STEPHENSON HARWOOD
(SINGAPORE) ALLIANCE

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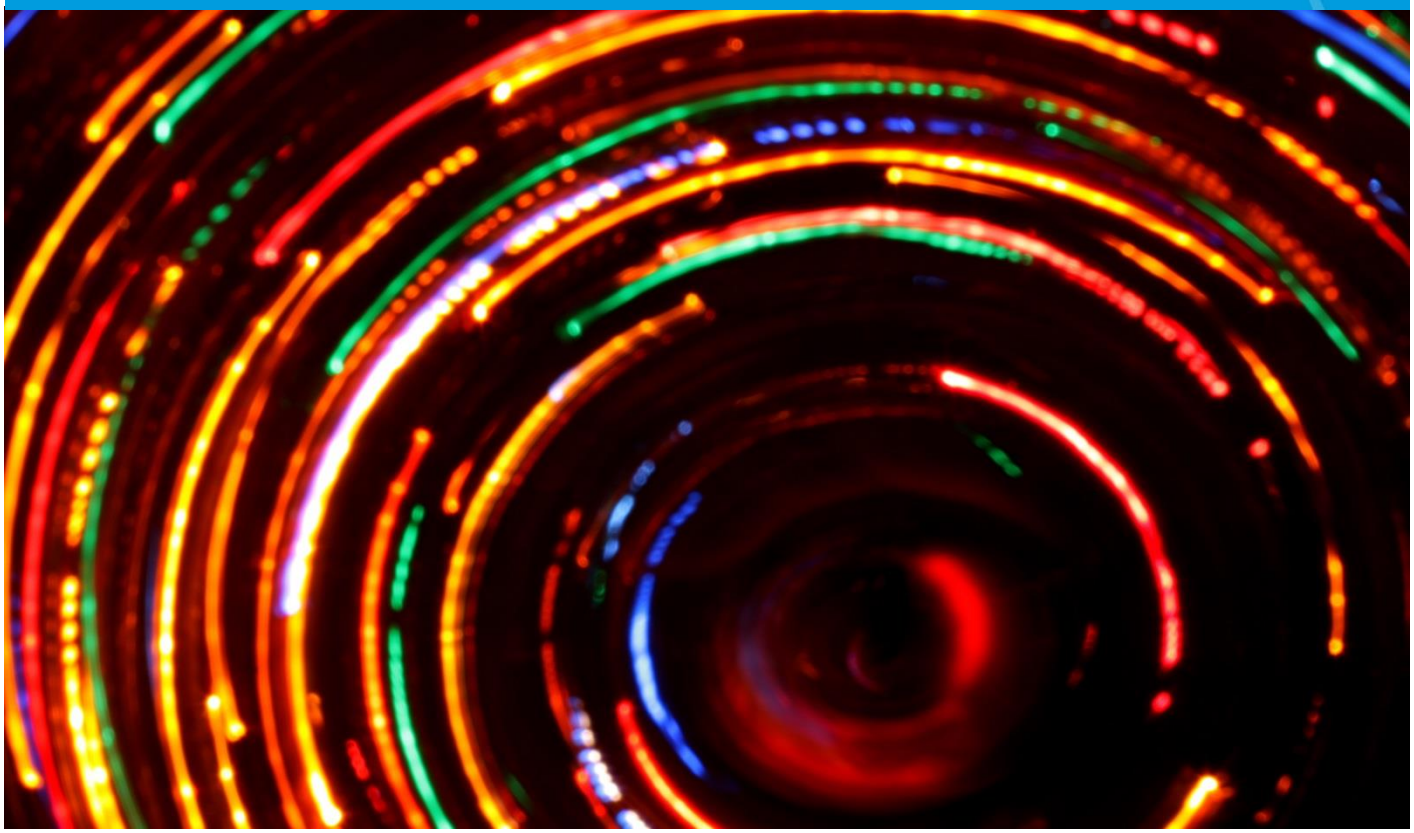
Going concerns

Restructuring and insolvency



In this issue

"They provide legal advice that takes into account practical considerations."

