



Legitimate discount or undervalue transaction? – *Parakou Investment Holdings Pte Ltd and another v Parakou Shipping Pte Ltd (in liquidation) and other appeals* [2018] 1 SLR 271

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I. Introduction

An “undervalue transaction” occurs when a company enters into a transaction where it receives no consideration or where it receives a consideration of significantly less value than what it has provided. Such a transaction is liable to be impugned if the company is insolvent at the time of the transaction or if it becomes insolvent in consequence of the transaction (Section 98 of the Bankruptcy Act read with Section 329 of the Companies Act).

In such cases, the key issue to be determined is whether the value of the asset sold by the insolvent company significantly exceeds the consideration provided by the other party for its purchase. This typically involves a comparison of the objective value of the asset, as assessed by an independent valuer, against the total benefit received by the company.

But what if the independent valuation provides a range of values for the transaction? And what if the transaction involves the sale of a group of items sold in bulk – would it be legitimate to apply a discount to the objective sale price on that basis? These were questions which fell to be decided by the Court of Appeal (“CA”) in *Parakou Investment Holdings Pte Ltd and another v Parakou Shipping Pte Ltd (in liquidation) and other appeals* [2018] 1 SLR 271 (“**Parakou**”).

II. Background facts

In *Parakou*, the Liquidator of the respondent company, Parakou Shipping Pte Ltd (in liquidation) (“**Parakou Shipping**”), brought a

claim against its directors (the “**Directors**”) and their related companies, which included Parakou Investment Holdings Pte Ltd (collectively referred to as the “**Defendants**”).

At issue was a number of transactions entered into by Parakou Shipping at the time of its insolvency. In particular, the Directors had authorised the sale of ten vessels and two hulls (the “**OPL Vessels**”) to Parakou Investment Holdings Pte Ltd, which they owned, for approximately \$9.9m. The Liquidator contended that this was an undervalue transaction that was calculated to strip Parakou Shipping of its assets prior to liquidation.

To prove that this was not an undervalue transaction, the Defendants commissioned a desktop valuation report before the vessels were sold, which valued the vessels at a price range of S\$9.906m to S\$12.291m. Even though the sale price of S\$9.9m was at the lower end of this range, the Defendants asserted that it sufficed that this was within the price range given.

The High Court Judge disagreed, holding that the fact that the sale price fell within the price range given in a valuation report did not necessarily mean that the sale was at a fair market value. Instead, the High Court Judge accepted the evidence of Parakou Shipping’s expert that if the company had carried out the sale at arm’s length and tried to market the vessels to the broader market (instead of selling the vessels at inexplicable haste), the vessels would have fetched a sale price within the mid-range or even high range of the valuation.

Given that the mid-range value was about S\$11m, the difference between that and the

sale price (*i.e.*, a difference of S\$1.9m) was deemed to be significant enough to give rise to an undervalue transaction,

III. CA's decision

The CA reversed the finding of the High Court and made two important observations.

First, the CA found that because big-ticket items like a fleet of vessels can fetch a range of prices, so long as the consideration received fell within this range, such consideration cannot be regarded as "significantly less" than the value of the vessels so as to amount to an undervalue transaction.

Second, the CA found that even if one were to utilise a single value in the range as the basis for comparison, this single point has to be determined by reference to the specific facts of the case and the market conditions for the sale of the specific items. On the facts, the CA agreed with the Defendants that a "fleet discount" should have been taken into account given that the OPL Vessels had been sold as a fleet. Accordingly, there was no reason to use a mid-point of the valuation range to represent the value of the OPL Vessels (as had been done by the High Court Judge).

IV. Discussion

The CA's reasoning in respect of whether bulk or 'fleet' discounts affect the valuation of an asset raises several interesting issues.

For one, some may perceive that a bulk discount which is offered due to an insolvent company's desire to quickly offload its assets falls squarely within the type of transactions which are deemed to be undervalued.

When assessing whether a transaction is undervalued, the courts will query whether, under the circumstances, "*there was a bargain of such magnitude that it could not be explained by normal commercial practice*" (see *Show Theatres Pte Ltd (in liq) v Shaw*

Theatres Pte Ltd [2002] 1 SLR(R) 578 at [12]). More often than not, this inquiry will be informed by an assessment of whether the assets had been sold at market value. In this regard, it has been noted that "market value" is determined by asking what price would have been obtained between a willing but not anxious seller and a willing but not anxious buyer in an ordinary commercial transaction (see *Spencer v The Commonwealth* (1907) 5 CLR 418 at 441).

Thus, it may be questioned whether a bulk discount given due to the anxiousness of the seller to dispose of its assets in a short period of time should amount to "normal commercial practice" and whether a valuation of the assets based on such a discount appropriately reflects "market value".

That said, given that "market value" is to be assessed by the specific circumstances of the case (*i.e.*, the specific circumstances of the sale), it would also be artificial to exclude how a buyer in the market would price the assets if he were in fact asked to purchase the assets in bulk.

In that regard, it may be that the censure against such transactions lies not in the fact that a discount had been given for a bulk sale, but is instead a reproach against the decision to even sell the assets in bulk in the first place.

It is apposite to note that the CA agreed with the High Judge that the sale of the OPL Vessels had been somewhat rushed and that a better price could have been realised with more diligence. Nevertheless, its scope of inquiry was constrained by the Liquidator's case. Indeed, the CA took pains to emphasise that the Liquidator had confined his case to challenging the value of the sale, but not the decision to sell the OPL Vessels (in the circumstances which they were sold) or the process of the sale itself, which was why the CA only assessed the legitimacy of the former.

Therefore, where a financially distressed company has instigated a sale of a group of its assets at a discount, instead of questioning the legitimacy of the discount, perhaps what should be closely scrutinised is the decision to dispose of the assets in bulk, which would likely have fetched a higher price on the market if the assets had been sold individually to discrete buyers.

On that basis, even though the CA did not regard the transaction as being undervalued, the decision in *Parakou* should not be seen as giving carte blanche to owners to simply dispose of an insolvent company's assets quickly and in bulk, without giving due regard to the creditors' interests in selling the assets at a market price.

V. Conclusion

The decision in *Parakou* has implications for liquidators, creditors and insolvent companies alike. A key takeaway from the decision lies in the importance which is ascribed to the context of the sale in determining whether a particular transaction is indeed an undervalue transaction.

In this regard, by allowing for a discount to be taken into account when assessing the price paid in a bulk sale, the CA has seemingly left the door ajar for companies to legitimately sell their assets at a lower range of the valuation price on the basis that a bulk discount had been given.

The onus will thus be on Counsel to shut the door by ensuring that challenges against such transactions are not only directed against the value of the transaction, but also the decision to even sell the assets in bulk in those circumstances.

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