SINGAPORE UNVEILS MAJOR DEBT RESTRUCTURING LAW REFORMS

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Legal Briefings – By **Paul Apathy** and **Emmanuel Chua**

Singapore's Ministry of Law has unveiled significant proposed changes aimed at revising Singapore's restructuring and insolvency laws and developing Singapore into a regional debt restructuring hub.[1]

IN BRIEF

Draft legislation unveiled

The proposals include major changes to Singapore's laws relating to schemes of arrangement, judicial management and cross border insolvency. These changes will significantly improve the legal framework for undertaking major debt restructurings in Singapore, and the ease with which non-Singapore companies can access these improved Singapore procedures. These changes will therefore be of interest to financial market participants and restructuring professionals throughout the Asia-Pacific region, both as a potential new tool for undertaking cross border restructurings and also as a model for potential law reforms in other jurisdictions.

The draft legislation is the first phase in a series of forthcoming law reforms intended to implement recommendations made by the Insolvency Law Review Committee and the Committee to Strengthen Singapore as an International Centre for Debt Restructuring.

The proposed amendments in this initial draft legislation include some of the most significant reforms proposed by those committees, and are aimed at implementing key changes to make Singapore's corporate rescue and debt restructuring tools more broadly available and effective.

Outline of changes

The draft legislation introduces changes in the areas of schemes of arrangement, cross border insolvency and judicial management.

Schemes of Arrangement

The changes to the Singapore regime for schemes of arrangement are particularly noteworthy. The proposed amendments adopt a number of concepts from the United States' Chapter 11 process, including concepts of super-priority debtor-in-possession financing, a strengthened and broad reaching ('world-wide') moratorium and a cram-down mechanism for approval over the dissent of certain creditors. There is also provision for a 'pre-pack' type mechanism allowing the court to approve a scheme without a formal creditor meeting where certain requirements are satisfied.

The result could be considered a 'super-charged' scheme procedure (or 'Chapter 11 lite') that addresses many (although not all) of the key weaknesses of the existing scheme of arrangement procedure when used in a debt restructuring context. This reform is the first of its kind amongst the various Anglo legal-jurisdictions that have versions of schemes of arrangement on their statute books, and its implementation will therefore be watched with great interest in the United Kingdom, Hong Kong, Australia and elsewhere.

Cross-border insolvency and other changes

The draft legislation also has a significant focus on making Singapore restructuring and insolvency procedures more accessible for foreign companies, which will be important for allowing Singapore to act as a regional restructuring hub. The legislation achieves this through introducing a new 'substantial connection' test to determine whether non-Singapore companies can file for Singapore schemes of arrangement and judicial management.

The legislation also formally adopts the UNCITRAL Model Law on Cross-Border Insolvency in Singapore (**Model Law**). The Model Law is a central aspect of cross border restructuring and insolvency practice, and has been adopted in many other key jurisdictions. Its introduction in Singapore will make it significantly easier for companies undergoing foreign insolvency and restructuring procedures to obtain the assistance of the Singapore courts.

Further changes are also made to abolish the Singapore's liquidation ring-fencing rule, to make it easier to file for judicial management and to apply the rescue finance regime to judicial management.

Consultation process

The amendments are currently in the public consultation phase, which began on 21 October 2016 and is open until 2 December 2016. The current expectation is that the legislation will be enacted in early 2017.

This article summarises key aspects of these exciting new proposed amendments and comments on the implications of these changes.

IMPLICATIONS

The proposed amendments have profound implications for restructuring and insolvency practice in Singapore. Among other things they will:

- make Singapore schemes of arrangement a much more powerful debt restructuring and corporate rescue tool;
- encourage a market for American style ‘debtor-in-possession’ rescue finance in Singapore restructurings; and
- make it significantly easier for foreign companies to utilise Singapore procedures to restructure (including by using these new, more powerful, scheme mechanics which are not available elsewhere in the region).

These are encouraging developments. In broad terms we believe the proposals will significantly improve the legal framework for undertaking major debt restructurings in Singapore. However, the detail of the proposed legislative amendments will require careful consideration to ensure that they deliver on this promise and work smoothly alongside existing Singapore law, especially given that a significant number of the changes have been based on provisions of the US Bankruptcy Code.

