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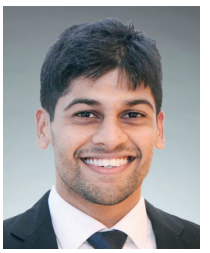
Cross-class cramdown of secured creditors – Singapore's implementation of a US Chapter 11 tool



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With the introduction of cross-class cramdown provisions into Singapore's Insolvency, Restructuring and Dissolution Act 2018 ("IRDA"), secured creditors may potentially find themselves bound by a scheme of arrangement even if they have voted against it. This article explores the cross-class cramdown provisions in the IRDA, in particular the requirement that such a scheme be "*fair and equitable*" and focuses on what this means specifically in the context of under-secured creditors.

Since 2017, Singapore has continually revamped and enhanced its corporate debt restructuring mechanisms. One of these enhancements is the introduction of the cross-class cramdown in Singapore's Insolvency, Restructuring and Dissolution Act 2018 ("IRDA").[1]

The cross-class cramdown is a powerful tool which is intended to prevent minority dissentients from blocking the passage of a scheme of arrangement. It can bind entire classes of dissenting creditors, as long as at least 1 class has voted in favour of the scheme, among other requirements.[2]

Given the highly coercive nature of the cross-class cramdown, it is unsurprising that the IRDA contains in-built safeguards which must be satisfied before the tool can be invoked. However, these safeguards have yet to be tested before the Singapore court and until then, there is uncertainty about their interpretation.

This article focuses on the cross-class cramdown of secured creditors and explores what is required in order for such a scheme to be considered "*fair and equitable*".

Overview of the cross-class cramdown

To cramdown on classes of dissenting creditors, 3 requirements must be met:[3]

a) Taken as a whole, all the creditors (irrespective of class) must have approved the scheme by a majority in number representing 75% in value of the overall debt.
b) The court must be satisfied that the scheme does not discriminate unfairly between 2 or more classes of creditors.
c) The court must be satisfied that the scheme is fair and equitable to each dissenting class.

For a scheme to be "*fair and equitable*", it must first at least give the dissenting class an amount that is equal to what they would receive in the "*most likely scenario if the compromise or arrangement does not become binding*".[4]

In addition, where the dissenting class comprises secured creditors, each dissenting secured creditor must receive either:[5]

a) deferred cash payments totalling its claim and the preservation of its security;
b) a charge over the proceeds of the sale, if the secured assets are to be sold; or
c) the "*indubitable equivalent*" of its security.

In the language of the statute, each of these options must be able to satisfy the "*creditor's claim that is secured by [its] security*".

The difficulty which arises is what monetary value should be ascribed to a secured creditor's claim. The phrase "*creditor's claim that is secured by [its] security*" has two potential meanings:

a) the face value of the creditor's claim; or
b) the value of the creditor's claim up to the value of the collateral held by the creditor as security for its claim.

For example, take a creditor who is owed $10m and has a security over an asset for its claim, but the asset (i.e. the collateral) is presently only worth $7m. Is the "*creditor's claim that is secured by [its] security*" $10m (being the face value of the debt) or $7m (being the part of the debt which is effectively secured)?

Where a creditor is fully secured (or over-secured), either interpretation yields the same result. However, for an under-secured creditor, as in the example above, the interpretation of this phrase will have important practical ramifications, as it would directly affect its treatment under the scheme.

Language of equivalent provisions in US Bankruptcy Code

Typically, in interpreting a Singapore statute, case law interpreting the foreign statute from which the provision was imported is instructive.[6]

While the cross-class cramdown provisions in the IRDA were generally adapted from §1129(b)(2) of Chapter 11 of Title 11 of the US Code ("US Bankruptcy Code"), the phrase "*creditor's claim that is secured by [its] security*" does not appear there. Rather, the US Bankruptcy Code uses phrases such as "*allowed amount*"[7] and "*holder's interest in the estate's interest in such property*".[8]

The first phrase ("*allowed amount*") refers to what practitioners usually think of as the quantum of the claim accepted by the debtor for the purpose of the restructuring (i.e. the accepted portion of the creditor's proof of debt).

