised by the courts. This should be so even when the holding company did not procure the subsidiary to be in breach of the relevant financial assistance prohibition applicable to it or when the holding company did not hive off an asset to that subsidiary so as to indirectly engage in financial assistance. The test to be applied should then be whether the subsidiary was a sham or façade, although past experience with this test in other areas of corporate law is that it has a narrow scope of application.³¹

In *Acatos & Hutcheson v. Watson*,³² concerning the purchase by a company of the shares of another company where the sole asset of the acquired company was the shares in the acquiring company, Lightman J. granted the declaration sought that this was not in breach of the prohibition against a company acquiring its own shares. Lightman J. also rejected the single economic entity rationale and relied on the “façade or sham or unlawful device” test,³³ in finding that the equivalent of our section 76(1)(b) had not been breached. If a court would not lift the veil in such a situation relating to the indirect acquisition by a company of its own shares, it is submitted *a fortiori*, that the courts should not lift the veil in a mere financial assistance case, where arguably the capital maintenance considerations are less intense, where the subsidiary company is not a “façade or sham or unlawful device.”

It should be noted that in *Acatos*, the main rationale for the transaction was for tax avoidance reasons and not to circumvent any maintenance of capital rules. The acquired company was not set up to enable the acquiring company to acquire its own shares. The case was brought by the company seeking a declaration from the court as to the regularity of the proposal and no creditors or minority shareholders were unfairly prejudiced by the transactions. In the *Acatos* case, Lightman J. concluded that

[W]hilst such a purchase by one company of a shareholder in it is not absolutely prohibited, in view of the potential for abuse and for adverse consequences for shareholders and creditors, the court will look carefully at such transactions to see

²⁹ See *Lew Syn Pau*, *supra* note 14 at [201]-[212]. See also *Adams v. Cape Industries plc* [1990] Ch. 433 (C.A.), which was followed in Singapore in *Win Line (UK) Ltd v. Masterpart (Singapore) Pte Ltd* [2000] 2 S.L.R. 98 (H.C.).

³⁰ *Ibid.* at [10].

³¹ See, for example, in the context of company charges, *Welsh Development Agency v. Export Finance Co Ltd* [1992] B.C.L.C. 148 (C.A.), and the reference by Staughton L.J. to the “internal” and “external” routes to construction (at 186-7). However, it may be that a broader approach towards recharacterisation of transactions has been taken by the House of Lords in *National Westminster Bank plc v. Spectrum Plus Ltd* [2005] 2 A.C. 680: see A. Berg, “The Cuckoo in the Nest of Corporate Insolvency: Some Aspects of the Spectrum Case” [2006] J.B.L. 22. See also S. Atherton and R.J. Mokal, “Charges Over Chattels: Issues in the Fixed/Floating Jurisprudence” (2005) 26 *Company Lawyer* 10. In Singapore, see now *Cheah Geok Tuan v. Lie Khin Sin* [2006] 1 S.L.R. 340 (H.C.), discussed in H. Tjio, “When is an Elephant a Bird?” S.Ac.L.J. (forthcoming 2006).

³² *Supra* note 27.

³³ *Ibid.* at 223; See also, R.C. Nolan, “Shares: The Veil Intact” [1995] 16 *Company Lawyer* 180.

that the directors of the acquiring company have acted with an eye solely to the interests of the acquiring company (and not e.g. to the interests of the directors) and have fulfilled their fiduciary duties to safeguard the interests of shareholders and creditors alike.³⁴

It was also the case in *Lew Syn Pau* that Compart Mauritius was set up for reasons of tax planning,³⁵ and we shall later examine if the entire transaction, which involved its giving financial assistance for the purchase of BIGL shares, was in the interests of the company (and what that really means in this context). We will suggest an approach that is not dissimilar to that advocated by Lightman J. for share repurchases.

III. FINANCIAL ASSISTANCE

The focus of this note though is on the meaning of financial assistance in the context of section 76. First, Menon J.C. quickly dismissed defence counsel's argument that section 76 as a whole should be interpreted so that it only covered transactions involving a change of control. While the provision may have been intended to prevent abusive takeovers of cash-rich companies,³⁶ Menon J.C. noted that the language of section 76, as well as its legislative history, did not permit the restrictive interpretation proffered by counsel. As to the meaning of financial assistance itself, he first referred to *Charterhouse Investment Trust Ltd v. Tempest Diesels Ltd*,³⁷ where Hoffmann J. (as he then was) explained that:

One must examine the commercial realities of the transaction and decide whether it can properly be described as the giving of financial assistance by the company, bearing in mind that the section is a penal one and should not be strained to cover transactions which are not fairly under it.