The proposals are also consistent with some of the key recommendations arising from the recent Insolvency Service review in the United Kingdom,[2] which recommended that the United Kingdom introduce a three month restructuring moratorium, increase availability of rescue finance and a court approved cram-down process. This gives some indication as to the tide of thinking regarding global restructuring law and the recognition in various jurisdictions that reform is necessary and desirable to stay globally competitive and to deliver better outcomes for distressed companies.

Whether the proposals deliver on the objective of creating a Singapore debt restructuring hub remains to be seen. There are a number of further legal reforms that are not included in the proposed amendments that would also be worth considering, including:

- restricting the operation of ‘ipso facto’ contractual termination clauses upon the commencement of restructuring or insolvency procedures;

- abolishing the scheme of arrangement ‘headcount’ test;[3] and
- introducing a shareholder cram-down mechanic, allowing shares to be issued or transferred to creditors as part of a creditor scheme of arrangement without shareholder consent (where the shareholders are demonstrably ‘out of the money’).

There are also further issues that will impact on the success of Singapore as a debt restructuring hub, including:

- the extent to which Singapore restructurings will be recognised in foreign jurisdictions where the Singapore proceedings affect non-Singapore companies, assets or claims; and
- the development of an internationally respected community of Singapore based restructuring professionals.

The Ministry of Law has indicated that further legislative amendments will be forthcoming that may address some of these issues and further foster the development of Singapore as a debt restructuring hub.

We recommend that any interested parties take advantage of the public consultation process that is currently underway on this major law reform.

SCHEMES OF ARRANGEMENT

Section 210 of Singapore’s Companies Act (the **Act**) provides for the entry by a company into a compromise or arrangement with its creditors or members (or holders of units of its shares), generally referred to as a ‘scheme of arrangement’.[4]

The proposed amendments are focussed on improving the use of schemes of arrangement as debt restructuring tools. Accordingly, the new scheme provisions are only available in connection with creditor schemes of arrangement that *compromise* the rights of creditors (or a class of them).[5]

Enhanced moratoriums

The draft legislation introduces a series of ‘enhanced moratorium’ provisions. These new moratorium provisions are in addition to the existing (fairly limited) moratorium provisions contained in section 210(10) of the Act.

Moratorium orders

The proposed amendments allow the court, on the application of the company or a creditor, to make an order for a moratorium where the company:

- has made an application to the court to call a meeting of its creditors; or
- intends to make such an application as soon as practicable.

Notice of the application for a moratorium order must be given to (among others) every (known) creditor sought to be bound by the compromise or arrangement.

The draft legislation also includes a requirement that the court application include (among other things) evidence of support for the proposed compromise or arrangement from creditors:[6]

- representing not less than **one-third in value** of the creditors sought to be bound by the proposed compromise or arrangement; or
- whose support for the proposed compromise or arrangement would be important for the success of the proposed compromise or arrangement.

Scope of the moratorium

The moratorium order that may be granted by the court can include orders preventing:

- winding up of the company;
- appointment of a receiver or manager;
- commencement or continuation of proceedings against the company;
- execution or distress against the company’s property;
- enforcement of security over the company’s property, or repossession of goods under leases, hire purchases or retention of title arrangements; or

- re-entry or forfeiture under any lease of the company.

This is similar to the moratorium available in judicial management, and is not limited to creditors subject to the proposed scheme of arrangement.

Automatic interim moratorium

There is also an automatic 30 day interim moratorium that applies from the making of the application for a moratorium order (which covers all of the matters referred to above). This is presumably intended to provide interim protection for the company in the period before the application for a moratorium order is heard.

'World-wide' moratorium orders

The amendments provide that the court may make a moratorium order expressed to apply to any person within the jurisdiction of the court, whether the act takes place in Singapore or elsewhere.

This is broadly equivalent to the 'world-wide' stay granted at the commencement of a US Chapter 11 process. Its extra-territorial effectiveness therefore relies on the personal jurisdiction of the Singapore court over the relevant creditors (e.g. because they have assets or operations in Singapore).

