Directors' Duties For Companies In Financial Difficulties

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In Chee Yoh Chuang and Another (as Liquidators of Progen Engineering Pte Ltd (In Liquidation)) v Progen Holdings Ltd [2010] SGCA 31("Progen"), the Court of Appeal reiterated that when a company is insolvent or is facing financial difficulties, its directors have a fiduciary duty to take into account the interests of the company's creditors when making decisions for the company. This fiduciary duty requires directors to ensure that the company's assets are not dissipated or exploited for their own benefit to the prejudice of creditors' interests.

The rationale for such a duty is that, when a company is insolvent, the creditors' interests come to the fore as the company is effectively trading and running the company's business with the creditors' money. Because of the limited liability principle, the risks (of trading when the company is insolvent) on shareholders would be minimal as they would at worst lose only what they have already invested in the company in their capacity as shareholders. Unsecured or partially secured creditors on the other hand may never recover any monies due to them. Unlike shareholders who have the most to gain from risky ventures, unsecured creditors, in particular, have everything to lose when illegitimate risks are taken. As such, it is only right that directors ought to be accountable to creditors for the decisions they make when the company is, or perilously close to being insolvent.

While the directors have to take into account the interests of the company's creditors, this duty is owed to the company - there is no duty owed directly to creditors. In other words, individual creditors, cannot, without the assistance of the liquidators, directly recover from the directors for such breaches of duty.

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to task when they appear to have been attempting in good faith to facilitate the preservation or rehabilitation of a company, and where they had reasonable commercial grounds for believing that the transaction would benefit the company. However, payments made to related parties (for example, companies with common directors), would be viewed with a good measure of skepticism by the Court. In relation to payments made by companies in the same group with common directors, each company is a separate legal entity and the directors of each company have to discharge their duties with regards to the interests of the creditors of that company.

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The result in Progen itself was an order that payments made by the subsidiary to its holding company which the holding company distributed to its shareholders by way of capital reduction were unfair preferences. It is pertinent to note that the Court of Appeal ordered a director of the subsidiary (who was also a director and shareholder of the holding company), who had authorised the payments to the holding company, to personally bear the legal costs and expenses of the legal proceedings.