Rising corporate failures and new Act on insolvency, restructuring and dissolution

Written by Robson Lee Teck Leng
Published: 07 November 2020

Robson Lee Teck Leng is a partner in Gibson Dunn's Singapore office and a member of the firm's Mergers & Acquisitions and Capital Markets Practice Groups. With more than 25 years of experience, Mr. Lee focuses his practice on M&A, corporate finance and capital markets. He has substantial experience in Singapore public company M&A and regularly advises companies on listings with the Singapore Stock Exchange. He represents public listed companies on securities transactions, cross-border M&A and foreign joint venture investments. He also advises local and foreign companies in their funds raising and market flotations.

Whither the Development of Singapore as a Debt Restructuring Hub of Asia – destructive effects of COVID-19 and trail of corporate failures

Curtain Raiser on the Relevant Legislative History

The global economy has been hit badly by the COVID-19 pandemic. Globally, companies facing corporate defaults continue to increase. Closer to home, some prominent recent collapses include giant oil trader Hin Leong Trading, Falcon Energy, ZenRock Commodities Trading, Agritrade International, Hontop Energy, as well as former market darling, Hyflux.

As the number of companies seeking restructuring in Singapore will likely continue to trend upwards, this casts a spotlight on the Insolvency, Restructuring and Dissolution Act 2018 ("IRDA") that came into effect on 30 July 2020.

The genesis of the IRDA can be traced back to the Ministry of Law's appointment of an Insolvency Law Review Committee in 2010 to review the then existing bankruptcy and corporate insolvency regimes in Singapore. Later, changes were made in three phases to unify and consolidate the laws on insolvency, restructuring and winding-up into an omnibus statute. The first two phases introduced amendments to the (now repealed) Bankruptcy Act ("BA") and the Companies Act (Chapter 50 of Singapore) ("CA") in 2015 and 2017 respectively. The enactment of an omnibus IRDA is the third and final phase of the reform. Besides introducing certain changes, the IRDA also consolidates and replaces the BA and corporate insolvency provisions in the CA.

For the purposes of this article, we will refer to the present law encapsulated under the IRDA as the present regime. This article seeks to answer some of the frequently asked questions in relation to the present regime. Particular attention is paid to the restructuring options of judicial management ("JM") and the debtor in possession restructuring scheme ("DIP Scheme") with case examples of Singapore incorporated companies.

- In essence, when a company is placed under JM, an external judicial manager is appointed by the court to take control of its management to restructure the company.
- In a DIP Scheme, the existing directors remain in management control and lead the company in seeking a compromise or arrangement with creditors to give the company breathing space and a new lease of life.

1. *What are the key debtor-in-possession ("DIP") legal provisions under the CA that were later imported into the IRDA? What are some salient legal provisions introduced by the IRDA itself?*

Key debtor-in-possession legal provisions under the present regime

- *Priority rescue financing*

  Distressed companies frequently face difficulties in securing fresh funding that is required for its survival. New lenders are unwilling to provide credit to a distressed company, while existing creditors are often reluctant to extend further loans. Accordingly, one main development under the present regime is the availability of priority rescue financing under the respective JM and DIP Scheme frameworks. This concept is predominantly modelled on the "debtor-in-possession" financing characteristic of Chapter 11 of the US Bankruptcy Code. In an insolvency situation, creditors are ranked by the seniority of their debt. The priority rescue financing framework allows for rescue financing loans to rank equally or above the senior creditors of the company or take senior or equal security over an existing security over the company's assets. Having a statutory priority facilitates and encourages the provision of rescue financing to distressed companies.

  Under the present regime, rescue financing may be granted varying levels of priority. The level of priority depends on the terms of the rescue financing and is subject to the court's approval. In order to grant super priority status to a rescue financing, the court must be satisfied that the financing is necessary for the survival of the company as a going concern, or necessary to achieve a more advantageous realization of its assets than on a winding up. There must also be sufficient evidence that it would not otherwise be possible for the company to obtain rescue financing without according to it such priority status.

