

Roll-up rescue financing in Singapore: Giving old debt senior priority

*by Alvin Chia, Smitha Menon, Clayton Chong and Lorraine Koh

Abstract: At its introduction into Singapore's restructuring laws in 2017, rescue financing was heralded as value enhancing and associated with a higher probability of successful recovery for distressed companies. This article discusses the application of the rescue financing regime, including the first instance of a roll-up, and the way forward for rescue financing in Singapore.

Key takeaways for lenders

- The High Court's decision in *Re Design Studio Group* signals that roll-up rescue financing is permissible and in line with policy objectives behind the rescue financing regime in Singapore to increase the availability of rescue financing. While the use of cross-collateralisation has not been tested here, it is arguably not prohibited under the regime.
- A proposed roll-up must meet the basic requirements for a rescue financing order to be approved by the court and ultimately also create new value for the debtor company, involve the injection of new funds amounting to more than just a minuscule or token amount, and provide support for the debtor in the restructuring which culminates in some benefit for it.

Authors Alvin Chia, Smitha Menon, Clayton Chong and Lorraine Koh

Smitha Menon, Clayton Chong and Lorraine Koh are part of the Restructuring & Insolvency Practice at WongPartnership LLP. They regularly act for financial institutions, private equity funds, turnaround practitioners and debtor companies on a broad range of court proceedings and restructuring mandates. Email: smitha.menon@wongpartnership.com; clayton.chong@wongpartnership.com and lorraine.koh@wongpartnership.com.

Alvin Chia is a partner in the Banking & Finance Practice at WongPartnership LLP. His main areas of practice include syndicated loans, project finance, property development loans, trade financing, debt restructuring, private banking transactions, standard forms for consumer credit transactions and sales and participations of credit receivables. Email: alvin.chia@wongpartnership.com.

The WongPartnership team advised and acted for the Hongkong and Shanghai Banking Corporation, Singapore Branch ("**HSBC**") in the S\$62.08m rescue financing package involving the first roll-up approved in Singapore: *Re Design Studio Group Ltd* [2020] SGHC 148 ("**Re Design Studio Group**").

Singapore's recent restructuring law reforms

1 Since 2017, Singapore's restructuring laws have undergone sweeping reform aimed at improving the country's attractiveness as an international debt restructuring hub. This began with a range of debtor-in-possession tools largely inspired by the US Chapter 11 bankruptcy reorganisation regime (including rescue financing, or debtor-in-possession ("**DIP**") financing in the US context) introduced by way of major amendments to the Companies Act in 2017. In 2020, the omnibus Insolvency, Restructuring and Dissolution Act ("**Insolvency Act**") was enacted to consolidate all bankruptcy, corporate insolvency and restructuring laws previously located in separate statutes including the Companies Act and Bankruptcy Act.

2 At the inception of these reforms, a committee comprising members of the legislature, judiciary, regulators and restructuring professionals (“**Committee**”) was tasked with recommending specific changes that would need to be made to position Singapore as a centre for international debt restructuring. Amongst extensive recommendations in the Committee’s final report was a push to increase the availability of rescue financing in Singapore.

Increasing the availability of rescue financing in Singapore

3 The DIP regime is premised on the continuation of the debtor’s business and operations as a going concern, with a view to eventually achieving either the rescue of the debtor’s business, or a better return for its creditors (compared to liquidation as a first resort) should the rescue fail. In the interim, the debtor must procure urgent working capital to fund its operations and finance the reorganisation to preserve all prospect of emerging from insolvency. Yet it has little to offer as commercial incentive to persuade potential financiers to shoulder the risk of lending to a distressed company, especially if its assets are mortgaged to the hilt.

