INSOLVENCY & RESTRUCTURING

Singapore High Court Rules That Lock-Up Agreements Will Not Generally Fracture Scheme Classes

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In the first reported Singapore decision of its kind, the General Division of the Singapore High Court ("**High Court**") held, subject to certain caveats, that creditors who enter into lock-up agreements generally need not be placed in a separate class from other creditors for the purpose of voting on a scheme of arrangement (i.e., the lock-up agreements would generally not fracture the class of creditors for the purposes of voting): *Re Brightoil Petroleum (S'pore) Pte Ltd* [2022] SGHC 35 ("***Brightoil***").

Our Comments

Lock-up agreements are a crucial and useful part of any multi-lender/multi-creditor restructuring. Under a lock-up agreement, a lender or creditor that supports a debtor company's restructuring proposal provides an irrevocable undertaking to vote in favour of a scheme of arrangement. These lock-up agreements, by design, typically provide some form of material inducement for lenders or creditors to commit to their voting positions early. One common mechanism is to include the payment of a consent fee (in addition to the scheme distributions it would receive) to supporting lenders or creditors, if the scheme of arrangement is later approved by the requisite majorities of creditors and sanctioned by the court.

These creditor lock-up arrangements help to facilitate an effective and efficient restructuring process, as they enable the debtor company to gradually build up support for its proposed scheme, and confer greater certainty and visibility as to whether and when the requisite creditor approval thresholds have been met. If a debtor company does not know whether the requisite creditor approval thresholds have been met, it may end up wasting time and costs in calling for a scheme meeting that would ultimately prove futile. If the debtor company is able to "lock-up" the requisite majorities of creditors for the scheme, it might be able to obtain sanction of the scheme through an expedited pre-pack scheme process.

Without lock-up arrangements, creditors may prefer to reserve their positions and only express affirmative support for a scheme when the proposed scheme is put up for a vote at a scheme meeting convened by the court. Collective action problems may also arise, as some creditors may choose to "free-ride" in the restructuring process, leaving other creditors to consider and vote on the scheme proposal. Lock-up agreements help to incentivise creditors to commit their resources and attention to actively consider the proposed scheme and to make an affirmative decision at an earlier stage, thereby avoiding a prolonged restructuring process.

Lock-up agreements have been used in recent years in Singapore restructurings, such as in the cases of Pacific International Lines and Miclyn Express Offshore, but *Brightoil* is the first decision which analyses in detail classification issues relating to lock-up agreements. The High Court's clarification that lock-up agreements do not generally fracture a class of creditors, subject to certain safeguards, is very valuable as it gives debtors greater confidence in the use of lock-up agreements in restructuring. If lock-up agreements providing for consent fees could fracture a class of creditors in every case, it would render such agreements largely meaningless, as the creditors who were not locked up would form their own class for the purposes of

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scheme voting, and would then have a veto against the scheme. This may result in the fracturing of classes even where there is no clear dissimilarity of rights resulting from the lock-up agreements, such that minority dissenting creditors form a class of their own, with a disproportionate right of veto.

The High Court's decision and clarification in *Brightoil* is hence a welcome addition to the Singapore restructuring and insolvency jurisprudence.

This update takes a look at the High Court's decision.

Background

In 2018, Brightoil Petroleum (S'pore) Pte Ltd ("**BPS**"), together with its ultimate holding company, Brightoil Petroleum (Holdings) Limited ("**BOHL**"), and other related companies, embarked on a major debt restructuring exercise.

BPS eventually managed to resolve a significant part of its liabilities totalling exceeding US$390 million, and proposed a scheme of arrangement to restructure the remaining debts owed by BPS to its unsecured creditors.

Under the scheme, the scheme creditors would receive payments fixed at US$6 million to be distributed on a *pari passu* basis, with a potential recovery of about 12% of the debt value, compared to 0.2% in a liquidation. Liquidation was the most likely alternative outcome if the scheme was not sanctioned by the court.

Additionally, all the scheme creditors were offered the opportunity of entering into a lock-up agreement with BOHL, by which they would undertake to vote in favour of the scheme in return for a consent fee of 1% of their admitted debt.

Only three of the scheme creditors ("**Locked-in Creditors**") entered into the lock-up agreements.

Of these three, one Locked-in Creditor's lock-up agreement was modified such that, in addition to the consent fee, its support for the scheme was also conditional on BOHL paying a further US$1.25 million in part satisfaction of BOHL's guarantee obligations linked to loan facilities extended by that Locked-in Creditor to BPS.

Voting forms for the scheme were issued to the 12 scheme creditors eligible to vote, to determine the notional votes in favour of the scheme if a creditors' meeting had been held. 11 of the 12 scheme creditors (representing US$50,143,082.20 in value) cast votes, and of the votes cast, ten scheme creditors (representing US$47,269,535.04 or 94.26% in value) voted in favour of the scheme while one (representing US$2,873,547.16 or 5.74% in value) voted against.