- *Enhanced moratorium for a Scheme of Arrangement ("Scheme")*

  Upon application to court for a Scheme, there is an automatic moratorium of 30 days. A moratorium restrains parties from legal action or proceedings against the company. The court has the power to extend the Scheme moratorium, and to order a similar stay on related companies. The potential scope of the moratorium order is also very broad, and the court may choose to express that such order has a "world-wide" effect applicable to any act of any person within the jurisdiction of the court, whether the act takes place in Singapore or elsewhere. In the case of H&C S Holdings, the High Court of England and Wales accorded recognition to the moratorium order by a Singapore court.

- *Pre-packaged Schemes*

  The present regime introduced a faster and more cost-effective route for a Scheme to be implemented. The court has the power to approve a pre-negotiated Scheme that fulfils certain conditions, without the need to convene a creditors' meeting to vote on it. Hoe Leong Corporation is an example of a distressed company that successfully utilized a "pre-pack" Scheme to fast-track the restructuring of its debt. Its Scheme was sanctioned in approximately two months from the dispatch date of its Scheme documents.

- *Cross-class creditor cram down*

  When voting for a Scheme, creditors may be divided into different classes where each class votes on the Scheme separately. Subject to the court's approval, the present regime allows the company to "cram down" on a dissenting class of creditors. This addresses the "hold-out" problem under the previous regime, where a small fraction of creditors could band together as a class to block a Scheme.

  Notably, prior to the IRDA, there was a concern that the then statutory law required shareholders to voluntarily divest their interests in the company before a cram down order could be made against a dissenting class of creditors, thereby creating a procedural difficulty since shareholders may choose not to cooperate. This is because the previous provision under the CA provided that where the creditors in the dissenting class are unsecured creditors, the terms of such compromise or arrangement *"must not provide for … any member, to receive or retain any property on account of … the member's interest"*, unless those dissenting unsecured creditors are paid in full. The IRDA included additional wording to the provision in question, to clarify that in a cram down, shareholders must not receive or retain *"any property <u>of the company</u>"* and not just *"any property"*. The principle behind this is clear. Persons subordinate in priority to the dissenting class of creditors must not be allowed to receive or retain any property of the company under a procedure which allows the company to "cram down" on the interests of those same dissenting creditors. The insertion of the words *"of the company"* simply clarifies that the cram down procedure is not concerned with adjustments to any shareholder's interests in the company, and is thus not contingent on such shareholders' cooperation in the divestment of their own shares.

<u>*Salient legal provisions under the IRDA*</u>

- *Restriction on ipso facto clauses*

  An *ipso facto* clause is a contractual provision that allows one party to unilaterally terminate a contract solely due to the occurrence of a triggering event. The IRDA introduced a restriction on *ipso facto* clauses. It restricts the ability of parties to unilaterally terminate or amend, or claim an accelerated payment or forfeiture of the term under any agreement with the company by reason only that certain proceedings (*e.g.*, a Scheme or JM) have commenced, or that the company is insolvent. This restriction on the *ipso facto* clause has the benefit of preserving key contracts that are vital to a company's ongoing business(es), which is paramount whilst it is undergoing debt restructuring.

- *Introduction of wrongful trading*

  Under the previous regime, criminal liability must be established before the court may impose civil liability against directors of a company for "insolvent trading". The IRDA introduces a new "wrongful trading" provision to replace insolvent trading. A company is deemed to trade wrongfully if it incurs debt or liabilities when insolvent (or becomes insolvent as a result of incurring such debt or liability), without reasonable prospect of meeting them in full. There is no longer a prerequisite to fulfil the higher criminal standard of proof. A director who permits a company to engage in wrongful trading can be personally liable. The IRDA also provides that judicial managers and liquidators can enter into third-party funding agreements to fund legal claims against errant directors for wrongful trading. This will facilitate the recovery of losses suffered by an insolvent company as a result of wrongful trading.

- *Commencement of judicial management*

  Prior to the IRDA, a company could only be placed under JM through a formal application to the court. The IRDA provides the option for a company to be placed under JM upon obtaining a resolution by its creditors to do so. This new statutory provision can help to reduce the expenses arising from a JM process, and expedite the commencement of JM.

2. *What are the pros and cons of the Debtor-in-Possession Restructuring ("Management-led Restructuring") under the IRDA?*

Businesses fail for many reasons, but distressed companies often signal some weakness in management. This brings into question the basis for allowing existing management to continue running the company after it has fallen into a financial quagmire under its watch.