Chambers Asia Pacific 2019

Introduction

Welcome to the inaugural edition of Going Concerns, in which we strive to bring you the latest updates on restructuring and insolvency law. For this issue, we focus on Singapore and provide:

1. A case summary on ***Re IM Skaugen SE and other matters*** **[2018] SGHC 259**, the first decision on a foreign company successfully applying for a scheme of arrangement moratorium pursuant to s. 211B of the Companies Act (Cap. 50);

2. Our views on whether the restriction of *ipso facto* clauses in the upcoming Insolvency, Restructuring and Dissolution Bill will affect the shipping industry;

3. A case summary of ***Re Swiber Holdings Ltd and another matter*** **[2018] SGHC 180**, where we consider whether a creditor holding security over an asset of a related third party may vote the full value of its claim in a creditors' meeting concerning a debtor in judicial management; and

4. A case summary of ***Re Fan Kow Hin*** **[2018] SGHC 257** which appears to keep third party litigation funding open in a bankruptcy context.

We hope you enjoy reading this issue as much as we have enjoyed preparing it. If you have any comments or would like to learn more about any topic, please feel free to contact us.

Clarity on the s. 211B scheme moratorium regime

***Re IM Skaugen SE and other matters* [2018] SGHC 259** is the first decision on what is required to obtain a scheme of arrangement moratorium under s. 211B of the Companies Act (Cap. 50)(the "**Act**"), and also provides clarification on the operation of ss. 211B(4)(a) and 211B(4)(b) of the Act and the territorial scope of the moratorium.

Background

Our clients, IM Skaugen SE ("**IMS**"), a 102 year old Oslo listed Norway gas carrier company, and its Singaporean subsidiaries, IMSPL Pte Ltd ("**IMSPL**") and SMIPL Pte Ltd (collectively, the "**Skaugen Group**"), were in the midst of a business reorganisation when multiple arbitrations seated in London and in Singapore were commenced against them. With our assistance, the Skaugen Group applied for moratorium relief pursuant to s. 211B of the Act for much needed breathing room to complete its restructuring. MAN Energy Solutions SE ("**MAN**") opposed the applications for moratorium by IMS and IMSPL on the basis that, amongst others, the applications were not *bona fides*; and IMSPL did not have evidence of support as required pursuant to s. 211B(4) of the Act.

Good faith requirement

The Court considered various US authorities relating to US Chapter 11 petitions for bankruptcy protection and held that an application for a scheme of arrangement moratorium must be *bona fides*. The Court will conduct a multifactorial assessment in the particular context of each case and the court should ensure that the applicant had "*an honest intent and genuine desire… to use the statutory process to effect a plan of reorganisation*" (***In Re Metropolitan Realty Co* 433 F 2d 676 (5th Cir, 1970)** at 678).

MAN's main contention was that IMSPL did not bring the applications *bona fides* as IMSPL itself did not have operating business to resuscitate and that the timing of the application suggested that it was a collateral attack on and a further attempt to delay the enforcement of an arbitral award they had obtained against IMSPL. The Court did not agree.

For the first issue, the Court thought it was not uncommon for business groups to be structured like the Skaugen Group, placing emphasis on the Skaugen Group's restructuring over each individual companies' restructuring.

> *"The requirement that an application be bona fide was made clear in relation to applications under s 210(10) even though that provision similarly makes no such stipulation… I agreed that having such a requirement for s 211B(1) applications was consistent with the purpose of the statute and the general interest of the court in preventing abuses of process"* – [69] of ***Re IM Skaugen***

For the second issue, the Skaugen Group had taken steps for the restructuring since 2017, and the application was not a last-ditch attempt to prevent enforcement of an arbitral award. The Court went further to say that it was not uncommon to file an application for an automatic moratorium to stave off a winding-up order, and that that did not in and of itself render the application not *bona fide*. The Court also took into account the fact that the Skaugen Group did obtain support from some significant creditors as creditors would only support *bona fides* restructuring attempts.

