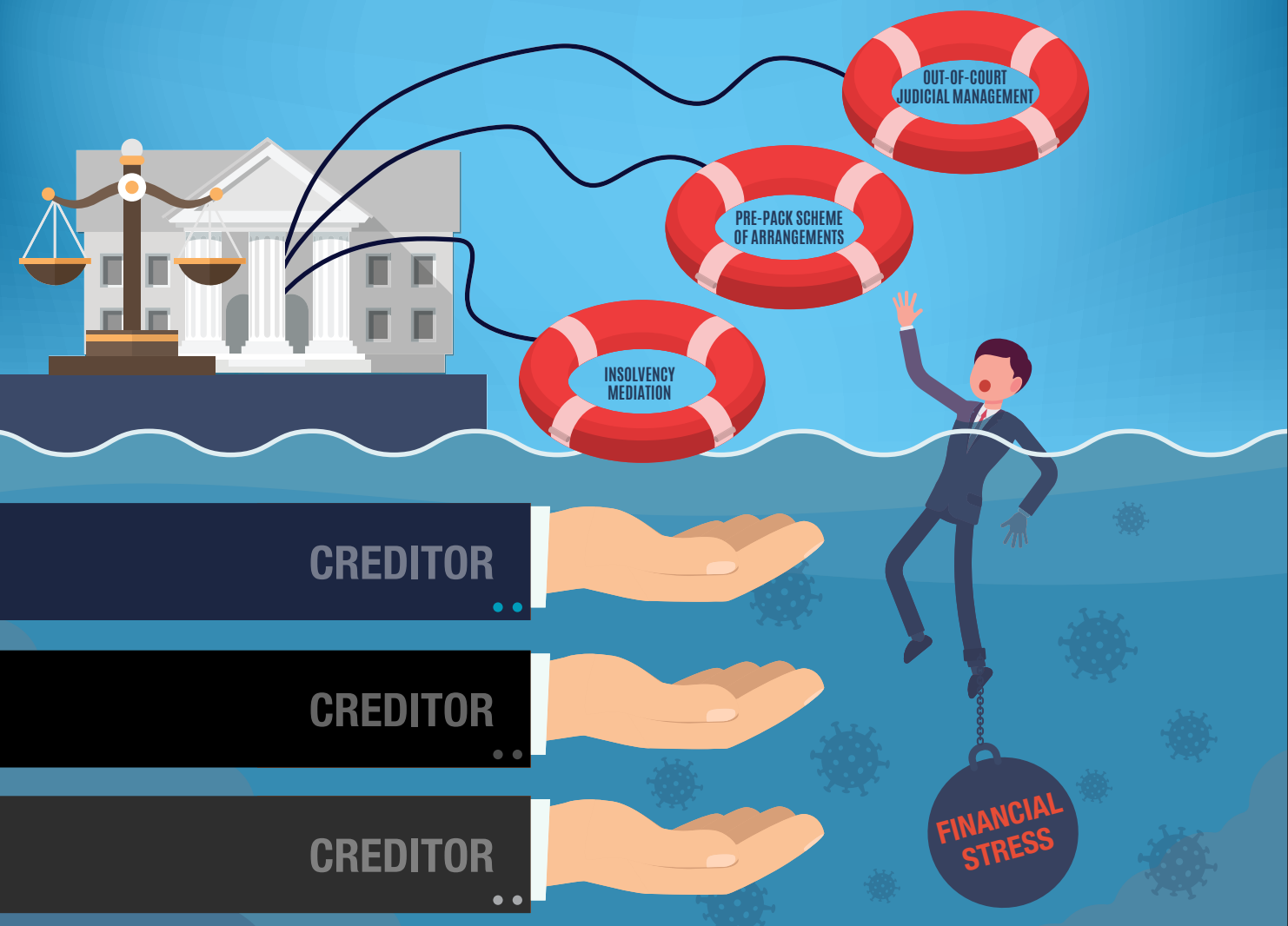
Out-of-Court Insolvency Relief for Distressed Companies

By **SMITHA MENON**, **CLAYTON CHONG** and **SEAN LEE** of WongPartnership LLP



Temporary relief measures have been introduced to help distressed companies affected by the pandemic, but will gradually be phased out. To stay afloat in these trying times, companies in financial distress should look beyond the temporary measures and consider utilising out-of-court insolvency relief mechanisms such as pre-pack schemes, out-of-court judicial management and mediation.

Many companies are facing financial stress in the light of the economic impact from the Covid-19 pandemic.

Legislation has been enacted to ameliorate the negative effects of the pandemic on businesses. For example, the Covid-19 (Temporary Measures) Act was introduced in April 2020 to provide relief to parties adversely affected by the Covid-19 pandemic. The Covid Act enables parties under certain categories of contracts to obtain temporary relief from legal and enforcement actions if they are unable to perform their contractual obligations due to Covid-19.

