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Going concerns

Restructuring and insolvency



In the twelfth edition of the Going concerns, we cover set-offs and the net result of a creditor dealing with a company in liquidation; the first cross-border pre-pack scheme filed in the Singapore International Commercial Court ("**SICC**") by a foreign unregistered company that has been successfully sanctioned in Singapore: *Re No Va Land Investment Group Corporation* [2024] SGHC(I) 17 ("**No Va Land**"); and UAE's new bankruptcy law that came into effect on 1 May 2024, a relatively substantial overhaul of the onshore insolvency and restructuring regime in the UAE.

We hope you enjoyed this edition of the Going concerns and we look forward to your continued support in the coming editions of the same. As usual, please feel free to contact us should you like to learn more on any topic.

Content

Setting the record straight on set-off in insolvency	2
Successful pre-pack scheme of arrangement by foreign unregistered company in Singapore	5
The UAE's New Bankruptcy Law	7

Setting the record straight on set-off in insolvency



Whether a creditor can rely on set-offs can greatly affect the net result of a creditor dealing with a company in liquidation. Without a set-off, the creditor effectively would have to pay its debt to the company in liquidation in full but can only recover the debt owed by the company in liquidation on a *pari passu* basis (which often is only a few cents on the dollar).

This article discusses the recent cases of *Kyen Resources Pte Ltd (in compulsory liquidation) and others v Feima International (Hongkong) Ltd (In Liquidation) and another matter* [2024] SGCA 7 ("**Kyen Resources**") and *Park Hotel CQ Pte Ltd (in liquidation) and others v Law Ching Hung and another suit* [2024] SGHC 105 ("**Park Hotel**"). These cases shed light on, amongst others, whether a creditor can rely on all forms of set-off against a company in insolvent liquidation.

Kyen Resources

In *Kyen Resources*, Kyen Resources Pte Ltd ("**Kyen**") and Feima International (Hong Kong) Ltd ("**Feima**") were related companies that were both placed in liquidation. As Kyen was a Singapore incorporated company, Kyen was wound up in Singapore by the Singapore Courts. Feima was a Hong Kong incorporated company and was wound up in Hong Kong by the Hong Kong Courts.

The Feima liquidators lodged a proof of debt for about US\$49m against Kyen in relation to goods sold and

delivered by Feima to Kyen and for monies paid by Feima on behalf of Kyen. The Kyen liquidators asserted that Kyen had crossclaims against Feima for about US\$159m in relation to losses suffered by Kyen on certain third-party transactions which had been caused and/or occasioned by Feima. The Kyen liquidators therefore rejected the Feima liquidators' proof of debt on the basis that, amongst others, Kyen's crossclaims against Feima exceeded the claim in the Feima liquidators' proof of debt. The Feima liquidators brought an application before the Singapore courts to appeal the rejection of the proof of debt.

At first instance, the Judge allowed the Feima liquidators' application in part. This left the Kyen liquidators unsatisfied and they appealed the decision.

The main issue on appeal was whether liquidators are entitled to account for a liquidated company's crossclaims against its creditor when adjudicating the creditor's proof of debt. The Court of Appeal answered in the negative. In this regard:

1. The Court of Appeal emphasised that the proof of debt process primarily serves as a substituted means of enforcing debts against the liquidated company. This process represents a shift from a grab race, in which the swiftest creditors gain satisfaction at the expense of the not-so-swift, to a collective enforcement procedure that results in *pari passu* distribution of the company's assets.
2. Only permissible set-offs may be taken into account in the proof of debt process. While all set-offs generally constitute a cross claim, not all cross claims are set-offs.
3. In particular, the Court of Appeal accepted that insolvency set-off was one such permissible set-off that may be taken into account in the proof of debt process. The policy justification was that where parties have been giving credit to each other on their ability to secure payment by withholding what is due from them, it would be unjust where one party enters liquidation to deprive the solvent party of his security and to compel him to pay what he owes in full and be left to prove for his own claim. This is a clear exception to the *pari passu* principle and allows the solvent party to collect payment ahead of other creditors, analogous to that of a secured creditor.
4. The Court of Appeal further noted the suggestion that other forms of set-off (i.e. equitable set-off or legal set-off) could also be permissible set-offs that may be taken into account in the proof of debt process but declined to express a firm view on this as this was not an issue in this case. This leads us to the case of *Park Hotel* (discussed below) which considered this question.

