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THE FINANCIAL ASSISTANCE PROHIBITION: CHANGING LEGISLATIVE AND JUDICIAL LANDSCAPE

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This article looks mainly at the recent changes to the law relating to financial assistance in Singapore, but in doing so will also consider the treatment of the same rule in other jurisdictions. It does so with a hope that it will be helpful to the ongoing consideration of its further reform in Singapore and elsewhere.

I. INTRODUCTION

This article considers a prohibition that has long vexed lawyers and companies in Singapore and elsewhere. The prohibition, which exists in the *Companies Act* of Singapore,[1] essentially bans a company from providing financial assistance for the acquisition of its own shares, and the shares of its parent company.

Singapore is not alone in having this law. The ban exists also in the U.K., Hong Kong, Australia, New Zealand and Malaysia. In all of these jurisdictions, and in Singapore, the ban has been reworked by the Legislature over the years. Further reform is currently being considered in Singapore, Hong Kong and Malaysia. When the *Second EU Directive* allows for it, the U.K. is likely to also reform its law on the prohibition, which, following the 2006 amendments, applies now only to public companies.

Why do we ban financial assistance? This is a question which continues to engage law reform experts, and which in Singapore resulted in the changes introduced by the *Companies* (*Amendment*) *Act 2005*[2] on 30 January 2006. After an arid spell of more than a decade since the Court of Appeal's attempt in *Intraco Ltd. v. Multi-Pak Singapore Pte. Ltd.*[3] to temper the ban with some measure of commercial sensibility, the High Court has more recently attempted to do the same in *Public Prosecutor v. Lew Syn Pau and Another*[4] and *Wu Yang Construction Group Ltd. v. Zhejiang Jinyi*

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1 Cap. 50, 2006 Rev. Ed. Sing. [*Singapore Companies Act*].

2 No. 21 of 2005 [the *2005 Amendments*].

3 [1995] 1 S.L.R. 313; [1994] SGCA 142 [*Intraco*].

4 [2006] 4 S.L.R. 210; [2006] SGHC 146 [*Lew Syn Pau*].

Group Co. Ltd. and Others.[5] The High Court's signal of a willingness to reform the prohibition judicially was however reined in by the Court of Appeal in the latter case.

This article looks mainly at the recent changes to the law relating to financial assistance in Singapore, but in doing so will consider also the treatment made by other jurisdictions of the same rule. It does so with a hope that it will be helpful to the ongoing consideration of its further reform in Singapore and elsewhere. Whilst this article looks at the recent to help with the future, it is nevertheless useful to look to the past for an understanding of the reason for the prohibition's creation. Part II of the article therefore looks to the history which made the law, before it considers the law in contemporary setting. Part III will consider the legislative changes that have recently been made to the law, both in Singapore and elsewhere. Part IV will consider recent judicial treatment of the rule in the Singapore, and Part V will end the article with the writer's suggestions as to the best way forward for a more enduring treatment of the prohibition.

II. Then and Now

A. *Origins*

The ban on financial assistance had its inception in England as a response to a particular problem which had arisen after World War I.

It appeared that many companies which had prospered in the wartime economy and built up assets were unable to manage those assets properly in the changed circumstances of the 1920s. The Greene Committee,[6] then tasked with reviewing the *Companies (Consolidation) Act 1908* (U.K.), received complaints from former shareholders who alleged that they had been bought out of their companies by persons using company money or assets to effect the purchase.

The Greene Committee thought the practice was "highly improper", "open to the gravest abuse" and close to "a company trafficking in its own shares".[7] The Committee thought that the transactions involved the companies effectively acquiring their own shares. The solution which the Committee proposed was legislative prohibition of the practice of companies giving financial assistance for the purchase of their shares. That recommendation was adopted by the U.K. Parliament and subsequently enacted as section 45 of the *Companies Act 1929*.

The transactions outlawed in fact involved no acquisition by the company of its own shares and no necessary infringement of capital maintenance principles. In 1961 the Jenkins Committee very correctly criticised the attempt to align the financial assistance prohibition with capital maintenance.[8] The Jenkins Committee nevertheless proposed that the offence be maintained on the ground that such transactions were likely to lead to the company's assets being lost because of the lack of

5 [2006] 4 S.L.R. 451; [2006] SGHC 152 [*Wu Yang (H.C.)*].

6 "Report of the Company Law Amendment Committee", Cmd 2657 in *Sessional Papers* (1926) (President: Wilfred Greene).

7 *Ibid.* at paras. 30-31.

8 U.K., Board of Trade, "Report of the Company Law Committee" Cmnd 1749 in *Sessional Papers* (1962) at para. 173 (Lord Jenkins chair).

credit-worthiness of the assisted parties, thus raising risks in particular for minority shareholders and creditors.

B. *Since Then*

> Human ingenuity is well nigh boundless and the more it is thought that the ambit of the prohibition is obscure, the more this will encourage the wasteful application of such ingenuity in search of a design that might be passed off as defensible.
>
> Sundaresh Menon J.C. in *Lew Syn Pau*[9]

It was largely felt, as early as the Jenkins Committee Report,[10] that the outright ban on financial assistance was unnecessarily restrictive. Until 1981, however, such assistance remained more or less absolutely prohibited. Many complained that the prohibition was drawn in terms so wide and general that it appeared to penalise a number of innocent transactions. It would affect all acquisitions of shares, regardless of whether a change in control was involved, and was in such broad terms that it was capable of catching potentially beneficial or at least innocuous transactions.

In most jurisdictions, an earlier legislative response to this concern was to add clarifying subsections or qualifications to the meaning of prohibited financial assistance, and temper the prohibition with the addition of exceptions from time to time. Many jurisdictions have now extensive lists of exempted transactions; some jurisdictions also provide a way for shareholders to authorise the provision of financial assistance.

As a result, the financial assistance provision in most jurisdictions today no longer looks anything like the rule introduced in response to the Greene Committee's[11] concern. What started as a simple prohibition became increasingly long and complex, largely obscuring its original purpose. The qualifications and exceptions resolved the problems manifest in the original prohibition, but created further difficulties and failed to provide a clear policy direction, resulting in costly uncertainties.

The rules are a trap for the unwary, capable of defeating perfectly reasonable and sensible transactions or placing obstacles in the way of such transactions. The more sophisticated companies spend a disproportionate amount of time and money structuring transactions to avoid contravening the prohibition, and with the help of savvy corporate financiers, they are usually able to work their way around the rules even when the transactions may have harmful effects.

It is perhaps a little bewildering that a response to a possibly mistaken analysis of the legal nature of a problem in a particular period of time in the history of the U.K. could survive within other systems of capital maintenance, and for so long. The prohibition has in fact shown remarkable resilience, and even survives in New Zealand and Guernsey which have all but abandoned the capital maintenance system.

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9 *Supra* note 4 at para. 152.
10 *Supra* note 8.
11 *Supra* note 6.

III. Legislative Responses

A. *The Prohibition in Singapore*

> Indeed, s. 76 of the Act was rather more modest in length prior to the numerous amendments that have been effected over a great many years to it.
>
> Andrew Phang J. (as he then was) in *Wu Yang (H.C.)*[12]

The rules which make up and define the scope of the prohibition are in section 76 of the *Singapore Companies Act*, a section with 22 multi-paragraphed subsections. The consequences of a violation of the prohibition are in both sections 76 and 76A, the latter of which contains 14 multi-paragraphed subsections. These are not easy rules to navigate around, even for the more experienced lawyers.

The rules provide a multi-faceted approach to the prohibition. A company (also its subsidiary) is prohibited from providing financial assistance for the purpose of, or in connection with the acquisition (or proposed acquisition) of the company's shares, but particular transactions and institutions are excluded. The scope of the prohibition is also circumscribed by requirements that financing the acquisition of the shares must be a substantial purpose of the giving of the financial assistance, and knowledge on the part of the company that its action in connection with the acquisition would financially assist the acquisition. There is also a whitewash procedure, essentially by shareholder concurrence, which will legitimise a transaction on which the prohibition would otherwise bite.

The *2005 Amendments*[13] introduced two additional exceptions based on solvency. First, provided that the directors of the company are able and prepared to sign off on a statement stating that the company will remain solvent (on a cash flow and balance sheet basis) after the transaction, the assistance will be allowed if it does not exceed 10% of the total paid-up capital and reserves of the company.[14] Second, any amount of assistance will be allowed if there is, additionally, a unanimous shareholders' agreement by resolution for the giving of the financial assistance.[15] The directors are also required to resolve, giving full grounds for their conclusions, that the company should give the assistance, that it is in the best interest of the company, and that the terms and conditions are fair and reasonable to the company.

