Insolvency, Restructuring and Dissolution Act – Key Changes from the Financiers' Perspective

This update describes some of the key changes introduced by the Insolvency, Restructuring and Dissolution Act ("**IRDA**") that may be of interest to banks and other lending institutions, and analyses the potential benefits and implications of these changes on lenders' rights and interests.

Background

The IRDA, together with its related subsidiary legislation, came into operation on 30 July 2020.

The IRDA mainly serves to consolidate Singapore's bankruptcy, corporate insolvency and debt restructuring laws into a single piece of legislation. These laws were previously codified in the Bankruptcy Act and the Companies Act. In addition, the IRDA introduces refinements to Singapore's insolvency and restructuring laws as part of the country's efforts to modernise the law and further strengthen its position as an international centre for debt restructuring.

In 2017, prior to the IRDA being introduced, the Companies Act was amended to enhance the corporate debt restructuring regime in Singapore. The 2017 amendments included the introduction of:

(a) a super-priority rescue financing regime for companies undergoing scheme of arrangement or judicial management proceedings;

(b) an automatic interim stay of proceedings for 30 days when a company applies for a scheme moratorium;

(c) enhanced moratorium provisions enabling the Court to grant moratorium protection for related entities of a company seeking to implement a scheme of arrangement, and extraterritorial *in personam* moratorium orders over a company's creditors;

(d) a cross-class "cram-down" mechanism allowing the Court to sanction a scheme even if the approval threshold for one or more of the classes of creditors is not met, provided certain safeguards are met; and

(e) a process for implementing an expedited "pre-packaged" scheme of arrangement without convening a Court-sanctioned creditors' meeting.

For more details on the 2017 amendments and how they have worked in practice, please refer to our updates *Overview of Singapore's new Restructuring Framework*, *Singapore's enhanced corporate debt restructuring mechanisms - One year on*, and *Roll-up Rescue Financing – A New Tool for Banks to Salvage Non-performing Loans*.

The IRDA builds on the changes made in 2017 and represents another step in the continuing evolution of Singapore's insolvency and restructuring laws.

Restrictions on the Exercise of Rights Under *Ipso Facto* Clauses

One of the more prominent features of the IRDA is the introduction of the *ipso facto* regime under section 440, which restricts the exercise of certain contractual rights, such as termination or acceleration, while a company is undergoing judicial management or scheme of arrangement proceedings.

The term "*ipso facto*" is a Latin phrase meaning "by the fact itself". An *ipso facto* clause typically gives one party the ability to terminate a contract "by the fact" that the other party is insolvent or carrying out a restructuring.

The *ipso facto* regime only applies to contracts entered into from 30 July 2020 onwards. Certain prescribed financial contracts are excluded from the *ipso facto* regime, including derivatives contracts, margin lending agreements or securities contracts.

The *ipso facto* regime was introduced to aid the rehabilitation efforts of companies. In the Second Reading of the Insolvency, Restructuring and Dissolution Bill, the then Senior Minister of State for Law, Edwin Tong Chun Fai, cited the restructuring of Hyflux Ltd ("**Hyflux**") to illustrate the negative consequences of *ipso facto* contractual provisions. Hyflux's filing for moratorium protection, without more, constituted an event of default allowing Hyflux's creditors to accelerate repayment terms and exercise set-off rights, which in turn restricted Hyflux's cash flow and exacerbated the company's financial position. The intention behind introducing the *ipso facto* regime was to ensure that a company in a similar situation in the future can continue with its business operations while restructuring its debts.

The introduction of the *ipso facto* regime is likely to be a helpful addition to Singapore's corporate debt restructuring framework as it helps to preserve the viability and value of businesses which are undergoing restructuring. A company's restructuring efforts may be undermined if key suppliers or service providers terminate their contracts for the sole reason that the company is insolvent, even where the company remains capable of performing its obligations. In the grand scheme of things, this will translate to benefits for lenders as it helps preserve value when a borrower attempts restructuring and improves the lenders' overall prospects of recovering their debts through a successful restructuring.

In practical terms, the *ipso facto* regime will likely have a muted impact on most lenders for the following reasons:

(a) First, the *ipso facto* regime does not prevent a lender from terminating a contract on grounds unrelated to the company's insolvency or commencement of restructuring proceedings. For example, a lender can terminate its agreement with the company if the company fails to make payments under the agreement.

(b) Second, the IRDA provides that the *ipso facto* regime does not require the further advance of money or credit to the company, meaning that lenders will not be compelled to increase their exposure even if they are prevented from terminating their agreement with the company.

(c) Third, in judicial management and most scheme of arrangement scenarios, the borrower would have a moratorium protecting it from legal proceedings and enforcement of security by creditors. This means that a lender's avenues for enforcing its debt are restricted anyway, even absent the *ipso facto* regime.