Under the US Bankruptcy Code, the secured creditor files its claim with the court.[9] The entirety of such claim is deemed "*allowed*", unless the debtor objects.[10] Additionally, the "*allowed*" claim of a secured creditor is treated as a secured claim "*to the extent of the value of such creditor's interest in the estate's interest in such property*".[11] As such, the "*allowed amount*" is generally understood as referring to the value of the collateral held by the creditor.

The second phrase ("*holder's interest in the estate's interest in such property*") is used in the context of the deferred cash payment requirement to satisfy the "*fair and equitable*" standard for cramming down on secured creditors (i.e. option (a) of the 3 options summarised above).

In this regard, the US Bankruptcy Code sets out two sub-requirements: (i) the deferred cash payments must total the "*allowed amount*"; and (ii) the present value of the deferred cash payments must total the creditor's "*interest in the estate's interest in the property*".[12]

The operation of these two sub-requirements is in turn affected by the under-secured creditor's right of election under the US Bankruptcy Code.[13] Using the same example, if the creditor elects to have its $10m claim treated as an "*allowed*" secured claim, then for the plan to be considered "*fair and equitable*", it must provide for all deferred cash payments to the creditor to total $10m. However, the present value of all the deferred cash payments to the creditor need only total $7m.[14]

In the non-election scenario, the figure under both sub-requirements would be $7m, being the value of the collateral held by the creditor. It can thus be said that generally, the US Bankruptcy Code adopts a value-focused approach.

This same focus on the value of the collateral can also be gleaned from the "*indubitable equivalent*" concept (i.e. option (c) of the 3 options summarised above).[15] While undefined in the statute, the US Bankruptcy Courts have interpreted the concept as referring to "*the unquestionable value of a lender's secured interest in the collateral*".[16]

Overall, the thrust of the protection afforded to secured creditors who are subject to a cross-class cramdown under the US Bankruptcy Code appears to be preservation of the value of their collateral.

Interpretation of "creditor's claim that is secured by that security".

Returning to the issue at hand, how should the Singapore court interpret the phrase "*creditor's claim that is secured by that security*"?

Singapore courts interpret statutory provisions

in a manner which promotes the statute's purpose.[17]

It can be argued that the purpose of the safeguards in the cross-class cramdown provisions is to provide secured creditors with certainty that they are not receiving less value than they would have received if they had enforced their security. Put another way, it is to protect secured creditors' interests by giving them the economic equivalent of their security under the scheme, in lieu of allowing them to enforce on their security.

Certainty lies at the heart of what is considered "*fair and equitable*" in the context of secured creditors. By virtue of their status as holders of security, they should be able to have recourse to their collateral (or if not, have the comfort of its economic equivalent) in all scenarios unless they voluntarily choose to surrender that collateral.

For example, in the context of liquidation, secured creditors take free of the insolvency regime in that they are entitled to realise their security and recover their debts from such proceeds, ahead of payment of preferential debts and other unsecured debts.[18]

However, importantly, the extent of that certainty afforded to secured creditors does not extend beyond what is commensurate with the value of the collateral.

To illustrate, in the context of judicial management, a secured creditor must deduct the value of its security from its proof of debt and can only vote in respect of the unsecured portion of its debt at a creditors' meeting.[19] This rule serves to adjust the size of a secured creditor's vote, so that it does not have an outsized say in how the company's unencumbered assets are administered for the benefit of the unsecured creditors.[20]

Similarly, in the context of a scheme, the sanctity of a secured creditor's security (being a bargained-for right) cannot be intruded upon via the cramdown mechanism contrary to the will of the class of secured creditors, unless the statutory safeguards are complied with, with the effect that such creditors are given the economic equivalent of their claim.

The cross-class cramdown provisions thus strike a balance between preventing viable schemes from being stymied by a dissident class of creditors, while ensuring that standards of fairness and equitability are satisfied such that the dissenting class is not prejudiced by the cramdown.[21]

This is also consistent with the IRDA's broader purpose of encouraging corporate rescues and restructurings, which takes a collective view of the interests of investors (both creditors and shareholders alike) alongside the interests of the economy at large.[22]

In the round, the interpretation that better serves the purpose of providing secured creditors with certainty that they are not receiving less value than they would have received if they enforced their security, should be preferred. The phrase "*creditor's claim that is secured by that security*" should thus be interpreted as the value of the under-secured creditor's debt up to the value of the collateral held as security for its claim (i.e. $7m using the example above), rather than the face value of its claim.