It is uncertain how many companies have availed themselves of the solvency exceptions since 30 January 2006 when they were first introduced, but the fact that further liberalisation to the prohibition is being considered in the current review of the *Singapore Companies Act* suggests at the very least that the solvency exceptions have not provided a complete solution.

This is likely to be because of the requirement that all directors make the solvency declaration.[16] This requirement may stand in the way of companies availing themselves of the exceptions. If one or more of the directors is unable or unwilling to make the declaration, the company will not be able to utilise the exceptions unless the

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12 *Supra* note 5 at para. 28.

13 *Supra* note 2.

14 *Singapore Companies Act*, s. 76(9A).

15 *Singapore Companies Act*, s. 76(9B).

16 This is the writer's own assessment from discussions with industry players.

dissenting director or directors resign. It may be expected that some non-executive directors may abstain from signing the solvency certificate on the grounds that they are less familiar with the operations of the company than executive directors. Criminal liability attaches to directors who make a solvency statement without having reasonable grounds for the opinions expressed in it,[17] and this is also likely to deter some directors from providing the certification.

Consequently, although in theory the solvency exceptions make it unnecessary for Singapore-incorporated companies to determine whether a transaction involves the giving of prohibited financial assistance, in practice however, the majority of companies are likely to still have to work with the "old" rules. In New Zealand, and more recently in Guernsey, financial assistance is allowed only on the basis of a solvency certification, and yet the system appears to work tolerably well. The next section of this article suggests a reason why the same requirement can work in these two jurisdictions.

The Singapore financial assistance prohibition is made more complex by being juxtaposed with the capital maintenance rules on buy-backs and lending on the security of the company's shares. These are dealt with within the sections 76 and 76A of the *Singapore Companies Act* as well, suggesting that they address the same mischief, or at least have a similar underlying policy—that of maintaining the capital of the company.

Recent decisions of the Singapore courts, considered later in this article, have consistently affirmed this to be so. At the Court of Appeal in the case of *Wu Yang Construction Group Ltd v. Mao Yong Hui and another*,[18] Chan Sek Keong C.J. stated:

> It is well known that s. 76 of the CA is based on s. 54 of the *Companies Act 1948* (c 38) (U.K.). The provision was enacted to prevent abuses in the form of persons or syndicates indirectly using the funds of the target company to acquire control of the target company by, first, obtaining bank loans to finance their purchase of the target company, and then, after gaining control of the target company, using the target company's funds to repay those bank loans: see Arden L.J.'s comment in *Chaston* ([40] *supra*) at [48] (referring to a passage from *Brady* ([40] *supra*), which is reproduced below at [48]). Such practices might deplete the assets of the target company and thereby offend the rule on capital maintenance, which protects the interests of creditors.[19]

Andrew Phang J. (as he then was), who heard the case at first instance, also thought the rule to be one of capital maintenance, referring to local and English texts which stated it to be so.[20] As did Sundaresh Menon J.C. in *Lew Syn Pau*:[21]

> It is convenient first to recall the legislative objective in enacting s. 76. This was restated in 1986 (when the section was repealed and re-enacted with a number of changes) by the Minister for Finance at the time he moved the second reading of the Bill as follows: "The main purpose of the section is to ensure that the capital

[17] See *Singapore Companies Act*, s. 7A(6): The director is liable on conviction to a fine of up to $100,000 or to imprisonment for a term not exceeding 3 years or both.
[18] [2008] 2 S.L.R. 350 [*Wu Yang (C.A.)*].
[19] *Ibid.* at para. 45.
[20] *Wu Yang (H.C.)*, *supra* note 5 at paras. 30-31.
[21] *Supra* note 4 at paras. 79-80.

of the company is preserved intact." See: *Singapore Parliamentary Debates, Official Report* (5 May 1986), vol. 48 at col. 39.

Opinions have however been expressed elsewhere that the prohibition has little to do with the maintenance of capital. The writer can empathise with these views.

The premise of the capital maintenance theory is that creditors provide funds or credit on the basis of an express or implied representation that consideration received for shares (the share capital) shall be applied only for the purposes of the business, and that it shall not be returned to the shareholders except in a winding up after all creditors have been satisfied.[22] The capital maintenance rules consequently place restrictions on the return of capital to the shareholders. These rules are applied to limited companies, as shareholders of these companies are limited as to their personal liability in the amount of the capital that they contribute to the company. Restrictions on return of capital have, on the other hand, not been applied in relation to the share capital of unlimited companies since their shareholders would be liable in a liquidation to pay in whatever might be needed to discharge the company's debts.

The main essentials of the doctrine of capital maintenance are not clearly visible in the financial assistance prohibition. If a company lends $500,000 to someone to acquire its shares, the company's share capital will not be in any way altered by that loan or the subsequent purchase of the shares. If the loan is provided at arms-length, negotiated on proper terms, and secured by perfectly good collaterals, it is unlikely to affect the assets of the company. On whatever terms, the loan was not any more likely to infringe the company's capital than a loan given for any other purpose or any other transaction.

It may be thought that if the prohibition was intended to preserve capital it would not bite if the assistance is not financed out of capital. The *Hong Kong Companies Ordinance*,[23] for example, allows unlisted companies to give financial assistance in connection with the purchase of shares in the company where either the company has net assets which are not thereby reduced by the giving of the assistance, or the funds are provided from distributable profits.[24] In Singapore however, it would seem that the prohibition applies even if the assistance was financed fully out of distributable profits, and consequently not out of capital at all.

The prohibition in section 76 is not restricted to providing assistance to a shareholder, although with the acquisition the person does become one. So, to the extent that capital maintenance is about restricting the return of capital to the shareholders, it is not a real fit this way either.

It is therefore respectfully submitted that it is not incontrovertible that the doctrine of maintenance of capital underpins the financial assistance prohibition in Singapore. Even if the legislative intent was to create a rule of capital maintenance, it is not entirely clear that it has quite succeeded. Further, there must be considerable doubt, after the *2005 Amendments*, as to whether the rule is now about the preservation of the share capital fund at all. If a company is allowed to finance an acquisition of its own shares, even out of capital, provided the solvency and interest of the

22 The risk that the capital would be lost in the ordinary course of business was, however, one which creditors had to bear.

23 Cap. 32, 1950 [*Hong Kong Companies Ordinance*].

24 *Ibid.*, ss. 43E to G.

company requirements are met, then section 76 appears less to express a policy about capital maintenance than general concern about creditor and minority shareholder protection.

Sundaresh Menon J.C.'s proposition in *Lew Syn Pau*[25] that "detriment" to the company or the creditors is a prerequisite to the rule is, in the writer's opinion, more consistent with a solvency-based rule than a rule of capital maintenance. Creditors and the company would be adversely affected by the insolvency of the company but not necessarily by the loss of some of its capital. Many viable companies operate with a low capital base, the reduction of which will have little or no impact on the company and its creditors. *Lew Syn Pau*, a criminal prosecution under the financial assistance rule, will be considered in more detail in Part IV of this article.[26]

Singapore's pragmatic response to the reform—the provision of more exceptions—has resulted in the financial assistance prohibition being underpinned by a curious mix of both the nineteenth-century common law concept of the maintenance of capital and the solvency test which underlies the solvency method of creditor protection.

The solvency method is another technique that has evolved in company law for the protection of creditors. The theory underpinning this approach to creditor protection is that the law should focus on the core risk at stake—insolvency of the company—since this is the only situation in which creditors will be left unpaid. In jurisdictions which adopt this form of creditor protection (New Zealand and Guernsey, for example), all forms of distribution to shareholders, including payment of dividends, capital returns and buy-backs are allowed, provided relevant solvency tests are met, without distinguishing between payment from capital or profits. The argument for this method is that creditors are more concerned with a company's solvency than the preservation of its share capital.

Singapore formally retained all of its capital maintenance rules after the *2005 Amendments* but introduced the solvency requirement into almost all of them.[27] Solvency is now a pre-requisite for share buy-backs, even if they are funded out of distributable profits and not out of capital at all. Capital can be returned to shareholders provided the solvency requirements are met.

It is of course entirely possible to have a bifurcated approach to creditor protection, but the linking of the two sets of rules with divergent objectives makes for difficult law. Which of these should judges now look at to define the parameters of the rules? It is suggested that the *2005 Amendments* have effectively made the preservation of the capital fund mostly optional as they allow for significant derogations from the prohibition and the capital maintenance principle. The reader may share the writer's sense of disquiet as to the point in having rules that purport to be about capital maintenance, but which are not about the preservation of the share capital fund at all.

