STEPHENSON HARWOOD
(SINGAPORE) ALLIANCE

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Going concerns

Restructuring and insolvency

In this tenth edition of the Going concerns, we cover the innovative attempt by a distressed company to shut out low-valued creditors in a scheme of arrangement, the utility of the Singapore recognition of foreign insolvencies regime to assist international liquidations, and the factors which the Singapore Courts will consider when deciding whether to stay a bankruptcy application. It has been a pleasure preparing these articles over the past five years and a big thank you to our readers!

Content

Shutting out low-valued creditors through classification?

"A majority in number representing three-fourths (¾) in value of the creditors or class of creditors" represents the support required for any company undergoing a scheme of arrangement. One difficulty commonly faced by said distressed company is that the throng of trade creditors may have the power to thwart the proposed restructuring as they represent the 'majority in number' but may only represent less than 5% of the value of the total debt.

In ***Re Zipmex*** [2022] SGHC 306, Zipmex Singapore Pte Ltd and Zipmex Australia Pty Ltd (collectively, "**Zipmex**"), as part of their pre-packaged scheme ("**Prepack**") application under s 71 Insolvency, Restructuring and Dissolution Act 2018 ("**IRDA**") sought the approval of the Singapore Courts of the classification of its unsecured customers whose debt values were less than or equal to US$5,000 as a separate class of creditors in the Prepack (commonly described in the United States as an administrative convenience class). It was intended to cram down the creditors in the administrative convenience class and have their debt discounted based on the proposed scheme of arrangement.

The Court dismissed Zipmex's application as:

1. It was unclear if the Court had the jurisdiction to entertain such an application.
2. The Court did not have any powers to grant the application before the Prepack application itself.

While no determination was made in the judgment, the Court was wiling to discuss the possibility of placing unsecured creditors with debt values less than or equal to US$5,000 in a separate class and the Court made some notable comments which will be useful as a guide for subsequent applications. In particular, we highlight two points:

1. Any application to place unsecured creditors with debt values of less than or equal to US$5,000 in a separate class should be made with the Prepack application

The Court made it clear in the judgment that an applicant ought to make an application for the sanction to place unsecured creditors with debt values of less than or equal to US$5,000 in a separate class (i.e. an administrative convenience class) alongside the Prepack application, and not before it.

Zipmex cited the inherent jurisdiction of the Court, and the general provisions under the Supreme Court of Judicature Act ("**SCJA**") which the Court thought was unlikely to be a sufficient basis. Given that what was sought was the approval of an administrative convenience class for purposes of the envisaged Prepack (which is governed by the framework under s 71 of the IRDA), the Court was of the view that "*one would have expected that any such application process would have been laid down expressly by statute, or at least strongly implied as a matter of necessity to give effect to that statutory mechanism*" and there was therefore no room for the Court to be given jurisdiction to entertain such an application because of inherent powers or under the SCJA. Any such application should therefore be made alongside the Prepack application, relying on the Prepack framework laid down under s 71 of the IRDA.

However, s 71 of the IRDA is silent on the creation of an administrative convenience class.

Referring to US law, the Court did not view this as fatal to the creation of an administrative convenience class. In particular, the Court noted that s 1122(b) of the US Bankruptcy Code, which permits the US Courts to allow the creation of such a class, with the objective of reducing the burden on the restructuring company by grouping separately low value creditors, was merely a codification of previous practice.

2. Adequate safeguards should be in place for the administrative convenience class

What was important to the Court was "*whether such an administrative convenience class may be properly adopted in a [Prepack] are how the various interests are balanced, what trade-offs are incurred, and what safeguards are put in place.*"

There is presently zero guidance on what safeguards the Court will consider as adequate before sanctioning the creation of an administrative convenience class. Nonetheless, as mentioned above, the Court may take guidance from US law. In this regard, s 1122(b) of the US Bankruptcy Code provides "*A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves* ***as reasonable and necessary*** *for administrative convenience.*"

Based on the above, it is clear that an application for the sanction of a creation of an administration convenience class must at the very least ease a sizeable burden to the estate. For instance, an applicable scenario may be where the fees incurred by the estate in administrating the large number of creditors may be disproportionate to the value of their claims, and may even lead to the prejudice of the overall recoveries by creditors. That said, the Court may require more justification where the Prepack envisages the administration convenience class being bound by the scheme of arrangement (typically receiving a haircut to their claims) without first receiving a vote of approval from said class of creditors in *Re Zipmex*.

