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TAKING STOCK OF THE INSOLVENCY TESTS IN SECTION 254 OF THE *COMPANIES ACT*

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The recent Court of Appeal decision in *BNP Paribas v. Jurong Shipyard Pte Ltd* is a landmark decision on the insolvency tests in s. 254 of the *Companies Act*. Although the court did not expressly decline to follow English law, various propositions in the judgment mark the beginning of a distinct Singaporean jurisprudence on the meaning of the insolvency tests. This article explains the old law, which is poorly understood due to a lack of discussion, and examines the extent to which that has been altered by *BNP*.

I. INTRODUCTION

Inability to pay debts, as provided in s. 254(1)(e) of the *Companies Act*,[1] is one of the grounds to wind up a company. For convenience, this term will be used interchangeably with 'insolvency' in this article. It is further provided in s. 254(2) that a company shall be deemed insolvent if any one of the tests set out in that sub-section is satisfied.

It is unlikely that many businessmen will know of the existence of the two statutory provisions. However, it cannot be doubted that it is general knowledge in the commercial world that a creditor may apply to court to wind up an insolvent company. Even so, winding up is very much a last resort in a businessman's armoury of debt collection methods. In the relatively rare case where an application is actually made, the outcome is usually not in doubt. The debtor company will either not contest the application or, where it does, it is usually so hopelessly insolvent that the court will have no difficulty finding that one of the insolvency tests is satisfied. These and other reasons account for the few reported cases on the meaning of 'insolvency', and even fewer appeals.

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

Against the aforesaid background, any decision of the Court of Appeal on the meaning of 'insolvency' deserves careful study. The significance of *BNP Paribas v. Jurong Shipyard Pte Ltd*,[2] however, extends far beyond that. Hitherto, Singaporean courts have followed English cases. This is not surprising as until the amendments in 1986, the relevant English provisions[3] were for all purposes identical to Singaporean provisions. It is true that the Court of Appeal did not expressly decline to follow English law. However, various propositions in the judgment are at variance with English law. It is no exaggeration to state that *BNP* marks the beginning of a distinct Singaporean jurisprudence on the meaning of 'insolvency' under s. 254(2) and the exercise of the winding up jurisdiction. The extent of the divergence from English law is unclear at the moment. Some of the most interesting propositions laid down in *BNP* are *obiter dicta*. They are highly persuasive, but strictly speaking not binding on the lower courts. As there is room for argument on how the *dicta* will develop in future cases, there will probably be a period of uncertainty as the courts work out the details of the new law.

The purpose of this article is to explain the old law on the insolvency tests in s. 254(2) and examine the impact of *BNP*. It does not deal with other interesting issues arising from the case, for example, the proposition that the court is entitled to take into account the interests of the public at large in deciding whether to make a winding up order. In fact, it does not even offer a critique of the relative merits of the new Singaporean jurisprudence on the insolvency tests in s. 254(2). Discussion of those issues will have to await another day. The focus of this paper is strictly as aforesaid. There has not been much discussion of the meaning of 'insolvency' as a ground of winding up in Singapore and England, especially at a more general level, examining the similarities and differences among the various insolvency tests.[4] The lack of discussion on that is not helpful to a proper understanding of the old law, without which we cannot appreciate the significance of *BNP* and anticipate future developments. This paper seeks to help fill that gap.

Nomenclature-wise, references to 'the company' in this article mean the debtor company against which a winding up application is to be made or has already been made. The creditor, whether an individual or a company, means the entity which asserts that the company owes it a debt for which it intends to take out a winding up application or has already done so. Historically, the manner of invoking the court's winding up jurisdiction is by way of a winding up *petition*. That was changed to a winding up *application* in 2005.[5] Both terms are used in this paper; nothing turns on

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2 [2009] 2 S.L.R.(R.) 949 (C.A.) [*BNP*].

3 *Insolvency Act 1986* (U.K.), 1986, c. 45, ss. 122(1)(f), 123(1)(a), 123(1)(b), 123(1)(e), 123(2).

4 The following is a selection of literature that discussed specific aspects of the insolvency tests and/or the winding up jurisdiction: Lee Beng Tat, "Claiming a Pound of Flesh as a Contingent or Prospective Creditor under the Companies Act" [1993] Sing. J.L.S. 144; Fidelis Oditah, "Winding up recalcitrant debtors" [1995] L.M.C.L.Q. 107; Lee Eng Beng, "Excessive Statutory Demands in Winding up and Bankruptcy" [1997] Sing. J.L.S. 532; Lee Eng Beng, "Winding up Petitions Founded on a Bona Fide Disputed Debt" (1998) 10 Sing. Ac. L.J. 180; Andrew Keay, "Disputing Debts Relied on by Petitioning Creditors Seeking Winding-up Orders" (2001) 22 The Company Lawyer 40; Suet Lin Joyce Lee, "The Court's Jurisdiction to Restrain a Creditor from Presenting a Winding Up Petition where a Cross-Claim Exists" (2010) 69 Cambridge L.J. 113.

5 By virtue of the *Statutes (Miscellaneous Amendments) (No. 2) Act 2005* (No. 42 of 2005, Sing.), s. 5.

the precise wording used. Finally, all references to statutory provisions in this paper are to the *Companies Act* unless otherwise indicated.[6]

II. The Insolvency Tests in Section 254(2)

Section 254(1)(e) gives a court the jurisdiction to wind up a company if the company "is unable to pay its debts". Section 254(2) states that a company "shall be deemed to be unable to pay its debts" if one of the following paragraphs of the subsection is satisfied:

- Under paragraph (a), the company has "neglected" to pay the debt stated in a statutory demand served on the company, or to "secure or compound for it to the reasonable satisfaction of the creditor". For convenience, this test will be referred to as the 'test of neglect to meet a statutory demand'.
- Under paragraph (b), execution or other process issued on a judgment or order of any court in favour of a creditor is returned unsatisfied in whole or in part. This will be referred to as the 'test of unsatisfied execution'.
- Under paragraph (c), "it is proved to the satisfaction of the Court that the company is unable to pay its debts", and in determining this "the Court shall take into account the contingent and prospective liabilities of the company."

In *Re Great Eastern Hotel (Pte) Ltd*,[7] Grimberg J.C. held that s. 254(2)(c) consisted of two different tests, *viz*., the cash flow (or commercial) insolvency test and the balance sheet insolvency test.[8] It will be argued later that the cash flow insolvency test in this paragraph and the tests in paragraphs (a) and (b) are all different species of a genus. To avoid confusion, the cash flow insolvency test in paragraph (c) will be referred to as the 'general' cash flow test to distinguish it from the other cash flow tests.

The above proposition of Grimberg J.C. is a significant one. Earlier authorities had restricted their pronouncements to cash flow insolvency. For example, both the Privy Council in *Malayan Plant (Pte) Ltd v. Moscow Narodny Bank Ltd*[9] and the Court of Appeal in *Re Sunshine Securities (Pte) Ltd*[10] held that the insolvency raised by the presumption in s. 254(2)(a) was cash flow insolvency. Both cited with approval a passage in *Buckley on the Companies Acts* stating that the "particular indications of insolvency mentioned in [paragraphs] (a), (b) and (c) are all instances of commercial insolvency, that is of the company being unable to meet current demands upon it."[11] There was no discussion of s. 254(2)(c) or balance sheet insolvency. It seems that *Great Eastern Hotel* is the first Singaporean case which stated unequivocally that s. 254(2)(c) consisted of cash flow and balance sheet insolvencies. This proposition

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6 *Supra* note 1.

7 [1988] 2 S.L.R.(R.) 276 (H.C.) [*Great Eastern Hotel*].

8 *Ibid.* at paras. 73, 74.

9 [1979-1980] S.L.R.(R.) 511 at para. 12 (P.C.) [*Malayan Plant*].

10 [1977-1978] S.L.R.(R.) 148 at para. 19 (C.A.) [*Sunshine Securities*].

11 J.B. Lindon, G. Brian Parker & Hugh R. Williams, eds., *Buckley on the Companies Acts*, 13th ed. (London: Butterworths, 1957) at 460. The provisions referred to are the *Companies Act 1948* (U.K.), 11 & 12 Geo. VI, c. 38, ss. 223(a)-(c). Sub-sections (a) and (b) correspond to ss. 254(2)(a), (b) of our *Companies Act*, *supra* note 1. Sub-section (c), which applied in Scotland, has no Singaporean counterpart.

was affirmed by Chao J.C. (as he then was) in *Re Sanpete Builders (S) Pte Ltd*,[12] albeit without reference to *Great Eastern Hotel*.

