

CASE UPDATE

LIQUIDATORS' RULES TO LIVE BY – INDEPENDENCE, OBJECTIVITY AND IMPARTIALITY

Fustar Chemicals Ltd (Hong Kong) v Ong Soo Hwa (Liquidator of Fustar Chemicals Pte Ltd) [2009] SGCA 35

Executive Summary

The Singapore Court of Appeal has, in an interesting decision handed down last Thursday, revisited the principles governing a liquidator's duty in assessing a proof of debt. Particular emphasis was put on how the liquidator should carry out his duty to scrutinise a proof of debt and his obligation to act independently and fairly.

Indraneel Rajah, SC and **Daniel Tan** of Drew & Napier LLC acted for the successful appellant creditor in this appeal.

Factual Background

On 26 July 2004, the directors of Fustar Chemicals Pte Ltd (the "**Company**") passed a special resolution to place the Company under members' voluntary liquidation as a solvent company. The directors of the Company were its main shareholder, Ms Wong Ser Wan ("**WSW**"), and her daughter.

WSW and her daughter appointed Ms Ong Soo Hwa (the "**Liquidator**") as the liquidator of the Company.

The Company's main creditor was Fustar Chemicals Ltd (Hong Kong) ("**FCL**"), a Hong Kong company which sold mainly paraffin wax from China. FCL was part of a group of companies that was controlled by the family of WSW's ex-husband, Mr Ng Cheong Ling ("**NCL**").

It was not disputed that the Company was the vehicle or "pass through" by which FCL sold paraffin wax to customers and through which payment by customers was made to FCL. The Company's main business was to on-sell the goods to customers and collect payment from FCL's customers in Taiwan and South Africa. The Company's business activities halted in 1997 when NCL's and WSW's marriage broke down and their relationship became intractable.

In December 2005, FCL submitted a proof of debt for sums owed by the Company since 1988 for goods supplied.

The Liquidator requested FCL to provide supporting evidence in the form of invoices, purchase orders, delivery orders, shipping documents and other relevant documents.

FCL was able to provide copies of the Company's audit confirmations and ledger entries and FCL's own audited accounts evidencing the debt owed, i.e. an account stated as between the companies. However, FCL could not provide the primary documents which were no longer available. They had either been lost or destroyed because FCL was, under Hong Kong law, obliged to keep documents and records for only 7 years and this period had lapsed.

The Company's own audited financial statements for the relevant period also acknowledged the debt claimed by FCL.

The Liquidator rejected FCL's proof of debt for reasons which included the following:

- (a) FCL was a related company and the Liquidator considered it necessary to look behind the acknowledgment of debt between the parties; and
- (b) other than the Company's ledger entries, there were no primary source documents to support FCL's claim.

FCL appealed to the High Court against the Liquidator's decision and asked for FCL's proof of debt to be admitted in full.

The High Court at the first instance rejected FCL's appeal. Dissatisfied, FCL appealed against the High Court's decision to the Court of Appeal.

Decision of the Court of Appeal

The Court of Appeal allowed FCL's appeal and directed the Liquidator to accept FCL's proof of debt, with interest. The court was not satisfied that the Liquidator had discharged her duty fairly and impartially and consequently held that the Liquidator's costs and disbursements in relation to FCL's proof of debt had been improperly incurred, and as such ordered that such costs and disbursements be paid only after all other creditors had been paid.

The Liquidator's duty in verifying FLC's proof of debt

A liquidator's duty in assessing a proof of debt is to ensure that genuine debts are admitted and false claims rejected.

Although the liquidator has a duty to scrutinise all proofs of debt, the requisite level of scrutiny depends on the circumstances of each case. He is only bound to take extraordinary steps to scrutinise a proof of debt on the basis that it could be a false claim if he has *reason to be suspicious* about its genuineness or legal validity.

These factors should be considered: (a) the origins of the debt; (b) the length for which the debt has been due; (c) how the company treated the debt in its financial statements; (d) the company's business; and (e) where relevant, the relationships between the claimants and the controlling shareholders of the company.

In assessing these factors, the liquidator must rely on: (a) his knowledge of general company accounting principles; (b) the auditing practice of companies by independent auditors; (c) the effect and implication of directors' and shareholders' approvals of company accounts; (d) the customary insolvency practice in verifying debts; and (e) some degree of common sense in understanding human relationships. He must also apprise himself of the nature of the company's business and other facts peculiar to the company.

Although the liquidator has power to look behind audited financial statements and audit confirmations, a creditor's proof of debt should not be lightly rejected if the debt has consistently been acknowledged in such statements. Such acknowledgments amount to an admission of the debt.

Further, debts which have been included as part of the company's audited accounts and approved by the directors and shareholders in general meeting *prima facie* bind the shareholders (although they may not bind creditors). In such cases, the liquidator has *no duty* to expend company funds in scrutinising such debts unless he has reason to suspect that they were entered into the books to defraud creditors.

In the present case, therefore, the Court of Appeal took the view that the liquidator ought to have had regard not only to the running account which the Company's directors and shareholders had unequivocally accepted as correct, but also to the reason why FCL had been unable to produce supporting primary documents, namely, that they had been lost or destroyed, the statutory period for keeping such documents having long expired.

The court also held that the Liquidator had acted *in excess* of her duties in rigorously insisting on proof of the debt exclusively through primary documents, given that: (a) the Company had consistently acknowledged the debt in its audited financial statements and audit confirmation statements; (b) there were no discrepancies between the accounts stated and other documents; and (c) there were no circumstances to warrant suspicion of improprieties having been perpetrated or that the dealings were not at arm's length.

The Liquidator's duty to act independently and fairly

A liquidator has a duty to maintain independence and act fairly regardless of the manner of his appointment and his appointer's identity. He must "*hold an even hand*" in dealing with the often competing interests of creditors, contributories and his appointers. He must *never* favour the interests of his appointers over that of the other legitimate claimants to the company's assets.

So, for example, in a voluntary liquidation, the liquidator should not be open to influence from the appointing directors, especially when any of them has a vested interest in denying creditors their proofs of debt.

The Court of Appeal took the view that the Liquidator had, in the circumstances of the case, failed to act independently and fairly. The context in which she had rejected FCL's proof of debt gave rise to real concerns as to whether she had gone out of her way to reject it. The facts suggested that she had been *"in a position of conflict of interest, because what she set out to do was not reasonable and could only benefit her appointer, WSW, and no one else"*.

Comment

The Court of Appeal's decision is a timely reminder that a liquidator is under a duty to maintain independence and to act fairly (and to be seen to be acting in such manner). In situations where the interests of his appointer are in conflict with that of other creditors, a liquidator must not unfairly or improperly favour such interests over those of legitimate creditors.

If you would like more information about this case or wish to discuss how it may potentially affect you or your business, please feel free to contact the litigation and dispute resolution lawyers in Drew & Napier LLC (please refer to the Directors' profiles on our [website](#)), or:

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