

## A Set of Set-offs or Just the One: Insolvency Set-off in Liquidation

Insolvency set-off is an important quasi-security device for parties engaging in trade or other dealings with a company. It enables mutual debts owed between a party and a company to be set off against each other if the company goes into judicial management or liquidation. Without insolvency set-off, a party dealing with a company which enters into judicial management or liquidation would have to pay its debt to the company in full, while only being entitled to receive a *pari passu* repayment on the debt owed by the company to it (which often may be mere cents on the dollar) (referred to as a “dividend”).

In *Park Hotel CQ Pte Ltd (in liquidation) and others v Law Ching Hung and another suit* [2024] SGHC 105, the General Division of the High Court (**High Court**) provided a rare examination of the parameters of insolvency set-off, and held that:

- (a) A creditor of a company in insolvent liquidation can only invoke a statutory insolvency set-off against the company (as opposed to other types of set-off, such as legal and equitable set-off). Thus, in proceedings initiated by a company in insolvent liquidation, a defendant can only advance a counterclaim without obtaining the prior permission (referred to as “leave”) of court under section 133(1) of the Insolvency, Restructuring and Dissolution Act 2018 (**IRDA**) if the counterclaim falls within the scope of insolvency set-off.
- (b) A defendant which is sued by a company’s liquidators for alleged wrongdoing cannot rely on insolvency set-off to diminish the claims against him, as a claim based on his wrongdoing does not constitute “mutual dealings” with the company (which is a requirement for insolvency set-off to apply).

### Background

Section 133(1) of the IRDA (**Section 133(1)**) provides, among other things, that “no action or proceedings may be proceeded with or commenced against [a company in respect of which a winding up order has been made or a provisional liquidator appointed] except ... by the leave of the Court”.

Two companies in insolvent liquidation commenced proceedings against certain creditors. The creditors sought leave under Section 133(1) to amend their defences in the proceedings and to introduce counterclaims against the companies.

Two interrelated questions arose from the creditors’ applications:

- (a) When, if ever, can a creditor advance a counterclaim in proceedings initiated by a company in insolvent liquidation without having to obtain leave of court under Section 133(1)?

- (b) Can a creditor rely on other forms of set-off known to the general law, such as legal and equitable set-off, against a company in insolvent liquidation?

## The High Court's Decision

The High Court answered the above two questions as follows:

- (a) A creditor can only advance a counterclaim that amounts to a permissible set-off against a company in insolvent liquidation without having to obtain leave under Section 133(1).
- (b) A creditor can only invoke an insolvency set-off against a company in insolvent liquidation.

*Only counterclaims amounting to permissible set-offs (i.e., insolvency set-offs) can be advanced without leave of court under Section 133(1)*

The High Court held that only counterclaims amounting to permissible set-offs against the company's claims can be advanced without obtaining leave under Section 133(1), i.e., the only type of set-off that can be asserted against a company in insolvent liquidation is insolvency set-off. Thus, it is only where the defendant is relying on an extinguishment of the insolvent company's claim against him through the operation of insolvency set-off that leave of court under Section 133(1) would not be required.

The High Court accepted that *Hyflux Ltd v SM Investments Pte Ltd* [2020] 4 SLR 1265 (*Hyflux*) laid down the proposition that no leave under Section 133(1) is required "where the counterclaim is sought to be utilised to set-off against the plaintiff's claim". It rejected the defendants' contention that *Hyflux* was authority for the broad proposition that any counterclaim is outside the scope of the moratorium in Section 133(1) and therefore may be brought without leave of court. It also took the view that the foreign authorities cited in *Hyflux* (e.g., *Langley Constructions (Brixham) Ltd v Wells* [1969] 1 WLR 503) supported its interpretation of *Hyflux*, i.e., only counterclaims satisfying the substantive requirements of a set-off fall outside the requirement of obtaining leave of court under Section 133(1).

*As a matter of general principle, neither legal set-off nor equitable set-off can be asserted*

The High Court held that insolvency set-off displaces all other forms of set-off, including legal set-off and equitable set-off, against a company in insolvent liquidation.

It prefaced its conclusions by reasoning that:

- (a) The issue must be approached from the principle that *pari passu* distribution is the default rule in insolvent liquidation. Anything that provides for some other form of distribution is an exception to that rule. The question, properly framed, therefore is whether legal or equitable set-off should be recognised as a true exception to the *pari passu* principle.