The proposition, though well-established, is not without difficulty. While s. 254(2)(c) can fairly be seen as imposing the balance sheet insolvency test, it is difficult to see how it can be said that it also contains a cash flow insolvency test.[13] The former requires the court to take into account the *contingent* and *prospective* liabilities[14] of the company but these are excluded from the latter.[15] Indeed, the cash flow test excludes even due debts[16] of which repayments are not demanded, let alone liabilities.[17]

Our courts have not dealt with the problem of interpretation identified above. In both *Great Eastern Hotel* and *Sanpete Builders*, the judges relied on learned English and Australian texts for their proposition that s. 254(2)(c) consisted of both cash flow and balance sheet insolvencies.[18] Unfortunately, English and Australian law then may not be as clear as that presented by the writers. In *Re Cheyne Finance plc (No 2),*[19] the court stated that English courts, when addressing the old English equivalents to s. 254(2)(c), did not draw any rigid distinction between cash flow insolvency on the one hand and balance sheet insolvency on the other,[20] and that the two tests were only split for the first time in the *Insolvency Act 1985*[21].[22]

It has been suggested that the 'general' cash flow test is to be found in s. 254(1)(e), rather than s. 254(2)(c).[23] This derived some support from *Re Dayang Construction and Engineering Pte Ltd*.[24] Unfortunately, this argument is not without difficulties. Before *BNP*, it would have been arguable that the wording of ss. 254(1)(e) and

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12 [1989] 1 S.L.R.(R.) 5 at para. 49 (H.C.) [*Sanpete Builders*].

13 In *Sealy & Milman: Annotated Guide to the Insolvency Legislation 2010*, 13th ed. (London: Sweet & Maxwell, 2010) vol. 1 at 121, earlier identical English provisions were criticised for being unhelpful for the same reason as that expressed in the main text above.

14 For a detailed discussion of what constitutes a contingent or prospective liability, see Lee Beng Tat, *supra* note 4; Roy Goode, *Principles of Corporate Insolvency Law*, 4th ed. (London: Sweet & Maxwell, 2011) at paras. 4-26, 4-27. In *Re People's Parkway Development Pte Ltd* [1991] 2 S.L.R.(R.) 567 at paras. 10, 11 (H.C.), Thean J. (as he then was) held that a contingent or prospective creditor is a person towards whom, under an existing obligation, the company may or will become subject to a liability to pay a sum of money on the happening of some future event or at some future date.

15 *Re European Life Assurance Society* (1869) 9 L.R. Eq. 122 (cash flow insolvency).

16 See Goode, *supra* note 14 at para. 4-17:

> A debt is a liquidated claim, that is, a claim for an amount which is ascertained or can be readily and without difficulty ascertained, as by mere calculation or the taking of an account. It is to be distinguished from an unliquidated claim, *e.g.* for damages for breach of contract or tort, which involves questions of liability and assessment.

17 *Re Capital Annuities Ltd* [1979] 1 W.L.R. 170 (Ch.).

18 Lindon, Parker & Williams, *supra* note 11 at 460 and J. O'Donovan, *McPherson: The Law of Company Liquidation*, 3rd ed. (New South Wales: The Law Book Company, 1987) at 54 respectively.

19 [2007] EWHC 2402 (Ch).

20 *Ibid*. at para. 34.

21 (U.K.), 1985, c. 65.

22 *Supra* note 19.

23 Lee Eng Beng, "Insolvency Law", (2001) 2 Sing. Ac. L. Ann. Rev. 239 at 241.

24 [2002] 2 S.L.R.(R.) 197 at para. 36 (H.C.) [*Dayang*]. Belinda Ang J.C. (as she then was) held that as the debt was an undisputed judgment debt, the court was entitled to infer that the company was unable to pay its debts within the meaning of s. 254(1)(e) (at para. 36). The learned Judicial Commissioner did not cite *Great Eastern Hotel*, *supra* note 7 or enter into a discussion on the relationship between ss. 254(1)(e) and 254(2)(c).

254(2)(c) suggests that insolvency under the former is actual insolvency, whereas that under the latter is based on presumptions (deemed insolvency). The meaning of actual and deemed insolvency and the implications of drawing that distinction are complex questions which are not necessary to get into in this article.[25] The point to note is that it was established law before *BNP* that the 'general' cash flow test is not a measure of the company's overall insolvency. Indeed, it will be seen that this test is in substance no different from the other cash flow tests in ss. 254(2)(a) and (b).[26] Whatever may be the meaning of actual insolvency under s. 254(1)(e), it is submitted that the limited criteria used by the 'general' cash flow test to determine insolvency means that it is unlikely to qualify as a test of actual insolvency under s. 254(1)(e). As for the position after *BNP*, the argument does not fare better. Section 254(2)(c) is said to be concerned with actual insolvency.[27] If so, it would seem odd for balance sheet insolvency to be found in that provision and for the 'general' cash flow insolvency to be found in s. 254(1)(e) where both are concerned with actual insolvency.

It is submitted that the best way forward is to amend the law to provide separately for cash flow insolvency and balance sheet insolvency. The English did that in 1986.[28] We should consider doing something similar. This will not change the law, but remove the difficulty of having to hold, as our courts currently do, that s. 254(2)(c) consists of both the cash flow and balance sheet insolvencies when the wording therein does not really support such an interpretation.

III. The 'General' Cash Flow Insolvency Test

This section analyses the 'general' cash flow insolvency test as accepted and applied by our courts before *BNP*,[29] and considers the impact of that case on the old law. It starts by examining the crucial features of the 'general' cash flow test. It will be shown that before *BNP*, the courts had accepted that the test was satisfied when the company had failed to pay an *undisputed* debt of which repayment had been demanded. Despite the shorthand description of the test as a 'general' insolvency test, there was, in truth, no necessity to establish that the company was in *general* default. Next, *Cornhill Insurance plc v. Improvement Services Ltd*,[30] where the court allowed a winding up petition to be presented against an apparently solvent company, will be analysed in great detail. The case has been cited and approved in Singapore, but in view of *BNP*, it will be seen that much of that is no longer good law.

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25 In *BNP*, *supra* note 2 at paras. 5, 7, the Court drew a distinction between actual and deemed insolvency, but that was in relation to ss. 254(2)(c) and 254(2)(a). This is an important point which will be examined in some detail later.

26 See *Companies Act*, *supra* note 1, s. 3(a)(iv) (not a general measure of cash flow solvency).

27 *BNP*, *supra* note 2 at paras. 5, 7.

28 *Insolvency Act 1986*, *supra* note 3, s. 123(1)(e) ("if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due") and s. 123(2):

> A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

29 *Supra* note 2.

30 [1986] 1 W.L.R. 114 (Ch.) [*Cornhill Insurance*].

A. *Definition of the Test*

In *Great Eastern Hotel*,[31] Grimberg J.C. held that the 'general' cash flow insolvency test was satisfied when a demand was made of a debt already due, and the company was unable to pay the debt out of its available liquid resources.[32] This definition of the test will be examined in some detail below. Its application at the *interlocutory* and *hearing* stages of a winding up application will then be explained, and the impact of *BNP* on the old law examined.

It should be stated at the outset that in the following discussion of the 'general' cash flow test, this writer will as far as possible rely on authorities where no s. 254(2)(a) statutory demand had been served. Unfortunately, that is not always possible. This may be because there is no Singaporean or English case on the specific point under consideration. Alternatively, it may be because most well-known cases involved the service of a statutory demand.[33] However, great care has been taken to ensure that where a statutory demand had been served in the case cited, the proposition relied on applied also to the 'general' cash flow test. That may be because the judge expressed the proposition generally,[34] or it may be because even though a statutory demand was served it was found to be defective and thus formed no part of the reasoning.[35]

1. *Repayment of Debt Must Have Been Demanded*

Under the test, only debts of which current repayments are required are to be considered.[36] This means that "even debts which are technically due are to be ignored where there is no current indication that the creditors concerned are requiring repayment."[37] This rule makes good sense in practice.[38] Were it otherwise, banks and most start-ups will be insolvent under the test. Banks do not keep enough liquid assets to be able to pay all their depositors at the same time. Most start-ups are thinly capitalised and they borrow heavily from their shareholders on loans which are repayable on demand or short notice. Even more important is the impact of the rule on companies generally. If overdraft facilities which are repayable on demand and trade debts which are granted indulgence by creditors who are under no contractual obligation to do so have to be taken into account, some companies that are trading as going concerns will become insolvent under the test.

This aspect of the cash flow test, that it takes into account only debts of which current repayments are demanded, leads to the conclusion that it is not a general test of the company's cash flow insolvency. It was for all intents and purposes accepted

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31 *Supra* note 7.
32 *Ibid*. at paras. 71-74.
33 For *e.g*., *Cornhill Insurance*, *supra* note 30.
34 For *e.g*., *Sunshine Securities*, *supra* note 10 at para. 19.
35 For *e.g*., *Cornhill Insurance*, *supra* note 30; *Sanpete Builders*, *supra* note 12 ; *Dayang*, *supra* note 24.
36 *Re Capital Annuities Ltd* [1978] 3 All E.R. 704 at 718 (Ch.); *Great Eastern Hotel*, *supra* note 7 at paras. 72, 85.
37 Goode, *supra* note 14 at para. 4-19.
38 *Ibid*.

in *Great Eastern Hotel* and formed part of its *ratio*. That is something we will look into shortly.

