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Singapore: Changes to the Companies Act - Implications for Corporate Restructuring

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Key Takeaways

- **Automatic moratorium on the company and its related entities upon court application**
- **Super priority of rescue financing**
- **Cram down of dissenting classes of creditors**

A) Background

The 2nd reading of Companies (Amendment) Bill [Bill No. 13/2017] was held on 10/03/17, with the bill passed on the same day[1]. The Act would amend the Companies Act (Chapter 50 of the 2006 Revised Edition, "Companies Act"). Certain amendments to the Companies Act could have a material impact on the restructuring of corporates in Singapore courts. It is worth noting that some of these amendments are related to the recommendations in the report of the Insolvency Law Review Committee (dated 04/10/13) and the report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring (dated 20/04/16). It is our intent to have a brief review of the relevant changes as well as the accompanying explanatory statements, and the implications for bondholders in Singapore.

Disclaimer: Please note that this report reflects our interpretation of the amendments to the Companies Act, <u>in the context of potential implications for bondholders</u>. It should not be taken to provide a holistic review of all the amendments, nor should it be taken as a legal opinion. Where legal or other professional advice is required in relation to any particular matter, please seek advice from your own legal or other professional advisors.

B) Automatic moratorium on the company and its related entities

i) As per **section 211B**, when the company applies to the Court to propose a compromise or arrangement ("proposal") with its creditors, or state its intent to do so, the Court would have the power to order a moratorium (stay on proceedings against the company). <u>An automatic moratorium period of not more than 30 days would commence upon the company application</u>. As per clause 211B(7), the Court may allow for an extension of the moratorium should the company apply prior to the expiry of the period. As per clause 211B(4), when making the application, the company would have to file 1) evidence of support by creditors for the proposal or 2) when no proposal has been made, a brief description of the intended proposal, with sufficient particulars to allow the Court to assess the feasibility and if the proposal merits consideration by creditors. As per clause 211B(6), the company has to make available to the Court information and reports that support the proposal (creditors may gain access by making an application).

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[1] https://www.parliament.gov.sg/publications/bills-introduced

Implications: The above is largely an extension to the existing Court sanctioned Schemes of Arrangements (as described in the Companies Act section 210 and 211). Previously, the automatic moratorium would only apply should the company file for judicial management. Now, the automatic moratorium would apply for Court sanctioned schemes of arrangements as well. This allows the company more breathing room to consider its restructuring proposal, without having to separately file for a moratorium during the initial period. This would hopefully lead to a more orderly restructuring process, with potentially a restructuring proposal made earlier, helping to retain value for all stakeholders.

ii) As per **section 211C**, the Court has the power to grant a similar moratorium in favour of a subsidiary, holding company, or ultimate holding company to the applying company. This moratorium on related entities would only be granted if the related entities play an integral role to the proposal, and that the proposal will be frustrated if actions halted by the moratorium are instead taken on the related entities.

Implications: For complex restructurings that may affect several entities simultaneously (such as the trigger of contingent liabilities or corporate guarantees or cross default clauses), by having the moratorium apply automatically across related entities, it again could buy more time for the group in general, and facilitate a quicker restructuring proposal. The caveat is that the moratorium on related entities cannot be unfairly prejudiced to the creditors of the related party.

iii) As per **clause 211B(5)(b)**, the moratorium applies on any act of any person in Singapore, or within the jurisdiction of the Court, regardless of the act taking place in or outside Singapore.

Implications: So long as the Court has jurisdiction, the moratorium would also prevent actions being taken on the company outside of Singapore.

C) Super priority of rescue financing

As per **section 211E**, the Court can order that debt arising from any rescue financing obtained or to be obtained by the company in restructuring to be accorded super priority over existing debt (in a winding up scenario). Specifically, the rescue financing could be given priority over preferential unsecured claims (such as wages) as mentioned under section 328. Do note that these preferential unsecured claims rank ahead in priority to general unsecured creditors, such as bondholders. Under clause 2111(c)(d), the company may also raise rescue financing that is secured by an existing interest on property that was unencumbered, or already encumbered (but if the rescue financing is to be ranked pari passu, there has to be adequate protection for the interests of the existing holder of the security interest, such as over-collateralization). To be clear, "rescue financing" is 1) financing deemed necessary for the survival of the company as a going concern and/or 2) financing necessary to achieve a more advantageous realisation of assets compared to winding up the company.