Menon J.C. qualified the last point above — the modern position is to take a literal and purposive approach, even with penal legislation, and a strict construction is used only if that approach results in ambiguity.³⁸ Given this, Menon J.C. stated that the instances of financial assistance given by section 76(2), which he acknowledged were *not* exhaustive,³⁹ all involved an actual or potential depletion of corporate assets.⁴⁰

³⁴ *Ibid.* at 225.

³⁵ *Lew Syn Pau*, *supra* note 14 at [11].

³⁶ Such as occurred in the well-known case of *Selangor United Rubber Estates Ltd v. Craddock (No 3)* [1968] 1 W.L.R. 1555 (Ch.). See also *Re V.G.M. Holdings Ltd* [1942] 2 Ch. 235 (C.A.) at 239 per Lord Greene M.R. See also U.K., *Company Law Amendment Committee Report*, Cmd 2657 (London: H.M.S.O., 1925–26) (W.A. Greene, chairman) at paras. 30–31, which introduced the prohibition against financial assistance to address what the report considered an improper practice at that time of a company lending money to facilitate the purchase of a controlling interest in the company's shares; U.K., *Report of the Committee on Company Law Amendment*, Cmd 6659 (London: H.M.S.O., 1945) at para. 170 (Lionel L. Cohen, chairman), which extended this prohibition to holding companies; and the U.K., *Report of the Company Law Committee*, Cmd 1749 (London: H.M.S.O., 1962) at paras. 170–87 (Lord Jenkins, chairman), which expressed concern as to the sweeping nature of the prohibition and recommended that a company could approve the giving of financial assistance if a special resolution was passed and minority interests were protected.

³⁷ [1986] 1 B.C.L.C. 1 (Ch.) at 10.

³⁸ Following the decision in *Forward Food Management Pte. Ltd. v. P.P.* [2002] 2 S.L.R. 40 (H.C.)

³⁹ *Lew Syn Pau*, *supra* note 14 at [141].

⁴⁰ *Lew Syn Pau*, *supra* note 14 at [151].

There are Australian cases that support this point. Menon J.C. relied quite heavily on what Hutley J.A. said in *Burton v. Palmer*⁴¹ — “the assumption by the company of obligations, even if it is unlikely that they may have to be honoured, diminishes its resources” – which was re-emphasised in *Darvall v. North Sydney Brick & Trust Co Ltd* by Hodgson J. at first instance⁴² and Kirby P. (as he then was; and with some reservations) in the New South Wales Court of Appeal.⁴³

While Menon J.C. accepted that some doubt had been cast on Hutley J.A.’s *dictum* in some subsequent cases, he thought that those cases misapplied the test, which he recast as “simply whether in the ordinary commercial sense the assets of the company have been used or put at risk in connection with the acquisition of its shares”.⁴⁴ Illustrative of such cases is *Dempster v. National Companies and Securities Commission*⁴⁵ where Malcolm C.J., who applied Hoffmann J.’s point about commercial realities in a case involving an actual arms length loan given by a company for the acquisition of its shares (where the company’s balance sheet is not impaired if the purchaser is creditworthy), stated:⁴⁶

The most which may be said about the impoverishment test is that it may provide some assistance in determining whether the transaction was a genuine commercial transaction. It may be relevant to the question of financial assistance and to the question of purpose, but, in my opinion, it would not be decisive of either question.

Menon J.C. however, thought that depletion of assets, broadly understood in the sense that the assets have been put at risk (since there is always a possibility that a borrower, however creditworthy, defaults),⁴⁷ is a necessary condition, although, as we shall see, not sufficient in itself. He regarded the giving of a guarantee as the provision of financial assistance, even though the Federal Court of Australia in *Milburn v. Pivot Ltd*⁴⁸ did not. While a guarantee should clearly be seen as a form of contingent liability, even a broad depletion of assets test for financial assistance may not, however, catch the archetypal situation of financial assistance, where the company gives credit for the purchase of its own unissued shares.⁴⁹

It can be argued that a company does not make a loan in this situation, since no cash is given out. It was held in *Champagne Perrier Jouet SA v. HH Finch Ltd*⁵⁰ that the debts incurred by a shareholder director to the company which resulted

⁴¹ (1980) 5 A.C.L.R. 481 at 484 (N.S.W.C.A.). See also per Mahoney J.A. at 494.