2. *Sufficient Liquid Assets to Meet Demands*

A company is not insolvent under the test if it has sufficient liquid assets to meet demands for repayment of its debts.[39] So long as the company is able to do that, it does not matter that the company does not have sufficient ready cash *in its hands* to do so.[40] The reason is because the company may borrow money or dispose of liquid assets within the required time to pay the debts.[41]

3. *Temporary Lack of Liquidity is no Defence*

The obverse of the aspect described above is that a temporary lack of liquidity is no defence to the 'general' cash flow test. In fact, it is no defence to any of the three cash flow tests; statutory demands were served in some of the cases to be cited below. One can find in cases statements that a temporary lack of liquidity does not mean that the company is cash flow insolvent.[42] With respect, this confuses the 'general' cash flow insolvency test with the balance sheet insolvency test.[43]

Under the balance sheet insolvency test, a temporary lack of liquidity is not an issue as a company may be solvent but illiquid, for example, where the bulk of the company's assets consists of land and buildings. However, lack of liquidity is precisely the issue under the 'general' cash flow test, and it cannot be met with the argument that the company has sufficient assets which, if given enough time, may be realised to pay the debt of which repayment is demanded, or even all its liabilities. It is true that statutory demands were served in some of these cases, but the principle is the same.[44] For example, in *Sunshine Securities*,[45] the Court of Appeal held that a company may be at the same time wealthy and insolvent. It might have wealth locked up in investments not presently realisable, but although this was so, yet if it had not assets available to meet its current liabilities, it was commercially insolvent and might be wound up.

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[39] *Re a Company* [1986] Butterworths Company Law Cases 261 (Ch.); *Great Eastern Hotel*, *supra* note 7 at paras. 71, 72.

[40] *Bank of Australasia v. Hall* (1907) 4 C.L.R. 1514 at 1543 (H.C.A.); *Sandell v. Porter* (1966) 115 C.L.R. 666 (H.C.A.).

[41] *Great Eastern Hotel*, *supra* note 7. If the liquid asset that is to be disposed of to pay the debts is essential to the continuance of the company's business as a going concern, the prospective proceeds cannot be taken into account: *Re Timbatec Pty Ltd* (1974) 4 A.L.R. 12 (N.S.W.S.C.).

[42] See *e.g.*, *Sandell v. Porter*, *supra* note 40 at 670, 671 (Barwick C.J.): "The conclusion of insolvency… ought not to be drawn simply from evidence of a temporary lack of liquidity"; *Tong Tien See Construction Pte Ltd (in liquidation) v. Tong Tien See* [2001] 3 S.L.R.(R.) 887 at para. 55 (H.C.). The latter derived the proposition from *Sanpete Builders*, *supra* note 12. With respect, that was probably an incorrect reading of *Sanpete Builders* as it was quite clear that Chao J.C. in *Sanpete Builders* made that proposition in relation to the balance sheet test, not the cash flow test.

[43] Lee, "Insolvency Law", *supra* note 23.

[44] For *e.g.*, *Malayan Plant*, *supra* note 9 at para. 12; *Sanpete Builders*, *supra* note 12 (statutory demand was served in this case but Chao J.C. also considered the position under the 'general' cash flow test); *Dayang*, *supra* note 24 (statutory demand was served but as it was argued that the demand was defective; Belinda Ang J.C. also considered the position more generally).

[45] *Supra* note 10.

4. *Not a General Measure of Cash Flow Solvency*

A necessary corollary of the rule that the 'general' cash flow insolvency test is concerned with timely payment of an undisputed debt of which repayment has been demanded is that this test is *not* concerned with the *general* health of the company's cash flow. In reality, inability to pay a single debt is usually symptomatic of deeper financial difficulties. However, that is not the same as saying that the 'general' cash flow insolvency test is only satisfied if it can be shown that the company is in general default.

One may find in judgments statements to the effect that the 'general' cash flow test is a *general* measure of a company's ability to pay its current debts.[46] If one is not careful, one may form the same impression after reading the discussions of the cash flow test in leading texts. For example, Goode states that "[t]he essential question [of the 'general' cash flow test] is whether the company's financial position is such that it can continue in business and still pay its way."[47] This statement, if understood correctly within the context in which it appears—a discussion on the element of futurity in the cash flow test under the English statutory provision—is, with respect, entirely correct.[48] However, the writer's concern is that the statement might be taken out of context to mean that the cash flow test is a general measure of a company's cash flow position, which this writer submits is erroneous.

First, the 'general' cash flow test which the law uses for the purpose of determining whether a company is insolvent or not is *not* a measure of the company's liquidity, unlike the liquidity tests accountants or finance professionals use. Those people use various financial ratios to determine the financial strength of a company, for example, its profitability, liquidity, *etc*. Two key tests they use for determining the liquidity of a company are the current ratio and the quick ratio. In *Great Eastern Hotel*[49] it was argued that the two ratios were the correct tests under s. 254(2)(c). The argument was rejected by Grimberg J.C.[50] It is not proposed in this article to enter into a discussion of the differences between the current and quick ratios on the one hand and the 'general' cash flow test on the other. It suffices to point out that, as

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46 For *e.g.*, *Sandell v. Porter*, *supra* note 40 at 670, 671 (Barwick C.J.): "The conclusion of insolvency ought to be clear from a consideration of the debtor's financial position in its *entirety*" (emphasis added); *The Bell Group Ltd (in liquidation) v. Westpac Banking Corporation (No 9)* [2008] WASC 239 at para. 1066: the test "assesses the financial health of a company by reference to its capacity to finance its current operations."

47 Goode, *supra* note 14 at para. 4-16. To similar effect is Andrew R. Keay, *McPherson's Law of Company Liquidation*, 2nd ed. (London: Sweet & Maxwell, 2009) at 102.

48 The reference to the element of futurity is that the court should look into not only debts of which repayment are due and demanded at the date of the hearing of the petition, but also debts which will become due and payable in the near future and which demands for repayment are expected. See *Re Cheyne Finance plc (No. 2)*, *supra* note 19 at paras. 39, 53. If what is meant is that the cash flow test is satisfied if the company is unable to pay *any* of the aforesaid 'future' debts, the statement is, with respect, entirely correct. It seems that is likely to be Goode's view, as he emphasised a few pages down that failure "to pay even a single debt" will satisfy the cash flow test: Goode, *supra* note 14 at para. 4-21. It is not necessary to discuss in this article whether, in view of the different wording between the Singapore and English provisions, the element of futurity applies similarly in Singapore.

49 *Supra* note 7.

50 *Ibid*. at paras. 68, 82-84.

explained above,[51] the 'general' cash flow test, unlike the two ratios, leaves out of consideration due debts of which repayments are *not* currently required.

Second, whilst no doubt evidence that a company is *generally* unable to meet demands to repay its due debts is good evidence that it is cash flow insolvent,[52] that is *not* a requirement under the 'general' cash flow test. Failure to pay a *single* debt suffices. Companies have been wound up on the ground that they had failed to pay *an* undisputed debt.[53] As Professor Fletcher points out:[54]

> It has been consistently held by courts up to the level of the [English] Court of Appeal that failure to pay even a single debt which is due and not disputed is of itself evidence of insolvency on which a winding-up order can be made.

In principle, there is no reason why a company can only be found to be cash flow insolvent if it fails to pay more than one debt, or fails to pay the debts of more than one creditor. Any such rule will be unworkable and unfair in practice. The creditor who takes out the winding up application may not have information on the debts that the company owes to other creditors. It is true that other unpaid creditors of the company may appear at the hearing of the winding up application to lend their support. In reality, however, those creditors usually do not bother to turn up at the hearing.[55]

B. *The Common Feature of All Cash Flow Tests*

It has been asserted earlier that the common feature of the three cash flow tests is that all of them ask the question whether the debtor company has failed to meet a current demand. In view of its importance, it bears repeating what it means here, *viz.*, whether the company has failed to pay an undisputed debt of which repayment has been demanded, it being irrelevant whether the failure to pay is due to deliberate refusal or genuine inability.

The broad features of the 'general' cash flow test have been sketched out above. They can be seen to support the assertion that it possesses the common feature mentioned. It is however necessary to delve deeper to see the application of the test at both the *interlocutory* and *hearing* stages of a winding up application. That will be done in the next sub-section of this article. It will be seen that *BNP* has departed from the old law substantially.

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51 See text to note 36.

