

Restructuring &amp; Insolvency

# Exploring the Limits of Contractual Discretion

## Court Considers Discretion to Withdraw Banking Facilities in Winding Up Application

### Introduction

In commercial contracts, it is not uncommon to find provisions allowing for contractual discretion on the part of one or more parties, such as the discretion to vary certain interest or payment terms, to choose a port of delivery, or an option to purchase. While such provisions give a certain amount of decision-making power to the party that has been conferred the discretion, they are not without limit. These limits were explored in the Singapore High Court decision of *Maybank Singapore Ltd v Synergy Global Resources Pte Ltd* [2023] SGHC 258.

The claimant bank in this case had granted various trade facilities to the defendant. When the defendant failed to make payment when it fell due, the claimant recalled the entire banking facilities. The claimant demanded repayment of all outstanding sums, and when the defendant failed to do so, the claimant applied to have the defendant wound up by the Court.

In resisting the winding up, the defendant relied largely on the argument that the claimant had wrongfully exercised its discretion to recall the banking facilities. However, the Court found that the defendant's arguments did not raise any triable issue and allowed the winding up application.

In reaching its decision, the Court highlighted that contractual discretion must be exercised within reasonable boundaries, and set out the applicable principles for determining the limits of such discretion. The decision thus provides an insight on how contractual discretion should be exercised in order to avoid challenges to validity.

### Brief Facts

The claimant had granted various trade facilities to the defendant, including a Trust Receipt Invoice Financing ("**Trust Receipt**") for pre-shipment financing. The defendant defaulted in paying for the Trust Receipt when it fell due, leading the claimant to exercise its contractual discretion to recall the entire banking facilities granted to the defendant and demand the repayment of all outstanding sums from all banking facilities.



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When the defendant did not comply with the letter of demand, the claimant issued a Statutory Demand which went unpaid. The claimant then applied to Court for the defendant to be wound up, submitting that by virtue of section 125(2)(a) of the Insolvency, Restructuring and Dissolution Act 2018 ("IRDA"), the defendant was deemed to be unable to pay its debt and may be wound up by the Court.

The defendant sought to resist the winding up application, arguing that the claimant had wrongfully exercised its discretion to recall the banking facilities. The defendant submitted that it had a genuine and serious cross-claim exceeding the debt under the Statutory Demand as the claimant's alleged wrongful termination deprived the defendant of profit under certain pending trades.

### Holding of the High Court

The Court granted the winding up application, finding that the defendant had failed to raise any triable issues.

#### Winding up

The Court first set out the general law for in relation to a court's discretion to dismiss a winding up application:

- Where the debtor fails to pay an undisputed debt after being served with a statutory demand by the creditor, it is the duty of the Court to direct a winding up.
- Where the debtor rightfully disputes the debt, the Court will stay or dismiss the winding up application. In assessing whether there is a substantial and *bona fide* dispute over the debt, the debtor would have to raise triable issues.
- Where the debtor does not dispute the debt but seeks a stay or dismissal of the winding up application on the ground that it has a genuine and serious cross-claim equal to or exceeding the debt, the Court should stay or dismiss the application if the debtor can raise triable issues.

Applying these principles, the Court held that the claimant had raised a *prima facie* case that the defendant was unable to pay its debts pursuant to section 125(2)(a) of the IRDA. The defendant was well aware that the Trust Receipt had fallen due but defaulted in paying when it first fell due, as well as on two subsequent occasions (when the letter of demand was issued and when the Statutory Demand was issued).

It would thus be appropriate to allow the winding up application unless the defendant could raise any triable issue, which, in the present case, was what the defendant alleged to be a genuine and serious cross-claim equal to or exceeding the debt. However, the Court found that the defendant had not raised any triable issue that would compel the Court to either dismiss or stay the winding up application.

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### Contractual discretion

The defendant's main argument that a triable issue existed was that the claimant had wrongfully exercised its discretion to recall the banking facilities. However, the Court rejected this as the defendant had not sufficiently explained why the claimant's exercise of its discretion to recall the banking facilities was done wrongfully.

- The defendant had alluded to the claimant's renewal of another trade facility to the defendant to justify its claim that the recall of the banking facilities was wrongful. However, the defendant had not explained why that act of renewal would curtail the claimant from exercising its absolute discretion to recall the banking facilities, as the claimant had provided clear reasons why it recalled the banking facilities, i.e. the defendant's failure to repay, among other things, the sum owing under the Trust Receipt.
- In any event, the Court observed that the limitations on contractual discretion should not apply to a discretion to terminate a contract. As such, even if the claimant had not provided clear reasons for recalling the banking facilities, the Court would be precluded from even questioning whether the claimant had exercised its discretion wrongfully, since this was a discretion to terminate the contracts for the various banking facilities.
- Even if the claimant had renewed the trade facility, that act of renewal did not entitle the defendant to ignore clear contractual provisions which obliged it to repay sums as they fell due.