It is unclear from the proposed amendments whether the 30 day automatic interim moratorium would have world-wide effect.

Moratorium orders for subsidiaries

Where a moratorium order is made in respect of a company, the subsidiaries of that company may also apply to be granted a moratorium order subject to certain conditions being met. Notably the conditions do not require that the subsidiary has a nexus to Singapore, instead focusing on the applicant 'playing a necessary and integral role' in the scheme proposed by the holding company (provided that there is no unfair prejudice to creditors of the subsidiary). The extension of the moratorium to subsidiaries that are not directly participating in the Singapore procedure, whilst potentially helpful in situations involving restructurings of large corporate groups, could be controversial given this goes beyond even what is normally available in a US Chapter 11 process.[7]

Rescue finance

The amendments also introduce rescue finance provisions for schemes of arrangement. These provisions are similar to the debtor-in-possession financing scheme under section 364 of the U.S. Bankruptcy Code.

The rescue finance provisions allow a company to seek a court order as to the priority of credit incurred for the purpose of enabling the company to continue as a going concern.

The court is able to grant an order that such credit:

- be treated as a cost or expense of the winding-up of the company;
- has priority over all preferential debts (subject to either being 'necessary to enable' or 'for the purpose of enabling' the business of the company to continue as a going concern);[8]
- be secured by a security interest over unsecured property of the company or by a subordinate security interest on secured property of the company (subject to the requirement at (b) being satisfied and the company being unable to obtain the credit from any person unless the debt is so secured); or
- be secured by a security interest with an equal or higher priority on property of the company subject to an existing security interest (subject to the requirements at (b) and (c) being satisfied and there being 'adequate protection'[9] of the interest of the holder of the existing security interest).

The power under paragraph (d) allows the court to grant 'super-priority' status to financiers who provide critical funding in the period prior to the scheme being implemented. In a distress situation such financiers will frequently require first ranking security to reflect the risk that they are undertaking. Without statutory priority, this is dependent on the consent of existing secured creditors who may be reluctant to surrender their priority.

The proposed amendments also include similar priority arrangements for rescue finance to the judicial management regime in the Act.

Cram-downs

Further proposed amendments enable the court to approve a scheme of arrangement relating to multiple classes of creditors even if a class of creditors opposes the scheme, provided that certain prescribed requirements are satisfied. These 'cram-down' provisions appear to have been based on the cram-down mechanics applicable to plans of arrangement in section 1129 of the US Bankruptcy Code.

Under the amendments the court may approve a scheme, despite there being a dissenting class of creditors, where:

- in respect of ***at least one class of creditors***, creditors representing a majority in number and at least 75% in value (present and voting) support the scheme;
- in respect of ***the scheme creditors as a whole***, creditors representing a majority in number and at least 75% in value (present and voting) support the scheme; and
- the court is satisfied that the scheme:
    - is 'fair and equitable' to the dissenting class(es) of creditors; and
    - does not 'discriminate unfairly' between two or more classes of creditors.

The term 'fair and equitable' is further defined in the proposed amendments. It requires that no creditor in the dissenting class receives an amount under the scheme that is lower than the creditor is estimated to receive in the event that the company is wound up. Further specific requirements apply to the treatment of secured and unsecured dissenting creditors, respectively, which are based on provisions of the US Bankruptcy Code.[10]

The term 'discriminate unfairly' is not defined in the proposed amendments, although (like the fair and equitable concept) it appears to have been adopted from the US Bankruptcy Code requirement. In the US, unfair discrimination relates to comparing treatment between equally situated classes to ensure that any difference in treatment is not unfair. What is deemed unfair will therefore depend on how the classes are treated, and case law from the United States in this regard is likely to be an important guide for the Singapore courts in developing this concept.

The introduction of a cram-down mechanic to schemes of arrangement is highly significant, and has long been on the 'wish list' of international restructuring lawyers. Schemes of arrangement have traditionally had limited ability to deal with 'hold out' junior creditors that are economically 'out of the money' but who could block a scheme that sought to compromise them on the basis that they were in a separate class. Introduction of a 'cram down' mechanic therefore provides a powerful new tool to push through restructurings.

