
Restructuring & Insolvency

High Court Issues Largest Award for Fraudulent Trading in Singapore

Introduction

If the business of a company has been carried on with the intent to defraud creditors, directors and officers who were knowingly a party to the carrying of business in that manner may be liable for fraudulent trading. Under Singapore's restructuring and insolvency regime, they may be held personally liable for all or any the company's debts. In *Tendcare Medical Group Holdings v Gong Ruizhong* [2021] SGHC 80, the High Court issued the largest award for fraudulent trading in Singapore so far, holding a company director (and a company owned and controlled by him) liable for substantially all the debts of the company in the sum of US\$65,207,538.03. In addition, the Court found the director to be liable for breaches of fiduciary duties for US\$35 million and S\$500,000.

The fraudulent trading in this case involved an audacious scheme to defraud the institutional investors of a company ("**Tendcare**"). The defendant director, Mr Gong, had raised funds from debt and equity investors for Tendcare pursuant to a prospective initial public offering ("**IPO**"). However, the evidence showed that the IPO was never on the cards, and that the funds were in most instances misappropriated and transferred out of Tendcare shortly after Tendcare's receipt of the funds from its investors.

The Court held that Mr Gong was liable for fraudulent trading and breaches of fiduciary duties, and found several other defendants jointly liable for dishonest assistance, holding them responsible for the full sum of the claim. In its decision, the Court set out the principles regarding the law of fraudulent trading and the extent of liability for fraudulent trading.

The plaintiffs – Tendcare and its judicial manager – were successfully represented by Lee Eng Beng S.C., Mark Cheng, Chew Xiang, Priscilla Soh, Tan Tian Hui and Darren Lim of Rajah & Tann Singapore LLP.

This Update provides a summary of the Court's decision, as well as the key principles regarding the law of fraudulent trading.

Brief Facts

The first defendant, Mr Gong, was the founder and director of Tendcare, holding beneficial ownership of most of its share capital. He was also the sole director and shareholder of another company, HXTJ.

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The Plaintiffs were Tendcare, which had since been placed under judicial management by the Singapore High Court, and its judicial manager.

Tendcare had raised substantial funds from debt and equity investors for a purported IPO. However, as the High Court found, "*IPO was never on the cards*" and the funds were in most instances misappropriated from Tendcare shortly after receipt from investors, and not used for Tendcare's business or the purported IPO.

The Plaintiffs alleged that Mr Gong and his accomplices had fraudulently caused Tendcare to incur debts in the sum of US\$65,207,538.03 from lenders with no intention of conducting the IPO. Significant portions of these loans were thereafter fraudulently transferred, through a complicated web of transfers, without authority and without legitimate purpose. The Plaintiffs asserted that Mr Gong and his accomplices were liable for fraudulent trading for these loans totalling.

The Plaintiffs also claimed against Mr Gong for breach of fiduciary duties, and other co-defendants for dishonest assistance in misappropriating the funds, in the sum of about US\$35,000,000 and S\$500,000, which Tendcare raised from equity investors.

Holding of the High Court

The Court found the defendants liable as follows:

- (a) Mr Gong and HXTJ are jointly and severally liable for fraudulent trading and are liable to pay for substantially all the liabilities of Tendcare in the sum of US\$65,207,538.03.
- (b) Mr Gong is in breach of his fiduciary obligations for misappropriating equity investors' funds through HXTJ, and HXTJ is jointly and severally liable with him for dishonestly assisting Mr Gong with such transfers. Mr Gong and HXTJ are jointly liable for US\$35,000,000 and S\$500,000.
- (c) Mr Gong is liable for breach of fiduciary duties owed to Tendcare for the transfer of a further sum of USD6,000,000 through a Hong Kong company, beneficially owned and controlled by one Mr Miao. Mr Gong and Mr Miao are jointly and severally liable for US\$6,000,000.

Liability for fraudulent trading

In the proceedings, Tendcare and its judicial manager relied on the fraudulent trading provisions previously set out in section 340(1) read with section 227X(b) of the Companies Act. While section 340(1) of the Companies Act has since been repealed, it has been re-enacted as section 238(1) of the Insolvency, Restructuring and Dissolution Act 2018.

To establish liability under section 340(1), an applicant must show that:

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- (a) The business of the company was carried on with intent to defraud creditors of the company or for any fraudulent purpose; and
- (b) The party sought to be made liable was knowingly involved in the fraudulent business.

Notably, Mr Gong did not turn up for the trial and did not explain his absence. As a result, his Affidavit of Evidence in Chief, as well as all of the evidence contained in the various affidavits he had filed in this action, could not be considered by the Court.

Notwithstanding Mr Gong's absence, the Court considered the merits of the claims against Mr Gong based on Mr Gong's pleadings and other evidence which were before the Court. The Court found that Tendcare's business was carried on with the intent to defraud creditors or for a fraudulent purpose. The funds which were raised by Tendcare from investors were mostly transferred out of Tendcare shortly after receipt, and there was no evidence that the funds were used for the intended purposes. The evidence suggested that the funds were misappropriated and the Tendcare IPO was never on the cards. The Court found that Mr Gong and HXTJ were knowingly involved in the fraudulent scheme.