The solvency exceptions in the *Singapore Companies Act* may provide flexibility, but do not simplify the law enough to be useful, and may in fact have implications on the interpretation of the rules that the courts have yet to consider. The linking

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25 *Supra* note 4.

26 Lew Syn Pau was formerly a Singapore Member of Parliament.

27 Save for the rule against a company lending on the security of its own shares in the *Singapore Companies Act*, s. 76(1)(c).

of two sets of rules (capital maintenance and the solvency method) with divergent objectives has resulted in further muddying of the objectives that they are in fact pursuing.

The question as to whether Singapore should continue to maintain its system of capital preservation or move more fully to the solvency method of creditor protection is not one which the writer seeks to explore in this article as this involves a consideration of issues beyond the scope of this article. This article does, however, seek to highlight the difficulties that can arise from introducing the solvency test into the financial assistance prohibition where judges have traditionally looked to capital preservation as defining the parameters of its rules. The writer suggests in Part V of this article that, for the financial assistance prohibition to be a meaningful restriction, it would be desirable to provide a clearer direction as to the policy which the rules are intended to implement.

B. *The Prohibition Elsewhere*

Ironically, the U.K., which introduced the financial assistance ban to the world, has recently abolished it for private companies. It has been retained for public companies, largely because the *Second EC Directive* was thought to require it.

The Company Law Review Steering Group took the view that the financial assistance provisions imposed unjustified costs on private companies, and proposed that they be repealed. The Steering Group had earlier considered a "solvency margin" regime but rejected it on grounds that a solvency margin (as an exception to the financial assistance prohibition) is "disproportionate…and over-regulatory". It thought that the law relating to protections and sanctions under the *Insolvency Act 1986* and in particular section 214 (on wrongful trading), created "a substantial disincentive for directors to sanction financial assistance which reduces the company's assets in a way which endanger creditors". It was also of the view that other protections found in the sphere of directors' duties of fidelity and fairness and the use of powers for proper purposes with a duty of care, as well as minority protection of the shareholders, were adequate to protect creditors and members.[28]

The financial assistance prohibition has long been abolished in the United States and in a number of provinces in Canada. The prohibition however remains in the respective companies legislations of Australia, New Zealand, Hong Kong and Malaysia.

The *New Zealand Companies Act 1993* and the *Companies* (*Guernsey*) *Law 2008*[29] both allow financial assistance with a solvency certification by the directors. This is in fact the only premise upon which financial assistance is allowed.

There are similarities between the New Zealand solvency requirements (and to a lesser extent, the Guernsey one) and the solvency exceptions in the *Singapore Companies Act* which borrowed from the *New Zealand Companies Act*, but the underlying philosophies of the methodologies are quite different. The New Zealand and Guernsey rules on financial assistance are part of a creditor protection scheme

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28 Company Law Review Steering Group, *Modern Company Law for a Competitive Economy: Developing the Framework* (2000, URN 00/656) at 232-234.

29 *Companies (Guernsey) Law* 2008, s. 331.

that allows distributions on the basis of solvency. Singapore, on the other hand, has incorporated the solvency requirement as exceptions to a prohibition within a capital maintenance framework, making it unclear what policy the rules now seek to enforce.

The rules on what is financial assistance under the New Zealand and Guernsey Acts are relatively straightforward. Protection for creditors is solely on the basis of the company's solvency. The *New Zealand Companies Act* requires the board to also resolve that the company should give the assistance, that it is in the best interest of the company, and that the terms are fair and reasonable to the company,[30] and either that there is unanimous shareholder approval,[31] or the procedures for special financial assistance (where not all shareholders are extended the assistance) are followed;[32] or the financial assistance does not exceed 5% of shareholders' funds.[33] These are shareholder protection measures. The *Companies (Guernsey) Law* on the other hand treats the procedure for financial assistance the same way as that for other distributions (other than that of dividends). No special requirements aside from the solvency certification have been specified[34] but there is provision for regulations to be made later.[35]

It may be recalled that the Singapore solvency exception requires all directors to sign the certification, and the point has been made earlier that this is likely in practice to limit its application. The *New Zealand Companies Act*, on the other hand, requires only a majority of directors to sign the solvency certification, and the *Companies (Guernsey) Law* requires only one to sign on behalf of the board. There are practical reasons for these Acts requiring less than a full board certification. As solvency is a pre-requisite and not an option to all forms of distribution under these Acts, including financial assistance, the systems would not be workable in practice if they required all directors to make the certification.

The *Australian Corporations Act* allows financial assistance if the giving of the assistance does not materially prejudice the interests of the company or its shareholders, or the company's ability to pay its creditors.[36] According to the accompanying Explanatory Memorandum[37] to the *Company Law Review Bill 1997*:

> This approach is intended to minimise the difficulties the rule currently causes for ordinary commercial transactions. In particular, for transactions which do not involve material prejudice, the new rules will make it unnecessary to decide whether the transaction involves the giving of financial assistance.[38]
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> Whether a particular transaction involves a material prejudice, and therefore requires shareholder approval, will be a question of fact to be answered in the light of the circumstances of each case. For example, material prejudice to the company, its shareholders and the company's ability to pay its creditors may occur

30 *Ibid.*, s. 76 read with s. 77.
31 *Ibid.*, s. 76.
32 *Ibid.*, s. 78.
33 *Ibid.*, s. 80.
34 *Ibid.*, s. 309.
35 *Ibid.*, s. 333.
36 Australian *Corporations Act*, 2001(Cth.), s. 260A.
37 Austl., Canberra, *Company Law Review Bill Explanatory Memorandum 1997*, AGPS (1997) at para. 12.75.
38 *Ibid.* at para. 12.76.

if a company withdraws a large amount of money from its bank and lends it to a company that is bordering on insolvency, or if it guarantees a loan to a company that is likely to default.[39]

The doctrine of maintenance of capital is said to continue to be an important part of company law in Australia,[40] but the main essentials of the doctrine are not clearly visible in the "capital maintenance" rules of the *Corporations Act* after the 1998 reform. An examination of the rules that purport to be about capital maintenance show that they are not about the preservation of the share capital fund at all. Not just financial assistance, but capital reductions, redemptions and buy-backs are also generally allowed (with no prescription as to the source of funds) provided that there is no material prejudice to the company, its shareholders, and the ability to pay creditors. The ability to pay creditors is a test of cash flow solvency.

In Malaysia, the Corporate Law Reform Committee has recommended that the strict prohibitive regime for financial assistance in the *Malaysian Companies Act* be replaced (for all companies) with a more facilitative regime where a company is permitted to provide financial assistance subject to a solvency declaration made by a majority of the directors and a special resolution by shareholders.[41] If the recommendations of the Corporate Law Reform Committee were to become law, the *Malaysian Companies Act* would retain the prohibition on financial assistance, but allow it on the basis of a solvency test that is similar in form to the test in New Zealand.[42] As in Singapore, the solvency requirement will be an additional exception to the prohibition.

In Hong Kong, the financial assistance rules apply differently to listed and unlisted companies.[43] Special restrictions apply to listed companies (section 47D), whilst unlisted companies are provided with an additional exception premised upon solvency and are subject to a special resolution of the shareholders (section 47E). The solvency exception for unlisted companies is much the same as that for private companies in the *U.K. Companies Act 1985*, the precursor to the *Companies Act 2006*. The financial assistance prohibition is currently being reviewed in Hong Kong as part of its comprehensive review of the *Hong Kong Companies Ordinance*.

There are differences in the scope and application of the solvency exception in Hong Kong and Singapore. The exception is extended to all companies in Singapore whilst it would not be available to listed companies in Hong Kong. The *Singapore Companies Act* requires all directors to sign off on the solvency statement whilst only a majority need do the same in Hong Kong. The solvency test under the *Hong Kong Companies Ordinance* is one based on cash flow alone. The solvency requirement in the *Singapore Companies Act* has an additional cumulative balance sheet solvency test which requires that the value of the company's assets be not less than the value of its liabilities both before and after the proposed financial assistance. At first blush, this

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39 *Ibid.* at para. 12.77.

40 Robert Austin & Ian Ramsay, *Ford's Principles of Corporations Law*, 13th ed. (Australia: LexisNexis, 2007) at 1290.

41 Companies Commission of Malaysia, *A Consultative Document on Capital Maintenance Rules and Share Capital: Simplifying and Streamlining Provisions Applicable to the Reduction of Capital, Share Buy Back and Financial Assistance* (Corporate Law Reform Committee, 2007) at 42-44.

42 *Ibid.* at 14-16.

