Overview of Singapore's New Restructuring Framework

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Profile

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Introduction

Given its geographical position in the heart of South East Asia and being one of the busiest ports in the world, it is no surprise that corporations in or linked to the marine industry play a significant role in the Singapore economy. Many in this industry have faced difficulty in light of the falling oil and resource prices, resulting in numerous recent corporate debt defaults. A recent high-profile example is Swiber Holdings Ltd., which is still undergoing a restructuring process in Singapore. Companies in various other industries such as a major commodities trading house, a large offshore solutions provider for the oil and gas industry, and a major semiconductor player have also fallen victims to the economic slowdown.

There are some USD 12bn worth of bonds falling due this year in Singapore alone. As the economic outlook remains uncertain, the risk of corporate default increases, and if companies seek to carry on as going concerns, they will need to restructure their debts. This in turn contributes to the general upward trend of companies from the Asia Pacific region undergoing debt restructuring exercises.

Given the global footprint of many of these companies, they should seek to restructure their debts in a jurisdiction that grants them sufficient flexibility while ensuring oversight that provides creditor assurance. Singapore hopes to be that jurisdiction. It recently introduced various enhancements to its restructuring and insolvency regime that came into operation on 23 May 2017.

OLD REGIME: Framework Supported by a Forward-Thinking Judiciary

The previous regime, which the current enhancements build on rather than replace, provided a workable framework for insolvencies in Singapore. The focus of the legislative framework, however, was on liquidation of companies, rather than their rehabilitation.

Jurisdictional issues

To adapt to new issues placed before the courts, case-law has filled in the gaps left by legislation. An example is the requirement of assets within the Singapore jurisdiction or a sufficient nexus to Singapore before the court exercises its discretion to call for a creditors meeting or provides any other relief to a foreign debtor seeking to restructure its debts by way of a scheme of arrangement in Singapore. In a recent case, the fact that the foreign debtor was listed on the SGX-ST established sufficient nexus.

Lack of express Provisions on cross-border insolvencies

In addition, the old legislative framework did not set out the powers of the court in relation to foreign insolvency proceedings. Global restructurings require some co-ordination across various jurisdictions, and representatives of debtor companies often seek recognition of foreign insolvency proceedings, usually accompanied by a request for relief in Singapore, for example, a stay of proceedings or a discovery order in Singapore.

To keep pace with such developments, the Singapore courts have granted such applications using common law recognition and assistance doctrines, in an exercise of its inherent jurisdiction.

Shortcomings of popular debt restructuring mechanism

A popular mechanism for debt restructuring in Singapore is the scheme of arrangement, which is a court-sanctioned arrangement or compromise between a company and its members and/or creditors. The scheme of arrangement can operate as a debtor-in-possession regime (albeit in a more limited form than that provided under the US Chapter 11 process), meaning management remains in control of the company.

Under the old regime i.e. section 210(10) of the Companies Act, the court could only grant a stay of proceedings that had already commenced.

In practice, the court has often, using its inherent jurisdiction, also granted a stay of pending and future proceedings when a scheme is to be proposed.

A key reason for the popularity of the statutory scheme of arrangement is that it enables the company to "cram down" the scheme on dissenting creditors as long as a statutory majority (more than 50% in number, and more than or equal to 75% in value, of creditors) in each class of creditors vote in favour of the scheme. This overcomes the need for individual agreements between a debtor company and each of its creditors to achieve a restructuring of its debts.

To overcome the "holdout" problem, where creditors with a fraction of the debt of the company band together to form a majority in number to block the scheme of arrangement, the old regime gave the court discretion to order a different majority for the "number" requirement.

However, the requirement to classify the company's creditors into separate classes if their rights are so dissimilar that they cannot sensibly consult together with a view to their common interest means a class of creditors, regardless of how small the quantum of debt owed to them, may still block the scheme.

Unwillingness to give up control of company

Another regime under which a debt restructuring can be carried out is the judicial management regime which is similar to the administration regimes in the UK and Australia. Judicial management involves the appointment of an insolvency practitioner, usually a public accountant other than the company's auditor, to manage the company with a view to rehabilitating it. Unlike the scheme of arrangement, this regime gave greater protection to the company's creditors by providing independent oversight over the affairs of the company.

However, judicial management has proven to be less popular than schemes of arrangement for debt restructuring exercises, likely due to the requirement of insolvency, and the need for management to give up control of the company.