Critical: evidence of support

MAN also argued that IMSPL was required to produce evidence of support from its creditors pursuant to s. 211B(4)(a) read with s. 211B(4)(b) of the Act, and further argued that IMSPL was bound to fail in this regard, given that MAN was IMSPL's majority creditor (and would not be supportive).

The Skaugen Group argued that s. 211B(4)(a) should be read disjunctively from s. 211B(4)(b) and since IMSPL had not proposed a compromise or arrangement yet, there was no need for evidence of support (see s. 211B(4)(b)).

Ss. 211B(4)(a) and 211B(4)(b) provides that:

"*The company must file the following with the Court together with the application under subsection (1)*:

a. *evidence of support from the company's creditors for the intended or proposed compromise or arrangement, together with an explanation of how such support would be important for the success of the intended or proposed compromise or arrangement;*

b. *in a case where the company has not proposed the compromise or arrangement to the creditors or class of creditors yet, a brief description of the intended compromise or arrangement, containing sufficient particulars to enable the Court to assess whether the intended compromise or arrangement is feasible and merits consideration by the company's creditors when a statement mentioned in section 211(1)(a) or 211I(3)(a) relating to the intended compromise or arrangement is placed before those creditors;*"

The Court ultimately found that neither party was right and held that only s. 211B(4)(a) would apply where a company had already proposed a compromise or arrangement whereas ss. 211B(4)(a) and 211B(4)(b) applied conjunctively where the company had not proposed a compromise or arrangement but intended to do so (the "**2nd Scenario**"). The evidence of support would refer to evidence of support for the moratorium rather than the compromise or arrangement itself.

> "*I would emphasise that it is the quality of the support that is most important… If the biggest creditors of the group as a whole are behind the group restructuring efforts, that does point to the conclusion that the efforts have a reasonable prospect of working and being acceptable to the creditors.*" – [63] of ***Re IM Skaugen***

In support of the above, the Court highlighted that s. 211B(4)(a) referred to "*the intended or proposed compromise or arrangement*" whereas s. 211B(4)(b) only referred to the "*case where the company has not proposed the compromise or arrangement*". The Court also emphasised that s. 211B(4) was introduced as a safeguard against abuse of the moratorium relief, particularly where a compromise had not been proposed. This added requirement in the 2nd Scenario would act as a mechanism to prevent abuse of the moratorium, particularly where a debtor was in possession and sought moratorium relief without even having proposed a compromise.

Given the finding that IMSPL had to demonstrate evidence of support from its creditors pursuant to s. 211B(4)(a), the Court went on to consider how such evidence of support could be obtained.

The test for "*evidence of support*" in s. 211B(4)(a) was whether, on a broad assessment, there was a reasonable prospect of the proposed or intended compromise working and being acceptable to the general run of creditors. This approach balanced between giving the debtor adequate breathing space and ensuring that the creditors' rights were not excessively restrained.

The Court paid particular attention to the overall support of the creditors for the Skaugen Group's restructuring efforts, rather than support of the creditors for the individual company's (IMSPL) restructuring, of which MAN was the overwhelming majority creditor. As the biggest secured creditors of the Skaugen Group, Nordea and Swedbank had (at the time) shown some level of support for the restructuring

of the Skaugen Group, the Court concluded that the Skaugen Group's restructuring efforts had a reasonable prospect of working and being acceptable to its creditors.

Finally, the Court also did not find MAN's position, that it would as IMSPL's main creditor vote down any compromise or arrangement, fatal to the moratorium application as MAN's seemingly entrenched position may change subsequently following the presentation of a proposed compromise or arrangement and that a detailed scrutiny of the likelihood of a proposed scheme obtaining the requisite creditor support at this stage was premature.

