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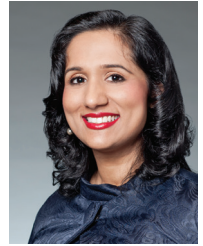
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The emergence of a debt restructuring regime for corporate groups in Singapore

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Debt restructurings involving corporate groups pose unique challenges. There is often a need for debt restructuring solutions that address the financial problems across an entire corporate group. The law in Singapore has developed in an incremental and principled way that, while not immediately apparent, lays strong groundwork for effective restructuring of corporate groups. In this article, we illustrate the potential of the Singapore regime in this context by examining the 2019 decision of the Court of Appeal in *Pathfinder Strategic Credit LP v Empire Capital Resources Pte Ltd* [2019] 2 SLR 77 and related legislative developments in the area, and conclude with thoughts on how the law may develop further.



Debt restructurings involving corporate groups pose unique challenges. Entities in a corporate group are often functionally and financially interdependent. When one entity in the group becomes insolvent, it threatens the solvency of related entities which are operationally or financially connected to it. It is also not uncommon that the insolvency of an entity triggers cross-defaults under the financing contracts of related entities within the group, further jeopardising the financial stability of these related entities.

These difficulties necessitate debt restructuring solutions that address the financial problems across an entire corporate group. Solutions that are neat in theory, such as excising the financially troubled parts of the group, may be difficult to apply in practice given the intricate connections between the various entities in the group. Furthermore, as the entities in a group have separate legal personalities and insolvency estates notwithstanding some overlapping creditors, the starting premise is that their debts must be restructured on an entity-by-entity basis – this exponentially compounds the complexity of achieving any comprehensive debt restructuring arrangement.

The law in Singapore has developed in an incremental and principled way that, while not immediately apparent, lays strong groundwork for effective restructuring of corporate groups.

The turning point was the 2019 decision of the Singapore Court of Appeal in *Pathfinder Strategic Credit LP v Empire Capital Resources Pte Ltd* [2019] 2 SLR 77 (*“Empire Capital”*) which throws into sharp relief the potential of

Singapore’s restructuring regime in the context of corporate group restructurings.

In this article, we will examine the *Empire Capital* decision and related legislative developments in this area, and conclude with thoughts on how the law may develop further.

Empire Capital

Empire Capital involved the restructuring of the Berau Group, one of the world’s largest coal producers based in Indonesia.¹ The restructuring involved two sets of notes issued by the Berau Group – these were referred to in the judgment as the “2015 Notes” and “2017 Notes” (collectively, the “Notes”). The 2015 Notes were issued by Berau Capital Resources Pte Ltd (“BCR”), a Singapore-incorporated special purpose entity established for raising debt-financing.² The 2017 Notes were issued by PT Berau Coal Energy Tbk (“BCE”), the Indonesia-incorporated holding company helming the Berau Group.³

The Berau Group sought to restructure the 2015 Notes and 2017 Notes through schemes of arrangement in Singapore. A scheme of arrangement (a “scheme” in abbreviated form) is a compromise or arrangement between a debtor company and its creditors to modify their respective rights. Debtors and creditors have flexibility in formulating the terms of a scheme. For example, a scheme can incorporate features such as payment deferrals, principal haircuts, and debt to equity conversions. A scheme is a potent debt restructuring mechanism as it binds all creditors (including dissenting creditors), provided that the scheme receives the approval

of a majority in number of creditors representing 75% in value of the debt and is approved by the court.⁴

Initially, the Berau Group proposed two separate schemes of arrangement to restructure the Notes – one by BCR for the 2015 Notes and one by BCE for the 2017 Notes. However, two creditors collectively holding more than 25% in value of the 2015 Notes opposed BCR's scheme (the "opposing creditors").⁵ Since a scheme requires the approval of at least 75% in value of the creditors, the opposing creditors were able to veto BCR's scheme.

This posed a significant problem as both schemes had to succeed in order for the Berau Group to emerge from insolvency. Various entities in the group provided guarantees and security in favour of the Notes. The security providers and guarantors for both sets of Notes largely overlapped,⁶ meaning that the Group could not simply excise the limbs that were at risk of enforcement if either the 2015 Notes or 2017 Notes were not successfully restructured.

The Berau Group ended up withdrawing the proposed schemes as a result of the opposition from the opposing creditors.

Several months later, the Berau Group initiated a new scheme proposal. This time, a single scheme of arrangement was proposed for both Notes. The scheme was proposed not by BCR or BCE, but by Empire Capital Resources Pte Ltd ("Empire Capital"), a Singapore-incorporated subsidiary of the Berau Group which had guaranteed both the 2015 Notes and the 2017 Notes. The scheme sought to compromise Empire Capital's liabilities as *guarantor* of the Notes, and ancillary to that, the scheme sought the compromise of BCR, BCE and the other co-guarantors' liabilities in relation to the Notes (we will refer to this as the "third party releases").