⁴² (1987) 12 A.C.L.R. 537 at 560 (N.S.W.S.C.).

⁴³ (1989) 15 A.C.L.R. 230 at 261-262 (N.S.W.C.A.).

⁴⁴ *Lew Syn Pau*, *supra* note 14 at [107].

⁴⁵ (1993) 10 A.C.S.R. 297 (W.A.S.C.).

⁴⁶ *Ibid.* at 353.

⁴⁷ *Lew Syn Pau*, *supra* note 14 at [92]. Indeed, except for some sovereign debt, the Basle capital adequacy requirements allocate a risk weightage to all forms of loans: see e.g. J.R. Macey and G.P. Miller, *Banking Law and Regulation*, 2d ed. (Aspen: Little Brown & Co Law & Business, 1997) at 302.

⁴⁸ (1997) 15 A.C.L.C. 1520. Contrast Miller J.A.’s judgment in *Lipschitz No v. UDC Bank Ltd* [1979] 1 S. Afr. L.R. 789 at 800-801 (S. Afr. S.C.), referred to by Menon J.C. in *Lew Syn Pau*, *supra* note 14 at [131].

⁴⁹ It is clearly financial assistance if the debt which is due to the company is deemed to be paid up and the purchase price reduced: see e.g. *EH Dey Pty Ltd (in liquidation) v. Dey* [1966] V.R. 464 (Vic. S.C.), following *Shearer Transport Co Pty Ltd v. McGrath* [1956] V.L.R. 316 (Vic. S.C.).

⁵⁰ [1982] 1 W.L.R. 1359 (Ch.).

from trading between him and the company was not a loan that would have been prohibited by the U.K. equivalent⁵¹ of section 162 of our *Companies Act*. We have seen, however, that Menon J.C. has stated that the references to the five forms of financial assistance in section 76(2), which includes the “making of a loan, the giving of a guarantee, the provision of security, the release of an obligation or the release of a debt or otherwise” are not exhaustive. If so, giving a “quasi-loan” should be considered a form of providing financial assistance. The difficulty though is to see how the assets of the company have been depleted, even on a broad reading, through the giving of credit.

While it may be argued that the company has suffered a loss defined by the opportunity cost of obtaining immediate valuable consideration from issuing the new shares, this argument disappears once we see that shares are not assets on the balance sheet of the company that issues them (or even owning them in the case of treasury shares). Indeed, shares are residual claims on a company’s assets. The case that is relevant here is *Pilmer v. Duke Group Ltd.*,⁵² where the Australian High Court held that unissued shares are not property from the company’s standpoint and so it suffers no loss when it discovers that it has issued too many shares for an acquisition because of overvaluation of the target by an auditor.⁵³ The loss, if any, is felt directly by the shareholders because of the diluting effect on the value of their shares. But the company’s assets are not really depleted.

It may, however, be that a depletion of assets test focuses too much on the plight of the creditor, when modern incarnations of the financial assistance prohibitions also recognize that shareholders can also suffer from dilution because financial assistance has been given to another group of shareholders. Understanding this, though, means that depletion, and financial assistance, must be seen in light of its linkage to the acquisition of shares, and not in isolation. Potential claims on the assets should therefore include the residual claims of shareholders, even if these do not really put corporate assets at risk since they are locked into the company.⁵⁴

It is submitted, though, that Menon J.C.’s test would still capture these situations. Accountants would treat the issue of shares as one for cash, which is attributed to the share capital account, and the company then makes an immediate loan of the same sum to the shareholder, so that in that sense corporate assets has been depleted, even if no actual cash changes hand. As a matter of policy this must be right. In the Enron debacle, one of the problems involved the sale of Enron shares to closely related special purpose vehicles in return for a debt, thus boosting the balance sheets of both

⁵¹ Section 330(2) of the U.K. *Companies Act 1985*, although it would in England today be considered a “quasi loan” that could be prohibited under section 330(3) of the U.K. *Companies Act 1985*, which has no equivalent here.

⁵² (2001) 75 A.L.J.R. 1067.

