CORPORATE INSOLVENCY, RESTRUCTURING, AND RECOVERY IN THE COVID-19 WORLD - PART 2

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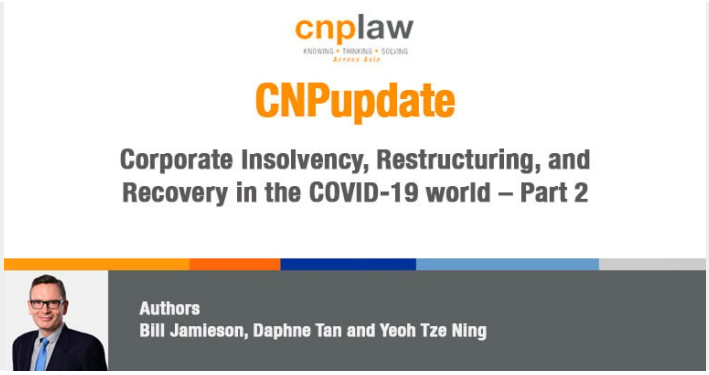

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Introduction

In part 1 of our multi-part series on Corporate Insolvency, Restructuring and Recovery in the COVID-19 world, we outlined two major changes introduced by the long-awaited Insolvency, Restructuring and Dissolution Act 2018 ("**Act**"). The Act officially came into force two days later, on 30 July 2020. Here in part 2, we explore the manner in which a company may seek to restructure its debts under the Act.

A. What is debt restructuring and in what circumstances would a company apply for one?

Debt restructuring is a process that allows a financially distressed company to reduce and renegotiate its existing payment obligations with the objective of improving the company's debt load. Such restructuring improves the company's ability to repay its debts, thereby allowing the company to avoid being compulsorily wound-up.

A company should consider applying for debt restructuring where its underlying business still has the potential to generate value, such that there is a real prospect that the company may remain as a going concern after it has recovered from temporary financial distress.

B. What are the types of debt restructuring available in Singapore?

There are two primary modes of debt restructuring available in Singapore – judicial management (analogous to administration in the United Kingdom), and schemes of arrangement.

Judicial management involves the appointment of an external party – a judicial manager – who takes over the affairs of the company and attempts to restructure or compromise the company's debts and obligations with its creditors. Because the judicial manager takes over the company's affairs, the managers of the company are said to be displaced and the company is said to be in the possession of a professional. Hence, judicial management may also be referred to as "professional-in-possession" ("**PIP**") restructuring.

Judicial management is often contrasted with schemes of arrangement. A scheme of arrangement is an agreement between the company and its creditors which sets out the terms of the restructuring of the company's debts. Generally, under a scheme of arrangement, the company's creditors agree to compromise their claims against the company (namely, agree to a reduction of the company's debts to them) in exchange for the latter's commitment to repay the creditors in accordance with the terms of the scheme of arrangement. The scheme of arrangement, once approved by the High Court, is binding upon all of the company's creditors, including those who oppose the compromise embodied in the scheme of arrangement. It is not mutually exclusive with judicial management, as judicial managers can always propose that a company enter into a scheme of arrangement with its creditors. However, unlike judicial management, the company's existing managers can themselves propose to enter into a scheme of arrangement with the company's creditors directly in anticipation of or in response to insolvency proceedings against the company, in which case the debtor-company remains in possession of the company and its assets. Hence, schemes of arrangement may be referred to as a form of "debtor-in-possession" ("**DIP**") restructuring.

The question of which mode of restructuring is preferable is highly context-dependent. Nevertheless, generally speaking, if the company's creditors are satisfied that the company is in financial distress due to circumstances outside of its control, are persuaded that value continues to underlie the debtor-company's business, and do not have any concerns regarding the governance and management of the company, DIP restructuring may be more appropriate. This is because the existing managers of the company may be in a better position to rehabilitate and steer the company towards recovery. On the other hand, PIP restructuring may be preferable where the creditors require independent oversight over the company's affairs, especially if there is a potential dispute between the company and its board of directors.

C. How to apply for debt restructuring in Singapore

(a) Judicial management

A company can enter into judicial management by way of a court order or, alternatively, since the introduction of the Act, by a resolution of the creditors of the company.