Multiple issues pointing to need for enhancement of regime

The measures taken by the Singapore courts to keep pace with the realities of multi-jurisdictional debt restructuring while working within the previous confines of the Companies Act are commendable and displays a forward-looking judiciary. However, multiple instances of such gap-filling exercises, along with pressures for change by insolvency practitioners, indicated that the old legislative framework was ripe for improvements.

Enhanced Restructuring Regime

The Singapore government recognised this need and set up committees that examined the legislative framework in depth, recommending a slew of amendments including an omnibus Insolvency Act, similar to that of the United Kingdom.

While the omnibus Insolvency Act has yet to be introduced, in the interim, certain portions of the Companies Act were amended by the Companies (Amendment) Act 2017 (Act 15 of 2017) to introduce significant improvements to the restructuring regime in Singapore. The changes relating to the restructuring regime came into operation on 23 May 2017.

These changes, along with the pragmatism and relative efficiency that Singapore is known for are expected to place Singapore as a serious contender when companies decide on a jurisdiction to restructure their debt.

The key areas of enhancement are:

- schemes of arrangement
- judicial management
- adoption of the UNCITRAL Model Law on Cross-Border Insolvency ("Model Law").

Key development: availability of super-priority for rescue financing in both schemes and judicial management

The key development common to both schemes of arrangement and judicial management is the availability now of super-priority for rescue financing akin to "DIP financing" under US Chapter 11.

This means rescue financing, which can be worked into a restructuring effected through a scheme of arrangement or under a judicial management, may be granted varying levels of priority, including super priority status, by way of a court order.

Such orders can be made to grant rescue financiers a security interest over the company's property that is equal to or higher than the existing security interest, if there is adequate protection for the existing security interest.

Which level of priority such rescue financiers takes depends on negotiations between the parties, as the application for such priority under the Companies Act will be made by the company. It is important to note that the order granted is at the discretion of the court.

Key developments in schemes of arrangement

The following are key developments within the scheme of arrangement mechanism:

- Ability to cram down dissenting classes of creditors.
- Availability of an automatic stay upon the filing of a stay application.
- The Court's ability to order worldwide in personam stays against a wide range of acts including future proceedings and enforcement of security against the company.
- Availability of stays in favour of companies related to an entity undergoing a scheme of arrangement that are not themselves undergoing a scheme of arrangement.
- Availability of pre-pack schemes (expedited schemes of arrangement that can be implemented with prior negotiations with major creditors without the need to call for creditor meetings).

Key developments in judicial management

The following are key developments within the judicial management mechanism:

- Judicial management, previously only available to Singapore-incorporated companies, is now available to foreign corporations that are liable to be wound up under the Companies Act.
- The scheme of arrangement regime available to the judicial manager has been amended to require sanction from more than 50% in number, and more than or equal to 75% in value, of the creditors as opposed to only 75% in value under the old provision.
- The "veto" power available to secured creditors who can appoint receivers and managers is watered down. The secured creditor must now show that the making of a judicial management order will cause disproportionately greater prejudice to that creditor than the prejudice caused to unsecured creditors if the judicial management order is not made.
- The court can make a judicial management order at an earlier stage of the company's financial distress (when a company is "likely to become" unable to pay its debts as opposed to "will be" unable to pay its debts).

Key developments in cross-border insolvency

The key development here is the adoption by Singapore of the Model Law. This will ease recognition of foreign insolvency proceedings and rehabilitation proceedings.

The remedies available will vary depending on whether the insolvency proceedings are recognised as:

- foreign main proceedings (i.e. proceedings occurring in the company's centre of main interests), or
- foreign non-main proceedings (i.e. proceedings occurring in a place where the company has an establishment).

Upon recognition of a foreign main proceedings, a stay is granted automatically. Additional relief can be sought as required.

Upon recognition of a foreign non-main proceedings, the foreign representative of the company can apply for relief, including a stay, granted at the discretion of the court.

Shortcomings of Old Regime Largely Addressed

With the enhancements to the scheme of arrangement regime, Singapore moves closer to becoming a viable alternative to the USA Chapter 11 process. This could lead to Singapore companies with assets and creditors worldwide, such as Ezra Holdings Limited, which filed for Chapter 11 protection in USA, to choose Singapore instead.

Three key problems existing within the old regime have been directly addressed with the enhancements.

First, Section 211H of the Companies Act, now allows the scheme to be crammed down on dissenting classes of creditors. In effect, the "veto" right that each class of creditor had is removed.