⁵³ R. C. Nolan and D. Prentice argue that there is an opportunity loss as the share could, for example, have been issued for cash: (2002) 118 L.Q.R. 180 at 182.

⁵⁴ See e.g. L. Stout, “On the Nature of Corporations” (22 July 2004) U.C.L.A. Law & Economics Working Paper Series, Paper 4-05. The same argument holds for gifts of shares, even though this is not specifically included in the non-exhaustive meaning of financial assistance provided by section 76(2). In contrast, gifts are expressly included in section 152(1)(a) of the U.K. *Companies Act 1985*.

parties. William Bratton writes that:⁵⁵

Recall that Enron funded the LJM-related SPEs with \$1.2 billion of its own common stock, along with other assets, exchanged for debt instruments of the SPEs. A century ago, corporate law barred such transactions, prohibiting the use of debt or other promissory consideration in connection with the issue of new common stock. The risk that insiders would take the stock and enjoy an upside play without ever delivering on their promises was deemed great enough to support a *per se* prohibition. Today corporate law has a more relaxed attitude, remitting the decision as to the adequacy of consideration to the discretion of the board of directors. Accountants retain a healthy suspicion: Notes received in exchange for a company's own common stock must be booked as deductions from shareholders' equity. The newly issued stock is credited to the capital stock account at the purchase price, but the capital stock accounts elsewhere are debited (reduced) in the amount of the note. The result is a wash at the time the note is issued.

A provision like section 76, much maligned in modern corporate practice, would have prevented an Enron-type situation in Singapore, even if a depletion of assets must be proven, so long as a pragmatic approach is taken to what that means. It is respectfully submitted though that that approach is better guided if we think not of financial assistance in isolation but together with the second limb of section 76 which asks if the financial assistance was "for the purposes of, or in connection with" the acquisition of shares. This approach is supported by the case of *Belmont Finance Corp v. Williams Furniture (No. 2)*,⁵⁶ which otherwise causes some difficulty for the pure depletion of assets test.

Belmont is usually seen as supporting the proposition that even *bona fide* exchanges at a fair value can be financial assistance if the effect is to provide the purchaser with cash to pay for shares in the company. Menon J.C. thought, however, that the English Court of Appeal believed that the company bought the exchanged asset at a considerable overvalue.⁵⁷ But he acknowledged that what really coloured the transaction was that Belmont (the assisting company) had no genuine need for Grosscurth's (the assisted purchaser) shares in Maximum, being neither a transaction in the ordinary course of Belmont's business nor for its purposes.⁵⁸ Consequently, it was not a decision taken *bona fide* in the best interest of the company. This suggests that the search for whether financial assistance was given was influenced by the failure of the company to act in its own best interests and which was instead for the sole purpose of allowing its own shares to be acquired.

It would, appear, therefore, that, while a depletion of assets (from either a creditor or shareholder perspective) is found in almost all instances of colourable financial assistance, our perspective is sometimes influenced by the purpose behind the transaction.

⁵⁵ W. Bratton, "Enron and the Dark Side of Shareholder Value" (2002) 76 *Tulane Law Review* 1275 at 1314-5.

⁵⁶ [1980] 1 All E.R. 393.

⁵⁷ *Lew Syn Pau*, *supra* note 14 at [137]-[138].

⁵⁸ *Ibid.* at [137]-[139].

IV. COMMERCIAL REALITIES

At the other end of the spectrum, Menon J.C. also endorsed,⁵⁹ *obiter*, what he termed the “tentative view” of Buckley L.J. in *Belmont* that there may be cases of clear but warranted diminution of assets in that it is done *bona fide* in the best interest of the company. This is the point at which he discusses the important but difficult Court of Appeal decision in *Intraco Ltd v. Multi-Pak Singapore Pte Ltd (in receivership)*.⁶⁰ According to Menon J.C.⁶¹

It would be wrong then to approach the section in a way that would stifle legitimate commercial activity that is in the interests of the very company the section is meant to protect, or that would encourage creative but ultimately pointless efforts to get out of transactions that were entered into in good faith but which turn out later to have been less beneficial than expected, *Multi-Pak* being perhaps the clearest illustration of this.