On the facts, it was clear that there were no mutual credits, mutual debts, or other mutual dealings with regards to the claim in Feima's proof of debt and Kyen's crossclaims. The crossclaims by Kyen against Feima were independent claims and therefore did not satisfy

the requirements of an insolvency set-off. The Kyen liquidators were therefore not entitled to account for the crossclaims in the adjudication of the Feima liquidators' proof of debt. We now look at other forms of set-off as discussed in *Park Hotel*.



Park Hotel

The liquidators of Park Hotel Management Pte Ltd ("**PHMPL**") and Park Hotel CQ Pte Ltd ("**PHCQ**") commenced legal proceedings against Mr. Law Ching Hung ("**LCH**"), the former director and chief executive officer of PHCQ and the sole shareholder of PHMPL. These proceedings concerned LCH's alleged procurement of various payments from PHCQ and PHMPL to himself and various companies under his control before PHCQ and PHMPL entered liquidation.

LCH sought to introduce various counterclaims against PHMPL and PHCQ in the legal proceedings and for a relief that should he be found liable to PHMPL and PHCQ, that he should be entitled to set-off his counterclaims (where successful) against the claims made by PHMPL and PHCQ. One of the issues was therefore whether legal and/or equitable set-offs were permissible against a company in insolvent liquidation.

The High Court considered that the question, properly framed, is whether legal or equitable set-off should be recognised as a legitimate exception to the *pari passu* principle. The High Court answered this in the negative.

As the *pari passu* principle is prescribed by statute (see section 172 of the Insolvency, Restructuring and Dissolution Act 2018 ("**IRDA**")), it followed that any exception should be exclusively prescribed by statute. In particular, section 172 of the IRDA opens with the phrase "[s]ubject to the provisions of this Act as to preferential payments". This suggests that there are no exceptions to the *pari passu* principle unless provided

for in the IRDA. Such exceptions include the class of preferential debts (see Section 203(1) read with Section 203(6) of the IRDA) or insolvency set-off (see Section 219(2) of the IRDA).

Further, to allow contractual, legal, or equitable set-off to apply when insolvency set-off is not available, produces anomalous outcomes that undermines the *pari passu* principle and its underlying policy. To explain further:

1. **Legal set-off** – Legal set-off is a procedural device that does not affect the substantive rights of the parties against each other. It enables a defendant to require his cross-claim to be tried together with the plaintiff's claim instead of having to be the subject of a separate action. As this is merely an expedited method of enforcing a claim against the claimant in the interests of procedural efficiency, it is clear that allowing it to be used as a mode of enforcement against an insolvent company would undermine the *pari passu* principle. This would allow a creditor to gain priority at the expense of other creditors through a procedural device which cannot be right.

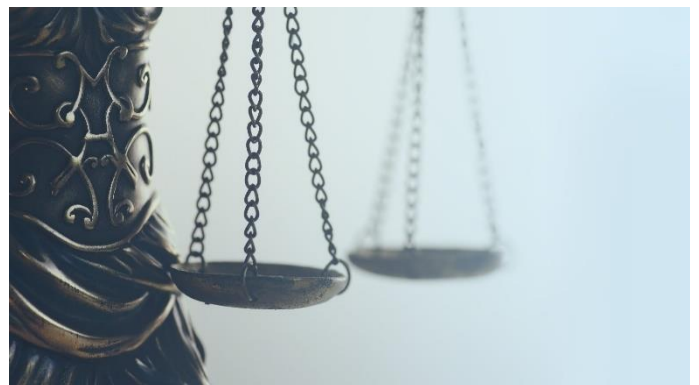
2. **Equitable set-off** – Equitable set-off operates to obviate the injustice that would result in allowing the claimant to assert his claim without accounting for a closely related counterclaim of the defendant. As opposed to legal set-off, an equitable set-off is a substantive defence to a claim. There is, therefore, an argument that equitable set-off should apply in an insolvency situation as it directly impeaches the liquidators' title to sue. The Court disagreed with this position for two reasons:

