SINGAPORE'S CORPORATE INSOLVENCY REGIME: JUDICIAL MANAGEMENT AND SCHEME OF ARRANGEMENT UNDER THE INSOLVENCY, RESTRUCTURING AND DISSOLUTION ACT 2018

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Introduction

Singapore's corporate insolvency regime is governed under the newly enacted Insolvency, Restructuring and Dissolution Act 2018 ("IRDA"). The IRDA is an omnibus legislation housing all of Singapore's insolvency and restructuring laws in one single piece of legislation. This memorandum will discuss the current provisions under the IRDA in relation to companies that are seeking protection under the judicial management regime and scheme of compromise and arrangement.

The judicial management regime aims to provide a company, which is unable to pay its debts as and when they fall due, some "breathing space" so as to be nursed back into financial health or to achieve a better realisation of its assets than it would have in a liquidation scenario. Judicial management is governed under Part 7 (Sections 88 to 118) of the IRDA.

Judicial Management

Commencing Judicial Management

The process of judicial management begins by an application made to court by way of petition for an order that the company should be placed under judicial management. The petition must state that the company is or is likely to become unable to pay its debts, and that there is a reasonable probability of rehabilitation for the company, or preservation of its business as a going concern, or that the interests of the creditors are better served than in a winding up. The petition must be supported by an affidavit verifying it. The petition, unless presented by the company, must be served on the company within seven days of the hearing of the petition. In addition, the petition is required to be advertised. The court may make a judicial management order in relation to the company only if it is satisfied that the company "is or is likely to become unable to pay its debts" (Section 91(1)(a) IRDA) and considers that the making of the order would be likely to achieve one or more of the purposes of judicial management mentioned in Section 89(1) (Section 91(1)(b) IRDA).

The cash flow test is applied by the court to determine whether a company "is or is likely to become unable to pay its debts" under Section 91(1)(a) IRDA (Gulf International Holding Pte Ltd v Delta Offshore Energy Pte Ltd SGHC 151 at , citing Sun Electric Power Pte Ltd v RCMA Asia Pte Ltd 2 SLR 478 ("Sun Electric")). The cash flow test assesses whether the company's current assets exceed its current liabilities such that it is able to meet all debts as and when they fall due, where "current assets" and "current liabilities" refer to assets which will be realisable and debts which will fall due within a 12-month timeframe.

In Sun Electric, the Court held that the cash flow test was the sole and determinative test under (now repealed) Section 254(2)(c) of the Companies Act, for the following reasons.

- Firstly, the plain words of Section 254(2)(c) did not envisage two or more different tests being applied

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but implied only a single test, namely, whether "it is proved to the satisfaction of the Court that the company is unable to pay its debts". In contrast, where Parliament intended to have separate insolvency tests, it has explicitly stated so in the statute. For example, Section 100(4) of the Bankruptcy Act explicitly distinguished the cash flow and balance sheet tests as, respectively, "he is unable to pay his debts as they fall due" (Section 100(4)(a) Bankruptcy Act) and "the value of his assets is less than the amount of his liabilities, taking into account his contingent and prospective liabilities" (Section 100(4)(b) Bankruptcy Act). The fact that no such distinction was made in the plain words of Section 254(2)(c) supported the inference that Parliament intended only for a single test to apply.

- Secondly, United Kingdom (UK) caselaw supported the interpretation that the cash flow test was the sole and determinative test under Section 254(2)(c). In relation to Section 518(e) of the Companies Act 1985, which was in pari materia with Section 254(2)(c), the UK courts interpreted it as requiring a single test of commercial insolvency, which assesses the company's present capacity to meet its liabilities as and when they became due.
- Thirdly, the single test intended by Section 254(2)(c) is not the balance sheet test. The balance sheet test compares a company's total assets with its total liabilities. However, the Court in Sun Electric considered that this ratio has no direct correlation with whether a company "is unable to pay its debts". For example, a company may have total liabilities that exceed its total assets by ten times, but these liabilities may only materialise in a hundred years, which means that the company will be able to pay its debts for the next hundred years (provided nothing else changes). Conversely, a company may have total assets which are ten times the total liabilities but these assets may all be illiquid and only realisable in a hundred years, whereas the liabilities may all be current. This means that the company may not be able to pay its debts for the next hundred years. The Court used these examples to show that it is not the total asset to total liability ratio which determines a company's present ability to pay its debts, but rather the liquidity of the assets and when the debts fall due. The balance sheet test is thus not a good indicator of the company's present ability to pay its debts and Parliament could not have intended for it to be the test for Section 254(2)(c).
- The Court also noted that Re Great Eastern Hotel (Pte) Ltd 2 SLR(R) 276 ("Great Eastern") was the first local case to take the view that both the balance sheet and cash flow tests were applicable under Section 254(2)(c), more than 30 years after the first iteration of the provision had been enacted in Singapore. Prior to Great Eastern, the cases expressed the view that only a cash flow test should be applied to Section 254(2)(c). In the Court's view, a wrong turn was taken in Great Eastern.