Here, Multi-Pak purchased debts from Intraco which were owed to it by City. The same persons managed both City and Multi-Pak. City was technically insolvent. If wound up, unsecured creditors would have received only 5 cents to the dollar. Yet Multi-Pak obtained only a slight discount on the price they paid Intraco for the debts. Almost immediately after the assignment, Intraco agreed to subscribe for shares in Multi-Pak at par value, so that no money changed hands between the parties. The Court of Appeal held that Multi-Pak did not in fact provide Intraco with any financial assistance. Multi-Pak was in some financial difficulty, and could not otherwise have persuaded Intraco to subscribe for its shares.

It would appear that Menon J.C. preferred, however, to see *Multi-Pak's* case as a situation where, financial assistance had *prima facie* been given, but with good commercial justification for Multi-Pak to purchase the debts from Intraco.⁶² Indeed, this was the alternative ground used by the Court of Appeal, which stated that Intraco was a government-linked company, and having it as a 20% shareholder enabled Multi-Pak to obtain loan facilities, which was otherwise not forthcoming. Further, by converting the purchased debt into equity, the directors had intended to make City a downstream subsidiary of Multi-Pak. It therefore held that any financial assistance rendered was not solely or mainly for the purpose of enabling the purchaser to acquire the shares in the company at no cost to itself.

One advantage of fusing the question of whether there has been financial assistance and whether the financial assistance is “for the purposes of, or in connection with” the acquisition of shares is that it can be used to control this unwieldy second limb. The width of this prohibition, found previously in section 54 of the UK *Companies Act 1948*, was criticised by Len Sealy for catching many innocent transactions.⁶³

⁵⁹ *Lew Syn Pau*, *supra* note 14 at [141]-[142].

⁶⁰ [1995] 1 S.L.R. 313; noted in H. Tjio, “Financial Assistance and Directors Duties” [1996] *Journal of Financial Crime* 307. At first instance, Chao J. (as he then was) had held that the directors of Multi-Pak acted in breach of fiduciary duty in purchasing the debts. Intraco, with at least constructive knowledge of such breach, was liable as knowing recipients of the money they received: [1994] 2 S.L.R. 282.

⁶¹ *Lew Syn Pau*, *supra* note 14 at [151].

⁶² *Ibid.* at [151].

⁶³ L. Sealy, *Cases and Materials in Company Law*, 3d ed. (London: Butterworths, 1985) at 343.

Hodgson J. in *Darvall v. North Sydney Brick & Trust Co Ltd*⁶⁴ also saw “for the purposes of” and “in connection with” as separate heads. While this issue was not considered by the majority in the New South Wales Court of Appeal, Kirby P. expressed tentative support for such a view.⁶⁵ In contrast, a general commercial realities test asks whether the company entered into the transactions in the *bona fide* belief that they were in the commercial interests of the company. Financial assistance is only connected to an acquisition of shares, and not for some other purpose, if the answer is in the negative. Put differently, “in connection with” connotes more than just a causal connection or temporal proximity between the financial assistance and share transaction.⁶⁶

On such an approach, what was possible financial assistance in *Belmont* was confirmed by the sole purpose of Belmont in putting Grosscurth in funds to acquire the company’s shares, whereas probable financial assistance in *Multi-Pak* was negated by looking at the transaction as a whole, including the reason why Intraco became a shareholder of Multi-Pak (indeed the *ratio* of *Multi-Pak* was that there was, in fact, no financial assistance). Because of the myriad nature of financial assistance, even on a broad depletion of assets test, the evidential help provided by the circumstances surrounding the acquisition of the company’s shares should not be discarded.

An important area in which such an approach can aid practitioners is with warranties and indemnities given by a company for the subscription of its shares. While the *Companies (Amendment) Act 2005* created a specific exemption from the financial assistance prohibition, the new section 76(8)(ga) only operates in the context of a public offer of the shares, and may not cover situations of corporate restructuring involving schemes of arrangement, mergers or takeovers. This is where the following argument made in *Ford’s Principles of Corporations Law* is highly useful, even if the relevant legislation there (section 260A of the *Australian Corporations Act 2001*) is worded somewhat differently:⁶⁷

[P]romises of the company which are an integral part of the share cannot be proscribed financial assistance. Nor in a case of acquisition by subscription would the incurring of liability as an issuer of a share that is imposed by law be financial assistance within s 260A. Presumably, warranties by a company in an underwriting agreement which merely reflected the issuing company’s liability under the Corporations Act or general law for misstatements or material omissions from a prospectus would not be within s 260A. But additional warranties could attract s 260A.