4 Rescue financing refers to the advance of new loans to the debtor company during its restructuring. Under Singapore’s rescue financing regime, a company which is already under protection of a scheme moratorium (under Section 64(1) of the Insolvency Act), or is undergoing judicial management, can seek court orders granting super priority status to the debts arising from the rescue financing. Local companies and foreign companies that have a substantial connection with Singapore can rely on the scheme of arrangement or judicial management provisions. The concept of super priority, imported from the US Bankruptcy Code (“**Code**”), premises the advancement of rescue financing on an assurance to the rescue lender that should the restructuring fail, its rescue financing loan will be paid out of the unsecured assets of the debtor ahead of all other unsecured claims and other priority expenses. There are various levels of super priority that may be accorded and the requirements to be satisfied are generally more stringent the higher the level of super priority sought.

[Optional: Super priority diagram in Annex below]

5 A roll-up is a feature of a rescue financing deal that upgrades the priority of a rescue lender’s pre-existing (i.e. pre-moratorium) debt. This is achieved by applying a portion of the rescue financing proceeds towards paying the pre-existing debt of the rescue lender. The pre-existing debt is, in effect, converted (or “rolled-up”) into the super priority rescue financing debt.

6 Apart from the guidance provided by the High Court in *Re Attilan Group Ltd* [2018] 3 SLR 898 (“**Re Attilan**”), the substantive aspects of the rescue financing regime have remained relatively unexamined since its inception via the 2017 reforms. More recently, the regime has been successfully applied in a handful of restructurings such as that of Swee Hong Ltd, Asiatravel.com Holdings Ltd and Design Studio Group. The rescue financing in the restructuring of Design Studio Group also involved the first roll-up to be approved by the High Court and was analysed in its decision in *Re Design Studio Group Ltd* [2020] SGHC 148 (“**Re Design Studio Group**”), heralding the use of roll-ups by financial institutions as a means to improve distressed credit recovery in Singapore. Prior to that, it was uncertain if roll-ups were permissible under the legislation as certain indications from Parliamentary reports and *Re Attilan* had suggested that the rescue financing regime was aimed at giving super priority for only the new monies funded and not the pre-existing debt of the rescue lender.

Requirements for a rescue financing order in Singapore

7 In *Re Attilan*, the High Court held that for super priority to be granted, the following conditions must be satisfied:

- The proposed financing must constitute “rescue financing”, i.e. it is:
 - Necessary for the survival of the insolvent company as a going concern;
 - Necessary to achieve a more advantageous realisation of the assets of the company than on a winding up of that company, and/or
 - (Additionally, in the context of judicial management) necessary for the Court’s approval of a scheme of arrangement.
- The condition(s) under the respective limb in Section 67(1) (for scheme proceedings) or Section 101(1) (for judicial management proceedings) of the Insolvency Act must be met; and
- The court must exercise its discretion to grant super priority.

8 It also elucidated several matters which may be relevant considerations for the court in the exercise of its discretion in adjudicating an application for super priority, namely whether:

- The proposed financing is in the exercise of sound and reasonable business judgment;
- Alternative financing is available on any other basis;
- Such financing is in the best interest of the creditors;
- Any better offers, bids, or timely proposals are before the court;
- The proposed credit transaction is necessary to preserve the assets of the estate, and is necessary, essential, and appropriate for the continued operation of the debtor’s business;
- The terms of the financing agreement are fair, reasonable, and adequate in the light of the circumstances of the debtor and the proposed lender; and
- The financing agreement was negotiated in good faith and at arm’s length between the debtor and the proposed lender.

9 Further, additional financing from an existing creditor may come within the scope of “rescue financing” provided that the existing creditor is not subject to a pre-existing obligation to inject such additional funds.

The permissibility of rescue financing tools such as roll-ups and cross-collateralisation in Singapore

10 Experience gleaned from DIP financing in the US has been instructive given the nascent state of rescue financing in Singapore, as well as the similarity between the US and Singapore regimes. Roll-ups are already common in the US, where courts have approved its use in numerous DIP financing arrangements such as those in respect of the reorganisations of Lyondell Chemical Company, Radioshack Corporation and Tronox Incorporated.