However, if management teams familiar with the operations of the company are removed at the outset, the impetus and ability to drive the company through a restructuring process could be diminished. By keeping existing management in place, there is arguably a better chance of rehabilitating a viable business. Judicial managers appointed by the court will not have the same relationship and goodwill with the customers, suppliers and existing business partners of the company that the incumbent management has. Professionals who are parachuted into the company in a JM will have to spend considerable time understanding the nature and peculiar issues and challenges facing the company that is already beset with liquidity and financial problems. Striking a compromise and work-out arrangement with all and sundry to give the company a new lease of life could be more difficult, especially if the business of the company is complex. The statistics to date since JM was first introduced in Singapore's corporate insolvency laws in 1987 show that few companies in Singapore have been successfully rehabilitated via JM. The rationale for the introduction of the Management-led Restructuring framework by the Singapore government in 2017 was to help Singapore plug the gap in our corporate restructuring laws, and to eventually develop Singapore into a regional hub for corporate restructuring. Public data shows that Management-led restructuring has resulted in more successful restructurings. Indeed, Management-led Restructuring provides an incentive for management to diligently work to achieve a turn-around, or risk having creditors apply to court to displace the existing management team and put the company into JM or liquidation.

While Management-led Restructuring can be beneficial to many companies, there are several salient points to note. Unlike JM, Management-led Restructuring is not bound by an initial statutory timeline of 180 days (subject to extension) to achieve a definitive outcome or to effect a winding-up of the company if no viable compromise with creditors is reasonably achievable. A Management-led Restructuring thus enjoys more latitude in that it is not required to be conducted within a statutorily prescribed period. To remedy this issue, the court has increasingly chosen to grant shorter moratorium periods, which requires the company and its advisers to frequently update the court on the status and progress of any ongoing plan of restructuring before an extension of moratorium is granted. In the cases of Kris Energy and Design Studio Group, the court granted moratorium periods of three to four months upon their first applications from 2019 to 2020. In the earlier cases relating to Hyflux and Swee Hong, the companies were each granted moratorium periods of six months upon their respective first applications in 2018 and 2019. Further, as the controlling shareholder(s) are usually part of existing management and are thus likely to be involved in a Management-led Restructuring, the interests of the shareholder(s) are more likely to be duly considered in any plan of restructuring to be presented for creditors' approval.

In a JM, on the other hand, the creditors in majority may play a more dominant or even determinative role in the outcome of any restructuring proposal recommended by the judicial managers. In court hearings requested by the JM to update the court, unlike creditors and save with the leave of court, shareholders of the company do not have the right to make submissions or raise objections against actions or any plan of restructuring proposed by the judicial managers.

Hyflux is a recent case of Management-led Restructuring. The company and its advisers were able to stave-off an initial application by creditors to put the listed company under JM. However, after more than two years of negotiations between the company and two groups of potential investors that did not lead to any fruitful outcome, the company's creditors became frustrated with the lack of progress. Creditors started to question the unduly long and protracted delay in achieving any meaningful outcome. There were also concerns raised publicly regarding the high fees that management had agreed to pay its advisers and the increasing drain on the company's cash reserves. The disquiet is exacerbated by the adverse publicity surrounding investigations by enforcement agencies against previous and current directors of the company. The train of developments and long delays aggravated the negative optics. All these factors contributed to an increasing loss of market and media confidence in the restructuring endeavors of the company led by its existing management and advisers.

Management-led Restructuring is very much reliant on court supervision. While the court does constantly monitor the restructuring progress, there are no legislative signposts as to when the court should direct a transition of the Management-led Restructuring to JM. Indeed, one reason behind the uncertain and protracted Hyflux restructuring is the lack of legislative signposts as to when the court should direct a transition of the Management-Led Restructuring to JM. However, when there are valid reasons for the court to believe that the incumbent management team can no longer be reposed with the trust to continue in management or that there are grounds that show that management could have been in serious dereliction of their management roles and duties, such as suspected criminal conduct, the court is likely to order the company to be placed under JM. A recent case in point is the Hin Leong group, where the court ordered the relevant companies to be put under JM notwithstanding the vigorous objections raised by their respective management teams.