Strategically, this was a deft move, as restructuring the Notes liabilities at a guarantor level (with corresponding releases at the borrower levels) opened the possibility of having the holders of both sets of Notes vote together in a single scheme of arrangement. The opposing creditors who initially blocked BCR's scheme for the 2015 Notes would no longer have a blocking vote if the value of the 2015 Notes and 2017 Notes were taken together, as they only held about 14% of the aggregate value of the Notes.⁷

For this approach to work, Empire Capital had to cross two fundamental hurdles. First, it had to satisfy the court that it was within the court's jurisdiction to allow a scheme to be proposed which sought to give the third party release of BCR, BCE and the other co-guarantors' liabilities. Second, it had to persuade the court that the holders of the 2015 Notes and 2017 Notes should vote together as a single class of creditors. If the Noteholders were split into two classes (one for each set of Notes), the scheme approval threshold of a majority in number representing 75% in value of the creditors would have to have been met within each class, meaning that the opposing creditors would retain its veto within the class of 2015 Noteholders and thereby block the scheme from passing.

The Court of Appeal ruled in favour of Empire Capital on both issues, although ultimately, Empire Capital's application failed for its failure to disclose adequate financial information.

On the issue of the third party releases, the court held that such releases are permissible under a scheme if there is sufficient nexus or connection between the release of the third party liability and the relationship between the company and the scheme creditors.⁸ The court found that the third party releases of the debts owed by BCR, BCE and the co-guarantors were evidently closely related to the creditor-debtor relationship between Empire Capital and the Noteholders, as the debts all arose out of the same note issuances.⁹

In some ways, the court's decision on this issue was not surprising as third party releases have historically been endorsed by the Court of Appeal.¹⁰ However, what was unique in this case was that, unlike the typical scenario where it is the *primary debtor* proposing a scheme and seeking third party releases of its *guarantors'* liabilities, here it was the reverse. The court nevertheless considered the distinction irrelevant.¹¹ This opens the door to exploring creative ways for a corporate group to restructure in a single scheme without much disruption to operations or existing financial obligations – an entity within the group can undertake, as an *additional* obligor, to guarantee the various buckets of debt to be restructured across the entire group.

In *Empire Capital*, the court emphasised

that the jurisdictional test had to be applied in a commercially sensible manner, particularly where a group restructuring is concerned. The court recognised that, even if it was the guarantor (and not the primary obligor) who was the scheme applicant, a release of the primary obligor's debt would still be **necessary**, since the group would remain exposed to liability and enforcement risks and the overall restructuring objective would not be met.¹²

On the second issue of classification, the court reaffirmed the test established in prior cases.¹³ If the scheme favours or prejudices a group of creditors (against other creditors) differently from how they would be favoured or prejudiced in the most likely scenario if the scheme is not approved (usually liquidation), then that group of creditors should be classed separately.

The court reached a provisional view¹⁴ that the two sets of Noteholders could be grouped as a single class as the 2015 Noteholders and 2017 Noteholders' relative positions in a scheme compared to a liquidation were not materially different. Under a scheme, both sets of Noteholders would receive the same treatment, while in a liquidation their respective rates of recovery only differed by around 3% which was not considered to be a material difference.¹⁵

Considering the case in its totality, the implications of the court's ruling are quite remarkable. Through the application of tried and tested principles, a Singapore-incorporated subsidiary with only a nominal share capital and no apparent commercial significance to the Berau Group was in principle able to propose a comprehensive scheme of arrangement to restructure the major financial liabilities of its entire corporate group. At the conclusion of this article, we will consider whether the boundaries of such group restructuring schemes can extend even further.

Related legislative developments

Prior to *Empire Capital*, in 2017, the debt restructuring regime in Singapore was enhanced in a manner that would promote Singapore as an international debt restructuring centre. Some of the legislative amendments improved the ability for corporate groups to restructure their debts in a coherent and orderly manner.