11 In the Lyondell deal, which remains one of the largest roll-ups to date (*In re Lyondell Chemical Company, et al*, Chapter 11 Case No 09-10023 (REG) (Bankr SDNY, 6 January 2009) (“**Lyondell**”), the US Bankruptcy Court of the Southern District of New York approved a financing arrangement which included a multiple draw term loan facility of US\$6.5b comprising US\$3.25b in new monies and a dollar-for-dollar roll-up of US\$3.25b in respect of certain pre-petition debt of the lenders. Its key considerations in authorising the record-breaking financing are encapsulated in the factors laid down by the High Court in *Re Attilan*.

12 The same considerations generally apply in the context of cross-collateralisation, a related concept where super priority is conferred for pre-existing debts of a rescue lender through the use of the debtor's assets as collateral for both the new and existing loans. Both roll-ups and cross-collateralisation are attractive tools to lenders in the recovery of non-performing loans from a debtor undergoing a court-supervised restructuring as they have the effect of elevating the priority of a rescue lender's pre-existing debt in the event of a liquidation.

13 The use of cross-collateralisation has been approved in several cases in the US, including *In re Vanguard Diversified, Inc.*, 31 B.R. 364 (Bankr, EDNY, 1983), *In re Roblin Industries, Inc.*, 52 B.R. 241 (Bankr, WDNY, 1985) and *In re Ames Department Stores, Inc.*, 115 B.R. 34 (Bankr, SDNY, 1990). In *In re Texlon Corp.*, 596 F.2d 1092 (2d Cir. 1979), the court found that the financing order was unauthorised on procedural grounds but did not rule out the permissibility of cross-collateralisation.

14 More specifically, it may be argued that the grounds cited in certain US cases prohibiting the use of cross-collateralisation are inapplicable in the Singapore context. The US Eleventh Circuit Court of Appeals decision *In the Matter of Saybrook Manufacturing Co., Inc.* 963 F.2d 1490 ("**Saybrook**") is the highest decision of a US court rejecting cross-collateralisation and, to date, there appears to be no case resolving the dissonance between *Saybrook* and the cases named above.

- In *Saybrook*, the court, referring to Section 364 of the Code, held that the words "*obtaining of credit or incurring of debt*" in the statutory provisions mean that only post-petition extensions of credit may be granted super priority. In contrast, Section 67(1)(b) of the Insolvency Act allows super priority to be granted for "*the debt arising from any rescue financing **obtained** or to be obtained*". The express terms apply to both future and pre-filing financing that satisfies the criteria under Section 67(9) of the Insolvency Act.
- The court in *Saybrook* also refused to grant the financing order on the basis that cross-collateralisation is beyond the scope of the bankruptcy court's inherent equitable power because it is directly contrary to the fundamental priority scheme of the Code. This reason is not applicable in Singapore where the rescue financing is sought under Section 67(1) of the Insolvency Act.
- In any case, the crucial difference is that US law specifically provides for a priority scheme which operates in reorganisations, whereas Singapore law does not (in the context of scheme proceedings). Section 507 of the Code fixes the priority order of claims and expenses against the bankruptcy estate so that creditors within a given class are to be treated equally, and bankruptcy courts may not create their own rules of super priority within a single class (so cross-collateralisation is in direct contravention of the same). By virtue of Section 103 of the Code, the priority provisions (in Chapter 5 of the Code) apply both in liquidations (under Chapter 7 of the Code) and in reorganisations (under Chapter 11 of the Code). In Singapore, it is clear from the express wording of Section 203 of the Insolvency Act that the priority provisions thereunder apply only "*in a winding up*". In *Hitachi Plant Engineering & Construction Co Ltd v Eltraco International Pte Ltd* [2003] 4 SLR(R) 384, the Court of Appeal further established that the application of the *pari passu* principle outside liquidation depends on whether the creditors to be affected by a proposed scheme of arrangement even require its protection. Dictating the distribution of assets in a *pari passu* manner decreases flexibility where, for example, a corporate rescue mechanism such as a scheme of arrangement may need to discriminate amongst creditors to be effective by repaying bigger creditors proportionately less than smaller creditors.