- a. First, there is a strict line drawn between pre-insolvency proprietary rights in the insolvent company's assets and personal rights against the insolvent company. Insolvency law clearly respects the former and rarely has any qualms on striking down the latter. Therefore, there is no basis for

an unsecured creditor who may have a right of equitable set-off to be accorded priority treatment as he ultimately only has a personal right of action against the company.

- b. Second, in any event, any unfairness would be dealt with through the mandatory operation of insolvency set-off (where applicable).

3. **Contractual set-off** – While this was already settled law, the Court reiterated that an attempt to contract out of insolvency legislation through contractual set-off, falling short of creating an actual proprietary interest in the insolvent company's assets, was contrary to the public policy underpinning the statutory scheme of *pari passu* distribution.



Conclusion

These decisions provide a very useful guide on the application of set-off under Singapore law, which may be the difference between a creditor recovering a majority of the debt owed by an insolvent company and a few cents to the dollar under a *pari passu* distribution. For completeness, while these decisions were made in the insolvency context, the concept of insolvency set-off has been extended to a company in judicial management, and these judgements should be similarly instructive.

Successful pre-pack scheme of arrangement by foreign unregistered company in Singapore

Re No Va Land Investment Group Corporation [2024] SGHC(I) 17 ("**No Va Land**") is the first cross-border pre-pack scheme filed in the Singapore International Commercial Court ("**SICC**") by a foreign unregistered company that has been successfully sanctioned in Singapore. In particular, the SICC provided guidance on satisfying the disclosure requirements for a pre-pack scheme to be sanctioned.



Background

No Va Land Investment Group Corporation (the "**Applicant**") is a Vietnamese real estate investment holding company incorporated in and conducting business in Vietnam. Its application for a pre-pack scheme of arrangement (the "**Scheme**") arose from its need to restructure the convertible bonds ("**Bonds**") which the Applicant issued in 2021 and defaulted by 2023. The application was uncontested, and the Scheme was sanctioned within 15 days of its application.

This article will explore the following issues that the SICC elucidated on:

- a. as a threshold matter, how does a foreign unregistered company qualify for relief to apply for a pre-pack scheme in Singapore; and
- b. how should an applicant satisfy the disclosure requirements for a pre-pack scheme?

Foreign unregistered company qualifying for relief for a pre-pack scheme

To have standing to apply for a pre-pack scheme, a foreign unregistered company needs to show that it has a substantial connection to Singapore (the "**Substantial Connection Test**").

The Substantial Connection Test is a fact sensitive test. The Court will consider, amongst others, whether the foreign unregistered company is carrying on business in Singapore, has substantial assets in Singapore, has chosen Singapore law as the governing law of its transaction(s) and has submitted to the jurisdiction of the Singapore Courts for the resolution of its dispute(s).

In *No Va Land*, the SICC held that the Applicant had undoubtedly satisfied the Substantial Connection Test as it had three independent sources of connection to Singapore, being:

- a. the Bonds were traded on the Singapore Exchange Securities Trading Limited;
- b. disputes relating to the indenture governing the Bonds were subject to resolution by means of arbitration seated in Singapore; and
- c. the proposed Scheme contemplated that the Applicant and its supporting bondholders would voluntarily submit to the jurisdiction of the SICC.

The Court left an open question on whether parties purposefully electing to commence proceedings in Singapore for a pre-pack scheme, alone and without the benefit of other connections, is sufficient to satisfy the Substantial Connection Test. The question was left unanswered as it was beyond the scope of *No Va Land*.

For now, without further guidance, it may be best for foreign unregistered companies to err on the side of caution in robustly satisfying the Substantial Connection Test, similar to the case of *No Va Land*.



