

Restructuring & Insolvency

## Singapore Court Issues First Decision on Classification of Creditors in Lock-Up Agreements for Schemes of Arrangement

### Introduction

The success of a scheme of arrangement in restructuring depends largely on the consent of the requisite statutory majority of the scheme creditors. To incentivise the creditors to commit to the proposal at an early stage, scheme companies may seek to enter into a lock-up agreement with the creditor, in which the creditor provides an undertaking to vote in favour of the scheme in exchange for certain benefits, such as consent fees.

While lock-up agreements are advantageous tools in the hands of a scheme company, the principles underlying such agreements have not been considered in detail by the Singapore Court. In *Re Brichtoil Petroleum (S'pore) Pte Ltd* [2022] SGHC 35, the Singapore High Court, for the first time, issued the grounds of its decision on whether creditors who enter into lock-up agreements should be placed in a separate class from the other creditors for the purpose of voting on a scheme of arrangement.

The Court held that a lock-up agreement will generally not fracture a class when voting on a scheme of arrangement, subject to certain requirements. The Court also set out the relevant principles in determining whether creditors who enter into lock-up agreements should be classed separately for the purposes of voting on a scheme of arrangement.

The Court's decision provides some much-welcome clarity on this topic. In this Update, we provide a summary of the Court's decision and highlight the key principles of law regarding lock-up agreements in schemes of arrangement.

### Brief Facts

The scheme company, BPS, had proposed a scheme of arrangement ("**BPS Scheme**") to restructure its debts owed to its unsecured creditors. Voting forms were issued to the BPS Scheme creditors ("**Scheme Creditors**"), and the results showed that there was sufficiently strong support for the BPS Scheme. BPS then sought the Court's sanction of the BPS Scheme under section 71 of the Insolvency, Restructuring and Dissolution Act 2018 ("**IRDA**").

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Three of the Scheme Creditors ("**Locked-In Creditors**") had provided undertakings to vote in favour of the BPS Scheme in exchange for certain benefits. Notably, the offer to enter into the Lock-up Agreement had been offered to all Scheme Creditors.

The issue which arose was whether the Locked-in Creditors should have been placed in a separate class when voting instead of being allowed to vote in a single class with the other voting Scheme Creditors. If they should have been classed separately, then the reliability of the vote conducted would be in question.

### Holding of the High Court

The Court held that there was no need to have placed the Locked-In Creditors in a separate class when voting on the BPS Scheme. Accordingly, as the notional voting outcome satisfied the statutory majority requirements and the reliability of the majority vote was not compromised due to any improper classification of creditors, the application for the Court's sanction of the BPS Scheme was granted.

#### Principles of law

The Court considered the case law in UK and Hong Kong, ultimately holding that lock-up agreements will generally not require a separate class of creditors when voting on a scheme of arrangement, subject to certain requirements.

The Court then set out the relevant principles to be considered in determining whether creditors who enter into lock-up agreements should be classed separately for the purposes of voting on a scheme of arrangement, even for the notional tabulation of votes under section 71 of the IRDA:

- (a) **Size of benefit** – Is the benefit conferred so sizeable that it would have a significant influence on the decision of a reasonable creditor when voting for the proposed scheme? This would involve an assessment of the relative size of the benefit when compared to the forecasted returns to creditors under the implemented scheme and the estimated recovery in liquidation.
- (b) **Equal rights** – Was the lock-up agreement made available to all scheme creditors within the relevant class such that they all had an equal right to enter into the agreement? Were the agreements made with each creditor on substantially the same terms?
- (c) **Good faith** – Was the use of the lock-up agreement *bona fide* (e.g., no misleading of creditors)?

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### On the facts

Applying the above principles, the Court determined that there was no need to place the Locked-in Creditors in a separate class from the other Scheme Creditors for the purpose of determining whether the notional voting outcomes satisfied the statutory majority requirements. On the facts, the reliability of the notional majority vote was not compromised.

- (a) **Size of benefit** – The Lock-Up Agreement offered a consent fee of 1.0% of the Scheme Creditor's admitted debt, which would not be so significant as compared to the potential recovery of 12.0% under the BPS Scheme and a 0.2% recovery in liquidation.
- (b) **Equal rights** – The Lock-Up Agreement was made available and sent to all Scheme Creditors, with offers being made on the same terms.
- (c) **Good faith** – The Lock-up Agreements were offered as a *bona fide* attempt, as part of the BPS Scheme, to introduce certainty into the restructuring process.

### Concluding Words

Lock-up agreements can potentially be extremely useful in securing consent for a scheme of arrangement. However, scheme companies should be aware of the conditions in which the creditors may have to be placed in separate classes for the purpose of voting on the scheme. A failure to properly structure the lock-up agreements such that separate classes are not required, or a failure to duly provide for separate classes of creditors once necessary, could lead to the Court declining to provide its sanction of the scheme.

The Court's decision in this case provides vital guidance on when separate classes of creditors would be required in the context of lock-up agreements. The factors set out by the Court should be duly considered by scheme companies seeking to offer lock-up agreements to its scheme creditors.

For further queries, please feel free to contact our team below.

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