15 Accordingly, while a cross-collateralisation has not been attempted in any of the rescue financing applications brought before the Singapore courts, the door remains open for its use in future rescue financings in Singapore.

Re Design Studio Group

16 In *Re Design Studio Group*, the rescue financing package proposed would provide fresh working capital and facilities for performance bond and advance payment guarantees to the Design Studio Group, the latter being the lifeblood of the group's interior design construction business. A portion of the rescue financing proceeds was also to be used to repay existing liabilities of the rescue lenders.

17 In the absence of the rescue financing, the group would likely be forced into liquidation resulting in minimal to no recovery for its unsecured creditors. There was thus a compelling case for the approval of the rescue financing which would give the group a valuable lifeline to continue operating and enhance its recovery of project receivables, thereby improving the unsecured creditors' prospects of a better recovery in the restructuring.

18 The court accepted that roll-ups could be permitted depending on the circumstances of the case and held that:

- The plain reading of "rescue financing" in the statute is sufficiently broad to encompass roll-ups.
- There is no legislative intent to prohibit all roll-ups from constituting rescue financing.
- In the case of roll-ups, only roll-ups which **ultimately create some new value** for the company should be regarded as rescue financing. New funds which are almost entirely used to repay old debts create little new value, and are not roll-ups which should be regarded as rescue financing. The amount of new funds put in as new value should not merely be a minuscule or token amount.
- The terms and conditions of each roll-up have to be scrutinised on a case-by-case basis.
- The nature of the incoming financing should be that it provides support for the company in the restructuring and leads to some benefit for it.

19 In the circumstances of the case, the court ultimately granted the rescue financing orders sought for the following reasons:

- No alternative financing was available – the court was satisfied that there was a *bona fide* and genuine attempt at obtaining other sources of funding, but none of the alternative proposals could match the terms.
- The terms of the proposed financing were fair, reasonable and adequate.
- Fresh capital and new facilities would allow the Design Studio Group to continue work and take up new projects to keep the group as a going concern.
- The court considered that the proposed financing might in fact be the only viable possibility, given that financing had largely dried up because of the COVID-19 pandemic.
- The proposed financing would be in the creditors' best interests as without financing to continue the company's operations, the scheme would not be viable, and the unsecured creditors could potentially receive a nil return in a liquidation scenario.

20 A key consideration which comes to the fore in the context of a roll-up is the extent to which other creditors are likely to benefit or be prejudiced if the roll-up was permitted since the court order

authorising the roll-up overrides any conflicting existing contractual rights of other lenders. However, in assessing whether a roll-up should be allowed, the court takes all other creditors' views in respect of the rescue financing application into account and can also weigh up the risk to creditors against the possible benefit to them, whether there is adequate protection for their interests, and whether any risks entailed can be managed.

21 Ultimately, the onus is on the debtor to also demonstrate the pertinence of the roll-up by reference to the viability of its business where, for example:

- There is a compelling link between the proposed rescue financing package and its ability to leverage on the fresh funding to emerge from insolvency and benefit its creditors eventually (by deploying the cash in sustainable business opportunities or where the continuation of credit lines for project performance bonds and advance payment guarantees is crucial to holding up group operations in sectors such as construction);
- The circumstances leading to its distress are temporary and unjustified;
- Where its immediate liquidation would lead to detrimental systemic consequences;
- There is considerable support from its creditors.