Judicial Management by Resolution of Creditors

The IRDA provides an out-of-court process for a company to place itself into judicial management with the approval of the company's creditors. Prior to the IRDA, a company was only able to enter judicial management through an order of court.

The company can initiate the out-of-court process if authorised by a members' resolution or, if permitted by the constitution of the company, a directors' resolution. Thereafter, a meeting is convened for the creditors to consider a resolution for the company to be placed under judicial management. The company is placed under judicial management if a majority in number and value of the creditors present and voting at the meeting resolve to do so.

Although the appointment of the judicial manager is made out-of-court, once the company is placed into judicial management, the judicial management process remains under the supervision of the Court and will continue in the same manner as a judicial management commenced by way of a court order.

The out-of-court process was introduced to minimise the expense, formality and delay in cases where creditors are supportive of the company entering into judicial management.

The ability to enter into judicial management through an out-of-court process may encourage companies and their lenders to view judicial management more as a consensual, rather than an adversarial, tool to facilitate rehabilitations. In the Insolvency Law Review Committee's 2013 report, it was observed that the judicial management regime had not seen a high level of success as a rehabilitation regime in Singapore due, among other reasons, to the negative publicity that comes with the making of a judicial management order and the potential concerns among management that a court application for judicial management may be seen as an admission that it had not managed the company properly.

The introduction of the more informal out-of-court process can facilitate consensual rehabilitation efforts through the use of judicial management:

(a) Companies in financial difficulties may be less averse to judicial management if they can avoid the publicity or contentiousness of court proceedings. The out-of-court process can encourage more constructive and frank commercial discussions between a company and its lenders, and promote the view of judicial management as an avenue for a consensual restructuring with the added comfort of a moratorium and an independent supervisor (who is an officer of the Court) for the rehabilitation process. Having the support of existing management also helps to overcome a common pitfall of adversarial judicial management processes: the inability to carry out operations effectively given the lack of industry expertise of the judicial manager.

(b) Commencing judicial management out-of-court can help to minimise the negative publicity and disruptions to the business, by averting disputes that might otherwise be litigated in open court. This may reduce some of the adverse impact that commencement of a judicial management process may have on ongoing operations of a company as well as its relationships with its customers and suppliers. In turn, the potential for rehabilitation and returns to lenders may be enhanced.

(c) The out-of-court process can expedite restructuring efforts, especially when used in tandem with other tools such as a pre-pack scheme of arrangement to expedite the process for achieving a restructuring with the support of major lenders.

Change in Time Periods for Avoidance of Transactions

When companies enter into winding up or judicial management, there are powers provided to the liquidator and judicial manager to impugn certain transactions. Such transactions will need to have occurred within a “relevant time” from the commencement of the insolvency process in order to be caught by these avoidance provisions. The IRDA alters these timelines.

A brief summary of the “relevant time” for the main types of avoidance provisions (compared against the “relevant time” under the previous legislation) is set out in the following table:

	Old relevant timeframe (from the time of commencement of the winding up or judicial management)	**New relevant timeframe under IRDA** (from the time of commencement of the winding up or judicial management)
Undervalue transaction	Five years	Three years
Unfair preference	Two years (connected persons) Six months (unconnected persons)	Two years (connected persons) One year (unconnected persons)
Avoidance of floating charges	Six months	Two years (connected persons) One year (unconnected persons)

The IRDA also makes clear that, for any period during which the company was in a scheme moratorium that overlaps with the new “relevant time”, that period will be added on to the “relevant time”. This means that if a company was granted a scheme moratorium that lasted six months but the company failed to commence a scheme and instead went into winding up, the period during which it was in moratorium and overlaps with the “relevant time” (i.e., six months) is added to the “relevant time”. This helps address the problem encountered under the old legislation where the avoidance period would continue to run and may potentially expire where the company has been under moratorium protection for a long period of time.

Conclusion

The IRDA is another valuable step in the evolution of Singapore's restructuring and insolvency regime and further boosts its standing as an international centre for debt restructuring. While it remains to be fully seen how extensively and creatively these provisions will operate in practice, the framework is in place for effective debt restructurings that help creditors and debtors maximise value in rescue situations.

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 the following:

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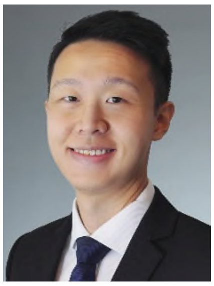

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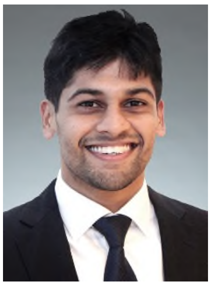

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