(i) Court application for judicial management

The debtor-company (by a members' resolution), its directors (by a board resolution), or its creditors may apply to the High Court of Singapore to place the company under judicial management. When such an application is made, an automatic interim moratorium against legal proceedings applies unless a similar application was made within the twelve (12) months prior to that application. A moratorium applies during the period when a judicial management order is in force as well.

A judicial management order will only be granted where the court is satisfied that (a) the company is, or is likely to become, unable to pay its debts; and (b) the making of the order would be likely to achieve one or more of the prescribed purposes of judicial management, such as rehabilitating the company or preserving all or part of its business as a going concern, or better serving the interest of creditors (i.e. a more advantageous realisation of the company's assets) when compared to a winding up.

(ii) Out of court judicial management

Before the Act came into force, a company could only enter into judicial management by way of a court order. Section 94 of the Act now allows companies to enter into judicial management without a court order, by way of a creditors' resolution.

A company proposing to obtain a creditors' resolution to place the company under judicial management must first give written notice of its intention to appoint an interim judicial manager. The company may only do so if all of the conditions prescribed by Section 94(3) of the Act have been met.

Once the interim judicial manager has been appointed, the company must give notice of the appointment of the interim judicial manager to the Official Receiver, Registrar of Companies, and to the public in the manner prescribed.

Thereafter, the company has to call a meeting of its creditors. Written notice must be given to the company's creditors and to the public. Further, at least one of the company's directors must attend the meeting. The company secretary must also attend the meeting and, together with the director, must disclose the company's affairs and circumstances leading up to the proposed judicial management to the creditors at the meeting.

The company can only enter into judicial management if a majority in number and value of the creditors present and voting at the meeting resolves to place the company under judicial management, and approves the appointment of a person as the judicial manager. If such requisite majority is not obtained, the company cannot enter into judicial management without a court order.

(b) Schemes of arrangement

Unlike judicial management, a court application must be filed if a company wishes to enter into a scheme of arrangement with its creditors, even if a majority of the creditors agree to the scheme.

(i) Court application to summon a meeting of creditors to consider a scheme of arrangement

A debtor-company, its creditors, members or the liquidator (in the case of a company being wound up) can apply to the High Court for an order summoning a meeting of the creditors and members of the company to

consider entering into a scheme of arrangement. When the company has obtained the court's leave to convene such meeting, notice of the meeting and an explanatory statement must be sent to the creditors. The explanatory statement need not contain the full terms of the proposed scheme, but it must explain (a) the nature and effect of the scheme; (b) any material interests of the company's directors, shareholders or creditors; and (c) the effect of such interests on the compromise or arrangement insofar as it is different from the effect on similar interests of other persons.

In order for the company to enter into the scheme of arrangement, the requisite majority for a scheme of arrangement is a majority in number representing three-fourths in value of the creditors or class of creditors or the members or class of members present and voting (either in person or by proxy at the meeting). If the requisite majority approves the proposed scheme, the court may sanction the scheme subject to such alterations or conditions as it thinks just.

Companies proposing or intending to propose a compromise or arrangement may make a court application for a moratorium order under Section 64(1) of the Act. Where such an application is made, a thirty (30) day automatic interim moratorium will be in place, pending the court's decision to grant the order. Such an interim moratorium will not be granted if a similar application was made within the period of twelve (12) months prior to that application. The moratorium may also be extended by a court order. Section 64 of the Act largely retains the former Section 211B of the Companies Act. There is one crucial difference however, where Section 64(12) of the Act now provides that neither a court order restraining certain actions and proceedings against the company nor an automatic moratorium will affect "the commencement or continuation of any proceedings that may be prescribed by regulations". At present, as provided under Regulation 4 of the Insolvency, Restructuring and Dissolution (Prescribed Arrangements and Proceedings) Regulations 2020, only admiralty proceedings (with respect to writs for an action *in rem* against a vessel) may be commenced notwithstanding the moratorium. Nonetheless, leave of court will still be required to carry on with such proceedings.