Further, even assuming that the claimant had wrongfully exercised its discretion, the defendant had not properly explained how that led to its alleged loss.

In reaching its decision, the Court set out the applicable principles relating to contractual discretion. Contractual discretions, even if framed in absolute terms, need to be exercised within reasonable boundaries. There are two methods a Court may use to limit a party's exercise of contractual discretion:

- The Court may interpret the scope of the relevant clause and determine whether compliance is to be measured against the objective or subjective standard of reasonableness.
- The Court may use implied terms to the effect that: (i) the contractual discretion will be exercised objectively reasonably; or (ii) the contractual discretion will not be exercised arbitrarily, capriciously, or irrationally.

The Court highlighted that the reason for the control of a party's exercise of a contractual discretion is because when two parties contract with each other to confer a discretion on one party, the Court will not allow the other party to be subjected to the first party's uninhibited whim.

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## Concluding Words

The Court's decision highlights that contractual discretion is not absolute; it has to be exercised within reasonable limits. These limits are to be determined according to the scope of the relevant clause and how it aligns with the standards of reasonableness in the context of the contractual relationship. Parties seeking to exercise discretion granted by a contractual provision should thus ensure that their actions may not be considered arbitrary or unreasonable.

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

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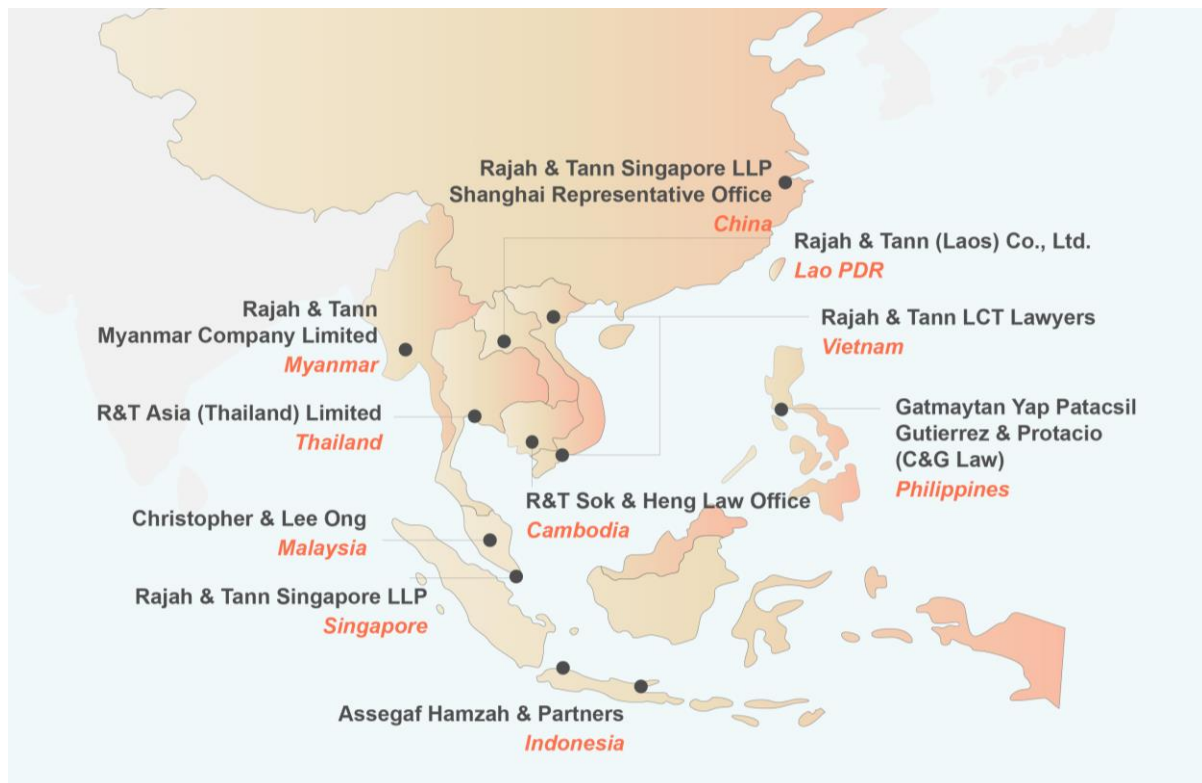
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