In any case, Menon J.C. acknowledged that a depletion of assets was not a sufficient condition, and perhaps it is only necessary on condition that a liberal interpretation can be given to it, one that takes into account the interests at stake. It is the acquisition of shares, and the reasons for it, which lies at the heart of the prohibition and which, as we have sought to argue, influences the very finding of financial assistance. This,

⁶⁴ (1987) 12 A.C.L.R. 537 (N.S.W.S.C.) at 559-561.

⁶⁵ *Darvall v. North Sydney Brick & Tile Co Ltd (No. 2)* (1989) 15 A.C.L.R. 230 at 259.

⁶⁶ See now, *Wu Yang Construction Groups Ltd v. Zhejiang Jinyi Group Co Ltd* [2006] SGHC 152; noted by Wan Wai Yee, S. Ac. L. J. (forthcoming 2007).

⁶⁷ H.A.J. Ford, R.P. Austin, I.M. Ramsay, *Ford’s Principles of Corporations Law*, 12th ed. (Chatswood, N.S.W.: LexisNexis Butterworths, 2005) at [24.720].

though, may sometimes involve more than a subjective inquiry into what was the best interest of the company.

In this context, we note that in *Belmont*, both Buckley and Waller L.J.J. thought that the section might not prohibit transactions entered into in the commercial interests of the company, but they were postulating an objective test.⁶⁸ In contrast, Mahoney J.A. in *Burton v. Palmer* stated that:⁶⁹

The position will be different where the company, for a collateral purpose, agrees to indebtedness in an amount to which otherwise it would not have agreed; and the Court will scrutinise carefully the circumstances of such an agreement; compare *Belmont Finance Corporation Ltd v. Williams Furniture Ltd (No. 2)*.

In the context of financial assistance, it has also been held that purpose is not to be equated with the reason why the purpose is formed.⁷⁰ Neither is it to be equated with intention,⁷¹ but focuses instead on the necessary effect of the transaction.

V. PREJUDICIAL TO THE INTEREST OF CREDITORS OR MEMBERS

*Ford's Principles of Corporations Law*⁷² has also observed that the financial assistance prohibition is a manifestation of the general rule that a company's resources should be used for proper corporate purposes, and for the company's benefit. Arguably, the proper purpose rule can impose more exacting requirements on directors when contrasted with their duty to act *bona fide* in the interest of the company.⁷³

The proper purpose rule usually comes up in share issues and the takeover context, where it is difficult to articulate the duty of directors in terms of the company's interest. This is because the company is less relevant here as a separate entity, and the balance of power between shareholders may be affected by the decision of the directors. In certain situations, they are expected not to discriminate against shareholders. In *Mills v. Mills*,⁷⁴ Latham C.J. said:

The question which arises is sometimes not a question of the interests of the company at all, but a question of what is fair between different classes of shareholder.

⁶⁸ *Supra* note 56 at 402 and 414 respectively. Their Lordships' observations were probably given statutory force by section 42 of the *Companies Act 1981*, now *Companies Act 1985*, s.153(1)(a). The section was, however, given a restricted interpretation by the House of Lords in *Brady v. Brady* [1989] A.C. 755.

⁶⁹ *Supra* note 41 at 490. See also the English Court of Appeal decision of *British and Commonwealth Holdings plc v. Barclays Bank plc* [1996] 1 W.L.R. 1 at 16.

⁷⁰ *Brady v. Brady*, *supra* note 68 at 779 (though discussing the "larger purpose" exception in section 153(1)(a) of the *Companies Act 1985*, not found in Singapore).

⁷¹ *Darvall v. North Sydney Brick & Trust Co Ltd*, *supra* note 64 at 559.

⁷² *Supra* note 67 at [24.670].

⁷³ For a review of the proper purpose rule, see e.g. C.L. Mok, "Re-thinking Director's Duties: An Analysis of the Proper Purpose Doctrine" (2002) 14 S.Ac.L.J. 387; R.C. Nolan, "The Proper Purpose Doctrine and Company Directors" in Barry Rider ed., *The Realm of Company Law* (London: Kluwer, 1998); R. Grantham, "The Powers of Company Directors And The Proper Purpose Doctrine" (1994-1995) 5 King's College L.J. 16; Cf. S. Fridman, "An Analysis of the Proper Purpose Rule" (1998) 10 Bond L.R. 164 who does not think that the proper purpose rule adds much to the duty that directors have to act in the best interest of the company.