This interpretation would also be in line with the general position in the US Bankruptcy Code, which effectively guarantees the secured creditor the value of its collateral.

The use of only one sub-requirement in the IRDA for the deferred cash payment requirement (compared to the two sub-requirement approach under the US Bankruptcy Code), coupled with the lack of an election right under the IRDA (which exemplifies the distinction between the two sub-requirements, as illustrated above), suggests an intention for the phrase "*creditor's claim that is secured by that security*" in the IRDA to take on the default meaning under the US Bankruptcy Code where the election right is not exercised. As mentioned above, this default position focuses on the value of the collateral.

One criticism of the interpretation which focuses on the value of the collateral is that

it requires the court to undertake a valuation exercise. Such exercises can be criticised as being potentially subjective, highly contentious and very technical, as can be seen from US Bankruptcy Code jurisprudence.[23] In contrast, the alternative interpretation (which simply looks at the face value of the debt) does not require a valuation exercise.

However, concerns over the potential subjectivity and complexity of a valuation exercise should not stand in the way of preferring of an interpretation which advances the underlying purpose of the provision. Moreover, Singapore courts are not averse to engaging in valuation disputes (which are often part and parcel of restructuring cases) and are well-equipped to do so.[24]

A further reason why the alternative interpretation referring to the face value of the debt should be rejected is that it may lead to an under-secured creditor receiving an undue windfall from any value increase in the collateral as part of the scheme (which it has refused to consent to). It may be better to leave such a windfall scenario to market forces instead.[25]

Conclusion

Until the issue arises before the Singapore court for conclusive determination, the interpretation of "*creditor's claim that is secured by [its] security*" remains uncertain. Secured creditors who are faced with the prospect of a cross-class cramdown may wish to pre-emptively undertake a scenario analysis, under each of two alternative interpretations, to consider whether there is a basis to resist the cramdown for being less than "*fair and equitable*".

Notes:

1 Insolvency, Restructuring and Dissolution Act 2018, Section 70.

2 Insolvency, Restructuring and Dissolution Act 2018, Section 70(1).

3 Insolvency, Restructuring and Dissolution Act 2018, Section 70(3).

4 Insolvency, Restructuring and Dissolution Act 2018, Section 70(4)(a).

5 Insolvency, Restructuring and Dissolution Act 2018, Section 70(4)(b)(i).

6 For instance, the Singapore High Court has held that since the rescue financing provisions in the IRDA were adapted from Chapter 11 of Title 11 of the US Code, case law from the US Bankruptcy Courts considering the equivalent foreign provisions could provide useful guidance to the Singapore court in determining how the IRDA provisions are to be interpreted. See *Re Attilan Group Ltd* [2018] 3 SLR 898 (SGHC) at [50]-[51] and *Re Design Studio Group Ltd and other matters* [2020] 5 SLR 850 (SGHC) at [31].

7 Chapter 11 of Title 11 of the US Code, §1129(b)(2)(a)(i)(I) and (II).

8 Chapter 11 of Title 11 of the US Code, §1129(b)(2)(a)(i)(II).

9 Chapter 11 of Title 11 of the US Code, §501. It should be noted that under Singapore's scheme of arrangement regime, the difference is that the creditor submits its proof of debt to the chairperson of the scheme meeting for adjudication. Hence, instead of the court assessing a creditor's claim at first instance (as is the case under the US Bankruptcy Code), it is the chairperson (often selected by the debtor) who does so under the IRDA. There is then a prescribed regime for disputing the chairperson's assessment. See generally, Insolvency, Restructuring and Dissolution Act 2018, Section 68. However, for present purposes, this is a difference without significance.

10 Chapter 11 of Title 11 of the US Code, §502(a). In the event of an objection, a hearing is held where the value of the collateral is determined for the purposes of assessing what is the "*allowed amount*": see Chapter 11 of Title 11 of the US Code, §502(b).

11 Chapter 11 of Title 11 of the US Code, §506(a)(1). Where the creditor is under-secured, this results in a bifurcation of its claim into (i) a secured claim for the value of the collateral, and (ii) an unsecured claim for the deficiency portion.