Implications: Prior to the introduction of super priority for rescue financing, it has been difficult for companies in distress to arrange for additional working capital, in order to continue as going concerns. The providers of rescue financing would potentially be subordinated to preferential unsecured claims (if the additional financing is unsecured). There could also be insufficient unencumbered assets for new rescue financing to take as security. Finally, if the company is already in restructuring, existing unsecured creditors could potentially hinder the encumbering of unsecured assets for the benefit of rescue financing. By allowing the super priority of rescue financing, this would likely create more supply of such financing (such as potentially bringing in alternative capital providers like hedge funds) to facilitate the rehabilitation of distressed companies in restructuring. In aggregate, we believe that on balance the introduction of super priority rescue financing is beneficial to the preservation of value for all stakeholders. Better access to capital would provide distressed companies with a better chance to survive as going concerns. Ultimately, we believe that in general companies are worth more as going concerns rather than gone concerns (liquidation). It should be noted however that for bondholders, rescue financing taken could subordinate bondholders' claims (which are generally ranked senior unsecured). In the event that the company fails in its restructuring and is wound down, recoveries for bondholders could potentially be lower as a result.

D) Cram down of dissenting classes of creditors

As per section **2111H**, the Court now has the power to "cram down" the proposal to dissenting classes of creditors (assuming multiple classes of creditors) by approving the proposal by the company and ordering that the proposal be binding on the company and call classes of creditors meant to be bound by the proposal. For the Court to exercise this power, at least one class of creditor needs to fulfil the requirements of clause 210(3), in which a majority of 75% in value of one creditor class approves the proposal by the company. The situation also calls for a dissenting class of creditors (another class also affected by the proposal) that failed to meet the 75% in value hurdle, and hence failing to pass the proposal. In addition, the Court has to be convinced that 1) a majority in number of creditors to be bound by the proposal have agreed to the proposal 2) that these majority of affirming creditors totalling more than 75% in value in affected claims (in aggregate across all creditor classes) 3) that the cram down would still be fair and equitable to the dissenting class (the test for this would be that no dissenting class should receive an amount that is lower as a result of the proposal, versus not accepting the proposal). Note that the above does not deprive secured creditors of their security interest (clause 211H(4)(b).

Implications: The above in summary allows for the Court to help break an impasse when disagreements arise when the company is negotiating its proposal. It seeks to facilitate the restructuring by preventing a large holder of a small creditor class from delaying the restructuring unilaterally in order to negotiate a better outcome (which the creditor class may not necessarily deserve). This would expedite the restructuring process and preserve value.

Example:

- A company seeking to restructure has SGD20mn in junior subordinated bonds ("junior bonds") held by two investors, and SGD100mn in senior unsecured bonds ("senior bonds") held by 10 investors. Recoveries for the SGD20mn in junior bonds are likely to be minimal, at less than SGD5mn. The senior bonds are expected to remain intact.
- As a result, the proposal by the company would be to equitize SGD15mn worth of notional junior bonds (junior bondholders would receive equity in exchange for part of their bond stake), while restructuring the balance SGD5mn as a new junior bond (that has its maturity extended). The senior bonds would just see its maturity extended (SGD100mn intact).
- A hedge fund buys SGD10mn notional of the junior bonds in the secondary market. They voted against the restructuring plan, as they are seeking for a better payoff (such as potentially more equity). As the hedge fund forms 50% of the junior bond class, the proposal fails. As background, 100% (or SGD100mn worth) of senior bond bondholders have voted to support the plan.
- The conditions for a cram down have been fulfilled: 1) a majority in number

of creditors to be bound by the proposal have agreed to the proposal (1 junior bond investor and 10 senior bond investors out of 12 investors in total) 2) that these majority of affirming creditors total more than 75% in value in affected claims (affirming investors hold SGD110mn in value out of SGD120mn) 3) that the cram down would still be fair and equitable to the dissenting class (the junior bond is deemed to recover only SGD5mn out of SGD20mn should the proposal not go through).

- As a result, the Court has the power to cram down the proposal on the dissenting creditor class (the hedge fund).

E) Conclusion

The various changes to the Companies Act seek to facilitate the restructuring process by applying an automatic moratorium, to provide the company with some breathing space to come out with a restructuring proposal. By allowing the moratorium to apply to related entities, it prevents creditors from taking action on the company indirectly, which in turn potentially disrupts the restructuring process. The amendments also allow for the provision of super priority rescue financing. Such financing allows distressed companies access to working capital, which helps them survive as a going concern. This is expected to maximize value for all stakeholders as a company is worth more as a going concern than a gone concern (liquidation). However, super priority of rescue financing would subordinate the claims of existing creditors, which could impact their recoveries in the event that the company fails in its restructuring and is liquidated. Finally, the provision of a cram down mechanism allows the Court to break an impasse in the restructuring, by enforcing the proposal across all creditors should certain conditions be fulfilled.

In aggregate, we believe that that above changes to the Companies Act is beneficial to bondholders as it facilitates the speedier restructuring of the stressed company (preserves value by restructuring the company’s balance sheet quicker so that it can continue with its business as a healthy entity) as well as provides a mechanism for the company to obtain working capital while in the process of restructuring (which improves the chances of the company surviving as a going concern, hence preserving value). It should be noted however that the above changes only apply in the case of a court-driven restructuring process. A quicker restructuring process would still potentially be the out-of-court bilateral agreements between bondholders and the company via a consent solicitation exercise (such as those seen for AusGroup and ASL Marine).