The scheme moratorium has extra-territorial effect akin to an anti-suit injunction

The Court clarified that the moratorium could extend to both local and foreign court proceedings and arbitrations pursuant to s. 211B(5)(b). S. 211B(5)(b) provided that:

"*An order of the Court under subsection (1) –*

a. *may be made subject to such terms as the Court imposes; and*

b. *may be expressed to apply to any act of any person in Singapore or within the jurisdiction of the Court, whether the act takes place in Singapore or elsewhere.*"

The Court also emphasised that it will not make an omnibus order but will instead make an order for a moratorium with respect to specific acts of a specific party who is in Singapore or within the jurisdiction of the Court. This is because the language of s. 211B(5)(b) clearly targets restraining the conduct of a specific party. This interpretation is further consistent with the recommendation in the *Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring*, 2016 that the moratorium is similar to an anti-suit injunction which restrains conduct against specific parties.

Conclusion

Interestingly, the Court placed much emphasis on the collective rehabilitation of the group of companies over a strict application of the basic tenet of company law of the separate legal personality. In particular, both the debtor companies and creditors should note from the case that the significant secured creditor of the group of companies will wield significant influence as to whether an application for a moratorium made under a scheme of arrangement succeeds or fails.

Insolvency no longer a terminable event – Is the shipping industry protected?

The Insolvency, Restructuring and Dissolution Bill ("**Bill**") had its Second Reading in the Singapore Parliament on 1 October 2018. The Bill consolidates the law relating to both personal and corporate insolvency into a single omnibus act, replacing the Bankruptcy Act as well as provisions relating to insolvency and restructuring in the Companies Act.

Some notable provisions include:-

- restriction on the enforcement of *ipso facto* clauses (s. 440(1) of the Bill);
- requirement that secured creditors must realise their security within 12 months after the commencement of a winding up if they wish to claim interest on the debt for the period between the order and enforcement of security (s. 223 of the Bill); and
- with respect to winding up, an increase in threshold from S$10,000 to S$15,000 to invoke the presumption that a company is unable to pay its debts (s. 125(2)(a) of Bill).

For more on this topic, please view our earlier briefing note here. As mentioned, a notable provision is the restriction on enforcement of *ipso facto* clauses. Such clauses allow one party to terminate or modify an agreement based on a specified event occurring to the counter party – for example, the insolvency of the counterparty or the counterparty filing for restructuring. Accordingly, a company undergoing a restructuring or insolvency process will have an added layer of protection as it would be able to continue with its business operations during the course of the restructuring process without the risk of key contracts being unilaterally terminated or modified because of the restructuring or insolvency process itself.

Protection for commercial charters

This restriction is itself subject to exceptions. In order to reduce any disproportionately adverse impact on markets, while balancing the efficacy of the restriction for certain types of contracts, this new provision will not be applicable to certain financial contracts, including "*any commercial charter of a ship*" (s. 440(5)(d) of the Bill).

The position in Australia is similar, albeit more limited. S. 451E of the Corporations Act (2001) read with Part 5.3A.50 of the Corporations Regulations 2001 provides that there can be no restriction of *ipso facto* clauses in the case of "*a contract, agreement or arrangement for the commercial charter of ship if (i) the ship is not an Australian ship (within the meaning of the Shipping Registration Act 1981; and (ii) the charter is by an Australian national (within the meaning of that Act) for the purposes of exporting goods from Australia, or from an external Territory, to another country*". As stated in the Explanatory Statement Provided For the Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018, this allows Australian exporters to retain the benefits of the right to terminate where the ship is not Australian – thereby putting these exporters on the same standing as other international exporters, rather than at a disadvantage.