[12] Chapter 11 of Title 11 of the US Code, §1129(2)(A)(i)(II). For ease of reference, this provision reads: "*... that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, or at least the value of such holder's interest in the estate's interest in such property*". In contrast, the IRDA only sets out one requirement, which is that the deferred cash payments must total the "*creditor's claim that is secured by that security*": see Insolvency, Restructuring and Dissolution Act 2018, Section 70(4)(b)(i)(A). For ease of reference, the relevant portion of this provision reads: "*... must provide for each creditor the dissenting class to receive deferred cash payments totalling the amount of the creditor's claim that is secured by the security held by the creditor ...*". The implication of this is discussed in the next section of this article.

[13] Chapter 11 of Title 11 of the US Code, §1111(b). Under this provision, under-secured creditors can elect to have their entire claim (i.e. beyond the value of the collateral) treated as an "*allowed*" secured claim. Using the example above, this means the creditor can elect to have its entire $10m claim treated as an "*allowed*" secured claim, in return for giving up its $3m unsecured claim. This election right is absent from the IRDA.

[14] Charles Jordan Tabb, *Law of Bankruptcy* (West Academic Publishing, 4th Ed, 2016) at p 1159.

[15] The concept of "*indubitable equivalence*" appears to have been first coined by Judge Learned Hand in the decision of *In re Murel Corp* 75 F.2d 941 (2d Cir. 1935), after which it was codified within the US Bankruptcy Code.

[16] *In re Philadelphia Newspapers*, LLC, 599 F.3d 298, 310 (3d Cir. 2010).

[17] *Tan Cheng Bock v Attorney-General* [2017] 2 SLR 850 (SGCA) at [37] and [54]; *Reed, Michael v Bellingham, Alex (Attorney-General, intervener)* [2022] 2 SLR 1156 (SGCA) at [69].

[18] Insolvency, Restructuring and Dissolution Act 2018, Section 203(1).

[19] Insolvency, Restructuring and Dissolution (Judicial Management) Regulations 2020, Regulation 39(1)(b).

[20] See *Re Swiber Holdings Ltd and another matter* [2018] 5 SLR 1130 (SGHC) at [19]-[22], and [33]-[35], discussing the predecessor provision, Companies Regulations (Cap 50, Rg 1, 1990 Rev Ed), Reg 76.

[21] Final Report of the Insolvency Review Committee (2013), Chapter 7 (Schemes of Arrangement) at [47], [49] and [53].

[22] The stated intent of the IRDA is to "*enhance Singapore's corporate rescue and restructuring process, in order to strengthen Singapore as an international centre for debt restructuring*": see Insolvency, Restructuring and Dissolution Bill (Bill 32 of 2018) at p 559; Singapore Parliamentary Debates, Official Report (1 October 2018) vol 94 no. 83 at pp 59–60 (Mr Edwin Tong Chun Fai, Senior Minister of State for Law (for the Minister for Law)). See also the Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring (2016), at [1], noting that a modern insolvency regime recognises that business failure is a commercial reality, and should offer distressed debtors an option to restructure and rescue the business, and also facilitate efficient division and distribution of a debtor's assets while balancing the interests of stakeholders.

[23] The speculative and subjective nature of comparative valuations, along with the fact that Singapore's smaller economy size could mean that comparative analysis cannot be undertaken in the same way as it can be done in the US with its larger and more developed economy, were cited by the minority members of the Insolvency Review Committee as to why they opposed the introduction of cross-class cramdown provisions into Singapore's insolvency regime: see Final Report of the Insolvency Review Committee (2013), Chapter 7 (Schemes of Arrangement) at [50] and [52].

[24] Similar sentiments are shared by the authors Stephanie Yeo and Clayton Chong in "*Fixing the Shareholder Holdout Problem in Singapore*", Singapore Global Restructuring Initiative Blog, 4 October 2022 (accessible at: https://ccla.smu.edu.sg/sgri/blog/2022/10/04/fixing-shareholder-holdout-problem-singapore).

[25] For example, where a debtor incentivises under-secured creditors to vote in favour of the scheme (e.g. by giving creditors an election right, under the scheme, to opt for certain proportions of their under-secured debt to be treated as a secured debt for the post-restructuring security given to them).

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