43 *Hong Kong Companies Ordinance*, *supra* note 23.

appears to make the Singapore exception more stringent, at least as to the definition of solvency, but this is not necessarily the case as the Hong Kong exception applies only if the net assets of the company are not thereby reduced by the provision of the financial assistance (unless assistance is provided out of distributable profits).[44]

Clearly, criticisms of the financial assistance ban have not gone unheeded. The law reform response has, however, taken rather different directions in the various jurisdictions that have had to contend with the ban, even as they are all intended to temper its reach.

IV. Judicial Responses

> Indeed, it will be seen that commercial reality infuses the operation of the financial assistance provisions under the Act
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> Andrew Phang J. (as he then was) in *Wu Yang (H.C.)*[45]

This part of the article considers two recent cases before the Singapore courts which provided opportunity to the presiding judges to make important observations on the financial assistance rule. The first is *Lew Syn Pau*,[46] a rare prosecution under section 76, a decision of the High Court. *Wu Yang*,[47] the second case considered here, came before both the High Court and Court of Appeal. Although both courts reached the same conclusion on the issue of financial assistance, it will be shown that the manner in which they arrived at that conclusion was quite different.

The discussions that follow will focus on the attempts of the judges at first instance to view the financial assistance rule through commercially sensitive lenses, and to consequently read beyond the words of the rule, and the appellate court's refocus on the rule as the Legislature has written them. They are not intended to provide a comprehensive consideration of all aspects of the judgments.[48]

A. *Lew Syn Pau*

In this case the learned judicial commissioner, Sundaresh Menon J.C., sought to limit the prohibition in two ways. The first was by inferring a requirement that the financial assistance must result in a depletion of the corporate assets, or at least put them at such risk. The second was related to the first. Even if the corporate assets are depleted (or put to such risk), the prohibition is not contravened if the transaction is genuinely entered into in the company's own commercial interest, and not merely to financially assist the acquisition of its shares. Menon J.C. found on the facts that there was no depletion of the company's assets, and hence the second proposition was strictly *obiter.*

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44 *Ibid.*, s. 47E(2).

45 *Supra* note 5 at para. 23.

46 *Supra* note 4.

47 See *Wu Yang (H.C.)*, *supra* note 5 and *Wu Yang (C.A.)*, *supra* note 18.

48 For a fuller and interesting consideration of *Lew Syn Pau*, see Michael Ewing-Chow & Hans Tjio, "Providing Assistance for Financial Assistance" [2006] Sing. J.L.S. 465, and Wan Wai Yee, "Financial Assistance: The Case for Re-Examining Section 76 of the Companies Act" (2007) 19 Sing. Ac. L.J. 80. The latter also provides a helpful consideration of *Wu Yang* (*H.C.*).

Compart Asia Pacific Limited ('Compart Mauritius') had provided a bridging loan to one Dick Tan Beng Phiau for his acquisition of new shares in Broadway Industrial Group Ltd ('BIGL'), its ultimate holding company. This was *prima facie* financial assistance,[49] but not such as was prohibited by the *Singapore Companies Act* as Compart Mauritius was not incorporated in Singapore (but in the Republic of Mauritius), and section 76 did not extend to foreign corporations.

Undaunted by this, the Public Prosecutor sought instead to frame charges against the Executive Chairman of BIGL and another on the basis that BIGL, the Singapore-incorporated parent company, had effectively provided the prohibited financial assistance for the purchase of its own shares.

The prosecution could not succeed, according to the High Court, for a number of reasons. The one relevant to the consideration here is that, according to the court, no part of BIGL's assets were used, encumbered or in any way put at a risk by the transaction.[50] The prosecution had to fail, according to Menon J.C., as detriment to the company, in the form of depletion of its assets, whether in fact or contingently, was a necessary element of banned financial assistance, a rule premised upon the doctrine of capital maintenance.[51]

This is judicial writing into the rule, as section 76 makes no mention of any requirement of depletion. The court thought, however, that the requirement could be inferred from the instances of financial assistance set out in section 76(2). This provides that a reference to financial assistance in section 76 included financial assistance by 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. All these, according to Menon J.C., involved the depletion of the assisting company's assets: "There is a common thread that runs through each of these instances of prohibited assistance and that is that the act in question actually or contingently depletes the assets of the assisting company."[52]

This reading into the instances of financial assistance departs somewhat from the interpretation of the equivalent section (section 677) of the *U.K. Companies Act 2006*. Similar descriptions of financial assistance there are not considered to require a resultant depletion of assets or detriment to the assisting company.[53] The financial assistance could in fact be beneficial to the company, as where the borrower from the company is a good credit risk and the interest rate is favourable, but the prohibition will still bite. Detriment is thought to be required only by the last description of financial assistance in the U.K. section (section 677(1)(d)): "where the company has

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[49] This is because a company may not give financial assistance to any person for the purpose of acquiring shares in itself or in its holding company: *Singapore Companies Act*, s. 76.

[50] *Lew Syn Pau*, *supra* note 4 at para. 241, *per* Sundaresh Menon J.C.

[51] There is no explicit requirement of detriment to the assisting company in s. 76, whether in the form of depletion of assets (in the manner required by Menon J.C. at paras. 92, 97, 99, 107 and 151), or actual diminution of the company's net worth (which Menon J.C. rejects, see para. 115). Menon J.C.'s depletion criteria do not require actual loss to the company. The fact or risk of depletion is said to be sufficient (para. 118).

[52] *Lew Syn Pau*, *supra* note 4 at para. 92.

[53] See *Chaston v. SWP Group plc* [2002] EWCA Civ. 199, *per* Arden L.J. (affirmed that the application of s. 152 of the *Companies Act 1985* is not conditioned upon showing objective detriment to the target company).

net assets which are thereby reduced to a material extent"[54] of which there is no equivalence in section 76(2) of the *Singapore Companies Act*.

The incorporation of the "depletion" requirement borrows from the decision of Hutley J. in *Burton v. Palmer*,[55] a decision of the Court of Appeal of New South Wales. In construing an earlier version of the financial assistance rule in Australia, Hutley J. had this to say:

> The ways in which a company can infringe s. 67 of the *Companies Act 1961* … are infinitely various but the essence of the matter is clear—has the company diminished its financial resources, including future resources, in connection with the sale and purchase of its shares …[56]

The *Burton* test has however been rejected by the Full Court of the Supreme Court of Western Australia in *Dempster v. National Companies and Securities Commission*.[57] According to Malcolm C.J.:

> 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.[58]

Menon J.C. however declined to follow the decision in *Dempster* on this point, which he thought arose from a failure to construe the *Burton* test properly or a failure to appreciate its commercial underpinnings:[59]

> I reiterate what I have said above at [107]: the search is not one directed at technical economic equivalence in the company's position before and after the transaction. Rather, the real issue is whether the assets of the company have in fact been used or been put at risk for the purpose of the intended acquisition. If the answer to this is in the affirmative, then there may be financial assistance in the relevant sense whether or not the risk has materialised and whether or not the actual asset position has diminished. …Secondly, having regard to the legislative purpose of the prohibition contained in s. 76 namely to preserve the company's capital and prevent the use of its assets in connection with an intended acquisition of its shares, there does not appear to me to be any good reason to conclude that the Legislature intended to criminalise conduct which did not in any way entail the use of a company's resources whether directly or in any way that encumbered or placed such resources at risk. I note in this regard that the same view is expressed in Prof. Walter Woon's treatise, *Woon's Corporations Law* (LexisNexis, 2006,

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54 See L.C.B. Gower & Paul L. Davies, *Principles of Modern Company Law*, 8th ed. (London: Thomson Sweet & Maxwell: 2008) at paras. 13-29; Catherine Roberts, *Financial Assistance for the Acquisition of Shares* (New York: Oxford University Press, 2005) at para. 7.21.

55 (1980) 5 A.C.L.R. 481 [*Burton*].

56 *Ibid.* at 484.

57 (1993) 10 A.C.S.R. 297 [*Dempster*].

58 *Ibid.* at 353.

59 *Lew Syn Pau*, *supra note* 4 at paras. 125-26.

Issue 21) at para. F150 as follows:

> **The mischief of the section** It is suggested that the mischief that the section is aimed at is the improper depletion of a company's assets to the detriment of its creditors: *Skelton v. South Auckland Blue Metals Ltd* [1969] N.Z.L.R. 955, 958 (Supreme Court of New Zealand).