Here to stay

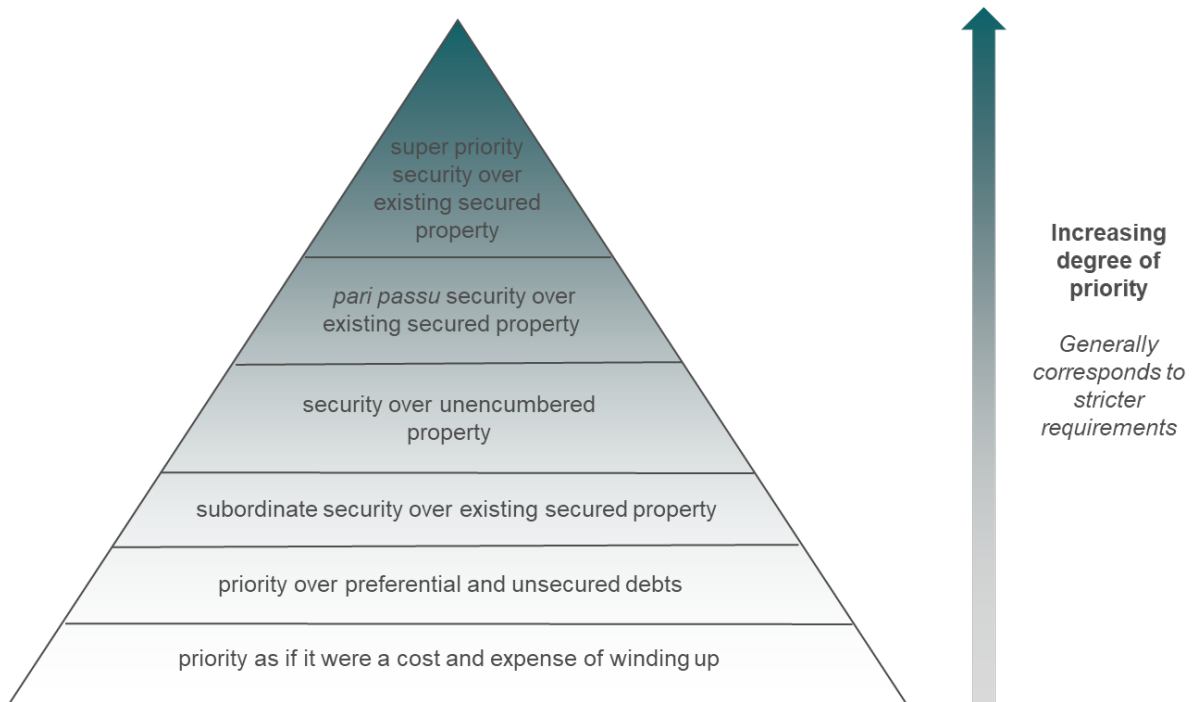
22 The High Court's decision in *Re Design Studio Group* signals the growing sophistication of Singapore's debt restructuring regime. It also marks the emergence of roll-up rescue financing as a new way for banks and finance companies to salvage non-performing loans ("**NPLs**"). By upgrading the priority of pre-existing debts, a roll-up allows a lender to increase the potential upside on the recovery of its pre-existing debts. This offers a strong commercial incentive for lenders to extend rescue financing to aid the successful rehabilitation of financially troubled companies in their NPL portfolios.

23 Roll-ups solve a basic collective action problem seen in many restructurings. Existing creditors and lenders of an insolvent company are usually reluctant to extend further credit or financing as this is seen as "throwing good money after bad", even in situations where some marginal additional financing can give an outsized overall return for the body of creditors by enabling the successful rehabilitation of the business. Lenders may be tempted to take enforcement action (which places further strain on the business), or even do nothing simply because it is seen as a safer or more defensible option.

24 Roll-ups rebalance the risk-reward calculus and incentivise rational rescue lending. An existing lender has a strong commercial incentive to extend rescue financing where it can reap the rewards of extending that rescue financing through an upgrade of its pre-existing debt into super priority debt. In the long term, this may also encourage syndicated rescue financing deals from existing lenders of a company undergoing restructuring.

25 Following *Re Design Studio Group*, banks and finance companies should now see roll-up rescue financing as a valuable addition in their toolboxes for salvaging NPLs by allowing enhanced recovery with downside protection.

Annex: Super priority diagram to be inserted at end of paragraph 4



DISCLAIMER: This update is intended for your general information only. It is not intended to be nor should it be regarded as or relied upon as legal advice. You should consult a qualified legal professional before taking any action or omitting to take action in relation to matters discussed herein.