Atlas Asia
Law Corporation

Insolvency considerations and the COVID-19 (Temporary Measures) Act 2020

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Introduction

The COVID-19 pandemic has had a severe impact on business owners. It is no surprise that many businesses in Singapore now face unavoidable challenges to cash flow. Many have to confront the prospect of not being able to continue as a going concern.

The Singapore Parliament passed the COVID-19 (Temporary Measures) Act 2020 (CTMA) on 7 April 2020. Among its provisions, the CTMA provides a safety net to cushion the impact of insolvency and bankruptcy laws. In this article, we focus on the effect of the CTMA on insolvency and businesses.

Effect of the CTMA

Increased threshold for inability to pay debts

Under the Companies Act (CA), one of the grounds that the Court may order the winding up of a company is when it is unable to pay its debts. There are instances when a company may be deemed to be unable to pay its debts, for example, if a creditor makes a claim against the company for a sum exceeding S$10,000 and the company is unable to pay the sum, or secure or compound it to the reasonable satisfaction of the creditor, within three weeks.

The CTMA increases:

- The $10,000 threshold to $100,000
- The three-week timeframe to six months

The increased threshold and timeframe will be from 20 April to 19 October 2020 (the Prescribed Period). This Prescribed Period may be extended or shortened.

Incurring of debts in the ordinary course of business

The CA makes it an offence for an officer of a company to enter into a debt when he has no good reason for believing the company would be able to pay the debt. The officer may be held personally liable for the

company's debts if he engages in such "wrongful trading".

The CTMA mitigates this by stating that the officer will be treated as having reasonable or probable ground of expecting the company to be able to pay a debt if it is incurred:

- In the ordinary course of the company's business
- During the Prescribed Period
- Before the appointment of a judicial manager or liquidator to the company

However, directors remain criminally liable if they carry on the business of the company with intent to defraud creditors of the company or creditors of any other person, or for any fraudulent purpose.

Insolvency, Restructuring and Dissolution Act 2018

The Insolvency, Restructuring and Dissolution Act 2018 (No. 40 of 2018) (IRDA) was passed by Parliament in 2018, and has come into force on 30 July 2020. Do note that:

- The IRDA consolidates Singapore's corporate and personal insolvency and debt restructuring laws (which are currently under the CA and the Bankruptcy Act (BA)) into a new omnibus legislation.
- The relevant provisions of the CTMA that apply to the CA and BA will similarly apply to the IRDA.
- Once the Prescribed Period is over, the provisions of the IRDA will apply to their fullest extent.

What happens after the CTMA's Prescribed Period?

For businesses in financial distress:

- Whilst the CTMA provides some respite, these measures are only temporary and business owners should proactively consider:
    - Reviewing existing contracts and renegotiating payment or other terms, to ensure continued ability to meet contractual obligations
    - Optimising existing business and operating models to reduce inefficiencies
    - Implementing cost-saving measures if they are facing excess manpower issues. Please refer to our article on managing excess manpower in the face of COVID-19 for more information on this.
- Keep in mind the new "wrongful trading" provisions, which will be introduced under the IRDA.
    - Under the existing law, a criminal conviction for insolvent trading is a prerequisite for civil liability to apply.
    - Under the IRDA, it will no longer be necessary to first establish criminal liability.

- A company will "trade wrongfully" if it: (1) when insolvent, incurs debts or other liabilities, without reasonable prospect of meeting them in full; or (2) incurs debts or other liabilities that it has no reasonable prospect of meeting in full and that result in the company becoming insolvent.
- The court has the power to declare that any person who was a party to the company trading wrongfully shall be personally responsible, without any limitation of liability, for any or all of the debts or liabilities of the company, if that person: (1) knew the company was trading wrongfully, or (2) as an officer of the company, ought, in all the circumstances, to have known that the company was trading wrongfully.

- Directors and other officers of a company should be mindful of this whilst managing and operating the business. For more information on directors' duties and liability, please refer to our article on how COVID-19 affects directors' duties and their personal liability.