It will be interesting to continue monitoring this space, and we will provide an update if the matter develops.

Recognition of foreign insolvencies and restructurings

This article briefly explores how the Singapore Courts may assist debtors and creditors alike when these huge conglomerates suffer financial difficulties and face restructurings and insolvencies in a foreign (i.e. non-Singapore) jurisdiction through Singapore's relatively recent adoption of The United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (30 May 1997) (the "**Model Law**") given the force of law in Singapore through Section 252 of the Insolvency Restructuring and Dissolution Act 2018) ("**IRDA**"). For convenience, we will refer to the Model Law as enacted in Singapore as the "**SG Model Law**".

Why is recognition required?

Where the corporation has significant amounts of assets in a foreign jurisdiction, there is a limitation on the enforcement reach of the foreign Court. A typical scenario is where a corporation applies for insolvency in the jurisdiction of its place of incorporation. Upon news breaking of an insolvency, creditors in all parts of the world will scramble to seek a recovery of sums due and owing to them. The insolvency practitioner appointed to oversee the restructuring or insolvency may therefore wish to make an application to the Singapore courts for recognition under the SG Model Law with, amongst others, ancillary relief for moratorium protection to prevent creditors in one jurisdiction from getting a leg up on other creditors.

The SG Model Law

One of the main difficulties with cross-border insolvencies is the contention between territorialism and universalism.

One form of territorialism is the English *Gibbs* rule which provides in effect that the English Courts will not consider English law claims to be discharged or compromised by a foreign proceeding unless the creditor submitted to the foreign proceeding (for e.g., through voting in the foreign proceeding). This may effectively require a debtor to bring separate restructuring or insolvency proceeding in the UK but also leads to the main criticism of territorialism as it inevitably risks different proceedings in different jurisdictions producing different results for creditors.

On the other hand, the *Gibbs* rule guarantees that when parties enter into an English law contract, the parties can rely on the trusted English law system to adjudicate their claims. Without the *Gibbs* rule, creditors may face risk that their debt can be compromised in a non-English jurisdiction and this may lead to increased uncertainty.

The other approach is universalism, which goes towards a procedural framework for cooperation between jurisdictions in order to facilitate and promote a uniform approach to cross-border insolvency.

The SG Model Law adopts the modified universalism approach whereby insolvency practitioners may make an application to the Singapore courts to recognise the foreign proceeding and seek relief from the Singapore Courts to, amongst others, restrain the commencement and continuation of proceedings in Singapore. There is an added safeguard that any stay and suspension must be the same scope and effect as if the debtor had been made the subject of a winding up order under the IRDA and subject to the same powers of the Singapore Court and the same prohibitions, limitations, exceptions and conditions as would apply under Singapore law for such a case.

The uses of the SG Model Law is not limited to seeking a stay of proceedings in Singapore. For instance, we have assisted various clients to:

1. obtain a groundbreaking Singapore recognition order for a People's Republic of China bankruptcy proceedings. In particular, the case is significant as it represents one of the first times that the Singapore Court has given recognition to Chinese bankruptcy proceedings and is referred to as a "*template*" for judicial cooperation in cross-border insolvency between the courts of Singapore and the People's Republic of China;[1]
2. obtain a Singapore recognition order to procure the cooperation of Singapore banks. Singapore banks will typically ask for an order of Court issued by the Singapore Courts as regards the legitimacy of the insolvency practitioner's appointment before assisting; and
3. obtain a Singapore recognition order to entrust the administration or realisation of the debtor's assets in Singapore to a foreign insolvency practitioner.

The SG Model Law is a useful tool for insolvency practitioners and improves Singapore's position as a restructuring hub. Please do not hesitate to reach out to us should you have any queries or if you require recognition assistance.

[1] https://abli.asia/order-first-recognition-by-the-singapore-court-of-chinese-bankruptcy-proceedings-as-foreign-main-proceedings/

Commencement or continuation of proceedings against a bankrupt

Upon the making of a bankruptcy order, no action or proceedings may be commenced or continued against the bankrupt in respect of a debt except with the permission of the Court. What factors should the Court then take into account in deciding whether to grant such permission?

Wang Aifeng v Sunmax [2022] SGHC 271 is the first reported case in Singapore which sets out the factors the Court should consider in the exercise of its discretion of whether to grant permission for the continuation or commencement of proceedings against a bankrupt.