52 See *e.g.*, *Re Tweeds Garages Ltd.* [1962] 1 Ch. 406 [*Tweeds Garages*]; *Re Lyric Club* (1892) 36 The Solicitors' Journal 801.

53 For *e.g.*, *Re Globe New Patent Iron & Steel Co.* (1875) 20 L.R. Eq. 337 [*Globe New Patent*] (failure to honour a bill of exchange); *Sunshine Securities*, *supra* note 10; *Dayang*, *supra* note 24 at para. 36 (though statutory demand was served in this case, the demand did not comply with all the formalities and the court held that regardless of whether the statutory demand was valid, it was entitled to infer that the company was unable to pay its debts); *Clowes Developments (Scotland) Ltd v. Whannel* (2002) S.L.T. (Sheriff's Court) 6 [*Clowes Developments*]. In *Taylors Industrial Flooring Ltd. v. M & H Plant Hire (Manchester) Ltd.* [1990] Butterworths Company Law Cases 216 (C.A.) [*Taylors Industrial Flooring*], the court held that the creditor was entitled to petition for a winding up order on the ground that an undisputed contractual debt was not paid.

54 Ian F. Fletcher, *The Law of Insolvency*, 4th ed. (London: Sweet & Maxwell, 2009) at para. 20-026.

55 The collective action problems that affected creditors were discussed by Hoffmann J. in *Re R.A. Foulds Limited* (1986) 2 British Company Cases 99269 at 99274, 99275 [*R.A. Foulds*].

The 'general' cash flow insolvency test may be relevant at either the interlocutory stage or the hearing of the winding up application taken out by a creditor. In the former case, the issue is usually whether the court should restrain the applicant from taking out a winding up application or from taking a further step in the proceedings. In the latter case, the court hears and decides on the merits of the application. It will decide whether to wind up the company or make some other orders. If the applicant succeeds in proving that the debtor is insolvent, the court will have jurisdiction, but is *not* bound, to wind up the company.[56]

C. *Application of the Test in Interlocutory Applications*

1. *Position Before* BNP

Before *BNP*, it was settled law that the question of whether a creditor is to be restrained in an interlocutory application depends on whether the debt which the creditor is relying on in its winding up application is an *undisputed* debt. If the debt is undisputed, it serves two functions. Firstly, it gives the creditor the *locus standi* he needs to make the winding up application. Secondly, it supplies the creditor, when the proceedings have proceeded to the hearing stage of the application, with the *ground* the creditor needs to establish to invoke the court's jurisdiction to wind up the company, *viz*., that the company is unable to pay its debts. The creditor is here relying on the 'general' insolvency test in s. 254(2)(c). As stated several times above, this test is satisfied if the company has failed to meet a current demand. That *will* be the case since the debt is an undisputed one of which repayment has been demanded, and the company has failed to pay the debt. Therefore, if the debt is undisputed the court will hold that the creditor is entitled to make the winding up application.

The above is well settled in England and, before *BNP*, in Singapore as well. Many local and English cases may be cited.[57] It is probably most instructive to examine *Taylors Industrial Flooring*[58] and *Cornhill Insurance*[59]. The former case is meaningful as it is one of the rare cases from the English Court of Appeal and it throws light on the relationship between the 'test of neglect to meet a statutory demand' in s. 254(2)(a) and the 'general' cash flow test in s. 254(2)(c). The latter case is perhaps the most well-known case on the right of a creditor with an undisputed debt to present a winding up application. It was also an issue which received considerable attention in *BNP*, even though the debt in *BNP* was disputed.

Taylors Industrial Flooring[60] is a good illustration of the application of the 'general' cash flow test in an interlocutory proceeding. In that case, the creditor presented a winding up petition against a company *without* serving a statutory demand on the

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[56] The word used in s. 253 ("may") is permissive. This proposition is so well established that it is trite law. If authority is needed, see *Bowes v. Hope Life Insurance and Guarantee Co.* (1865) 11 H.L. Cas. 389 at 402; *Re P. & J. Macrae Ltd* [1961] 1 W.L.R. 229 (C.A.); *BNP*, *supra* note 2 at para. 16.

[57] For *e.g*., *Globe New Patent*, *supra* note 53; *Re a Company* (1950) 94 The Solicitors' Journal 369 (Ch.) [*Re a Company*]; *Tweeds Garages*, *supra* note 52; *Cornhill Insurance*, *supra* note 30; *Sanpete Builders*, *supra* note 12; *Taylors Industrial Flooring, supra* note 53; *Dayang*, *supra* note 24.

[58] *Supra* note 53.

[59] *Supra* note 30.

[60] *Supra* note 53.

company beforehand. The company applied to restrain the advertisement of the petition. It was successful in the English High Court, as Scott J. held, *inter alia*, that the creditor should have served a statutory demand before the presentation of the petition. On appeal, the Court of Appeal set aside the decision of Scott J., holding that service of the statutory demand was unnecessary. It will be seen later that the question pertaining to the statutory demand, as explained by the Court of Appeal, was a red herring. For present purposes, the value of the case is that having resolved that issue, the court went on to consider the question of whether the creditor should be allowed to continue with the petition. The court held that on the facts, the debts were undisputed and, indeed, the company admitted that the debts were owed to the creditor.[61] The failure of the company to pay the debts was evidence of its inability to pay. Accordingly, the court held that the presentation of the winding up petition was amply warranted.

In practice, the main difficulty with the application of the 'general' cash flow test is over the issue of whether the debt which the creditor is relying on to establish its *locus standi* and proof of the company's insolvency is an undisputed debt. This is an issue we will look at briefly later. Another difficulty, more apparent than real, is whether a creditor may apply to wind up a recalcitrant debtor that appears to be solvent. The leading English case on this issue is *Cornhill Insurance*.[62] This case has been approved by our courts, but in view of *BNP*, its status has become uncertain.

The facts of *Cornhill Insurance* are most striking. Cornhill Insurance was a large and prosperous insurance company. It refused to pay an undisputed debt of £1154. When the creditor threatened to petition the court for a winding up order, Cornhill Insurance, instead of paying the debt, applied to court for an injunction to restrain the creditor from presenting the petition. It argued that as it had huge assets and there was absolutely no evidence that it was insolvent, the presentation of a petition would be an abuse of the process of the court. Harman J. granted an injunction *ex parte*, but on the substantive hearing refused to let it continue, and in fact stated that he should *not* have granted the injunction in the first place.[63] He concluded as follows:[64]

> This is a case of a rich company which could pay an undoubted debt and has chosen-I think I must use that word-not to do so… In my view in such circumstances the creditor was entitled to (a) threaten to and (b) in fact if it chose to present a winding up petition…

Cornhill Insurance, due to its remarkable facts, provides excellent support for the proposition that failure to meet a current demand is sufficient to meet the 'general' cash flow test, regardless of whether the company is solvent or not. As it is easy to misunderstand this case, it is necessary to devote a little space to explain what it does and does not stand for.

First, it may be thought that the case was wrongly decided. The argument runs as follows. Cornhill Insurance was able to pay the debt owed to the creditor and, further,

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61 The court also found that on the facts the sums were indeed undisputed.
62 *Supra* note 30.
63 *Ibid*. at 118.
64 *Ibid*.

was thought to be able to pay all its debts and liabilities. Therefore, to say that the court may conclude at the hearing of the petition, if it proceeded that far, that failure of the company to pay the debt is sufficient evidence of its inability to pay seems to be contrary to reality, or even perverse. This argument is misconceived. The concept of insolvency is not limited to balance sheet insolvency. The creditor was not arguing that Cornhill Insurance was balance sheet insolvent. Rather, it was arguing that since the company had persisted in not paying the debt, the 'general' cash flow insolvency test was satisfied and the company may be held to be insolvent.[65] As Vaisey J. stated in *Re a Company*[66] which Harman J. cited, where a company was well-known and wealthy, it was the more likely that delay in settlement of its obligation would create some suspicion of financial embarrassment: "Rich men and rich companies who did not pay their debts had only themselves to blame if it were thought that they could not pay them."[67]

Next, it is essential to remember that *Cornhill Insurance* was concerned with an interlocutory matter, *viz.*, whether the court should restrain the creditor from presenting a winding up petition against Cornhill Insurance. Harman J. answered this in the negative and discharged an injunction he granted earlier, thus clearing the path for the creditor to present the petition. He did not order the winding up of the company. That was simply not the issue before him. Whether Cornhill Insurance should be wound up would only become an issue which the court had to answer if the petition proceeded to the hearing stage. It did not happen,[68] and all the parties to the case knew that it would never happen. Cornhill Insurance had its own remedy in paying the undisputed debt which it should pay. Harman J. did not put Cornhill Insurance at the mercy of the creditor when he discharged the injunction.