In so far as the ban on financial assistance has its roots in a desire on the part of the Legislature to protect creditors from dissipation of corporate assets, there is a strong policy argument that depletion of the company's assets should be made necessary. The point has been made earlier in this article though that the issue of detriment appears more relevant to a rule based on the solvency approach to creditor protection than it is to a rule that seeks to protect the company's capital. Creditors are always at risk of being left unpaid when the company is insolvent, but not necessarily so if the company's capital is reduced.

Menon J.C.'s attempt to resurrect the *Burton* test for the Singapore rule is valiant, but it does run into a number of problems.

First, it is more usually thought that "detriment" to the assisting company is not a prerequisite—the step that constitutes unlawful financial assistance may even be positively beneficial to the assisting company.[60] This is one of the criticisms of the rule, which some jurisdictions have addressed, but with legislative changes.

Secondly, all transactions that a company undertakes would put it at some measure of risk. Unless the measure of risk is taken into account by an appraisal of the likelihood of the contingency occurring and the significance of the threat it presents, the depletion criteria is unlikely to provide any real limitation to the breadth of the financial assistance prohibition. Also, if contingent liabilities are to be taken into account, should contingent assets not be also, to see where the net balance of financial advantage lay?

A broad brush application of the depletion criteria may, however, have been sufficient on the particular facts of *Lew Syn Pau* to support the judgment's conclusion. Here the public prosecutor had tried to throw the net of the Singapore ban over the Singapore parent of the assisting company, a Mauritian company, which the net could not catch. The High Court declined to lift the veil of incorporation of the Mauritian subsidiary, and on the principle of separate legal entities, found that the Singapore parent had suffered no depletion or risk of depletion to its assets. It may be thought that even on the facts of *Lew Syn Pau*, the assets of BIGL—the Singapore parent—may have been put at risk of depletion if there was a risk of depreciation to the value of the subsidiary's shares. But this perhaps takes it too far.

Where the net is cast over the assisting company however (which is more usually the case, and which *Lew Syn Pau* suggests is the only way in which it should be cast), the broad brush application of the depletion criteria is more likely to catch than it is to release.

For the depletion criteria to work sensibly there must, it is respectfully submitted, be some measure of the depletion. At least two forms of such measure can be found in the financial assistance rules of the jurisdictions considered in Part III of this article.

[60] See Eilis Ferran, "Corporate Transactions and Financial Assistance: Shifting Policy Perceptions But Static Law" (2004) C.L.J. 225 at 240.

The first is the calibrated solvency measure used in the *New Zealand Companies Act 1993* and the *Companies (Guernsey) Law 2008*. Under these rules, a company can provide financial assistance if it will remain solvent by the cash flow and balance sheet measure of solvency of these rules, but not otherwise. A similar solvency measure has been written into the Singapore financial assistance rule by the *2005 Amendments*. However, because solvency has been incorporated as exceptions to the rule, strictly speaking, the issue of whether the company remains solvent after the assistance only arises for consideration where the company has sought to provide the financial assistance on the basis of a solvency certification. Unless a solvency exception in section 76(9A) or (9B) of the *Singapore Companies Act* is invoked, the fact that the company remains solvent under the solvency measure after the provision of the financial assistance is strictly not relevant.

An alternative would be a descriptive form of measure adopted in the *Australian Corporations Act* and applied in a more limited way in the *U.K. Companies Act 2006*. The *Australian Corporations Act* allows financial assistance if it does not affect the company's ability to pay its creditors and does not materially prejudice the company, shareholders and creditors. The *U.K. Companies Act 2006* refers to "any …financial assistance given by a company, the net assets of which are thereby reduced to a material extent".[61]

Menon J.C. was not unappreciative of the fact that some risk was inevitable in corporate transactions and the consequences therefore of applying the depletion criteria without more, as evidenced in the following paragraph of his judgment:

> In getting to the substance of the matter, there is always a danger that focusing on the fact that the company's assets might have been depleted, one loses sight of the equally important fact that the company may have entered into the transaction for perfectly good and legitimate commercial reasons rather than to deplete its assets in aid of the intended acquisition of its own shares. It would neither be desirable from the perspective of promoting legitimate enterprise nor necessary from that of protecting the company and its creditors, since some risk is inevitable in free enterprise, to lean in favour of invalidating such transactions without regard to the real commercial interests that caused the company to enter into the transaction. I note that Buckley L.J. in *Belmont Finance* in fact put forward the tentative view that a company which genuinely entered into a transaction in its own commercial interest and not *merely* to put the intending purchaser in funds would not be contravening the prohibition. I endorse this.[62]

This was an endorsement of Buckley L.J.'s proposition in *Belmont Finance Corporation v. Williams Furniture Ltd. (No. 2)*,[63] which the learned judicial commissioner acknowledged was tentatively made, that a transaction entered into partly for the

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[61] *U.K. Companies Act 2006*, s. 677(1)(d)(i).

[62] *Lew Syn Pau*, *supra* note 4, at para. 141.

[63] [1980] 1 All E.R. 393 [*Belmont*]. Buckley L.J. made the following proposition at 402:

> If the transaction is of a kind which A Ltd could in its own commercial interests legitimately enter into, and the transaction is genuinely entered into by A Ltd in its own commercial interests and not merely as a means of assisting B financially to buy shares of A Ltd, the circumstance that A Ltd enters into the transaction with B, partly with the object of putting B in funds to acquire its own shares or with the knowledge of B's intended use of the proceeds of sale, might, I think, involve no contravention of the section but I do not wish to express a concluded opinion on that point.

genuine commercial purposes of the company and partly to put the purchaser in funds to complete an acquisition of the company's shares would not contravene the prohibition.

Menon J.C.'s endorsement of Buckley L.J.'s proposition as a way of restricting the catch of the prohibition was strictly *obiter* as he had found on the facts that there was no depletion to the BIGL's assets. The relevance of *bona fides* and commercial interests to the Singapore prohibition was considered more fully in the *Wu Yang* case, the other case discussed here.

B. *Wu Yang at the High Court*[64]

At first instance, Andrew Phang J. (as he then was) took the pursuit of circumscribing the scope of the financial assistance prohibition even further. The learned judge would limit the scope of section 76 in these ways. First, the issuance of shares as consideration for an acquisition of assets would generally not come within the ambit of the prohibition.[65] Secondly, it is not the intention of section 76 to catch transactions entered into *bona fide* in the commercial interest of the company. Thirdly, the phrase "in connection with" in section 76(1)(a) should be read restrictively to mean no more than "for the purpose of".

The facts giving rise to the claim of financial assistance, dismissed by the learned judge, arose as follows:

The company said to have provided financial assistance was VGO, a listed company incorporated under the *Singapore Companies Act*. VGO had entered into a swap of assets for shares transaction with Kingsea. In exchange for Kingsea's assets comprising the entire issued share capital of Spring Wave,[66] VGO was to issue 134,705,882 new VGO shares credited as fully paid to Kingsea and a number of others.

Pursuant to an audit prior to the closing of the transaction, the net asset value ("NAV") of Spring Wave was found to be RMB 4,404,000 lower than the initial RMB 55 million stipulated in the agreement. The parties agreed to complete the transaction, but on terms that only 123,918,506 new VGO shares would be issued on completion to reflect the lower NAV and the remaining new VGO shares after Kingsea had injected cash or other assets into a subsidiary of Spring Wave to make up the shortfall in the NAV.

At the closing, VGO issued 123,918,506 new VGO shares but kept 59,339,238 of those shares in escrow to secure Kingsea's unfulfilled warranties. The escrow shares were subsequently sold to one Mao, the executive director of a sub-subsidiary of VGO (Hangzhou Kingsea), when Kingsea defaulted in its undertakings.

The larger purpose exception in the *U.K. Companies Act* which first appeared in section 42 of the (U.K.) *Companies Act 1981*, was possibly for the purpose of dispelling the doubt raised in *Belmont*. The larger purpose exception makes it clear that if the company has two or more purposes in giving the financial assistance, no infringement occurs if the company's principal purpose is not to give assistance for the acquisition of shares, or if the acquisition is merely incidental to a larger purpose of the company, but in either case the assistance must be given in good faith in the interests of the company.

64 *Wu Yang (H.C.)*, *supra* note 5.

65 *Ibid.* at paras. 20, 21-22.

66 A company incorporated in the British Virgin Islands with subsidiaries having businesses in China.

The plaintiff to whom the shares had been pledged by the second defendant, the sole owner and controller of Kingsea, obtained a Mareva injunction against the second defendant and Kingsea, effectively freezing and claiming the escrow shares. VGO and Mao applied for a variation of the Mareva injunction, claiming that they were entitled to the VGO shares. It was in this application that the claim of financial assistance was made by the plaintiff's lawyers, and quite "out of the blue", as the judgment noted.