Between the time an application for a judicial management order is filed, and when the judicial management order is granted, the court has the power, on application by the company, to appoint an interim judicial manager (Section 92 IRDA).

The application for a judicial management order may be made by the company or its directors (pursuant to a resolution of its members or the board of directors) or a creditor or creditors (including any contingent or prospective creditor or creditors) (Section 90 IRDA).

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If a party wishes to oppose the petition, he should give notice of this to the petitioner or the petitioner's solicitors. In this respect, affidavits in opposition of the making of a judicial management order or the nomination of the judicial manager may be filed. The parties who are entitled to appear and oppose the granting of a judicial management order include the creditors of the company and any person who has appointed or is entitled to appoint a receiver and manager of the whole or substantially the whole of the company's property under a debenture secured by a floating charge, or by a floating charge and one or more fixed charges.

Requirements for a Judicial Management Order

The court may make a judicial management order in relation to the company if it is satisfied that the company is or will be unable to pay its debts, and that there is a real prospect that the making of the order would likely achieve one or more of the following three purposes, namely:

1. the survival of the company, or the whole or part of its undertaking as a going concern;
2. the approval under the provisions of the IRDA of a compromise or arrangement between the company and creditors and/or members or any class of; or
3. a more advantageous realisation of the company's assets would be effected than on a winding up.

The mere fact that these conditions are satisfied do not, however, necessarily lead to the conclusion that a judicial management order will be made. In particular, it has been said that the court should be vigilant to ensure that judicial management is not directly or indirectly used by the directors or shareholders to the detriment of creditors, and in particular those whose claims are unsecured. Also, given that judicial management leads to a moratorium being imposed on claims against the company, which is an inroad into the rights of creditors, judicial sentiment has been expressed that the regime should not be abused or lightly brought.

Secured Creditors' Veto Power

There is one situation where the courts may dismiss the petition, where:

1. there is opposition by a person who has appointed or a receiver and manager under the terms of a debenture secured by a floating charge, or by a floating charge and one or more fixed charges; and
2. the Court is satisfied that the prejudice that would be caused to that person if the order is made is disproportionately greater than the prejudice that would be caused to unsecured creditors of the company if the application is dismissed (Section 91(6) IRDA).

Timeline for Judicial Management

The speed at which a judicial management application may be commenced depends essentially on the speed at which the applicant is able to gather sufficient information and prepare the necessary papers for

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an application for judicial management. An application will usually be fixed for hearing a few weeks after it is filed. In the meantime, a moratorium is imposed by virtue of the fact that the application for judicial management has been made.

On the hearing of the petition, the court may either dismiss the application, or adjourn the hearing conditionally or unconditionally, or make any interim order or any order that it thinks fit. The prevailing attitude of the courts is, however, to avoid, where possible, undue delay in the hearing of the petition. This is because while the petition subsists, there exists a moratorium on the claims against the company. This moratorium amounts to an inroad into the rights of creditors and should not be unnecessarily prolonged.

Where a judicial management order is made, the order will, unless discharged, remain in force for a period of 180 days from the date of the making of the order. The court may extend this period on the application of the judicial manager.

Moratorium

The main effect of the commencement of proceedings for judicial management is that a moratorium is imposed on claims against the company. The purpose of the moratorium is to assist the company to achieve one of the three stated purposes of judicial management outlined above.

Where a petition for judicial management has been presented or a notice for the appointment of an interim judicial manager filed, until such time when a judicial management order is made, or the petition is dismissed or appointment of interim judicial manager, the IRDA provides that:

1. no resolution may be passed, or order made for the winding up of the company;
2. no steps may be taken to enforce any charge on or security over the company's property or to repossess any goods in the company's possession under any hire-purchase agreement, except with leave of the court and subject to such terms as the court may impose; and
3. no other proceedings and no execution or other legal process may be commenced or continued, and no distress may be levied against the company or its property, except with leave of the court and subject to such terms as the court may impose.