Due no doubt to its striking facts, *Cornhill Insurance* has invariably been cited as *the* authority for the proposition that failure to meet a current demand suffices to satisfy the 'general' cash flow test, regardless of whether the company is solvent or not. It is however not a lone case. It did *not* make new law,[69] and moreover it has been cited with approval or applied in subsequent cases in England.[70]

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65 This was the explanation given by Chadwick J. in *Re a Company (No. 006798 of 1995)* [1996] 1 W.L.R. 491 at 502 (Ch.) of *Cornhill Insurance*:

> Harman J. explained that, in circumstances where a company fails to pay a debt which is admittedly due, it will be no answer to a winding up petition to show that the company is solvent on a balance sheet basis.

66 *Supra* note 57.

67 *Ibid.*; *Cornhill Insurance*, *supra* note 30.

68 The company is still very much around today. It was acquired by Allianz AG in 1996, and was renamed Allianz Cornhill Insurance plc in 2003. This became Allianz Insurance plc on 30 April 2007 but Cornhill was retained as a trading name. Allianz Insurance plc trades as Cornhill Direct in UK. More information may be obtained from Allianz Cornhill, "Cornhill Insurance becomes Allianz Cornhill Insurance" (13 January 2003), online: Allianz <https://www.allianz.com/en/press/news/company_news/brands/news29.html>; Allianz Insurance plc, "Allianz Cornhill becomes Allianz Insurance" (30 April 2007), online: Allianz <https://www.allianz.com/en/press/news/company_news/brands/news_2007-04-30.html>.

69 For *e.g.*, *Re a Company*, *supra* note 57; *Mann v. Goldstein* [1968] 1 W.L.R. 1091 at 1096 (Ch.).

70 For *e.g.*, *Taylors Industrial Flooring*, *supra* note 53 at 219, 220; *Clowes Developments*, *supra* note 53; *Re a Company (No. 006685 of 1996)* [1997] 1 Butterworths Company Law Cases 639 (Ch.).

Cornhill Insurance has been cited and approved in Singapore,[71] though we do not have any case with such remarkable facts. In *Hong Huat Development*,[72] a creditor with an arbitral award pending appeal presented a winding up petition. The winding up petition was stayed and the company ordered to provide adequate security for the debt in the arbitral award pending the appeal. Subsequently the winding up petition was withdrawn. The only issue was whether costs should be ordered against the petitioner. Choo J.C. (as he then was) stated that "a persistent reluctance to pay on an obvious debt may not unreasonably give rise to the impression that the company was unable to pay."[73] On that basis he held that the creditor was entitled to present the winding up petition, and was entitled to costs up to the date when the petition was stayed and the company ordered to provide security.

It has been emphasised numerous times above that the 'general' cash flow insolvency test is satisfied only if the debt is undisputed. If the debt is disputed, it is established law that a winding up application on the debt is an abuse of the process of the court which the court will restrain by injuncting the creditor from making an application or taking a further step in the proceeding. The leading case on this rule is of course *Mann v. Goldstein*.[74] It is noteworthy because the judge, Ungoed-Thomas J., reviewed older authorities and rejected the argument that the basis of the rule was that the court should restrain the assertion of doubtful rights in a manner productive of irreparable damage to the company. He decided to rest the basis of the rule on the inability of a creditor with a disputed debt to establish its *locus standi* to present a winding up petition. Since the winding up jurisdiction is not for the purpose of deciding a debt that is disputed on a substantial ground, to invoke the winding up jurisdiction when the debt is so disputed is an abuse of the process of the court.

It is beyond the scope of this article to discuss *Mann v. Goldstein* in detail. It suffices to make two points on the rule articulated therein. First, by basing the rule on the creditor's lack of *locus standi*, the question of whether the company is insolvent or not becomes irrelevant. A creditor whose debt is bona fide disputed by the company cannot get past the hurdle posed by the rule, even if it has good evidence of the company's insolvency. Second, the rule has meant that in practice a creditor of a recalcitrant debtor may find it extremely hard to use the threat of winding up to collect a debt. The debtor may raise a cloud of objections on affidavits in order to claim that a dispute of fact existed which could not be determined without cross-examination so that the petition could not be allowed to proceed. English judges have acknowledged the need to protect innocent creditors from recalcitrant debtors,[75] but have not found it easy articulating the circumstances under which the court may examine the dispute to determine whether or not it is a bona fide dispute. They have occasionally stated that the rule is one of practice and may be departed from in an appropriate case, but with little guidance offered on what would be an appropriate

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71 *Re Hong Huat Development Co (Pte) Ltd* [2000] 3 S.L.R.(R.) 431 at para. 5 [*Hong Huat Development*]; *Re Windsor Holdings Pte Ltd* [2001] 1 S.L.R.(R.) 280 at para. 8 (H.C.); *Dayang*, *supra* note 24 at para. 36.

72 *Ibid*.

73 *Ibid*. at para. 5.

74 *Supra* note 69.

75 For *e.g.*, *R.A. Foulds*, *supra* note 55 at 99274, 99275; *Re a Company (No. 006685 of 1996)*, *supra* note 70.

case, the law remains uncertain.[76] The divergent approaches of the members of the English Court of Appeal in *Re Claybridge Shipping Co SA*[77] is a vivid illustration of the difficult balancing exercise that the court has to carry out when applying the rule. That is a main reason for the statement above,[78] that the main difficulty with the application of the 'general' cash flow test is over the issue of whether the debt which the creditor is relying on to establish its *locus standi* and proof that the company is insolvent is an undisputed debt.

We can see from the above discussion that the crux of the English approach on the application of the 'general' cash flow test is whether the debt relied on by the creditor in making a winding up application is subject to a bona fide dispute or not. If it is not, the creditor is entitled to make the application, even though the company is able to pay the debt and appears to be balance sheet solvent. On the other hand, if the debt is bona fide disputed, it will be a high-risk strategy for the creditor to make the application, even where it has cogent evidence that the company is indeed insolvent.

Before *BNP*, Singaporean courts have accepted the aforesaid English approach on the 'general' cash flow test.[79] In fact, the High Court in *Jurong Shipyard Pte Ltd v. BNP Paribas*[80] applied the rule as explained in *Mann v. Goldstein*.[81] Lee J. held that, as the debt alleged by the creditor to be owed to it by the company was bona fide disputed, the creditor should be injuncted from taking out a winding up application.[82]

2. *Position After* BNP

In *BNP*,[83] the Court of Appeal affirmed Lee J.'s judgment, but on a different ground. It held that where a solvent company does not admit a debt and is prepared to offer security to defend the claim that the debt is owed, the court should not, as a matter of principle, allow the claimant to make a winding up application against the company.[84] Further, it stated in *obiter dictum* that "even in the case of an admitted debt, the debtor company is not deemed to be unable to pay its debts if it has not neglected to secure the debt demanded under the statutory notice."[85] It should be pointed out that although on the facts a statutory demand was served by the creditor, the *ratio* as laid down by the court applies more generally. The court stated in several

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76 See discussion in Oditah, *supra* note 4; Lee, "Winding up Petitions Founded on a Bona Fide Disputed Debt", *supra* note 4; Keay, "Disputing Debts Relied on by Petitioning Creditors Seeking Winding-up Orders", *supra* note 4.

77 [1997] 1 Butterworths Company Law Cases 572.

78 See text in body between notes 61 and 62.

79 For Singapore cases approving or applying *Cornhill Insurance*, *supra* note 30, see discussion in text to note 72. For Singapore cases approving or applying *Mann v. Goldstein*, *supra* note 69, see *Re Mechanised Construction Pte Ltd* [1989] 1 S.L.R.(R.) 500 at para. 11 (H.C.) [*Mechanised Construction*]; *Metalform Asia Pte Ltd v. Holland Leedon Pte Ltd* [2007] 2 S.L.R.(R.) 268 at para. 62 (C.A.) [*Metalform*]; *Pacific Recreation Pte Ltd v. S Y Technology Inc* [2008] 2 S.L.R.(R.) 491 (C.A.) [*Pacific Recreation*].

80 [2008] 4 S.L.R.(R.) 33 (H.C.).

81 *Ibid*. at paras. 34, 35.

82 *Ibid*. at paras. 83, 84.

83 *Supra* note 2.

84 *Ibid*. at para. 11.

85 *Ibid*. at para. 9.

places of the judgment that the company was a solvent company.[86] This involved not just an assertion that the company was not insolvent under s. 254(2)(a), but an extended conclusion that it was solvent generally.

The Court of Appeal did not state expressly that it was departing from existing law, but it cannot be doubted that that was the effect of the above propositions. This writer submits that, at a general level, the most significant departure is the central role played by the solvency of the company, as understood within the context of the *BNP* judgment, in the application of the cash flow insolvency tests. It has been stated above that under the old law, the application of the 'general' cash flow insolvency test does not depend on whether the company is solvent or not. This is no longer the case.