Secondly, the changes address the inadequate protection of companies looking to propose a scheme of arrangement. The enhanced stay provision introduced in section 211B of the Companies Act provides for an automatic stay upon filing, and further, grants the court discretion to order a variety of stays, including stays against future proceedings, resolutions to wind up the company, and steps to enforce security; and where necessary, give it a worldwide in personam effect.

Finally, the absence of a uniform law and approach to dealing with cross-border insolvencies and restructurings has been addressed by implementing the Model Law in Singapore.

These broad powers granted under the enhanced regime are tempered by some protection afforded to the affected parties.

Protection for dissenting creditors through the absolute priority rule

Sections 211H(3) and 211H(4) of the Companies Act requires companies to ensure that the scheme is fair and equitable in relation to classes of creditors who are crammed down. In essence, the Companies Act statutorily implements the absolute priority rule. Under the absolute priority rule, shareholders are compensated only after creditor claims are settled to the satisfaction of the court.

Protection for creditors of company granted a stay by requiring the disclosure of information

If a stay is granted under section 211B of the Companies Act, the legislation requires the court to also order that the applicant submit sufficient information relating to the company's financial affairs to enable the company's creditors to assess the feasibility of the intended or proposed compromise or arrangement.

Section 211B(6) of the Companies Act sets out such information which the Court may specify for submission:

- a report on the valuation of each of the company's significant assets,
- where the company acquires or disposes of any property or grants security over any property, information relating to that transaction within 14 days of such a transaction,
- periodic financial reports for the company and its subsidiaries,
- forecasts of profitability and cashflow from operations of the company and it's subsidiaries.

In addition, a creditor or receiver and manager of substantially the whole of the property or undertaking of the company may apply for a discharge of or variation of the stay.

Protection for creditors of company granted stay by allowing application to prevent dissipation of assets

To prevent the company from dissipating all its assets when a stay is in place, the court is also empowered under section 211D of the Companies Act to restrain disposition of assets or transfers of shares or membership upon an application for such relief by a creditor.

Thinking ahead: new features introduced

Apart from plugging holes in the old regime, the enhancements also introduce new features largely borrowed from the USA Chapter 11 process.

Super-priority for rescue financing

As set out above, chief among these is the availability of super-priority for rescue financing under sections 211E and 227HA of the Companies Act where the restructuring is effected by a scheme of arrangement or a judicial management.

Pre-pack schemes of arrangement

The enhancements to the Companies Act also introduce a faster and more cost-effective route for a scheme to be implemented where a company is able to work out an arrangement with major creditors (given a small amount of dissenting creditors) without the need to call for any creditor meeting(s).

The court may approve such "pre-pack" schemes under section 211I of the Companies Act, without any meeting being held, provided:

- the company has provided each creditor meant to be bound by the compromise with a statement setting out the details of the compromise
- the company has publicised the application for court approval of the pre-pack scheme
- the company has sent a copy of the application to each creditor that will be bound under the pre-pack scheme
- the court is satisfied that had a meeting of the creditors (or class meeting) been summoned, it would have been passed by the requisite majority (number (unless modified by court) and value).

Stays under scheme of arrangement regime can have worldwide effect

Considering companies have an increasingly global reach, their creditor profiles are likely to also include creditors from across the world. Section 211B(5) of the Companies Act empowers the court to give any of the stays it orders under section 211B(1), a worldwide in personam effect. In theory, this allows for companies to obtain a stay against parties who are subject to the jurisdiction of the Singapore courts from bringing actions against the companies in other jurisdictions.

Automatic stay

Further, upon filing an application for a stay under section 211B(1) of the Companies Act, the company is granted an automatic stay that lasts for 30 days, or until the date when the application is heard, whichever is earlier. This automatic stay, without more, does not have a worldwide in personam effect.

Availability of stays for related companies

Increasingly, restructurings do not only involve just one entity. Some entities may be involved in the larger restructuring of a group of companies, but may not be part of the scheme of arrangement itself.

Recognising this reality, the legislation provides for related companies of a successful stay applicant under section 211B(1) of the Companies Act to obtain a stay on similar terms to those applicable to the company that is the subject of the scheme of arrangement. This stay can also have worldwide in personam effect.

To succeed in an application for a stay, the related company must show that:

- it is not itself in liquidation, nor has any resolution been passed to put it under liquidation,
- it plays "a necessary or integral role in the compromise or arrangement" of the company undergoing the scheme of arrangement,
- the compromise or arrangement proposed by the company will be frustrated if action is taken against the related company, and
- the creditors of the related company are not unfairly prejudiced by the stay.