Satisfying the substantive statutory requirements for pre-pack scheme to be sanctioned

The statutory scheme provides broad descriptions of what needs to be disclosed but leaves room for interpretation and does not offer specific guidelines on exactly how much information should be disclosed. The test of sufficiency is creditor-centric - enough information needs to be furnished to enable an informed decision regarding the proposed compromise of a creditor's rights with respect to the company's obligations.

The SICC suggests that a pragmatic approach would be to consider the commercial practices within the relevant restructuring market for a benchmark of the adequacy

of disclosure. Disclosure practices currently used in the market, aimed at achieving substantially consensual out-of-court restructurings or similar financial transactions, while not determinative, may be useful in evaluating the disclosures required for a pre-pack scheme.

However, volume does not necessarily equate to better disclosure. The scheme participants require clear, concise and understandable description of the restructuring scheme, alternatives to the scheme, and risks and benefits of the same. This should be supported by clearly formatted supporting financial data and an index to related materials for further consideration if the participants thought necessary. Technology (websites and data rooms) can also be used to assist in fulfilling the disclosure obligation.

Though not a decisive factor, strong support for the scheme from the scheme participants may suggest to the Court the disclosure requirements have been satisfied because the scheme participants are satisfied that they have been sufficiently well informed on the scheme.

In the case of *No Va Land*, the Applicant received overwhelming endorsement for the Scheme – bondholders constituting 95.11% of the outstanding Bonds voted in favour of the Scheme; and not a single bondholder objected. The Applicant had used customary market behaviour as a reference point for measuring adequacy of disclosure, and had provided information to the bondholders that were sufficiently descriptive and commercially meaningful to enable them to understand and properly evaluate the benefits of the Scheme in comparison with foreseeable detriments to be suffered in a potential liquidation.

Conclusion

The case of *No Va Land* is a good example of a foreign unregistered company that has gone above and beyond mere statutory requirements in its application to effectuate a pre-pack scheme in Singapore. It robustly performed its obligations in putting together a comprehensive and commercially viable scheme, one that the Court sung high praise of and attracted sanction within a mere 15 days. A company looking to effect a pre-pack scheme should be supported by professionals in ensuring effective communication with scheme participants and that disclosure requirements are met.

The UAE's New Bankruptcy Law

The Financial Restructuring and Bankruptcy Law (Federal Law Decree No. 51 of 2023) (the "**New Bankruptcy Law**") came into effect on 1 May 2024, repealing Federal Decree Law No. 9 of 2016 (the "**Old Bankruptcy Law**"). It is the latest (and a relatively substantial) overhaul of the onshore insolvency and restructuring regime in the UAE. We explore some of its key features in this article.



1. What is the scope of application of the New Bankruptcy Law?

The New Bankruptcy Law is similar in scope to the Old Bankruptcy Law, applying to: (i) companies falling under the provisions of the UAE Commercial Companies Law; (ii) any natural persons having the capacity of trader; and (iii) licensed civil companies of a professional nature. Entities that are established "offshore" within free zones which have their own insolvency regimes are excluded from its scope. In reality, this would mean that companies established in the financial free zones, the Dubai International Financial Centre and the Abu Dhabi Global Market, where the DIFC Insolvency Law 2019 and the ADGM Insolvency Regulations 2022 respectively apply would be outside the scope of the legislation. However, the likelihood is that companies established in other free zones would still be subject to the New Bankruptcy Law. The uncertainty is that certain non-financial free zones (i.e. free zones other than DIFC or ADGM) have limited provisions in their regulations relating to

bankruptcy and it is unclear how these will be interpreted. Personal bankruptcies for individuals who would not be considered "merchants" or "traders" are still covered by Federal Law No. 19 of 2019 on the Insolvency of Natural Persons. Most government entities are subject to special bankruptcy provisions within their establishing legislation but the New Bankruptcy Law will apply where this is not the case.