Post-*BNP*, the 'general' cash flow insolvency test does not apply to a company if it has offered security for the debt.[87] The test is not proved by failure to pay a debt that is not disputed on a substantial ground, or even an admitted debt. A creditor with an undisputed debt that is not paid is therefore not entitled to make a winding up application against the debtor, provided that the debtor has offered security. This point will be considered in greater detail below.[88] What should be noted here is that much of *Cornhill Insurance* is no longer good law in Singapore.

It has been explained earlier that, pre-*BNP*, the crucial issue in the application of the 'general' insolvency test is whether the debt is disputed or not. It will be explained later that this is the same for the other two cash flow insolvency tests of 'neglect to meet a statutory demand' and 'unsatisfied execution'. Post-*BNP*, the crucial issue has become whether the company is solvent or not. Unfortunately, it is a little hard to ascertain from the judgment how the court came to the conclusion that the company was solvent. A simple explanation would be that the court held that the company was solvent because it made an offer to secure the debt. The court in *BNP* accepted that in *Mann v. Goldstein*[89] it was emphasised that the dispute should be a substantial one for an injunction to be issued. The reason for that emphasis, according to the court, was that the debtor did not offer to secure the debt. Where such an offer had been made, reasoned the court, the requirement that the dispute should be a substantial one was no longer a relevant consideration, given that the debtor was not unable to pay its debts.[90] This explanation is plausible, but not without difficulty.

Under s. 254(2)(a), the trigger for raising the presumption of insolvency is that the company has for three weeks after the service of a statutory demand "neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor". Hence, if the company makes an offer to secure the debt to the reasonable

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86 *Ibid*. at paras. 6, 7, 9.

87 It may be argued that in addition, the company must satisfy the court that it is solvent. The relationship between solvency and the offer of security for the debt owed by the company is a vexed question. The basis on which the Court of Appeal held that Jurong Shipyard was solvent is not entirely clear. As the Court stated in some places that Jurong Shipyard was solvent because it was able to offer security, and the Court did not consider other evidence of the financial health of Jurong Shipyard, it seems that the offer of security by Jurong Shipyard was the sole basis for the finding that it was solvent. With respect, however, there is difficulty with the argument that a company is always solvent so long as it is able to offer security. The issue is discussed briefly in the text following note 90 *et seq.*, but a thorough discussion will have to be undertaken elsewhere.

88 See Part IV(B) below (effect of *BNP*).

89 *Supra* note 69.

90 *Supra* note 2 at para. 9.

satisfaction of the creditor, that will prevent the presumption from arising. However, as will be explained later, a creditor is not bound to serve a statutory demand; it is entitled to rely on the 'general' cash flow insolvency test in s. 254(2)(c). There is no mention in that sub-section that if security is offered it will prevent a finding of insolvency, which will otherwise be made, from being made. Whilst an offer of security may mean that the company is not insolvent under s. 254(2)(a), it is hard to see how that *must* mean that the company is also not insolvent under s. 254(2)(c). In any event, looking at the matter more generally, it is difficult to accept the proposition that a company that is able to offer security, even by putting money in an escrow account, is necessarily solvent. The fact that the company is able to do that for one debt says nothing of its ability to do something similar or pay other debts. If that were not so, a grant of security will never be vulnerable as an unfair preference[91] or invalid as a late floating charge,[92] for the simple reason that the company was not insolvent when it granted the security.[93]

D. *Application of the Test at the Hearing Stage*

At the hearing stage, a finding by the court that the 'general' cash flow insolvency test has been proven will give the court jurisdiction to wind up the company. The inquiry here, whether the company has failed to meet a current demand, is similar to that in interlocutory proceedings. Before *BNP*, the question of whether the debt is bona fide disputed at the hearing of the winding up application, as in interlocutory proceedings, is of the utmost importance. If the debt is not disputed or the dispute is not bona fide, the court will hold that the company is insolvent, and may exercise its discretion to wind up the company.[94] If the debt is found to be bona fide disputed, the court will dismiss the winding up application,[95] unless the dispute does not extend to the whole of the debt so that the *locus standi* of the creditor is not in doubt, and it can be proved that one of the insolvency tests is satisfied.[96]

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[91] The operative provision is found in s. 99 of the *Bankruptcy Act* (Cap. 20, 2009 Rev. Ed. Sing.) [*Bankruptcy Act*], which is imported into the law on insolvent liquidation by virtue of s. 329 of the *Companies Act*, *supra* note 1.

[92] *Companies Act*, *supra* note 1, s. 330.

[93] With regards to unfair preference, the company must be insolvent or rendered insolvent by the preference (s. 100(2) of the *Bankruptcy Act*, *supra* note 91), and the meaning of 'insolvency' here (s. 100(4) of the *Bankruptcy Act*, *supra* note 91) is largely similar to that as defined in ss. 254(1)(e) and 254(2)(c) of the *Companies Act*, *supra* note 1. With regard to late floating charge under s. 330, it is ineffective to secure past indebtedness if the company was insolvent when it granted the floating charge.

[94] For *e.g.*, *Globe New Patent*, *supra* note 53; *Re A.B.C. Coupler and Engineering Co Ltd* [1961] 1 W.L.R. 243 (Ch.) (the company here was found to be insolvent, but the court refused to make a winding up order as it was opposed by the majority of the creditors, whose wishes were reasonable); *Sanpete Builders*, *supra* note 12; *Dayang*, *supra* note 24; *Clowes Developments*, *supra* note 53; *Parmalat Capital Finance Ltd v. Food Holdings Ltd* [2009] 1 Butterworths Company Law Cases 274 (P.C.); *Pacific Recreation*, *supra* note 79.

[95] For *e.g.*, *Re Lympne Investments Ltd.* [1972] 1 W.L.R. 523 (Ch.) [*Lympne Investments*]; *Mechanised Construction*, *supra* note 79; *Re Management Recruiters International (Asia) Pte Ltd* [2002] 2 S.L.R.(R.) 732. It so happens that a statutory demand was served in all those cases, but it cannot be doubted that the same rule applies to the 'general' cash flow insolvency test.

[96] For *e.g.*, *Tweeds Garages*, *supra* note 52. The *locus standi* of the creditor to present the winding up petition was admitted, but there was a dispute over the precise sum owed. There was abundant evidence

It has been explained above, in relation to interlocutory proceedings, that an important consequence of the judgment in *BNP* is to shift the focus from whether a debt is substantially disputed to whether the company is insolvent or not. This shift applies to the hearing of a winding up application as well. The Court of Appeal stated in *obiter* that if the creditor had made a winding up application, the court would have dismissed it on the ground that it was an abuse of process as the creditor would not have been able to prove that the company was unable or deemed to be unable to pay its debts.[97]

IV. The 'Test of Neglect to Meet a Statutory Demand'

Under s. 254(2)(a), neglect to pay the sum demanded in the statutory demand will raise a presumption that the company is insolvent. The court may but is not bound to exercise its jurisdiction to wind up the company. There is no neglect if the company has good reasons for refusing to pay, for example, where the debt demanded is disputed by the company on substantial grounds,[98] or where there is a cross-claim amounting to an equitable set-off that overtops the amount of the debt demanded.[99]

A. *The Test Before* BNP

1. *Defective Statutory Demand*

Perhaps the best evidence that the 'test of neglect to meet a statutory demand' in s. 254(2)(a) and the 'general' cash flow test in s. 254(2)(c) are similar is that a statutory demand that fails to comply with the formalities requirement may nevertheless be relied on as evidence that the company has failed to pay an undisputed debt of which repayment has been demanded, *i.e*. as satisfying the 'general' cash flow insolvency test. That was what happened in *Dayang*.[100] The statutory demand served did not comply with all the formalities set out in s. 254(2)(a). Belinda Ang J.C., after giving a restrictive interpretation of the formalities that must be complied for a demand to be valid, went on to hold that as the debt was a judgment debt and could not be disputed, the court was entitled to infer from its non-payment that the company was unable to pay its debts.[101] Similarly, in *Sanpete Builders*, Chao J.C. held that non-payment of a debt after demand may assist in proving insolvency quite independently of s. 254(2)(a).[102]

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that the company was insolvent, as creditors had not been paid and some had obtained judgments against the company. On that basis, Plowman J. ordered the company to be wound up.

97 *Ibid*. at para. 10.

98 See *e.g*., *Lympne Investments*, *supra* note 95 (the winding up petition in this case was dismissed); *Re a Company (No. 0012209 of 1991)* [1992] 1 W.L.R. 351 (Ch.) (Hoffmann J. granted an injunction to restrain the creditor from presenting a petition); *Mechanised Construction*, *supra* note 79 at para. 13 (the winding up petition in this case was dismissed).

99 For *e.g*., *McDonald's Restaurants Ltd. v. Urbandivide Co. Ltd* [1994] 1 Butterworths Company Law Cases 306 (Ch.) (an injunction was granted to restrain the creditor from presenting a petition).