Extent of liability for fraudulent trading

The Court has the discretion to determine the extent of liability of the relevant person for fraudulent trading. The Court held that, in general, the statutory purpose of the fraudulent trading provision serves a remedial or compensatory function; in such a case, causation has to be established and serves as a limiting factor. However, the Court went on to hold that, in exceptional circumstances, a punitive remedy may be ordered by the Court, in which case causation may not be a determinative factor.

In the present case, the Court found that causation was satisfied as regards the sums claimed by the Plaintiffs. But for the fraudulent conduct of Mr Gong and HXTJ, the debts owed to debt investors would not have been incurred by Tendcare. The Court held that once the causal link between the fraudulent conduct and the debts of the company is established, the full extent of liability ought to be imposed.

Breach of directors' duties

The Court found that the transfers from Tendcare to HXTJ represented a misapplication of Tendcare's funds, and were therefore custodial breaches of Mr Gong's fiduciary duties owed to Tendcare. The Court further found that the transfers from Tendcare to the Hong Kong company controlled by Mr Miao were a misappropriation of funds by Mr Gong and amounted to dealing with the funds in a manner inconsistent with Tendcare's interests. Mr Gong had thus breached his duties to Tendcare in transferring the funds without any proper basis for doing so.

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Concluding Words

The Court's decision provides a guide as to how it will approach allegations of fraudulent trading. It sets out the elements necessary to establish liability, and discusses the general position that the debts or liabilities claimed should be shown to be caused by the conduct of the fraudulent trader.

The decision also highlights that liability for such debts or liabilities will generally be awarded to their full extent once causation is shown, even if some of the proceeds were used to benefit the company.

For further queries, please feel free to contact our team below.

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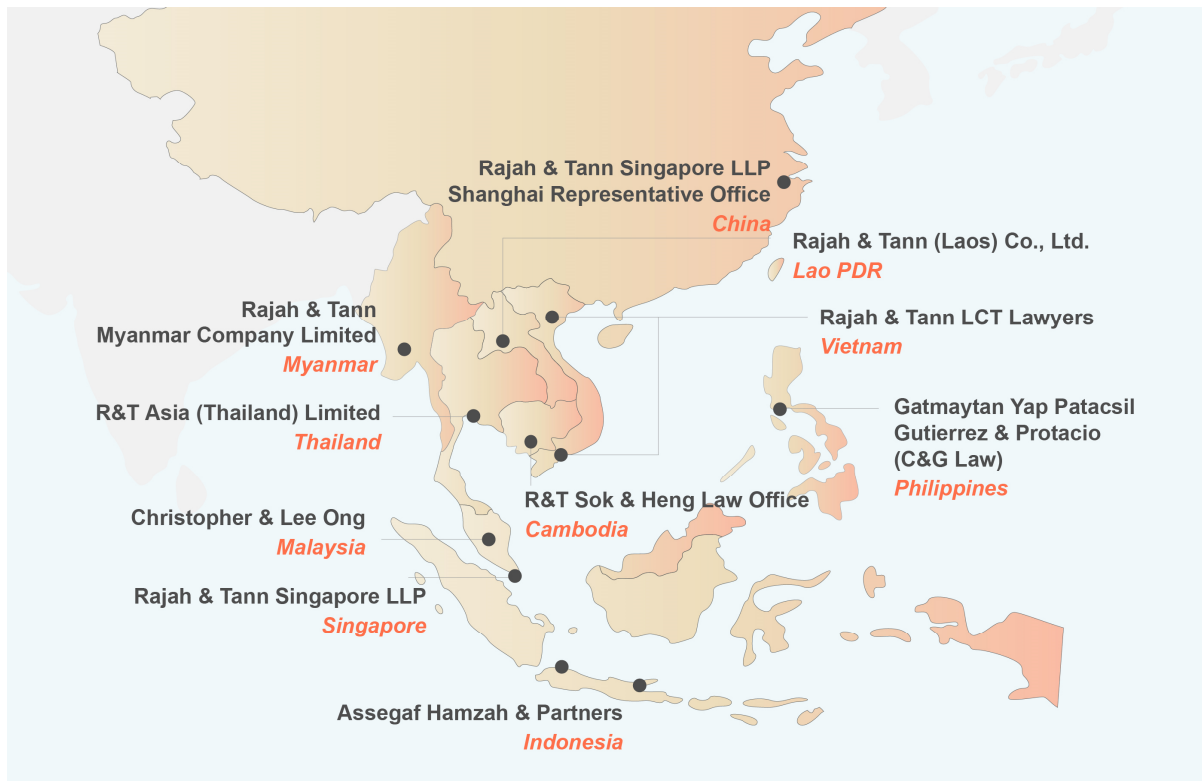
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