2. Introduction of the Bankruptcy Court and Bankruptcy Department

A key feature of the New Bankruptcy Law is the introduction of a new, specialised bankruptcy division within the onshore Courts, referred to as the "Bankruptcy Court". All existing bankruptcy proceedings will be transferred to the Bankruptcy Court. The Bankruptcy Court is expressly entitled to seek the assistance of experts and auditors in decision-making (which is a standard feature of onshore proceedings in the UAE, tending to be expert-led). The experts shall be reimbursed by the relevant judicial authority rather than any of the parties to proceedings.



Historically, one of the key drawbacks of previous bankruptcy regimes has related to the confidence that participants have had in the commercial experience of the experts used in court proceedings. It will be instructive as to whether this changes under the new regime.

Judgments of the Bankruptcy Court are immediately enforceable, and its decisions are immediately enforceable as writs of execution, with no requirement for service in each case. This means that judgment creditors would no longer need to make a separate application to the execution Courts for the enforcement process once they have achieved a beneficial outcome through a bankruptcy process which should cut down on cost and delay.

The creation of the Bankruptcy Court is coupled with the creation of a Bankruptcy Department which will be established at the Bankruptcy Court's headquarters and supervised by a judge (an appeal judge or higher). The Bankruptcy Department is entrusted with a range of powers to assist in running applications and ongoing processes pursuant to the New Bankruptcy Law. For example, it has the right to summon the debtor or his heirs, clients and employees to hear their statements on any matter related to the debtor's debts, assets or business. The Bankruptcy Department is also responsible for serving notices on interested persons in accordance with the law.

3. "Preventive settlement" process replaces "preventive composition" as the primary rescue tool for companies that are not yet insolvent

A welcome change under the New Bankruptcy Law is the replacement of the preventive composition process

(as per the Old Bankruptcy Law) with the "preventive settlement" process. Companies in financial difficulty but not yet bankrupt can apply to the Bankruptcy Court to enter a preventive settlement process. The previous process of preventive composition was rarely used due to various strict requirements including that you had to apply within a period of thirty days from the date that the relevant tests were triggered. It is notable that the formulation for these tests now suggest a cashflow based insolvency test should be used when the previous legislation also contemplated a balance sheet insolvency test. It is hoped that the new process will be more user friendly and will therefore be more widely used. Article 15 of the New Bankruptcy Law provides that a debtor may apply to the Bankruptcy Department for a preventive settlement or bankruptcy proceedings no later than *"sixty (60) days from the cessation of payment date or from the date on which it becomes aware of information confirming that it would be unable to pay of its debts when they fall due"*. "Cessation of debts" is defined as non-payment of debts for a period of ten days after the expiration of the deadline in the relevant notice of the debt (and is triggered even where the debtor holds sufficient assets to cover its debts or where the debt is secured). On a successful application, there will be a 3-month moratorium on claims (the "suspension of claims" period) from the date of issuance of the Court's decision to initiate the process (the **"PS Decision"**). This period can be extended up to a maximum of six months. There is also some market discussion as to the extent to which application for the preventative settlement process is now optional; the preventative composition was seen to be a mandatory requirement. Whether this is an intentional departure is still being clarified.

A key difference with the prior, preventive composition process is the removal of the trustee. Previously, on a successful application for preventive composition, a trustee was appointed by the Court to manage the rescue process, including taking an inventory of the company's assets, compiling a list of creditors and corresponding obligations and drafting a plan for the business. Under the new regime, the debtor company retains greater control and is entitled to manage its business and assets as long as its activities are not harmful to creditors' interests. Certain activities which go beyond "normal business" must however be approved by the Bankruptcy Court. Debtors that are subject to a preventive settlement process are legally

entitled to obtain new financing but they must inform the lender of the fact that the process has commenced. Parallels may be drawn with a US style debtor-in Possession financing arrangement, and it will be interesting to note whether local financial institutions have appetite to finance these types of arrangements.

Within ten days of the PS Decision, the debtor must coordinate with its creditors to form a creditors' committee consisting of representatives from the groups of creditors. The group is to be chaired and represented during the process by the creditor holding the largest amount of the debtor's debts in each group. The debtor is thereafter required to file its rescue / preventive plan within three months from the PS Decision and call the creditors to vote on the plan. The meeting must be attended by creditors holding more than 50% of the approved debts of the debtor and two thirds of them must approve it (as per the definition of the Required Majority in the New Bankruptcy Law).