- (b) True exceptions to the *pari passu* principle seem to be exclusively – or almost exclusively – prescribed by statute, as the *pari passu* principle is entrenched and put into place by statute (see section 172 of the IRDA). As such, apart from provisions of the IRDA varying *pari passu* distribution, no other exception can be admitted under common law.
- (c) Insolvency set-off is an example of a statutory (true) exception to the *pari passu* principle (as recognised in *Kyen Resources Pte Ltd (in compulsory liquidation) and others v Feima International (Hong Kong) Ltd (in liquidation) and another matter* [2024] SGCA 7). It is an exception to the *pari passu* principle as it allows an unsecured creditor to use his own indebtedness to the company as *de facto* security by setting it off against the company's claim(s) against him, if the requirements of insolvency set-off are met *vis-à-vis* his and the company's cross-claims.

The High Court then highlighted that:

- (a) Neither legal nor equitable set-off have a statutory foundation, being doctrines developed in judge-made law. This weighs against legal or equitable set-off being able to operate in the insolvency context as an exception to the *pari passu* principle.
- (b) Allowing legal set-off or equitable set-off to apply when insolvency set-off may not be available produces anomalous outcomes that undermine the *pari passu* principle and its underlying policy. For example, allowing a creditor to obtain satisfaction of a non-provable claim against the company by asserting legal or equitable set-off in an action brought by the company against the creditor would circumvent the legislative policy underlying the recognition of the class of non-provable claims.

The High Court therefore took the view that a legal set-off cannot be asserted against a company in insolvent liquidation for the following reasons:

- (a) In a legal set-off, the creditor would be circumventing the proof of debt mechanism put in place as the proper mode of enforcement of debts against an insolvent company. If legal set-off were available, but for the insolvent company bringing an action against the creditor, the only course of action available to the creditor would be to prove in the liquidation for a dividend that is likely cents on the dollar. There is no principled reason why a creditor's position should be vastly improved by the wholly fortuitous circumstance that he happens to be a defendant in a litigation brought by the insolvent company against him.
- (b) In addition, legal set-off is procedural in nature, being an expedited method of enforcing a claim against the claimant that is made available to the defendant in the interests of procedural efficiency. Allowing it to be used as a mode of enforcement against an insolvent company would permit a defendant to undermine the proof of debt regime and gain priority at the expense of other creditors through a procedural device. This would not be right.

The High Court also ruled that there is no scope for equitable set-off to operate against a company in insolvent liquidation:

- (a) Although it is arguable that equitable set-off is inherently contained within the company's right of action such that it must remain available even after the company passes into insolvent liquidation based on impeachment of title, the majority, if not the vast majority, of claims that could amount to equitable set-offs – and also legal set-offs – would already be subject to the mandatory operation of insolvency set-off. Creditors would not be visited with unfairness from their inability to rely on equitable set-off post-liquidation.
- (b) As long as a creditor does not, in a strict sense, have a proprietary interest in the company's assets before the company's insolvency, he would remain an unsecured creditor. There is no basis for him to be accorded priority treatment over other unsecured creditors. An equitable set-off cannot constitute or be treated in the same way as a proprietary interest in the company's assets. Ultimately, it is in the nature of a counterclaim, which is a personal right of action against the company. As it is placed in the same box of rights as contractual rights of set-off, and since insolvency law has long restrained prior contractual rights of set-off, there is little difficulty in the same approach being taken with respect to equitable set-off.
- (c) The effect of an equitable set-off is the same as paying a preference, which results in the unjust enrichment of the beneficiary of the set-off at the expense of the other unsecured creditors of the insolvent company. As such, it would be exceedingly rare that an equitable set-off could apply against an insolvent company.

### *Application to the facts of the case*

Here, the High Court found that the plaintiffs' claims were based on the defendants' wrongdoing. As one of the conditions of insolvency set-off is that "the company's claim must not have been based on the creditor's wrongdoing", the High Court held that the plaintiffs' claims were not amenable to insolvency set-off, and that the defendants were not entitled to rely on insolvency set-off to advance their counterclaims without obtaining leave of court under Section 133(1).

The High Court therefore dismissed the creditors' applications to amend their defences and introduce the counterclaims.

## **Conclusion**

This decision provides detailed and useful guidance on the scope and operation of insolvency set-off, which despite its long vintage in the statute books, is often a vexed and seldom discussed issue in case law. There are other unresolved complications relating to insolvency set-off, particularly in relation to how it operates for a company in judicial management. It was only recently through the commencement of the IRDA in 2020 that the applicability of insolvency set-off was extended to companies in judicial management. For more on this topic,

read our [article](#) published in the Singapore Academy of Law Journal Special Issue on Insolvency.

If you would like information and/or assistance on the above or any other area of law, you may wish to contact the Partner at WongPartnership whom you normally work with or any of the following Partners:

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