BPS then sought the court's sanction of the scheme under section 71 of the Insolvency, Restructuring and Dissolution Act 2018 ("**IRDA**").

A key question which arose was whether the Locked-in Creditors should have been placed in a separate class from other creditors when voting (instead of being allowed to vote in a single class with the other non-locked-in creditors). If the Locked-in Creditors should have been classed separately, the reliability of the vote conducted would be in question.

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The High Court's Decision

The High Court held that there was no need to place the Locked-in Creditors in a separate class from the other creditors for the purpose of determining whether the notional voting outcomes satisfied the statutory majority requirements. It also found that the reliability of the notional majority vote was not compromised.

Following a review of English and Hong Kong authorities, the High Court found, as a general position, that creditors who enter into lock-up agreements generally need not be placed in a separate class from other creditors for the purpose of voting on a scheme of arrangement, subject to the following non-exhaustive requirements:

- The benefit conferred on the creditors who enter into the lock-up agreement must not be so sizeable that it would have a significant influence on the decision of a reasonable creditor when voting for the proposed scheme. In determining whether there was significant influence, it is not sufficient to consider in the abstract, the absolute value of the consent fee, or even the percentage of such fee in respect of the face value of the debt held. Instead, one relevant factor may be how the size of the consent fee (or benefit) compares against the forecasted returns to creditors under the implemented scheme and the estimated recovery in liquidation (or another appropriate comparator), and whether such consent fees are sufficiently material to induce creditors to commit to vote for a scheme that they would otherwise have rejected.

- The lock-up agreement must have been made available to all scheme creditors within the relevant class, such that they were all given the equal right to enter into the agreement, and the agreement made with each creditor must be on substantially the same terms. Beyond that, whether a creditor chooses to exercise that right to enter into the lock-up agreement is beyond a scheme company's control.

- The use of the lock-up agreement must be done *bona fide* (e.g., the creditors must not be misled). The court will not sanction a scheme if the company and/or its majority creditors are not acting *bona fide* and this applies with equal force in the context of section 71 of the IRDA.

The High Court observed that some English authorities suggest that lock-up agreements should include a provision allowing a signatory to terminate the agreement and cease to support the scheme in the event of a "material adverse change" to the company's financial position. This is to ensure that a creditor would not be irrevocably bound in all circumstances. The High Court, however, was of the tentative view that such a provision, while going towards the *bona fides* and fairness of the arrangement, should not be mandatory – but noted that a conclusive pronouncement on this point would have to await full arguments in an appropriate case.

The assessment in each case is not one that is based purely on numerical comparisons, but must be done contextually, bearing in mind the specific facts of each case (e.g., whether creditors were given accurate information on the function of the lock-up agreements, and whether there was parity of information across different groups of creditors).

Here, the High Court noted that:

(a) The scheme creditors whose votes were solicited for the notional voting outcomes were fairly representative of the class of creditors to which they belonged.

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(b) The consent fee offered in this case (being 1% of the scheme creditor's admitted debt) was not so sizeable that it would have a significant influence on the decision of a reasonable creditor when voting for the proposed scheme. By acceding to the scheme compared to recovery in liquidation, there was a potential 60-fold recovery of the admitted debt value which would have been sufficient commercial justification alone for the scheme creditors to vote in favour of the scheme. As such, even without the additional consent fee of 1.0%, it was foreseeable that a reasonable creditor would have voted in favour of the scheme in any case. There was little reason to think that the voting outcomes were distorted.

(c) The lock-up agreements were offered as a *bona fide* attempt to introduce certainty into the restructuring process:

  (i) BPS had informed the scheme creditors of this application to sanction the scheme under section 71 of the IRDA and there had been no objections; and

  (ii) the expected recovery under the scheme was described in the lock-up agreements to be "between 8.8% and 18.1%" of the admitted debt, whereas it was stated that there would be "no recovery" in liquidation. This is not too far off from the eventual 12.0% and 0.2% recovery estimated in the respective scenarios.

(d) The lock-up agreements were made available and sent to all the scheme creditors, who had an equal right to enter into the lock-up arrangement on the same terms.

(e) As to the Locked-in Creditor who had entered into a modified lock-up agreement, the High Court took the view that the additional payment by BOHL in respect of BOHL's guarantee obligations, would not change substantively the Locked-in Creditor's legal rights *vis-à-vis* BPS. Accordingly, the Locked-in Creditor's rights were not so dissimilar with the other scheme creditors' such that it could not be classed together with them for voting.

The High Court therefore found that 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, and sanctioned the scheme.

If you would like information or assistance on the above or any other area of law, you may wish to contact the Partner at WongPartnership whom you normally work with or any of the following Partners:

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