The lawyers argued that the issue of VGO shares for assets of a lesser value amounted to financial assistance in the amount at which the contractual NAV exceeded the real NAV of Spring Wave.

Andrew Phang J. dismissed the plaintiff's argument as completely without merit. The learned judge thought that the case did not even fall to be considered within the literal ambit of section 76,[67] and certainly not within its spirit and intent.[68] It is easy to see why this very technical and, as the judge described it, creative argument which was raised to challenge what was undisputedly a commercial transaction, should not succeed. However, it is less easy to dismiss the claim that it fell within the prohibition's literal ambit, and it is not entirely clear what the judge's reasons were for doing so.

The learned judge observed that the escrow shares in question were, in point of fact, issued by VGO and were an integral part of the purchase consideration for another asset. It was said that this was a far cry from a situation where the company financially assists someone to purchase its shares, the only situation that falls within the ambit of section 76 of the *Singapore Companies Act*.[69]

Andrew Phang J. added that in issuing shares as the purchase consideration for the asset concerned, VGO did not in fact reduce its capital. Observing that a main thrust of section 76 was to ensure that the company does not deplete its capital to the detriment of its creditors and shareholders, he pointed out that this was clearly not the case in the proceedings at hand.[70]

As the treatment of the literal scope of section 76 was brief, it may be that the writer has not fully comprehended the learned judge's reasons for saying that the facts did not come within it. However, to the extent that the learned judge intended to suggest that the issuance of shares as consideration for an asset can never qualify as financial assistance within the section, it is very respectfully submitted that this possibly makes for too wide a proposition. A share for asset swap is as much an acquisition of the asset by one party as it is of the shares by the other. For Kingsea, the transaction was an acquisition of VGO shares. The question is whether VGO financially assisted the acquisition of its shares.

It may be thought that VGO could have done that by agreeing to issue shares credited as paid to a value that exceeds the value of the asset. VGO's waiver of Kingsea's obligation to provide assets of a certain value was technically financial assistance[71] which enabled Kingsea to acquire a bigger stake in VGO. This, it is

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67 *Wu Yang (H.C.)*, *supra* note 5 at para. 20.
68 *Ibid.* at para. 19.
69 *Ibid.* at para. 20.
70 *Ibid.* at para. 21.
71 The release of an obligation is an instance of financial assistance for the purpose of the section: *Singapore Companies Act*, s. 76(2).

respectfully submitted, is so even if VGO had very properly decided that it was nevertheless commercially advantageous to complete the transaction on that basis.

It is entirely correct that the issuance of shares at whatever consideration will not reduce the company's capital, since there is no paying out of capital. However, it is respectfully submitted that the theory of capital maintenance is not solely about the paying out of capital, even though it is more usually discussed in that context. To achieve the desired results in terms of creditor reliance on the subscribed capital and protection of shareholders against dilution of the value of their shares, the theory of capital maintenance also makes it essential that the amount of share capital should be properly paid in and that it should represent the real value stated.

To ensure that the shares represent the real value stated, the *U.K. Companies Act 2006* requires non-cash consideration to be independently valued and further provides that non-cash consideration cannot take the form of services.[72] The *New Zealand Companies Act* (which however implements the solvency method of creditor protection) requires directors who vote in favour of the non-cash consideration to sign a certificate stating that, in their opinion, the present cash value of the consideration to be provided for the issue of the shares is not less than the amount to be credited for the issue of the shares.

The issuance of shares at undervalue could consequently be a breach of the principle of capital maintenance, and it is submitted that it could also technically be a breach of the financial assistance prohibition if the company does not require just payment for the shares.

It may be that the transaction fell outside the catch of the prohibition in another way. The High Court found that VGO's sole purpose in acquiring Spring Wave's business as a going concern was to extend VGO's own business to the food and beverage industry. On that basis, even if there had been financial assistance, it had not been given "for the purpose of" the purchase of the VGO shares. The purpose rule in section 76(3) not having been met, it could be said that the transaction did not come within the literal ambit of section 76. But section 76(1)(a) also catches financial assistance given "in connection with" the acquisition of the shares, and it may be thought that the transaction may be caught this way, even if it does escape the "purpose" net. This was not to be so as the court ruled that the phrase "in connection with" is no wider than "for the purpose of".[73] The learned judge's reasons for so deciding will be discussed later in the article.

Whilst it may well have been that VGO entered into the swap for the purpose of acquiring Spring Wave, it may be thought that there was nevertheless at least a concurrent purpose to its agreeing to the swap on those particular terms. It could have been that Kingsea would not have been agreeable to completing the transaction with a lesser stake, so that VGO's agreement served both to enable Kingsea to acquire that stake, and to conclude the acquisition of Spring Wave. It is almost impossible to point to one to the exclusion of the other as the purpose or substance of the transaction. It would seem that even if a company genuinely enters into a transaction in its own commercial interest and not *merely* to assist the intending purchaser in the acquisition of its shares, it may still technically contravene the prohibition. There is no "larger purpose" exception to the Singapore prohibition, as this article will demonstrate later.

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72 This applies to public companies.

73 See *Wu Yang (H.C.)*, *supra* note 5 at paras. 63, 64, 66-67.

It seems, to the writer at least, that the facts of the case did fall within the literal ambit of section 76,[74] but not, the writer agrees, possibly within the spirit and intent of the section. The argument that section 76 could not have been intended to stand in the way of legitimate commercial transactions is one which few would argue against, and both the High Court and the Court of Appeal considered this transaction to be a genuine commercial one.

The difficulty with construing the financial assistance prohibition in section 76 in light of its spirit and intent is that it is not at all clear, particularly after the numerous amendments to its rules over the years as to what the precise intention of the prohibition is. Whilst it must be indubitably correct that most, if not all of the amendments were intended to ensure that the prohibition does not constitute an impediment to trade and commerce,[75] this does not, the writer submits, tell us the targeted mischief of the section and its scope of intended application.

This can be seen in the "*bona fide* commercial transaction" judicial whitewash which the Court of Appeal in *Intraco*[76] applied, and which the High Court in *Wu Yang* appeared to have endorsed, but which the Court of Appeal in the subsequent review of *Wu Yang* resoundingly rejected. The Court of Appeal in *Intraco* had suggested that section 76[77] would not be breached if the transaction (also coincidentally a swap in that case, but an equity-debt swap) was in the commercial interests of the assisting (or target) company. The High Court in *Wu Yang* agreed, pointing to the need to take a practical commercial approach towards the application of section 76(1)(a) of the *Singapore Companies Act*.[78] A central thread, according to the learned judge, is that section 76 is not intended to shipwreck what are clear and *bona fide* commercial transactions by the company itself.[79]

The Court of Appeal in *Wu Yang* was, however, far less enthusiastic about its own earlier decision in *Intraco*, and dismissed as incorrect the impression that the High Court had decided the case on the basis of a general *bona fide* commercial interest exception. It held that the High Court's decision was premised on its finding that VGO's sole purpose in acquiring Spring Wave was to extend VGO's own business (and not to finance the acquisition of VGO's shares), and that it was in this context that the Judge had observed that section 76 was not intended to interfere with commercial decisions made in a *bona fide* fashion.[80]

It is likely that that was the actual premise of the High Court's decision, but there was perhaps more than a suggestion in the judgment that the judge did not consider inappropriate the earlier Court of Appeal's application of *bona fide* commercial interest as a way of limiting the prohibition.[81] The Court of Appeal in *Wu Yang*, on the other hand, thought that the proposition that a transaction could be saved from

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74 This is assuming, as the High Court did, that the real value of the Spring Wave shares was in fact lower than that of the VGO shares issued for them. This was however denied by the Court of Appeal.

75 *Wu Yang (H.C.)*, *supra* note 5 at para. 28.

76 *Supra* note 3.

77 Of the then *1990 Companies Act*.

78 *Wu Yang (H.C.)*, *supra* note 5 at para. 45.

79 *Ibid.* at para. 50.

80 *Ibid.* at para. 44. Whilst that could have been the actual premise of the High Court's decision, there was perhaps suggestion in the judgment that the judge considered a wider application of the *bona fide* criteria.

81 There is an interesting suggestion in Wan, *supra* note 48 at 90, that in drawing a distinction between a transaction which is entered into *bona fide* in the commercial interests of the company, and a transaction

section 76 by reason only that the transaction was in the commercial interest of the company too wide and inconsistent with the language of the section.

The High Court wrapped up its findings on the issue of financial assistance with a consideration of sections 76(3) and (4), and a reading of section 76(4) that was clearly intended to further restrict the scope of the financial assistance prohibition in section 76.