There may be similar considerations in Singapore, particularly given Singapore's position as a key shipping hub. However, as the wording in the Bill simply states "*any commercial charter of a ship*", it is arguable that unlike Australia, there will be no restriction of *ipso facto* clauses with respect to all types of commercial charters (e.g. bareboat charter, voyage charter, time charter) regardless of the flag of the ship, the nationality of the charterer, or the purpose of the voyage.

Judicial management – When your vote counts

Re Swiber Holdings Ltd and another matter **[2018] SGHC 180** *("**Re Swiber**")* considers when a creditor can vote the full value of its claim in a creditor's meeting for a debtor in judicial management, where the same claim is secured over assets of a related third party.

Quite often, a parent company provides corporate guarantees to financial institutions for banking facilities extended to the subsidiaries, and the facilities are secured against assets owned by the subsidiaries. When the parent company enters into judicial management, should a creditor with claims secured against the subsidiaries' assets be regarded as a secured creditor of the parent company under Regulation 74 ("**Reg 74**") of the Companies Regulations (Cap.50) ("**Regulations**") and if not, how do you calculate that creditor's voting entitlement in the creditors' meeting? Further, what if this arose in a scheme of arrangement scenario? Lastly, does the analysis change where the creditor has realised the security after lodging the proof of debt?

Reg 74 provides that "*For the purpose of voting, a secured creditor shall, unless he surrenders his security, state in his proof the particulars of his security, the date when it was given, and the value at which he assesses it, and shall be entitled to vote only in respect of the balance (if any) due to him after deducting the value of his security. If he votes in respect of his whole debt he shall be deemed to have surrendered his security, unless the Court on application is satisfied that the omission to value the security has arisen from inadvertence.*"

The above issues were considered in ***Re Swiber***. Briefly, Swiber Holdings Ltd ("**SHL**") and Swiber Offshore Construction Pte Ltd ("**SOC**") provided corporate guarantees to financial institutions for banking facilities extended to their subsidiaries and the facilities were secured against the assets owned by the subsidiaries (rather than assets owned by SHL and SOC). SHL and SOC were placed under judicial management in 2016 and questions arose as to whether creditors holding security from the subsidiaries should be regarded as secured creditors of SHL and SOC under Reg 74 and, if not, what was their voting entitlement in the creditors' meeting.

The Court took the view that a creditor whose claim against SHL and SOC is secured by security from a third party is not a "*secured creditor*" for the purpose of Reg 74 and therefore did not have to deduct the value of its third-party security in terms of its voting

entitlement. This was because, amongst other reasons, third-party security was not an asset of the debtor company and it was untenable that Reg 74 was intended to interfere and abrogate the rights of the creditor arising from an arrangement to which the debtor company was not a party and over an asset which did not belong to them. The conclusion was the same where the third party was a subsidiary or an associate of the debtor company, because the related party would nonetheless be a separate legal person distinct from the debtor.

The Court went on to decide that a creditor was not required pursuant to Reg 74 to deduct the value of security provided by a third party for the purpose of voting in a scheme of arrangement proposed between a company under judicial management and its creditors (see s. 210 read with s. 227X of the Companies Act (Cap. 50)) as the creditors' meetings called for the approval of a scheme in the above context did not amount to a "*first meeting*" or "*the judicial manager's meetings of creditors*" under Regulation 61 of the Regulations.

Finally, the Court held that where a creditor files a proof of debt in the insolvency of the debtor and thereafter partially realises its security over an asset of the third party surety, it is not required to reduce its proof of debt by the value of the realised security and the surety is not entitled to submit a proof for the sum that the creditor received unless the debt under the guarantee is fully discharged. If the creditor instead fully realises its security over the asset of the surety, the creditor must then reduce its proof by the corresponding amount and the surety may then submit its own proof for the corresponding amount. The cut-off date to update the proofs of debt is the day before the date of payment of dividends, but the judicial manager may also set a cut-off date by which all updates on the proofs of debt must be submitted. Where a creditor filed a proof of debt in the insolvency of the guarantors (such as in ***Re Swiber***), the creditor must update its proof to reflect the reduced value of the principal debt by the day before the date of payment of dividends (if any) or by the time on the cut-off date set by the judicial manager.