The court is empowered to grant the stay over the related company so long as it is liable to be wound up under the Companies Act. Therefore, if the related company is a foreign company, it must show substantial connection with Singapore.

Foreign companies can be put under judicial management

The change in definition of "company" in section 227AA of the Companies Act now allows foreign entities that have a substantial connection to Singapore to be put under judicial management.

This means creditors who are unwilling to put up with the debtor-in-possession scheme of arrangement mechanism may apply for a judicial manager to be appointed over the company. Such an appointment may serve as a stand-in for the oversight provided by a Chapter 11 trustee that can be appointed in Chapter 11 proceedings in USA.

Potential Challenges

While the enhancements highlighted above provide a statutory framework for restructuring, there remain uncertainties in the legislation which may introduce new areas of disputes to the restructuring and insolvency regime.

Automatic stay not worldwide, worldwide stay limited

Creditors outside the jurisdiction are not bound by the automatic stay effective upon the filing of the application under section 211B(1) of the Companies Act. Once these creditors are made aware of the filing, they are open to pursue other remedies in other jurisdictions, without breaching the automatic stay order.

Even if the debtor company were to obtain a worldwide in personam stay (by way of an ex parte application filed at the same time as the application for a stay), this does not prevent creditors who are not subject to or within the jurisdiction of the Singapore court from seeking remedies in other jurisdictions. This raises the issue of fairness between creditors who are subject to the Singapore Court's jurisdiction and creditors who are outside the jurisdiction. One possible solution may be to apply for recognition in the US under Chapter 15 proceedings.

Unclear when "adequate protection" is provided

In situations involving rescue financing, it is likely that the rescue financier will require priority under the new super-priority provisions. Where such priority is equivalent to or higher than existing security interests, then there must be adequate protection of the existing security interest, in the form of relief resulting in realisation of the "indubitable equivalent" of the existing security interest.

These rescue financing provisions were adapted from the USA Chapter 11 super-priority financing mechanism. While there is case law from the USA on the interpretation of "indubitable equivalent", practically, it is unclear how the Singapore court will apply this standard.

For example, the USA bankruptcy courts have shown a willingness to arrive at a value between the liquidation value and the going concern value, depending on, inter alia, whether the market in which the company operates will turn around, and whether the company will be able to pay off the rescue financier in whole. It is unclear if the Singapore courts will take a similar approach, or develop other valuation methods.

Unclear what a secured creditor will need to show to exercise his "veto" over a company being put under judicial management

Secured creditors entitled to appoint a receiver and manager no longer have an unconditional veto over the appointment of a judicial manager. Such creditors must satisfy the court that the making of a judicial management order will cause disproportionately greater prejudice to the said creditor than the prejudice caused to unsecured creditors if the judicial management order is not made.

It is unclear what burden this places on the secured creditor, as it is unlikely that the secured creditor will have sufficient information on the company's debt profile to prove such prejudice.

Creditors not entitled to information and relief unless application made

The new provisions do not entitle creditors to information and reliefs as of right. For example, the company may dispose of assets during the moratorium without any requirement to inform creditors of the same unless so ordered by the court and even then the language of the legislation suggests that it only needs to make disclosure to the court within 14 days after such disposal. The disclosure of financial information to creditors is at the discretion of the Court and is restricted to sufficient information to enable creditors to assess the feasibility of the scheme. This leaves unanswered how the Singapore court will deal with a company which may have been involved in suspicious or fraudulent transactions.

Conclusion

The enhancements to the Companies Act are a major step toward attracting debtors and possibly creditors to come to Singapore for their restructuring needs. However, there are likely to be teething pains given the uncertainties that the new provisions introduce.

It is likely that rules and subsidiary legislation will be introduced to supplement the insolvency regime to assist the court and those before it.

Another area that could see development is the oversight burden on the courts being eased by implementing internal-governance based oversight bodies (such as a creditors' committee) or external oversight that answers to the court (such as a monitoring accountant) or a hybrid such as a chief restructuring officer who is an officer of the company but also answerable to the court.

Given the Singapore courts' practice-oriented and pragmatic approach, it is likely that such developments to practical issues will be forthcoming.

Overall, the enhanced regime appears attractive enough to attract debtors to Singapore to restructure, and depending on the success of these restructurings, creditors may call on debtors to use Singapore as a restructuring jurisdiction. If both creditors and debtors are satisfied with the Singapore regime as a potentially more cost-effective alternative for restructuring, then Singapore will have achieved its goal of being Asia's restructuring hub.

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