Interim Judicial Manager

After the presentation of the petition for judicial management and before the making of the judicial management order, the petitioner may apply, and the court has the power to, appoint an interim judicial manager who can be the same person nominated in the petition. The interim judicial manager shall exercise such duties, powers and functions as the court may specify in the order. The petitioner must show good reasons for the appointment of an interim judicial manager. Presumably, the court will order an appointment of an interim judicial manager if it can be shown that there is a danger that the assets of the company will be dissipated in the interim.

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Effect of a Judicial Management Order

Section 96(4) of the IRDA provides that where a judicial management order has been made and during such time when the order remains in force:

- no resolution shall be passed, or order made for the winding up of the company;
- no receiver and manager shall be appointed under the terms of any debenture of the company secured by a floating charge or by a floating charge and one or more fixed charges;
- no other proceedings and no execution or other legal process shall be commenced or continued, and no distress may be levied against the company or its property except with the consent of the judicial manager or with leave of the court and (where the court gives leave) subject to such terms as the court may impose;
- no steps shall be taken to enforce security over the company's property or to repossess any goods under any hire-purchase agreement, chattels leasing agreement or retention of title agreement except with the consent of the judicial manager or with leave of the court and (where the court gives leave) subject to such terms as the court may impose; and
- no right of re-entry or forfeiture under any lease in respect of any premises leased by the company except with the consent of the judicial manager or with leave of the court and (where the court gives leave) subject to such terms as the court may impose.

Proposals by Judicial Manager

Under the IRDA, the judicial manager is required, within 90 days of the making of the judicial management order (or such longer period as the court shall allow) to send to the creditors his proposals for achieving one or more of the purposes of judicial management.

There are no specific limitations on the type of proposals which a judicial manager may make. However, the proposal should state that it intends to achieve the objectives of the judicial management for whose achievement the order was made. In practice, some of the forms of proposals which have been made is for the company to enter into a scheme of arrangement or compromise (dealt with further below), and for the company to sell part or the whole of its undertaking which continue to remain viable. For avoidance of doubt, the proposal for the company to enter into a scheme of arrangement or compromise, and the scheme of arrangement or compromise, are separate matters.

Creditors Meeting to consider Judicial Manager's Proposals

At the meeting called to consider such proposals, the creditors shall decide whether or not to approve the judicial manager's proposals. The judicial manager's proposals would be accepted if passed by a majority in value and number of the creditors present and voting on the proposals. When passed, the IRDA requires the judicial manager to manage the affairs, business and property of the company in accordance with the

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proposals.

There is no requirement that the court approve the proposals. The proper remedy of any creditor or member unhappy with the proposals is to make an application to court on the grounds that the company's affairs have been carried out in a manner unfairly prejudicial to the creditors or members, or some of them (including the applicant), or a single creditor that represents one quarter in value of the claims against the company, or that any actual or proposed act of the judicial manager would be so prejudicial. This is in fact the general remedy available throughout the period where the judicial management order is in force.

The failure of judicial management will result in the company reverting to its pre-judicial management position. It is important to note that one of the prerequisites for the application for a judicial management order is that the company is not able to pay its debts. Where the company is the applicant, the fact of the application may then be taken as an admission that the company is insolvent. Insolvency or the inability of the company to pay its debts is one ground for winding up of the company. The judicial manager is under a statutory obligation to apply to discharge the judicial management order when it appears to him that the purpose specified in the judicial management order has been achieved or is incapable of achievement. The result of a successful completion of judicial management largely depends on the proposals of the judicial manager. Where the proposals result in a scheme of arrangement (below), this may have the effect of extinguishing part of the debts in accordance with the scheme.

Schemes of Arrangement

A Scheme of Arrangement is an agreement between the company and its creditors, containing terms that allow the company to restructure to meet its debt obligations. Schemes are fundamentally contractual in nature, the central document is the Scheme document, which binds the company and its creditors in the same way a contract does. A scheme of arrangement is different to a straight-out contractual relationship in that there may be in certain circumstances dissenting creditors that do not agree to but are bound by the scheme. Therefore, to prevent abuse of process, schemes of arrangement require Court sanction to legitimise the scheme. Scheme of Arrangements are governed primarily under Part 5 of the IRDA (Sections 63 to 72). Prior to the IRDA, the procedures for a Scheme of Arrangement were set out in Sections 210 and 211 of the Companies Act 1967. In 2017, the Companies Act was amended to significantly enhance the Scheme of Arrangement regime, introducing improved statutory moratoriums and pre-pack schemes, amongst other innovations. The existing statutory regime for Schemes, as amended in 2017, has been largely transplanted into the IRDA, with minor modifications.