⁷⁴ (1938) 60 C.L.R. 150 at 164.

Where such a case arises some test other than ‘the interests of the company’ must be applied...

In takeover situations, what is required is a balancing of the interests of existing shareholders – those with short term interests who are keen to sell, and those with longer term interests in the company’s viability. In these situations, the ‘company’ may not be seen as a monolithic whole where directors’ duties can be usefully be defined in terms of “the best interests of the company”. In *Pine Vale Investments Ltd v. McDonnell & East Ltd*,⁷⁵ however, the court followed *Mills v. Mills* but found that there was no evidence of discrimination, so that the director’s duty could be viewed as one to the company as a entire separate entity, and not individual shareholders:⁷⁶

Where, as is the case here, no question arises of shareholder’s individual rights, or of discrimination among shareholders or classes of shareholders *inter se*, it is contrary to both principle and practice to require them to ignore that duty and instead to attempt to determine whether fewer or more shareholders will be individually advantaged or disadvantaged by the course proposed.

In *Provident International Corporation v. International Leasing Corporation*,⁷⁷ another case dealing with the powers of directors to allot shares, the tests applied were an objective test of propriety coupled with a duty to be fair as between different classes of shareholder. It is submitted that a similar test of propriety coupled with a duty to be fair as between different classes of shareholders and creditors should also be applied to situations involving purported financial assistance. As we pointed out above, even where the focus is only on the issue of whether financial assistance has been given, where the question is whether corporate assets has been depleted, liability can only be properly understood if looked at from a creditor or shareholder perspective. This is even more the case if we believe that section 76 should be seen in a broader context, one involving the purpose behind the transaction, and which is only triggered by evidence of prejudice to creditors or shareholders.

Taking this argument further, it should be noted that section 76(10) allows a company to give financial assistance if, by special resolution, the members agree to the financial assistance and requisite notice is given to members and creditors as well as the public. However, section 76(12) allows members, creditors and/or the Registrar to oppose the financial assistance proposal by making an application to the court. Section 76(13) provides that the court in determining what order to make in relation to the application(s) should have regard to the rights and interest of members and/or creditors and should not approve the giving of financial assistance if the proposed financial assistance is likely to “prejudice materially the interests of the creditors or members of the company.” Section 76(9B), in a separate exception, which came into effect in January 2006, also allows a company to provide financial assistance if the directors make a solvency statement and if the members at a meeting called to approve the proposed financial assistance unanimously agree to do so, which thus ensures that the interests of creditors and minority shareholders are adequately protected.

⁷⁵ (1983) 8 A.C.L.R. 199 (Qld. S.C.).

⁷⁶ *Ibid.* at 211. *Winthrop Investments Ltd v. Winns Ltd* (1979) 4 A.C.L.R. 1 (N.S.W.S.C.) is to the same effect.

⁷⁷ (1969) 89 W.N. 370 at 376-377 (N.S.W.S.C.).

This seems to suggest a test different from a simple best interest test or the depletion of assets test underlies the financial assistance prohibition. Ultimately, the best interest test or depletion of assets test results in a further question as to whose interest or assets should the court should be concerned with. The “prejudicial to the interest of creditors or members” test answers that question to some extent, but it is context specific and not absolute, and is something that has to be weighed against possible justifications for an unfair outcome.⁷⁸

VI. CONCLUSION

Financial assistance prohibitions are a barrier to corporate reorganisation. In Singapore, however, it appears that the courts have taken a pragmatic approach underpinned by commercial realities. Unless corporate assets are depleted *and* controllers fail to act *bona fide* in the commercial interest of the company, the transaction will not be viewed as colourable, even when examined through the seemingly wide lens of section 76. We have suggested, however, that depletion is better understood when the totality of the transaction is examined, and that what should guide a court here is whether the relevant parties have acted for proper purposes. The *indicia* of a decision which has been taken for improper or collateral purposes would be unfairness or discrimination within a class of shareholders or creditors or between those two classes.

⁷⁸ This is generally the case with the proper purpose rule, see, e.g., in the context of alternation of articles by shareholders, *Sidebottom v. Kershaw, Leese & Co* [1920] 1 Ch. 154 (C.A.), which was discussed in *Gambotto v. WCP Ltd* (1995) 182 C.L.R. 432 (H.C. of Australia).