100 *Supra* note 24.

101 *Ibid*. at para. 36.

102 *Supra* note 12 at para. 51.

2. *Application of the Test*

Despite their practical importance, there has been little analysis of the relationship between the 'test of neglect to meet a statutory demand' and the 'general' cash flow test. We have seen that the essence of both tests is the failure of a company to pay a due debt of which repayment has been demanded. A creditor with an undisputed debt therefore has a choice of serving a statutory demand before presenting a winding up application, or presenting the application directly. This raises the issue of whether there is any advantage to the creditor in taking the additional step of serving a statutory demand before it makes a winding up application. We will examine this issue in two contexts: where the debt is undisputed, and then where it is disputed on a substantial ground by the company. It will be seen that the serving of a statutory demand in those situations does not help a creditor to prove that the company is cash flow insolvent.

3. *Debt is Undisputed*

There was a most instructive discussion of the utility or otherwise of serving a statutory demand by the English Court of Appeal in *Taylors Industrial Flooring*.[103] A winding up petition was presented against a company alleging that it had failed to pay an undisputed debt. No statutory demand was served. The company applied for and obtained an *ex parte* injunction restraining the advertisement of the petition. Thereafter, on an *inter partes* hearing in the English High Court, Scott J. struck out the petition as being an abuse of the process of the court. The learned judge held that although the reason put forward for non-payment might not be a very good one, no inference of inability to pay should be drawn from the fact of non-payment unless the reason was not put forward honestly. He suggested that these difficulties could have been avoided if the petitioner had served a statutory demand, the extra costs of which would have been trivial. On appeal, the English Court of Appeal held that Scott J. had misdirected himself as to the law.

Dillon L.J., whose judgment the other two judges concurred with, held that there was no requirement that a creditor must serve a statutory demand.[104] He explained that in the vast majority of cases creditors did not serve statutory demands. The reason was that winding up did not date back to the service of the demand. If a demand was served it would give the company an extra three weeks' grace during which the assets of the company might be dissipated in keeping the company afloat or might be absorbed into the security of a debenture holder. Therefore, there were practical reasons for not allowing extra time, particularly where commercial conditions and competition required promptness in the payment of debts so that the creditor could manage its own cash flow and keep its own costs down.

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[103] *Supra* note 53.

[104] In fact, this was already the law a century ago. In *Globe New Patent*, *supra* note 53, Jessel M.R. held that a company could be wound up whenever it was proved to the satisfaction of the court that it was unable to pay its debts. On the facts there was evidence that the company had not paid its debts and he was satisfied that it was unable so to do. He ignored any question of statutory demand, holding that that was merely another way of establishing the case. If further authority is needed, see *Cornhill Insurance*, *supra* note 30.

4. *Debt is Subject to Bona Fide Dispute*

We turn now to consider the situation where the debt relied on by the creditor is the subject of a bona fide dispute. Will serving a statutory demand in this case improve the prospects for the creditor? The answer is no, and the courts have given two reasons.

The first is that service of a statutory demand will not give rise to a presumption of insolvency if the debt is bona fide disputed. A presumption of insolvency does not arise invariably from a failure to meet a statutory demand which complies with the formality requirements as stipulated in the provision. Section 254(2)(a) stipulates that it does so only if the company has "*neglected* to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor".[105] Mere omission to pay a debt on demand does not of itself constitute neglect to do so within the meaning of that provision. The word "neglect" necessarily implies some element of fault.[106] So, for example, if the debt stated in the demand is bona fide disputed, there would have been no neglect within the meaning of s. 254(2)(a) and a presumption of insolvency would not have arisen.[107] A creditor, which will not succeed in winding up a company by relying on the 'general' cash flow insolvency test because its debt is bona fide disputed by the company, therefore cannot seek to circumvent this 'defence' by serving a statutory demand.[108] The same applies to the defence of cross-claim.[109] This is eminently sensible. There is no reason why a creditor which is not able to prove that its debtor is insolvent should, after carrying out a procedure which has nothing to do with the merits of its case, henceforth succeed in its proof.

The second reason is that if the debt is bona fide disputed, the creditor has no *locus standi* to invoke the winding up jurisdiction of the court. This is based on the well-known rule in *Mann v. Goldstein*,[110] which has been explained earlier in relation to the 'general' cash flow insolvency test. Accordingly, if a petition is presented, it is an abuse of the process of the court which the court will restrain by injuncting the creditor.

Both reasons were relied on by the court in *Lympne Investments*.[111] This case brought out the futility of serving a statutory demand when the debt relied on by the creditor is bona fide disputed by the company. Megarry J. dismissed the petition on the ground that as the debt was disputed, the creditor did not have the requisite *locus standi* to present the petition.

B. *Effect of* BNP

Several important propositions were made in *BNP*[112] on the test of failure to meet a statutory demand. First, and the most important, is that the presumption under

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105 Emphasis added.

106 *Lympne Investments*, *supra* note 95; *Ng Tai Tuan v. Chng Gim Huat Pte Ltd* [1990] 2 S.L.R.(R.) 231 at para. 14 (H.C.) [*Ng Tai Tuan*].

107 *Lympne Investments*, *ibid*.

108 See *e.g.*, *ibid*. where the winding up petition was dismissed.

109 See *e.g.*, *Ng Tai Tuan*, *supra* note 106 at para. 26, where Chao J.C. (as he then was) stayed the winding up petition. The law on cross-claims is now to be found in *Metalform*, *supra* note 79.

110 *Supra* note 69.

111 *Supra* note 95.

112 *Supra* note 2.

s. 254(2)(a) does not arise where the company has, within the period of three weeks after it has been served with a statutory demand, made an offer to secure the debt to the reasonable satisfaction of the creditor.[113] If the creditor claims that the security is not satisfactory and is determined to issue winding up proceedings, the company may apply to court for a restraining order so as to enable the court to determine on an *objective* basis what the reasonable satisfaction of the creditor should be.[114] Therefore, "even in the case of an admitted debt, the debtor company is not deemed to be unable to pay its debts if it has not neglected to secure the debt demanded under the statutory notice".[115] Secondly, s. 254(2)(c) is concerned with actual inability to pay debts, whilst s. 254(2)(a) is concerned with deemed inability to pay debts.[116] This point has been considered above under the 'general' cash flow test. Thirdly, if a company is able to offer security for the debt alleged to be owing to the creditor, this is a "patent indication" that the company is "both able and willing to pay in the event that the court determine[s] that it is liable to do so", and therefore that the company is not an insolvent company.[117]

The impact of the above propositions on the law discussed above is far-reaching. First, it is a substantial erosion of the rule, discussed earlier, that a creditor which has demanded repayment of an undisputed debt is entitled to make a winding up application against the company if the company fails to pay the debt timeously.[118] Because of *BNP*, it seems that such a creditor is no longer entitled to make a winding up application if the company offers security for the debt, unless the court holds that on an objective basis the security is not to the reasonable satisfaction of the creditor. The creditor's position has been rendered worse off. It can no longer rely on a threat to make a winding up application to collect an undisputed debt from a recalcitrant debtor company. The company, when faced with such a threat, can now choose to offer a security to the creditor to neutralise the threat. Further, the creditor is not entitled to reject the offer of security on the ground that *in its opinion* the security is not satisfactory. The reasonableness of the security is to be determined by the court on an *objective* basis. The offer of security here is obviously very different from that of a prospective lender bargaining for security as a term and condition of the loan. Unlike that scenario where the lender obtains the security which it demands, the creditor here neither bargains for the security nor is subjectively satisfied with it.

Secondly, *BNP* casts doubt on the existing case law that the test of 'neglect to meet a statutory demand' in s. 254(2)(a) and the 'general' cash flow test in s. 254(2)(c) are all cash flow insolvency tests, a point repeated several times above. This is a specific manifestation of a broader point discussed above, *viz.*, the impact of the *BNP* classification of the insolvency tests in s. 254(2) on the *Great Eastern* classification which was approved in earlier cases. Before *BNP*, there was no substantive difference between the two tests; the difference between them was formal, in that only s. 254(2)(a) prescribes formalities that have to be complied with. Although the extent to which that proposition has to be revised in view of *BNP* is unclear at present, there

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[113] *Ibid*. at para. 7.
[114] *Ibid*. at para. 5.
[115] *Ibid*. at para. 9.
[116] *Ibid*. at paras. 5, 7.
[117] *Ibid*. at paras. 6, 7.
[118] See text accompanying notes 62-73.

is little doubt that some revision is necessary. Take the case of a defective statutory demand. It has been shown earlier in this article that a defective statutory demand may be relied on as evidence that the company has failed to pay an undisputed debt of which repayment has been demanded. It is difficult to reconcile this rule with the reasoning in *BNP* that as Jurong Shipyard was able to offer security for the alleged debt, it was not insolvent.