Section 76(1)(a) defines prohibited financial assistance as that given for the purpose of, or in connection with, the acquisition of shares in the company. According to Andrew Phang J., the phrase "in connection with" should be read restrictively, so that it is consistent with the meaning of the phrase "for the purpose of". The learned judge pointed out candidly that this would render the phrase otiose,[82] and that there are weighty arguments that mandate a broad interpretation of section 76(1)(a) of the Act that treats the phrases "in connection with" and "for the purpose of" as distinct alternatives, but thought nevertheless that such a broad interpretation should not be followed.[83] Andrew Phang J.'s justification for reading the phrase this way is that it best achieves the legislative intention behind section 76(1)(a).[84]

It is very respectfully submitted that this reads more into the intention of the Legislature than it has been willing to confirm. In England, the phrase "in connection with" was deleted from the financial assistance section as a legislative amendment to reduce its scope when the purpose exceptions were introduced in section 42 of the *Companies Act 1981*. Singapore, on the other hand, has chosen to retain it. Whilst the learned judge's reading would no doubt please, as it would add certainty to the scope of an unwieldy prohibition, it would seem that in Singapore as well, a legislative change is required for the phrase "in connection with" to be properly excised from section 76(1)(a) and to cut down the scope of the prohibition.

C. *Wu Yang at the Court of Appeal*[85]

The Court of Appeal affirmed the decision of the High Court, but ultimately decided that there was no financial assistance on a different ground. It found that the consideration for the acquisition of the business of Spring Wave was not based solely on its NAV, and that even if it was, there was in fact no discrepancy between the NAV of Spring Wave and the value of the issued VGO Shares.[86]

The court could have, but was not content to rest its decision on these facts alone. It seized the opportunity to use its judgment as a corrective to the confusion said to have been caused by the earlier Court of Appeal decision in *Intraco*.[87]

Intraco, as the article noted earlier, has been frequently cited as authority for the principle that so long as the impugned transaction is in the commercial interests of the company whose shares were being purchased, section 76 of the *Singapore*

whose sole or primary purpose amounts to financial assistance, the High Court had viewed the prohibition as a rule supplementing directors' fiduciary duties.

82 *Wu Yang (H.C.)*, *supra* note 5 at paras. 64 to 65.

83 *Ibid.* at para. 63.

84 *Ibid.* at para. 66.

85 *Wu Yang (C.A.)*, *supra* note 18.

86 *Ibid.* at para. 33.

87 *Supra* note 3.

Companies Act is not breached. Both High Courts in *Wu Yang* and *Lew Syn Pau* had cited it for that proposition and in apparent agreement.

Chan Sek Keong C.J., who delivered the decision of the Court of Appeal, said that the earlier (differently constituted) Court of Appeal was mistaken, to the extent that it thought that the *bona fides* and commercial intent of the company could always absolve a transaction from violating the financial assistance rule. The element of commercial interest, Chan C.J. clarified, is only relevant in the context of examining the purpose for which the target company enters into a transaction.[88] Chan C.J. thought that the court in *Intraco* had confused the two elements, "reason" and "purpose" and had consequently come to the wrong conclusion on the scope of section 76(1).[89]

The distinction between the purpose for which the assistance is given and the reason why that purpose is formed, is of course the well-known distinction taken by the House of Lords in the case of *Brady v. Brady*,[90] which Chan C.J. adopted as authoritative. *Brady* makes it clear that an unlawful purpose is not removed by the fact that the directors were motivated by the best interests of the company. Their motivation was only a reason for their acts, not a purpose in itself. Lord Oliver, in a speech concurred in by the other Law Lords, pointed out that "purpose" had to be distinguished from "reason" or "motive" which would almost always be different and wider.

The Court of Appeal's approach clearly differed significantly from that of the High Court, and is likely to be seen as a step back from the perspective of those who would prefer the prohibition on financial assistance to be construed restrictively. By giving the purpose requirements a strict interpretation, as the House of Lords in *Brady* has done, it has effectively ruled against the broader exemption that the High Courts appear to have favoured to limit the application of the prohibition.[91]

The *Brady* distinction between "reason" and "purpose" was however made in the context of the U.K.'s "larger purpose" exception of which there is no equivalent in section 76 of the *Singapore Companies Act*. Under section 678(2) of the *U.K. Companies Act 2006*, the prohibition on a company from giving financial assistance before or at the time of the acquisition nevertheless does not apply if:

(a) The company's principal purpose in giving the assistance is not to give it for the purpose of any such acquisition; or
(b) If the giving of the assistance for that purpose is only an incidental part of some larger purpose of the company;

and the assistance is given in good faith in the interests of the company.

The purpose exception at the time of *Brady*, section 153(2) of the *U.K. Companies Act 1985*, is similar in the material aspects. The exception, typically referred to as the "principal purpose" or "larger purpose" exception excludes from the prohibition transactions the main, or at least larger, purpose of which was other than financially assisting the acquisition of its shares (or that of its holding company), if the assistance is given in good faith in the interests of the company. The purpose exception

88 *Wu Yang (C.A.)*, *supra* note 18 at para. 58.
89 *Ibid.* at para. 52.
90 [1989] A.C. 755 (H.L.) [*Brady*].
91 It is submitted that both these subsections are consistent with the central concept of commercial realities.

makes it clear that the company must have the object or intention of assisting in the acquisition, and not merely that the financial assistance happens to be in connection with the acquisition or results in the acquisition. Consequently, when the purpose exception was introduced in section 42 of the *Companies Act 1981*,[92] the scope of the prohibition was correspondingly cut down by the removal of the "in connection with" extension that was in section 54 of the *Companies Act 1948*. The aim of the purpose exception was said to be to limit the possible effect of the *obiter dicta* of Buckley L.J. in *Belmont*.[93]

It may be helpful to consider the facts in *Brady* to better understand the context in which the *Brady* distinction was made. However, it is not the intention of this article to review the House of Lords' decision.[94]

In *Brady*, a corporate restructuring was put in place to resolve a dispute in a family business called T Brady & Sons Limited. This involved the creation of two holding companies, each owned by one of the brothers which held between them the business of T Brady & Sons. As part of the restructuring, a debt was incurred by one of the holding companies for the purpose of the acquisition of shares in T Brady & Sons which was satisfied by T Brady & Sons transferring assets to the other holding company.

It was conceded that the company did give financial assistance within the meaning of section 152 of the *Companies Act 1985* by incurring the debt to assist in the acquisition of its shares, but the contention was that the financial assistance fell within the ambit of the larger purpose exception in section 153(2). It was argued that the financial assistance was but an incidental part of a larger purpose, which was the corporate restructuring of the company, T Brady & Sons. The House of Lords held that the financial and commercial advantages flowing from the corporate restructuring (without which it was acknowledged that the company could not have continued because of the hostility between the brothers) were the reasons and not the larger purposes to which the provision of financial assistance is incidental.[95]

The effect of the House of Lords' decision was to give what some have said to be an unduly restrictive interpretation to the "larger purpose" exception. Its critics have also said that it is difficult in reality to distinguish between purpose and reason in commercial activities. The Department of Trade and Industry (DTI) subsequently floated the idea of substituting "predominant reason" for "principal purpose"[96] in an attempt to lessen the effect of *Brady*. This proposal was supported by the Company Law Reform Steering Group.[97] The *Companies Act 2006* has nevertheless retained the "principal purpose" wording.

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92 This was in a form fairly similar to that of s. 678(2) of the *U.K. Companies Act 2006*.

93 *Supra* note 63.

94 There have been many helpful considerations of the decision: see *e.g.*, John Birds, "Financial Assistance and Ultra Vires" (1988) 9(6) Comp. Law. 136.

95 It has been said that it is difficult in reality to distinguish between purpose and reason in commercial activities.

96 A consultative document issued by the DTI, *Proposals for Reform of Sections 151-158 Companies Act 1985* (October 1993). The Company Law Review Steering Group supported the first of these suggestions: Company Law Review Steering Group, *Completing the Structure*, (2000, URN 00/1335), at para. 7.14 [*Completing the Structure*].

97 *Completing the Structure*, *ibid*.

The "purpose rule" in section 76(3) of the *Singapore Companies Act* is quite different from the English purpose exception, and even less amenable to supporting the argument of the counsel in *Brady.* Section 76(3) provides as follows:

> For the purpose of this section, a company shall be taken to have given financial assistance for the purpose of an acquisition or proposed acquisition referred to in subsection (1)(a) (referred to in this subsection as the relevant purpose) if-
>
> (a) The company gave the financial assistance for purposes that included the relevant purpose; and
> (b) The relevant purpose was a substantial purpose of the giving of the financial assistance.