4. Trustee-led processes under the New Bankruptcy Law

The New Bankruptcy Law continues to provide for these other processes where applications should now be filed with the Bankruptcy Court:

- **Restructuring:** an application for a restructuring can be filed by the debtor itself or one or more of the creditors meeting a value threshold or by a regulator. This process is applicable to more complex restructurings, where a preventive settlement process is unsuitable but the business remains viable. If successful, the company will continue to operate but under the supervision of a trustee. The debtor will prepare a restructuring plan under the supervision of the trustee which is then voted on by the creditors. However, the Court can ratify the plan even if the creditors reject it as long as creditors will not be worse off than they would be in the event of a bankruptcy. Notably, the Dubai-based contractor Drake & Scull International has recently completed a successful restructuring process pursuant to the provisions of the New Bankruptcy Law. The creditors, shareholders and the Court have approved a plan to write off 90% of the company's debts and to settle the remaining 10% of debts by issuing mandatory convertible sukuks (a Sharia-compliant financial certificate akin to a bond). Hopefully this serves as a positive

indication of acceptance by the market of the new regime.

- **Bankruptcy:** where a company is already insolvent and the business cannot be saved, an application can be made to the Bankruptcy Court to grant an order declaring the company bankrupt and ordering the liquidation of the company (again it can be made by the debtor, creditors or a regulatory authority). As with the restructuring process, this is a trustee-led process and involves the liquidation and distribution of the company assets by that trustee, in accordance with the priority rights of creditors.
- **Security:** we also note that the New Bankruptcy Law provides for secured creditors to apply to the Bankruptcy Court to enforce their security by means of a sale by the Trustee rather than through separate proceedings. However the legislation also sets out grounds to oppose the secured creditor's application including consideration of the extent to which it might hinder the debtor's business activities and the effect it may have on a potential preventative settlement plan. The trustee may even offer the secured creditor an alternative guarantee under the new legislation.



5. Update to rules on directors' and management liability

Under the new regime, there is increased scope for directors and managers to be found liable for acts in the period leading up to bankruptcy. Directors, managers and "any person responsible for actual management" (i.e. de facto directors) of a company which has been declared bankrupt, can be held liable to pay a proportion of the company's debts where:

- They have committed certain acts (e.g. undervaluing transactions, preferential payments, certain related-party transactions) during the 2-year period prior to the company ceasing to repay its debts; or
- Assets of the bankrupt are insufficient to cover 20% of debts due to mismanagement.

There is a 2-year limitation period from the date of the bankruptcy declaration within which the company or creditors must bring these types of claims. It is a defence in these claims if the individuals can show that they took precautionary measures to prevent or mitigate potential losses or if they individually objected to certain transactions. The onus is therefore on individual directors and management to document their decision-making once it becomes clear that a company is entering into financial difficulty.

6. Voidable transactions

The New Bankruptcy Law provides for a clawback period for certain transactions which took place in the six months prior to the date of cessation of payment of debts, which is extended to two years if the transaction was executed with a related party. The Old Bankruptcy Law had provided for a blanket 2-year clawback period. The types of transactions which are caught include donations or gifts (except small or customary ones), transactions where the obligations of the debtor are significantly unbalanced with the counterparty or early repayment of debts before maturity. The Bankruptcy Court may also find other transactions to be voidable, outside of the prescribed categories, at its discretion.

7. Final thoughts

The New Bankruptcy Law does not represent a complete break from the old regime but can be seen as a significant enhancement to the UAE's insolvency and restructuring regime. The real test will be whether the flexibility of the new regime gains the confidence of parties, both domestic and international. One final point to note is that the New Bankruptcy Law continues to leave out provisions for the recognition of foreign insolvency proceedings or providing for co-operation and co-ordination with the courts of other jurisdictions. Unlike many other countries with leading financial centres, it has not adopted the UNCITRAL Model Law on Cross-Border Insolvency (only within the confines of the DIFC and ADGM).

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