V. The 'Test of Unsatisfied Execution'

The test here, contained in s. 254(2)(b), is similarly concerned with the non-payment of a debt of which repayment has been demanded. However, this is different from the 'general' cash flow test and the test of 'neglect to meet a statutory demand'. The quality of the debt here is different. It is no ordinary debt arising out of a contract or statute, for example, an obligation to pay taxes. The alleged debt has been sanctioned by the court and converted into a judgment debt of a certain sum. Therefore, unlike an ordinary contractual debt which is susceptible to the defence that the alleged debt is bona fide disputed, the company cannot raise this defence against a creditor who has taken the time and trouble to convert its claim against the company into a judgment debt.[119] Other than this point, there is no difference between this test and the test of 'neglect to meet a statutory demand' in s. 254(2)(a) and the 'general' cash flow test in s. 254(2)(c). They are all cash flow insolvency tests.

It is difficult to find a case where a winding up order was actually made on the ground that this test was satisfied. Firstly, unless the debt is disputed, there is no need for a creditor to incur costs and suffer delay to convert a contractual debt into a judgment debt in order to obtain a winding up order. Secondly, even where a debt has been converted into a judgment debt, there is no necessity for the creditor to take the extra step of levying execution on the judgment debt, and then to make a winding up application if the execution is returned unsatisfied. In principle, the creditor can rely on the judgment debt to serve a statutory demand or for proof that the 'general' cash flow insolvency test is satisfied, and that has happened in practice.[120]

In *Re Douglas Griggs Engineering Ltd*,[121] the creditor obtained judgment against the debtor company. Pennycuick J. ordered the company to be wound up on the ground that execution levied on the judgment was returned unsatisfied. However, as pointed out by Millett L.J. in *Re a Debtor (No. 340 of 1992)*,[122] the reasoning of Pennycuick J. was erroneous as no execution had been levied by the judgment creditor.[123] The making of the winding up order should have been based on the ground that the petitioner had established that the 'general' cash flow test was satisfied

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[119] This may be inferred from *LKM Investment Holdings Pte Ltd v. Cathay Theatre Pte Ltd* [2000] 1 S.L.R.(R.) 135 at para. 18 (H.C.).

[120] For examples of statutory demands being served in respect of judgment debts, see *Wei Giap Construction Co (Pte) Ltd v. Intraco Ltd* [1977-1978] S.L.R.(R.) 498 (H.C.); *Dayang*, *supra* note 24 ; *Ng Tai Tuan*, *supra* note 106.

[121] [1963] Ch. 19.

[122] [1996] 2 All E.R. 211 (C.A.).

[123] *Ibid*. at 218.

as the company's solicitor had admitted that the company had no assets on which execution could have been levied.[124]

VI. Conclusion

Singaporean law on the insolvency tests in ss. 254(1)(e) and 254(2) of the *Companies Act*[125] have hitherto followed English law. *BNP* marks the beginning of a distinct Singaporean jurisprudence. This article seeks to present the law before that case as clearly as possible, and from that vantage point examine how *BNP* has changed the pre-existing law.

The law before *BNP* as explained above may be summarised as follows:

- First, the insolvency tests comprised in s. 254(2)(a) fell into two groups: one consisting of three versions of the cash flow insolvency test in ss. 254(2)(a), (b) and the 'general' cash flow test in s. 254(2)(c), and another consisting of the balance sheet insolvency test in s. 254(2)(c).
- Second, the common feature of all the cash flow tests was a failure of the company to pay timeously an undisputed debt of which repayment had been demanded. The differences between the different versions of the test were formal differences. They pertained to the different manners in which the demands were made: serving a statutory demand in accordance with the formalities in s. 254(2)(a), levying execution on a judgment and having the execution returned not fully satisfied in s. 254(2)(b) or simply demanding repayment in s. 254(2)(c).
- Third, following on the second point, a creditor was entitled to choose any of the cash flow tests to prove that the company was insolvent. There was no requirement that it must serve a statutory demand before making a winding up application, and there were practical reasons for not doing so. Next, the 'general' cash flow test in s. 254(2)(c) did not measure whether a company was *generally* able to pay its current debts.
- Fourth, as the emphasis of all the cash flow tests was that the company paid an undisputed debt timeously when demanded, it did not matter, when the company had failed to pay, whether the failure resulted from inability to pay (for example, due to a temporary lack of liquidity) or wilful refusal to pay albeit being able to do so. A creditor with an undisputed debt was thus entitled to threaten to make and in fact make a winding up application against a company that was apparently solvent if the company refused to pay the debt of which repayment had been demanded. If the company persisted in non-payment of the undisputed debt at the hearing of the winding up application, it was cash flow insolvent and the court might, but was not bound, to make a winding up order.
- Fifth, a creditor whose debt was disputed on a substantial ground would normally be restrained in an interlocutory proceeding by injunction from making or

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[124] Another similar case is that of *Re Flagstaff Silver Mining Company of Utah* (1875) 20 L.R. Eq. 268, where the company's solicitors told the creditor that there was no asset of the company on which he could levy execution. The court held that there was such evidence of the company's inability to pay its debts as to relieve the creditor from the necessity of issuing execution to bring himself within s. 80(2) of the *Companies Act 1862* (U.K.), 25 & 26 Vict., c. 89.

[125] *Supra* note 1.

continuing with a winding up application. The reason was that the creditor of a disputed debt was unable to establish its *locus standi* to make the winding up application. As that was the basis of the injunction, it did not matter whether the company was solvent or insolvent.

Due to the broad sweep of the *dicta* in *BNP*, it will take time for the full extent to which they have changed the pre-existing law to be worked out. Their impact as has been examined in this article may be summarised as follows. For ease of comparison, the numbering here corresponds to that used above to explain the pre-existing law:

- First, s. 254(2)(c) is concerned with actual insolvency, whilst s. 254(2)(a) and, it seems, s. 254(2)(b), are concerned with deemed insolvency. The latter are based on presumptions, whereas in the former it is a finding of fact which the court will only make if it is satisfied with the evidence of insolvency adduced. As there was no elaboration on the kind of evidence which the court requires, the effect of the proposition on the existing law is not clear. The crux here is whether it amounts to a rejection of the classification scheme under the pre-existing law.
- Second, following from the preceding point, it is uncertain whether failure to pay a single undisputed debt still suffices to constitute evidence of cash flow insolvency under s. 254(2)(c). If it does not, the tests in ss. 254(a) and 254(b) and the cash flow test in s. 254(2)(c) will no longer share any common feature.
- Third, it remains the law that a creditor is entitled to choose any of the cash flow tests to prove that the company is insolvent, and that a creditor is not required to serve a statutory demand before making a winding up application. However, it is not clear whether the 'general' cash flow test in s. 254(2)(c) measures a company's *general* ability to pay its debts.
- Fourth, there is now apparently a distinction, where a company has failed to pay an undisputed debt, between *inability* to pay and *refusal* to pay. It seems that a creditor is entitled to make a winding up application only when the company is unable to pay the debt. Where the company is able to pay, it may choose not to pay by offering to provide security for the debt. Where that is done, the creditor is not entitled to make a winding up application unless the court holds that on an objective basis the security is not to the reasonable satisfaction of the creditor. The right of a creditor with an undisputed debt to threaten to make and in fact make a winding up application against a recalcitrant debtor has been severely curtailed.
- Fifth, it remains the law that a creditor whose debt is disputed on a substantial ground will normally be restrained in an interlocutory proceeding from making or continuing with a winding up application. It is however less clear whether that is because of the creditor's inability to establish its *locus standi* or some other reason. It seems that another reason is equally or more important, *viz.*, that the creditor will not be able to prove that the company is insolvent at the hearing of the winding up application.

It may be seen from the above that doctrinally the most significant development of *BNP* is the shift from using *locus standi* as the criterion in this area of law, especially in interlocutory proceedings, to using solvency tests as the criterion. This theme permeated the entire judgment. It suffices here to list two examples. First, whereas the law pre-*BNP* used *locus standi* to decide whether a creditor with a debt that was disputed should be allowed to make or continue with a winding up application, the

law after *BNP* relies on solvency to decide on that issue. Secondly, the law pre-*BNP* did not draw a distinction between actual and deemed insolvency. The court was not required to be satisfied judicially that the company was in fact insolvent.[126] Hence, a creditor with an undisputed debt which the company had failed to pay when demanded was entitled to make a winding up application. Post-*BNP*, that is not possible if the company offers security for the debt, unless the court on an objective view holds that the security is not reasonable security.

[126] *Imperial Hydropathic Hotel Co., Blackpool v. Hampson* (1883) 49 Law Times Reports 147 at 150 (the court was concerned with a statutory demand, but the point applied generally).