Background

The claimant, Mr Wang Aifeng (the "**Claimant**"), had invested monies in an investment holding company, Sunmax Global Capital Fund 1 Pte Ltd ("**Sunmax**"). When the Claimant did not receive the alleged promised investment returns, he sued Sunmax and the director and representative of Sunmax, Mr Li Hua, for misrepresentation and/or unlawful means conspiracy. Amidst the proceedings, Mr Li Hua filed for and was declared a bankrupt (the "**Bankrupt**").

Following the declaration of bankruptcy, the Claimant could not continue the proceedings as against the Bankrupt without the permission of the Court (section 327(1)(c)(ii) of the Insolvency, Restructuring and Dissolution Act 2018 ("**IRDA**")). The Claimant therefore sought permission from the Court to continue the proceedings as against the Bankrupt.

Factors to consider in exercising discretion

The Court listed the following factors which it should consider in the exercise of its discretion of whether to grant permission for the continuation or commencement of proceedings against a bankrupt under section 327(1)(c)(ii) of the IRDA:

1. Timing of the application for permission

   This includes the stage to which proceedings have progressed and whether there is any delay in applying for permission. While mere delay by itself does not prevent permission from being granted, the Court will consider whether prejudice is caused to any party by reason of the delay (e.g., if it is

necessary to rely on the memories of the parties and other witnesses in the proceedings, but their memories have been impaired by the delay).

2. Nature of the claim

The claim must be of a type which should proceed by action rather than the proofing procedure in bankruptcy. The Court will consider the degree of complexity of the legal and factual issues involved, and whether it may be preferable for those issues to be resolved at a hearing rather than by way of a proof of debt (e.g., if other parties are involved in the proceedings and it is necessary for the bankrupt to be a party for the proper conduct of the same).

Separately, applications by secured creditors for permission will likely be granted as they stand apart from unsecured creditors.

3. Presence of existing remedies

This involves the consideration of whether the claim can be dealt with adequately within the bankruptcy regime, whether the bankrupt's assets will be dissipated by attending the claim and the reasons for wanting to proceed outside of the bankruptcy regime. If the claim can be dealt with adequately within the bankruptcy regime, the Court is less likely to grant permission for proceedings to be commenced or continued.

4. Merits of the claim

There should be a serious question to be tried in that the proposed claim is not clearly unsustainable. If the proposed action is doomed to fail from the start, it would not serve any good purpose to grant permission to commence or continue what would likely be an exercise in futility.

5. Prejudice to the creditors or to the orderly administration of the bankruptcy

The applicant has to demonstrate that there will be little or no prejudice occasioned to the creditors, the bankrupt's estate or to the orderly administration of bankruptcy if permission is granted.

6. Other miscellaneous factors

This includes the consideration of the potential of an avalanche of litigation being unleashed by the grant of permission; the proportionality of the cost of the proceedings to the bankrupt's resources; and the views of the majority creditors.

Application of the principles to the facts of the case

The Court granted the Claimant permission to continue with his proceedings against the Bankrupt for the following reasons:

1. the proceedings against the Bankrupt and Sunmax was filed some two years before the Bankrupt was adjudged bankrupt and was already proceeding towards trial. Hence, the proceedings were not filed in a scramble to reach the Bankrupt's assets and obtain an unfair advantage;
2. the proceedings would not offend the *pari passu* principle because the Bankrupt had no preferential or secured creditors. The trustee in bankruptcy also did not object to the application for permission;
3. the Bankrupt was a necessary party to the proceedings on misrepresentation because the key factual issue in dispute was whether the Bankrupt had misrepresented to the Claimant and whether he did it on behalf of Sunmax;
4. the issue in dispute of whether there was misrepresentation would be better resolved in the Courts rather than by the trustee in bankruptcy;
5. the Court was satisfied that the proceedings raised serious questions to be tried and were not doomed to fail from the start; and
6. there were no miscellaneous factors militating against the grant of permission.

Conclusion

There is now clarity on the considerations of the Court in deciding whether to exercise its discretion to grant permission for proceedings against a bankrupt to be commenced or continued. The common denominator in the Court's considerations is the effect of the grant of the permission on the rest of the unsecured creditors of the bankrupt.

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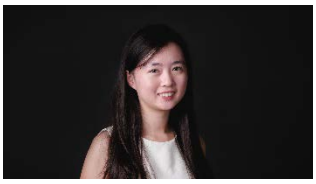

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