A scheme of arrangement and compromise outside judicial management involves the following steps:

A. An application being made to court for approval to call a meeting of creditors. The creditors should be

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divided into different classes if their interests are different. This will trigger an automatic moratorium.

B. If the approval is granted, the creditors will then consider the proposal and vote on it during the meeting of creditors. The majority of votes required is more than half in number representing three quarters in value of those present and voting at the meeting.
C. If the requisite majority is obtained, the court must further sanction the scheme. In general, the matters which the court will take into account in deciding whether or not to sanction a scheme includes a consideration of whether the statutory requirements to effect a scheme had been complied with, sufficient information had been given to the creditors and the terms of the scheme are reasonable.
D. Thereafter, if the court sanctions the scheme (and subject to certain administrative steps being taken), the scheme becomes binding as between the debtor company or entity and its creditors.

Foreign Companies

A foreign company can seek moratorium protection under a scheme of arrangement if it can show that it had a "substantial connection with Singapore", for example (a) it has assets located in Singapore; (b) it has substantial business in Singapore; (c) Singapore law had been used as the governing law for its business transactions; (d) the foreign company has submitted to the jurisdiction of the Singapore courts for the resolution of disputes relating to its business transactions; and/or (e) Singapore is the company's centre of main interests.

Moratorium

A moratorium is a stay on proceedings against the company. In a restructuring context, a moratorium gives the company some respite from proceedings against it and allows the company to have the time and space to focus on restructuring its liabilities.

Section 64(8) of the IRDA allows for an automatic moratorium of 30 days upon the filing of the application for a moratorium. Further, such an application may be made as long as the company intends to propose a Scheme. Upon the application being heard, the Court has the power to grant a longer moratorium as may be appropriate in the circumstances, which would give the company time to properly formulate the proposed Scheme and place it before the creditors.

Section 64(12)(b) of the IRDA provides that neither an order of Court to restrain proceedings against a company in a scheme of arrangement nor the automatic moratorium will affect the commencement or continuation of any proceedings that may be prescribed by regulations.

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Super priority for Rescue Financing

Rescue financing generally refers to financing (for example, loans) provided to troubled companies for the purpose of restructuring.

Understandably, lenders are reluctant to provide such rescue financing in case the restructuring fails, putting them in line together with other creditors of the company. However, the IRDA gives the Court power to order a "super priority" for debts incurred by the company in respect of rescue financing.

In this regard, Section 67 of the IRDA provides that the Court can grant such super priority if:

1. The funds provided are necessary for the company's survival or for the whole or any part of the undertaking of that company to remain as a going concern; or
2. The funds provided are necessary to achieve a more advantageous realisation of the company's assets of a company than on a winding up of that company.

Cross-class cram down

Under Section 70 of the IRDA, the Court may approve a Scheme even if there is a class of creditors which does not approve the proposed Scheme, as long as the below set out conditions are met:

1. A majority in number of the creditors meant to be bound by the arrangement, who voted at the creditors' meeting, have agreed to the arrangement;
2. The majority in number of creditors mentioned above represents three fourths in value of the creditors meant to be bound by arrangement; and
3. The Court is satisfied that the compromise or arrangement does not discriminate unfairly between 2 or more classes of creditors, and is fair and equitable to each dissenting class.

"Pre-Packed" – without creditors meeting

Section 71 of the IRDA allows the Court to approve a proposed Scheme of Arrangement without the need for a creditors' meeting – a so-called "pre-packed" Scheme. To succeed in an application under section 71, the company must satisfy the Court that had a creditors' meeting been summoned, the proposed Scheme would have been approved by the statutory majority (Section 71(3)(d) IRDA).

Proof of Debt procedure for Schemes

Section 68 of the IRDA sets out the formal procedure for creditors who wish to attend and vote at the creditors' meeting to file their proofs of debt such as the provisions for the filing of the proof of debt, inspection of another creditor's proof of debt, adjudication of the proof of debts by the Chairman of the meeting, and for how objections from creditors are to be made and resolved.

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With a few exceptions, the process for a scheme of arrangement within the context of judicial management is similar to that outside judicial management. The exceptions are set out below:

The requisite majority for the approval of a scheme within the context of judicial management is three quarters in value of the creditors present and voting. There is no further requirement of obtaining a majority in number.

The courts are generally more prepared to sanction a scheme within the context of judicial management as compared to one outside judicial management. This is because, with judicial management, there is the imposition of the judicial manager, an independent party, which would normally mean that there is more assurance of objectivity in the scheme.

Should you require any further information, please do not hesitate to contact John Mark Chen

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