Lord Oliver in *Brady* had, with commendable restraint, described the purpose exception in the *U.K. Companies Act* as "not altogether easy to construe".[98] Section 76(3) is considerably even more difficult to construe. Unlike the U.K. section 678(2), section 76(3) is not constructed as an exception to the financial assistance prohibition. It does of course tell us by implication what is not financial assistance for the purpose of an acquisition within section 76(1)(a), but falling outside the ambit of section 76(3) does not have the same effect as coming within the ambit of the U.K. principal purpose exception. A transaction that falls outside of section 76(3) may yet fall within the ambit of section 76(4).[99]

Section 76(4) provides that for the purposes of section 76, a company shall be taken to have given financial assistance in connection with an acquisition or proposed acquisition referred to in subsection (1)(a) if, when the financial assistance was given to a person, the company was aware that the financial assistance would financially assist-

(a) The acquisition by a person of shares or units of shares in the company; or
(b) Where shares in the company had already been acquired—the payment by a person of any unpaid amount of the subscription payable for the shares, or the payment of any calls on the shares.

Sections 76(3) and (4) in the *Singapore Companies Act* do not apply the same way as section 678(2) of the *U.K. Companies Act*. In relation to "purpose" in section 76(3), it is sufficient if the acquisition of the shares was a substantial purpose of the assistance, it does not have to be the principal purpose. The fact that there was another purpose to the transaction which was the principal one would take the transaction out of the U.K. but not the Singapore prohibition. There is no larger purpose exception in section 76(3).

Even if acquisition of the shares was not a substantial purpose of the assistance, it could still be prohibited financial assistance within the Singapore section if the company is aware that it would result in the acquisition of its shares (section 76(4)). On the other hand, the U.K. larger purpose exception would release from the prohibition, assistance which only incidentally helps in the acquisition of the company's shares, if such assistance is given in good faith in the interest of the company.

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98 *Brady*, *supra* note 90 at 778.

99 Unless the High Court's construction of "in connection with" in section 76(4) as being of the same scope as "for the purpose of" in section 76(3) is applied.

It may be thought that *a fortiori*, the fact alone that the target company had good commercial reasons for providing the financial assistance would not take the transaction out of the Singapore prohibition, but it is unclear if this was, in fact, the basis upon which the Court of Appeal applied the House of Lords' distinction between "reason" and "purpose" made in the context of the U.K.'s larger purpose exception, which Singapore does not have.

V. Looking Ahead

A. *To a more Enduring Reform*

The High Court in *Wu Yang* and *Lew Syn Pau* has sent out strong signals of judicial willingness to lead the response to policy concerns about the unwieldy breadth of the financial assistance prohibition through creative restrictive construction of the prohibition. But this creates a strain on the statutory wording. The Court of Appeal in *Wu Yang* has, on the other hand, reaffirmed the importance of adherence to the statutory wording. In light of the differences in judicial approaches, caution will probably dictate that until the judicially construed restrictions are placed more clearly into the statute book, companies and their lawyers should still look to the whitewash process or solvency, or other enacted exceptions on which to base their conclusion that their intended transaction will not contravene section 76.

It is probably not a matter of dispute that reform of the Singapore financial assistance prohibition is needed, as there is much scope for differences over the application of the prohibition and its exceptions. Indeed, this is what the government is seeking to do.[100] The more difficult question is the direction that such reform should take.

The writer's view is that the treatment of Singapore's financial assistance prohibition should largely depend on its relevance as a regulatory tool in Singapore today. If it is thought to serve no useful purpose, either because the abuse at which it is targeted is not a real concern in Singapore, or because there are better mechanisms in place to address such abuse, then perhaps the prohibition ought to be removed. There is increasingly opinion that the risks posed by outlawed financial assistance are better met by other more targeted legal provisions, including the remedies for wrongful trading,[101] directors' fiduciary duties and improved derivative action remedies, rules on conflicted transactions by directors and their associates, and minority shareholder oppression remedies.

If on the other hand, it is thought that the prohibition should be retained because it still has a role to play, it is hoped that this time, the change will be to formulate more precisely the definition of the conduct which the section seeks to prohibit,[102] and not merely to add to its numerous exceptions. There is a need to reconsider the reason for the ban on financial assistance in a contemporary setting. Supplementing the already extensive lists of exempted transactions and ways for authorising the provision of financial assistance may further liberalise the prohibition but will not simplify the law as much as is useful. The exceptions may be intended to, and have the effect

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[100] A public consultation is likely in early 2010 on the reform of s. 76.

[101] Singapore does not have the U.K. wrongful trading concept, but see *Singapore Companies Act* ss. 339-340.

[102] This is in order to draw a clearer line between objectionable financial assistance and permitted ones.

of, ameliorating the rigours of the prohibition so that it does not stand in the way of legitimate commercial transactions,[103] but they do not clarify the mischief that the prohibition is intended to address.

The current prohibition in section 76(1)(a) is so complex that its purpose is obscured. There is an absence of any clear understanding of the rationale of the prohibition and divergent approaches to its implementation and enforcement. There must be caution in assuming capital maintenance to be the underpinning policy, as the main essentials of the doctrine are not clearly visible in the prohibition. This is particularly so after the *2005 Amendments* which introduced the solvency exceptions. The linking of two sets of rules (capital maintenance and the solvency method) with divergent objectives has resulted in the present prohibition no longer having any clarity about what objectives it is in fact pursuing. This makes it additionally difficult to define the parameters of the rules. For the prohibition to be a meaningful restriction, it would be desirable to replace the current and rather complex, multi-faceted approach to the prohibition with one that provides a clearer policy direction.

It may be thought that the equivalence of the post World War I transactions in the U.K. (that gave rise to the financial assistance prohibition) today are the "leveraged buy-outs"[104] where a purchaser uses the target's assets to assist in financing such a transaction. If the purchaser was not creditworthy, a loan from the target (or provision of a guarantee to finance his debt) may result in the target replacing its assets with a riskier one. Whilst leveraged buy-outs do have the capacity to harm the interests of creditors, most leveraged buy-outs are not motivated by asset stripping, nor are they necessarily associated with the return of capital to shareholders.[105]

The ban on financial assistance which affects all acquisitions of shares, regardless of whether a change in control is involved, in any event catches more than a leveraged buy-out transaction. Since risks to creditors are not peculiar to companies undergoing leveraged buy-outs, nor do they arise only in the context of an acquisition of shares, it is not obvious why the wide and far-reaching prohibition should be imposed only in the context of an acquisition of shares, if it is thought necessary to protect creditors this way.

If such transactions are thought to raise particular risks, it may be that there should be legislation to control it, permitting it to take place subject to solvency requirements (in the manner of the *New Zealand Companies Act* or *Companies (Guernsey) Law 2008*) or provided there is no material prejudice to the company, shareholders and creditors (in the manner of the *Australian Corporations Act*). The New Zealand and Guernsey formulation provide a more empirical test than the Australian one.

The recent judicial responses to the financial assistance prohibition have highlighted a number of areas that merit attention if the current consideration of legislative change to the prohibition is to amend rather than repeal it. This includes the relevance of detriment to the company as a component of the rule, and the extent to which a legitimate commercial reason for the transaction is to be relevant to its exclusion

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103 *Wu Yang (H.C.)*, *supra* note 5 at para. 28, Andrew Phang J. (as he then was) ("To this end, there have been numerous amendments to s. 76 precisely in order to ensure that this particular provision does not constitute an impediment to trade and commerce").

104 See John Armour, "Share Capital and Creditor Protection: Efficient Rules for a Modern Company Law" (2000) 63 Mod. L. Rev. 355 at 369.

105 *Ibid.*

from the rule. In connection with the latter, it may be helpful to consider substituting the larger and principal purpose exceptions in the *U.K. Companies Act* for the "purpose rule" in section 76(3), which this article has sought to demonstrate, is quite different, and does not restrict the prohibition in the same way. Consideration should also be given to substituting "predominant reason" for "principal purpose" if it is thought that the House of Lord's construction of the U.K. exception in *Brady* was too restrictive. Removing the "in connection with" extension to the prohibition, as the High Court in *Wu Yang* had sought to do, would clearly be a sensible way of restricting the section's reach and bringing increased certainty to the scope of the prohibition.

It is hoped that the next reform of the rule will be a more enduring one which will point it more clearly in a particular direction of policy, and which will trim (or even repeal) rather than add to its length and complexity.