Pre-packaged scheme voting

The amendments introduce a provision that allows the court to approve a scheme of arrangement without any meeting of creditors being ordered or held.

Such an order can only be made if a number of requirements are satisfied, including that:

- the company has provided the creditors with a statement that explains the effect of the scheme, any material interest of the directors and the effect of the scheme on such interests (and a similar statement in respect of any trustee for debenture holders of the company);
- such statement is accompanied by various prescribed information;
- notice of the application is published in the Gazette and newspapers;
- notice and a copy of the application is sent to every creditor sought to be bound by the scheme; and
- the court is satisfied that, had a meeting of creditors (of class thereof) been summoned, the scheme would have been approved by the necessary majorities at that meeting.

This amendment is aimed at one of the most common criticisms of schemes – that they are slow and expensive given the requirement to make two court applications and to hold a meeting of creditors (even where the outcome of the creditors' meeting has been pre-determined via voting agreements).

In effect this provision allows a company and the requisite majority of creditors to pre-agree (or pre-package) a scheme of arrangement and thereby dispense with the normal scheme meeting formalities. The concept appears to be based on the common approach under the US Bankruptcy Code of allowing creditors to pre-agree to a plan of arrangement prior to the Chapter 11 filing.

The key test under the proposed legislation is whether the court is satisfied that, had a meeting been summoned, the scheme would have been approved by the requisite majorities. The draft provision does not indicate how a court is to be satisfied on this point. In the US, a prepackaged or pre-negotiated plan would typically be socialized with all constituents, or at least the major constituents, in an attempt to lock in support for a Chapter 11 plan prior to a Chapter 11 filing. This could be by way of a 'lock-up' or 'plan-support agreement', or by circulating the plan of arrangement, disclosure statement and voting ballots to solicit votes pre-filing. It will be interesting to see the nature and degree of creditor support that the Singapore courts will require to approve a prepackaged scheme.

Creditor protection and procedural changes

The proposed amendments also include a number of other creditor protections and procedural changes, including:

- where a moratorium order is made, requiring the company to provide certain financial information to enable creditors to assess the feasibility of a proposed scheme;[11]
- allowing any creditor of the company to apply to the court during the moratorium period (prior to a scheme being approved) for an order restraining the company from:
  - any disposition of company property (that is not carried out in good faith and in the ordinary course of the company's business);
  - any act or exercise of power of the company that is carried out in the ordinary course of the company's business, but that materially prejudices the creditors of the company or significantly diminishes the property of the company; or
  - any transfer of any share or any alteration in the status of the members of the company;
- providing a regime for the submission, adjudication and objection to creditor claims in respect of a scheme by way of a formal proof of debt process. These provisions were recommended in the Singapore Insolvency Law Reform Committee's Report in 2013 as a result of concerns arising in the *TT International* case.[12] The provisions include:[13]
  - the appointment of an adjudicator, nominated by the company, who is to adjudicate the validity of every proof of debt;
  - allowing creditors who have filed proofs of debt to inspect, and object to, proofs of debt filed by other creditors;
  - adjudication of disputes relating to proofs by an independent assessor agreed to by the parties or appointed by the court following the application of a party to the dispute;
- granting the court the power to order a creditor re-vote in respect of a scheme, instead

of approving or rejecting the scheme; and

- permitting review by the court of acts, omissions or decisions in respect of the scheme, after the scheme has been approved.

JUDICIAL MANAGEMENT

Singapore's judicial management procedure is similar in many respects to the administration regime in force in the United Kingdom and Australia . It allows the appointment of an independent manager to operate and run the company instead of the appointment of a liquidator. There are three statutory purposes to judicial management in Singapore:

- the survival of the company;
- the approval of a scheme of arrangement; and
- achieving a more advantageous realisation of the company's assets would be effected than on a winding up.

Under the Act, a judicial manager is empowered to propose a scheme of arrangement. This power is not slated to change under the proposed amendments. If a judicial manager does propose a scheme, the protections granted to a company undergoing a scheme of arrangement can be accessed by a company undergoing judicial management.