- Other parties (such as employees, contractors or counterparties of the company) should be aware that they may potentially be caught under the new wider provisions if they are a party to the company trading wrongfully.

Be vigilant

Business owners should be mindful when dealing with counterparties, especially those in danger of becoming insolvent.

- Transactions entered into with such counterparties may be at risk of being challenged or unwound if these counterparties become insolvent subsequently.

- Any contractual remedies against an insolvent counterparty are unlikely to afford adequate compensation.

- The IRDA introduces a new provision that restricts the operation of "*ipso facto*" clauses.

  - In an insolvency context, "*ipso facto*" clauses typically allow one party to terminate or modify a contract in the event of the counterparty's insolvency.

  - Under the existing law, there is no restriction on the exercise of "*ipso facto*" clauses in the event of insolvency.

  - One area that the IRDA will restrict is the ability of a party to terminate or amend certain agreements with a counterparty because the counterparty is insolvent, or if proceedings arising from creditor scheme of arrangement or judicial management applications have commenced against the counterparty.

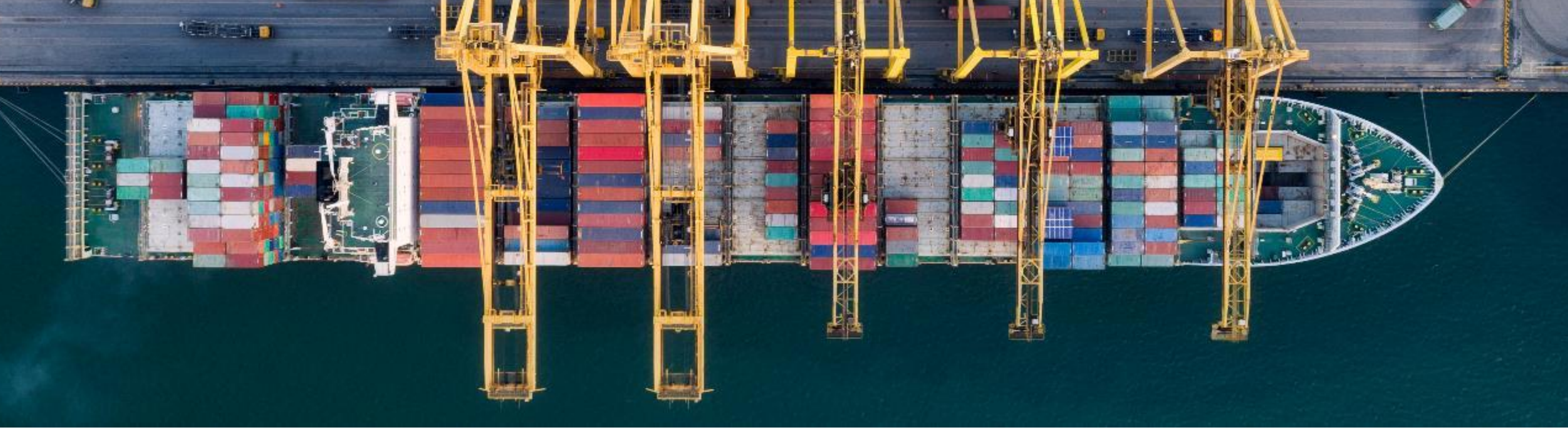
  - As this affects the contractual rights available against an insolvent counterparty, owners should:

    - Review "*ipso facto*" clauses under existing contracts, as well as in any new contracts being negotiated

    - Consider the implications arising under the IRDA in the event of a counterparty's insolvency

    - Renegotiate affected contracts to include additional terms to mitigate potential risks

  - To be clear, a party will not be precluded from exercising its contractual rights against an insolvent counterparty on other grounds, such as a breach of contract.



Anticipating and proactively addressing potential pitfalls will help business owners ensure that the right steps are taken today. This would be vital if owners wish to position themselves for recovery and enhance value in future. Owners who are uncertain of their current position should seek professional advice to avoid being caught off guard by any unexpected insolvency issues.

If you have any questions on this article, please contact:

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