3. *How does judicial management work? What are the powers and duties of judicial managers?*

During a JM process, the company's business is managed by a judicial manager for 180 days (subject to further extensions), and the board of directors is displaced. Prior to the appointment of a judicial manager, the court may appoint an interim judicial manager to carry out those functions.

A judicial manager is an officer of the court and is subject to the court's supervision. The judicial manager has a wide range of powers. He can enter into contracts on behalf of the company to sell or dispose the company's assets or businesses, and he can set aside certain transactions entered into by the company prior to the JM on certain grounds (such as if the transaction was made at an undervalue). He can also seek an extension of the JM from the court. Finally, the judicial manager also has the power to apply to court to wind up the company after the objects of the JM have been achieved, or if in the opinion of the judicial manager, the objects of the JM cannot be reasonably achieved.

4. *How are white knights considered in a judicial management? What should a shareholder do in the event it feels that the appointed judicial manager has not duly considered its interests in electing to sell the company's assets and business to a particular white knight? Under what circumstances will the court intervene in the judicial manager's decision?*

Broadly speaking, a white knight is usually a third-party investor who "rescues" the company from insolvency. However, different white knight rescue proposals may not weigh out the same from different stakeholders' perspective. When considering a rescue proposal from a white knight, the judicial manager must primarily consider whether the proposal is most likely to achieve the objectives of the JM. A judicial manager enjoys wide powers relating to the management of company so long as his decisions and actions are reasonably carried out in good faith and supported by a majority of the creditors. The judicial manager has the right to elect and recommend a rescue proposal for creditors' approval over other competitive bids, even if the recommended proposal may appear to be less beneficial to certain minority creditors or shareholders.

Creditors or shareholders who feel that they have been prejudiced by a judicial manager's actions may apply to the court for relief. However, the court is usually reluctant to second-guess the decisions of a judicial manager on commercial matters if the decisions are not unreasonable in the court's opinion. This is particularly so where creditors holding a majority of the company's debts are supportive or have approved the judicial manager's proposal.

A judicial manager is an agent of the company. The present regime allows a judicial manager to seek an indemnity from any other person in respect of contracts entered into by the judicial manager that are approved by the court. Notably, the regime does provide that where the court is discharging a judicial manager or where a judicial manager applies to court to be released, the court may if it thinks fit make an order releasing the judicial manager from liability in respect of any act or omission by the judicial manager or otherwise in relation to his conduct as judicial manager of the company. The relevant statutory provision however makes clear that any release order by the court does not relieve the judicial manager from liability for any misapplication or retention of any money or property of the company, or for which the judicial manager has become accountable or from any law to which the judicial manager would be subject in respect of negligence, default, misfeasance, breach of trust or breach of duty in relation to the company. What this means is that when a judicial manager acts *bona fide* in making commercial decisions on behalf of the company, it would be difficult for any disgruntled stakeholder to persuade the court to intervene and to hold the judicial managers personally liable, unless there is clear evidence of wrongdoing.

To the knowledge of this author, there has been to date no reported case in Singapore where a disgruntled shareholder or creditor has succeeded in persuading the court to overturn a proposal by a judicial manager that has been duly approved by the requisite majority of creditors. Similarly, this author is also not aware of a reported case in Singapore where a major creditor was prohibited from voting at a creditors' meeting to approve its own rescue proposal despite the obvious conflict of interest. The IRDA is also silent on such a situation.

5. *How does the court balance the interests of shareholders versus creditors in a reorganization proceeding? How about the interests among creditors?*

When a company is insolvent, its assets effectively belong to its creditors as they must go towards repaying the company's debts. Creditors' interests become paramount, and the shareholders' rights rank secondary.

Nonetheless, even though creditors may have duly approved a disposal of all or substantially all of the company's assets in a Scheme meeting, in a Management-led Restructuring, directors would still be obliged to convene a shareholders' meeting under Section 160 of the CA for shareholders to endorse the sale of all or substantially all the assets of the company.