Re Swiber is a welcome clarification on the effect of third party security rights in a judicial management scenario and may apply analogously to schemes of arrangement.

Third party litigation funding – Finally an open door?

In ***Re Fan Kow Hin*** **[2018] SGHC 257** ("***FKH***"), the Singapore High Court allowed the application by the trustees of the bankruptcy estate ("**Trustees**") for approval to assign and sell a proportion of the benefits or proceeds of the clawback claims pursuant to a third party funding agreement.

The Court thought that it was clear pursuant to ss. 78(1)(a) and 102(4) of the Bankruptcy Act (Cap. 20, Rev Ed.2009) ("**Act**") that the proceeds of clawback claims under ss. 98 and 99 of the Act form part of the bankrupt's estate. Ss. 78(1)(a) and 102(4) provides:

S. 78(1)(a): "*The property of the bankrupt divisible among his creditors (referred to in this Act as the bankrupt's estate) shall comprise – (a) all such property as belongs to or is vested in the bankrupt at the commencement of his bankruptcy or is acquired by or devolves on him before his discharge…*"

S. 102(4): *"Any sums required to be paid to the Official Assignee in accordance with an order under section 98 or 99 shall be comprised in the bankrupt's estate*."

The Court went on to consider whether ***In re Oasis Merchandising Services Ltd*** **[1998] Ch 170** ("***In re Oasis***") would affect the above finding. The Court distilled, amongst others, the following legal principles from ***In re Oasis***:

1. An assignment of the fruits of litigation operates in equity and will be valid where there is consideration. This will not offend the rule against maintenance or champerty (i.e. where a third party funds a legal action in consideration of a proportion of the proceeds of the successful action), if the assignee has no right to influence the course of proceedings.
2. There is a distinction between property of the company as at the time of the commencement of the liquidation; and those that arise after the liquidation and recoverable by the liquidator under statutory powers. The latter is not part of the company's property (the "**2nd Principle**").

Applying the 2nd Principle, it was arguable that monies clawed back by the Trustees would not form part of the company's property and assigning such proceeds of litigation as a means of funding the same litigation would be champertous and an abuse of process. It was further highlighted that the 2nd Principle was endorsed by the Singapore Court of Appeal in ***Neo Corp Pte Ltd (in liquidation) v Neocorp Innovations Pte Ltd*** **[2006] 2 SLR(R) 717** ("***Neo Corp***") and applied in a bankruptcy context in ***Trikamdas Mody and another v Sumikin Bussan International (HK) Ltd*** **[2014] 3 SLR 1161** ("***Sumikin***").

The Court distinguished and declined to follow ***Sumikin*** as it was not concerned with third-party litigation funding and instead looked at the question of who should pursue an action. ***Sumikin*** therefore did not directly engage the question of whether the fruits of litigation could be considered the property of the bankruptcy estate – i.e. s. 102(4) was not considered. In light of the above interpretation of ss. 78(1)(a) and 102(4), the Court concluded that the 2nd Principle did not apply to bankruptcies, and further found that nothing in ***Neo Corp*** would contradict this finding.

The Court also held that the proposed assignment would not be champertous so long as the assignee had no control over the conduct of proceedings; or was incidental to a transfer of property; or the assignee had a legitimate interest in the outcome of the litigation; or there was no realistic possibility that the administration of justice may suffer as a result of the assignment.

Finally, the Court did not find that the 2017 amendments to the Civil Law Act allowing for third-party funding in respect of certain types of proceedings would *ipso facto* preclude the Court from developing the law as needed, as the flexible and responsive development of the law is "*one of the great merits of the common law system.*"

FKH may have opened the door for third party litigation funding in the bankruptcy context. However, given the contrary finding in ***Sumikin***, it remains to be seen what the way forward is.

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