(ii) Court application to summon a meeting of creditors to consider a scheme of arrangement

The court has the power to approve pre-agreed (or "pre-packed") schemes of arrangement between the company and its creditors even though no meeting of the creditors has been ordered or held. This power was provided under the former Section 211I of the Companies Act, which has been re-enacted under Section 71 of the Act. The court cannot approve such a proposed compromise or arrangement unless the company has fulfilled certain requirements, including having (a) provided each creditor involved with information concerning the company's affairs and how the creditor's rights will be affected by the scheme; and (b) published a notice of the company's application for a court order in the manner prescribed. On top of these notice requirements, the court must be satisfied that had a meeting of the creditors been summoned, the requisite majority of votes for a creditors' meeting under Section 71(3)(d) of the Act would have been satisfied.

D. Can a foreign company apply for debt restructuring in Singapore?

Yes. Any corporation liable to be wound up under the CA is eligible, including a "foreign company", provided that the said company has a "substantial connection" with Singapore. A "substantial connection" with Singapore involves, for example, the company:

- (a) having its centre of main interests in Singapore;
- (b) carrying on business or having a place of business in Singapore;
- (c) being registered as a foreign company in Singapore under Division 2 of Part XI of the CA;
- (d) having substantial assets in Singapore;
- (e) having chosen Singapore law as the law governing a loan or other transaction or the resolution of a dispute arising out of or in connection with a loan or other transaction; or
- (f) having submitted to the jurisdiction of the Singapore courts for the resolution of one or more disputes relating to a loan or other transaction.

E. Why should creditors support/consent to debt restructuring?

When creditors bring their individual claims against the debtor-company for compulsory liquidation and the court makes a winding up order, the company's assets will be distributed in accordance with the ranking of claims prescribed by law. The costs of liquidation and preferential debts are paid in priority to unsecured creditors, who often do not recover much of what is owed to them as there is a real risk that the company has insufficient assets to repay those amounts after applying those assets to satisfy higher-ranking claims. In a debt restructuring, each unsecured creditor will almost inevitably receive a lower amount than that originally owed to them prior to the restructuring. However, creditors should nevertheless still seriously consider debt restructuring as an alternative option to compulsorily winding up the debtor-company, especially if the debtor-company does not have substantial known assets. In that situation, it may well be more likely that the creditors will, as a collective body, be repaid at least some of the monies due to them, rather than potentially none at all if the creditors were to have the company compulsorily wound up.

F. I am a creditor and I do not support/consent to the debt restructuring. Can the debt restructuring still proceed

notwithstanding my position?

(a) Judicial management

Yes, so long as a majority in number and value of the company's creditors present and voting at the meeting vote in favour of passing a resolution to place the company into judicial management.

(b) Schemes of arrangement

Yes, so long as a majority in number representing three-fourths in value of the creditors or class of creditors or the members or class of members present and voting (either in person or by proxy at the meeting). A key feature of schemes of arrangement would be the classification of creditors according to the similarity or dissimilarity of their rights and interests for the purposes of voting in different classes. Section 70 of the Act re-enacts the former Section 211H of the Companies Act which provides for a cross class "cram down" mechanism that empowers the court to approve a scheme of arrangement, notwithstanding that requisite majority approval is not obtained for one or more classes of creditors. It is possible to cram down where at least one class of creditors approves the scheme and another does not, so long as the scheme is fair and equitable to the dissenting class.

G. Third party funding

Before the Act came into force, it was unclear whether an insolvent company could enter into third-party funding agreements to pursue causes of action against those who had committed wrongs against the company. Liquidators traditionally looked to the debtor-company's creditors and shareholders to fund these actions, but these parties were typically unwilling or unable to fund such actions.
Liquidators and judicial managers are now expressly empowered to assign to third parties the proceeds of actions arising out of various avoidance provisions and insolvency offences – namely transactions at an undervalue, unfair preferences, extortionate credit transactions, fraudulent trading, wrongful trading, or damages against delinquent company officers. Together with the Civil Law Act which was amended in 2017 to validate certain third-party funding contracts relating to prescribed dispute resolution proceedings, which may allow distressed companies to also utilise third-party funding arrangements to pursue such claims, it is hoped that a greater realisation of the company's assets for the benefit of the creditors of the company may be achieved.

Looking Forward

The commencement of the Act is an encouraging milestone in Singapore's continuous journey to strengthen its insolvency and debt restructuring regime. The commencement of the Act is also timely in light of the impending expiry of the temporary relief measures afforded by the COVID-19 (Temporary

Measures) Act. We look forward to commenting further on the Act and on further developments in Singapore's insolvency and restructuring landscape.