In a JM situation where the judicial managers have signed a contract with a bidder to sell all or substantially all of the company's assets and undertaking, once the requisite majority of the creditors have approved the proposed disposal, dissenting creditors or shareholders can only seek judicial recourse by applying to court on the ground that the act(s) or proposed act(s) of the judicial manager have been or would be prejudicial to the interests of the applicant. The court is however restricted by the present regime not to make any order that will prejudice or prevent the implementation of any compromise under a Scheme that has been duly approved in accordance with the CA or by the court under the IRDA.

When we consider roll-ups and cross-collateralization, DIP financing could pose a conflict between new rescue financiers and existing creditors as well. A roll-up involves the debtor drawing from the new DIP financing to pay off an existing loan, thus 'rolling-up' a debt that was previously incurred to the detriment of other creditors. Similarly, cross-collateralization occurs when the debtor grants an existing creditor with a security interest in assets acquired after its insolvency, to secure its pre and post-insolvency debt.

Closing Thoughts

Much like Management-Led Restructuring, the purpose of JM is fundamentally that of rehabilitation. By providing a distressed company with breathing space to restructure its debts and businesses, it can regain its balance without the undue stress of dealing with numerous claims from competing creditors. The object is to preserve the value of the company for the benefit of its stakeholders and to achieve an outcome better than liquidation.

However, it must be noted that as is the case for any restructuring option, both Management-led Restructurings and JMs would invariably entail substantive compromises and significant concessions amongst shareholders and creditors with disparate rights and interests, to enable a distressed company to gain a new lease of life. Therefore, the reality is that shareholders' interests would often ultimately be compromised in an insolvency situation where creditors' rights are ranked higher.

It is not always clear whether Management-led Restructuring or JM is the better option to restructure a distressed company. Like Management-led Restructuring, JM may at times be a rather lengthy process. Swiber Holdings, for example, has been under JM for over four years. A choice between the two options depends on the company's peculiar circumstances that could change dynamically over time for any number of reasons.

Broadly, Management-led Restructuring is preferable when the company wishes to avoid the stigma of JM. Certain reasons may also justify having existing management remain its control over the company (*e.g.*, need to protect management ties with key trade creditors and customers, reliance on management's familiarity with the day-to-day operations, etc.). On the other hand, JM is more useful in cases where the company lacks restructuring expertise, or where there are doubts about the integrity or ability of the company's existing directors to remain in management control.

The COVID-19 pandemic has brought many global corporations to their knees, most recently, the liquidation of Singapore's 162-year-old iconic retailer, *Robinsons*. The government's foresight to legislate the present regime in the omnibus IRDA (that started 10 years ago) is a laudable move to position Singapore as a regional hub for corporate insolvency and debt restructuring.

The enactment of the IRDA is an important first step. The next step must be to attract more regional companies with good fundamentals but which are encountering financial difficulties to seek Singapore as a safe harbor from the chills of numerous creditors' claims, to rehabilitate, and to eventually get back on their feet.

The vaunted aim to establish Singapore as a regional debt restructuring center would depend very much on whether a culture similar to the concept of the US- style Chapter 11 rehabilitation can progressively take root in Singapore. In this respect, banks and financial institutions (which invariably form the major creditors of an ailing corporation) in Singapore will play a large role in helping to establish such a culture to enable the noble objectives of the IRDA to achieve not just the letter but more importantly the true spirit of the omnibus legislation.

Postscript:

1. *On 16 November 2020, the court ordered Hyflux to be placed under JM. The court had given the company's management and its professional advisers more than two years to resuscitate the beleaguered company. This has not happened despite more than 10 moratorium extensions. None of the suitors that had surfaced in the management-led restructuring has become the proverbial Messiah.*

2. *It is important to note that unlike restructuring advisers who are appointed by the company in a management-led restructuring, a judicial manager is an officer appointed by the court with statutory duties to be carried out under close court supervision. A judicial manager will ensure an orderly dissolution of the affairs and sale of the assets of the company if it is no longer possible to give the company a new lease of life through any white knight rescue.*

3. *It is possible for a company under JM to attract a white knight rescue. The JM has wide discretionary powers to manage the company and to deal with its assets including contracting a rescue plan with a white knight to enable the company to recover its balance with the support of its creditors. It is clear that the court in directing Hyflux to transition to JM has no confidence that the hitherto management-led restructuring would lead to any fruitful outcome.*

Robson Lee can be contacted at rlee@gibsondunn.com