Chief among these amendments was the introduction of moratorium protections for

related companies of a company seeking to implement a scheme. Prior to the introduction of the related company moratorium, only the scheme company could seek moratorium protection. There was a disconnect in the regime providing moratorium protection to the scheme company and the commercial reality that other entities within the group, though not needing to propose a scheme, required protection from enforcement by the intended scheme creditors. This was starkly prevalent in the shipping companies with their typical group structure of many single vessel owning subsidiaries. Now, a related company, such as a subsidiary or parent company, can apply for a moratorium preventing legal proceedings and enforcement action from being commenced or continued against it, if it plays a necessary and integral role in the proposed scheme and if the scheme will be frustrated without such protections.¹⁶

Another important addition to the toolkit for corporate group restructurings was the introduction of a "cross-class cram down" mechanism. This enables the court to approve a scheme even where there are dissenting classes of creditors, provided that in aggregate at least a majority in number and 75% in value of creditors approve the scheme and other safeguards are met.¹⁷ Using *Empire Capital* as an example, if the Noteholders had been split into two classes, the "cross-class cram down" provision could have enabled the scheme to be approved by the court even if one set of Noteholders opposed the scheme. This in effect prevents holdout creditors from frustrating a scheme that benefits the group's creditors as a whole. In a similar vein, the amendments also empower the court to adjust the "majority in number" voting threshold for the passing of the scheme.¹⁸

Other new provisions also facilitate restructurings of multi-national groups, including provisions which enable foreign companies with a "substantial connection" to Singapore to rely on its scheme of arrangement regime,¹⁹ and provisions which enable the court to impose a moratorium on creditor actions overseas by persons in Singapore or within the court's jurisdiction.²⁰

Concluding remarks

Empire Capital establishes a firm foundation for carrying out group restructurings in Singapore.

It affirms that a guarantor can propose a scheme of arrangement to restructure its liabilities and the liabilities of the primary debtor and other co-guarantors. The question now becomes how far the boundaries can be pushed for this type of scheme. Could a group seeking to restructure its debts establish a special purpose entity to unilaterally guarantee all the liabilities of the group, and then use that entity as a platform for implementing a global scheme of arrangement for the whole group?

For the doubting Thomases amongst us, this is not as outlandish as it may sound. A similar approach was adopted in the restructuring of the Codere Group. The Codere Group acquired an English incorporated company and caused it to assume a joint and several obligation under notes issued by another Codere entity, with the ultimate objective of having the English company invoking the scheme jurisdiction under English law.²¹ There, the court recognised the strategy as a clear case of forum shopping, but considered it *good* forum shopping as it was done with the aim of achieving the best possible outcome for the creditors.²²

If such an approach is used to effect a group restructuring, it might be seen as artificial or open to abuse. However, it should be kept in mind that any scheme ultimately requires the approval of a supermajority of the creditors and the court, meaning that it will likely not pass muster unless it is a commercially sensible, fair and *bona fide* scheme. There are legitimate reasons for allowing a group restructuring to be conducted via a single global scheme of arrangement. It would swiften and streamline the restructuring and enable the restructuring plan to be formulated in a coordinated and coherent manner. It would not only prevent the mushrooming of holdout creditor groups that could result if there were multiple schemes, but prevent creditors with relatively modest voices from having a disproportionate say in the fate of the group's restructuring.

The emergence of a group restructuring regime in Singapore has occurred slowly but surely. In the years to come, we can expect inventive and ambitious developments as Singapore's law makers, specialist insolvency bench, academics and practitioners work in tandem to realise Singapore's potential as a centre for international debt restructuring.

Notes:

- ¹ *Empire Capital* at [4].
- ² *Empire Capital* at [5] and [10].
- ³ *Empire Capital* at [5] and [11].
- ⁴ Section 210 of the Companies Act (Cap. 50, 2006 Rev ed) ("Companies Act").
- ⁵ These two opposing creditors also held about 5% of the 2017 Notes, but this is not relevant for present purposes.
- ⁶ *Empire Capital* at [11].
- ⁷ *Empire Capital* at [13].
- ⁸ *Empire Capital* at [77].
- ⁹ *Empire Capital* at [80].
- ¹⁰ *Daewoo Singapore Pte Ltd v CEL Tractors Pte Ltd* [2001] 2 SLR(R) 791.
- ¹¹ *Empire Capital* at [80].
- ¹² *Empire Capital* at [81].
- ¹³ *Empire Capital* at [87], citing *The Royal Bank of Scotland NV v TT International Ltd* [2012] 2 SLR 213.
- ¹⁴ The court only reached a provisional view as the financial disclosure provided by Empire Capital was considered inadequate (*Empire Capital* at [90] to [91]).
- ¹⁵ *Empire Capital* at [90].
- ¹⁶ Section 211C of the Companies Act.
- ¹⁷ Section 211H of the Companies Act.
- ¹⁸ Section 210(3AB)(a) of the Companies Act.
- ¹⁹ Section 210(11) of the Companies Act, read with Sections 351(1)(d) and 351(2A) of the Companies Act.
- ²⁰ Sections 211B(5)(b) and 211C(4)(b) of the Companies Act.
- ²¹ *Re Codere Finance (UK) Limited* [2015] EWHC 3778 at [6], [17] and [18]; see also *Re Codere Finance (UK) Limited* [2015] EWHC 3206.
- ²² *Re Codere Finance (UK) Limited* [2015] EWHC 3778 at [18].

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