Easier access to judicial management

The proposed amendments will make it easier for companies or creditors to obtain a judicial management order by lowering the threshold at which an order may be made. Currently under the Act, a company may apply for a judicial management order if the company 'is or will be' unable to pay its debts. Under the proposed amendments, the condition is lowered to apply to any company that 'is or is likely to become' unable to pay its debts.[14]

Additionally, the fact that a person who has or is entitled to appoint a receiver objects to the appointment of a judicial manager will no longer be an automatic bar to that appointment. Instead, they may object to the order and must show that the order would cause disproportionately greater prejudice to that person than the prejudice that would be caused to unsecured creditors of the company if the judicial management order were dismissed.

Rescue funding in judicial management

In addition to being able to access the benefit of the proposed amendments to the scheme of arrangement procedure, a judicial manager is also given specific power to seek an order for priority for rescue financing, regardless of whether a scheme is proposed. The terms of the proposed new priority regime for rescue finance in judicial management are substantially similar to the terms of the regime proposed for schemes discussed above, save that the new debt that is to be accorded priority is required to be incurred to enable the purposes of judicial management – the survival of the company, the approval of a scheme of arrangement or a more advantageous realisation of the company's assets than would be effected on a winding up.

CROSS-BORDER INSOLVENCY

Access to judicial management by foreign companies

Under current law, only a company incorporated pursuant to Singapore law can take advantage of judicial management proceedings.

The proposed amendments broaden the type of company which can take advantage of judicial management proceedings, by proposing a new definition of 'company' for the purposes of the judicial management procedure. The new definition allows 'any corporation liable to be wound up under this Act' to file for judicial management.

The phrase 'liable to be wound up' test is already used under the Act to determine whether a foreign company can be subject to a Singapore scheme of arrangement or a Singapore winding up.[15]

'Substantial connection' with Singapore

The proposed amendments also provide a new ground for a foreign company to be wound up in Singapore, which would in effect be the test applicable to foreign companies seeking to access the Singapore scheme of arrangement or (as a result of the amendments mentioned above) judicial management procedure.

The new criteria proposed is that the 'company has a substantial connection with Singapore', taking into account the presence of one or more of the following factors:[16]

- Singapore is the centre of main interests (COMI) of the company;
- the company is carrying on business in Singapore or has a place of business there;
- the company is a foreign company that is registered under Division 5 of the Act;
- the company has substantial assets in Singapore;

- the company has chosen Singapore law as the law governing a loan or other transaction (or the resolution of disputes thereunder); or
- the company has submitted to the jurisdiction of Singapore courts for the resolution of disputes relating to a loan or other transaction.

This ‘substantial connection’ test appears to have some similarities with the ‘sufficient connection’ test applied by English courts when determining whether an English court can sanction an English scheme of arrangement in respect of a foreign company. In England, most of these factors would by themselves provide sufficient jurisdictional grounds for an English scheme of arrangement. It will remain to be seen whether Singapore courts intend to take an equally expansive approach.

Adoption of the UNICTRAL Model Law on Cross-Border Insolvency

A further significant change is the full-scale adoption of the Model Law. Adoption of the Model Law will allow representatives of foreign insolvency and restructuring proceedings to be recognised in Singapore and gain assistance from the Singapore courts.

The Model Law has become a central aspect of cross border restructuring and insolvency, allowing a more coordinated and cooperative approach between jurisdictions where a debtor company operates. The Model Law has already been adopted in many other key jurisdictions including the United States, the United Kingdom, Japan, South Africa, South Korea, the Philippines, Australia, Canada, New Zealand, the British Virgin Islands and Greece.

To date, in the absence of the Model Law, Singapore courts have incorporated Model Law-type concepts into Singapore’s common law.[17] However, adoption of the Model Law will provide a clearer and more comprehensive framework for cross-border assistance and is to be welcomed.

Abolition of the ring-fencing rule

The proposed amendments will also abolish the so-called ring-fencing rule. Previously, where a foreign company subject to an insolvency procedure elsewhere had assets in Singapore, the Singapore liquidator of that foreign company had to pay debts in Singapore before remitting any remaining funds to the foreign jurisdiction.

This rule interfered with the equality of creditors by giving Singapore creditors priority over other creditors. Under the proposed amendments, this rule has been abolished for most companies, with the default position being that the foreign company’s liquidator in Singapore must remit all funds in Singapore to the liquidator in the foreign jurisdiction.[18]

ENDNOTES

1. Public Consultation on Proposed Amendments to the Companies Act to Strengthen Singapore as an International Centre for Debt Restructuring.

2. United Kingdom Insolvency Service's review (published in May 2016).

3. The 'headcount test' requires a scheme to be approved by a majority in number of creditors (irrespective of the aggregate value of their debts).

4. Section 210 is similar to the corresponding United Kingdom scheme of arrangement provisions (and similar provisions in other jurisdictions such as Australia and Hong Kong).

5. The omission of the reference to creditor 'arrangements' potentially limits the extent to which these new provisions are available in respect of all debt restructurings, given the courts have held that 'compromise' has a narrower meaning than 'arrangement'.

6. The Ministry of Law has specifically sought public input on whether either of these support requirements are feasible.

7. Under Chapter 11, a non-debtor subsidiary does not automatically have the benefit of the stay in respect of a debtor. A debtor may request from the court that the stay be extended to a non-debtor. However, such relief is at the court's discretion and is generally fairly rare and difficult to obtain.

8. The Ministry of Law has sought public input on which of these formulations is preferable.

9. The draft amendments expand upon how such 'adequate protection' can be provided, using concepts adapted from section 361 of the US Bankruptcy Code.

10. Careful consideration of these specific requirements is be warranted to ensure they work as intended in the context of a scheme of arrangement.

11. It is noteworthy that whilst this information is intended to assist creditors evaluate the scheme of arrangement itself, the provision only requires it be provided where there is a moratorium order. It is unclear why this approach has been taken.

12. The *Royal Bank of Scotland NV v TT International Ltd* [2012] SGCA 9.

13. The proposed amendment bolstering the proof of debt process appears to be an attempt to remove litigation over disputed claims from the Singapore courts in favour of a non-judicial decider in the first instance. Whilst the concerns arising in respect of the TT International case are valid, such issues are fairly rare in the context of schemes of arrangement. In debt restructuring cases, where the debt being compromised is external financing, the quantum and nature of the relevant creditor claims is normally clear. It will

therefore be important to ensure that the proof of debt process does not introduce undue delay and complication into such cases.

14. The ‘likely to become’ test bring the Singapore grounds for filing for judicial management into line with the test in the United Kingdom for directors to file for administration and the test in Australia for filing for voluntary administration, which are each available where the company ‘is or is likely to become’, insolvent.

15. The courts have interpreted this by asking whether the foreign company has local creditors and assets within Singapore (see *Re TPC Korea Co Ltd* [2010] SGHC 11).

16. It appears that the proposed amendments to which companies can be wound up in Singapore were drafted with judicial management and schemes of arrangement in mind. However, from the way the change is drafted, it appears to give the court power to wind up any company merely on the grounds that it has a ‘substantial connection’ to Singapore, regardless of whether it is insolvent or whether the shareholders have sought to wind it up.

17. See for example *Re Taisoo Suk (as foreign representative of Hanjin Shipping Co Ltd)* [2016] SGHC 195, where recognition was granted to Korean rehabilitation proceedings under existing statutory rules, and *Re Opti-Medix Ltd (in liquidation)* [2016] SGHC 108, where the Court used the Model Law concept of ‘centre of main interests’ at common law, to find that foreign insolvency proceedings of a company should be the recognised and given assistance by a Singapore Court.

18. There is still some protection for Singapore creditors. The new rule is subject to a court order to the contrary, and before remitting funds the liquidator ‘must be satisfied that the interests of creditors are adequately protected’ (proposed s 377(4A)). In addition, for a limited class of debtors, such as banks, insurers and securities traders, the ring fencing provisions remain, and the liquidator must first pay out Singapore creditors before remitting funds to the foreign jurisdiction.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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