However, the Covid Act is intended to be a stopgap measure and will be phased out gradually over the coming months. The relief period for event contracts and tourism-related contracts will end on 31 December 2020, and the relief period for construction contracts will end on 31 March 2021.

As the Covid Act will gradually be phased out, it is important for financially distressed companies to look beyond the temporary relief measures and explore the options available under restructuring laws. The legal framework for restructurings in Singapore has been enhanced in recent years to make it easier and faster for companies to restructure their debts.

Simplified insolvency programme for micro and small companies

Micro and small companies make up around 95 per cent of Singapore's enterprising framework. The economic downturn resulting from the Covid-19 pandemic is expected to impact a significant percentage of these micro and small companies.

To address this, legislation has been passed to introduce a Simplified Insolvency Programme to provide a simpler, faster and lower-cost procedure for micro and small companies to restructure their debts or wind up in an orderly manner. To qualify for the Programme, companies must meet certain specified eligibility criteria, including having an annual sales turnover of S$10 million or less, and liabilities of S$2 million or less.

A company may apply to the Official Receiver to be admitted into the Simplified Insolvency Programme. If the application is accepted, the company is protected by a moratorium against legal or enforcement action by creditors and a restriction on the operation of ipso facto clauses (i.e. clauses that allow counterparties to terminate or modify contracts upon the company's insolvency). This gives the company breathing space to try to restructure its debts.

A company under the Simplified Insolvency Programme can seek to negotiate and implement a restructuring by way of a pre-pack scheme of arrangement with its creditors. The basic framework and process for a pre-pack scheme is discussed in the section below. One key difference for a pre-pack scheme under the Simplified Insolvency Programme is that it imposes a lower creditor approval threshold of two-thirds in value, compared to the usual threshold of a majority in number holding three-fourths in value.

Pre-pack scheme of arrangement

A pre-pack scheme of arrangement is a mechanism introduced under the Insolvency, Restructuring and Dissolution Act 2018 (IRDA). It allows a distressed company to seek court approval for a scheme of arrangement without having to convene a meeting of creditors to vote upon the scheme, thereby simplifying the procedure. A pre-pack scheme of arrangement grants the opportunity for distressed companies to undertake a quick and less disruptive restructuring.

Under a regular scheme process, a company would have to first apply to court to obtain approval to call a creditors' meeting to vote on the proposed scheme. After the creditors' meeting, the company would then have to make a second court application to obtain the court's approval of the scheme. The pre-pack scheme process dispenses with the first court application and allows a company to directly apply for the court's approval of the scheme, provided it can show that the requisite threshold of creditors approve the proposed scheme. This would ordinarily require the creditors to provide written confirmation of their agreement to the terms of the scheme.

This efficient process allows distressed companies to resolve their financial issues via a pre-negotiated scheme within an accelerated timeframe. The relative speed at which a pre-pack scheme of arrangement can be implemented helps to mitigate the impact on the reputation of the company as well as the confidence of customers, suppliers and trading partners in the company and management.

Judicial management by resolution of creditors

Prior to the introduction of the IRDA, a company was only able to enter into judicial management through an order of the court. However, Section 94 of the IRDA provides an out-of-court process for a company to place itself under judicial management with the approval of the company's creditors.

The company may now initiate the out-of-court process by a members' resolution, or if the constitution of the company allows, by a directors' resolution. Subsequently, a meeting is convened for 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.

An out-of-court process encourages constructive and frank commercial discussions between a company and its lenders. Judicial management is an avenue for a consensual restructuring with the added comfort of an independent supervisor (who is an officer of the Court) having carriage of the process.

Similar to a pre-pack scheme of arrangement, commencing a judicial management out-of-court

can help to minimise the negative publicity and disruption to the business, by averting disputes that might otherwise be litigated in an open court. The out-of-court process can also expedite restructuring efforts, especially when used in tandem with other tools, such as the aforementioned pre-pack scheme of arrangement.

Insolvency mediation

Mediation is a process in which a neutral third party attempts to help parties reach a mutually satisfactory solution to the problem. The mediator hears all sides of the disagreement and communicates freely with parties on their views, constraints and commercial objectives. With this insight and knowledge, the mediator assists the parties to work out suitable solutions to bridge the differences between the parties.

In the context of insolvency, mediation can be conducted by specialist insolvency practitioners trained to help a distressed company and its creditors find solutions. All key stakeholders such as suppliers, customers or other parties to vital contracts can be included in the process to achieve a holistic outcome.

The Singapore courts have encouraged the use of insolvency mediation. It opined, in a recent case, how an experienced and skilled insolvency mediator can "assist to iron out many of the wrinkles and creases that frequently erupt in a restructuring and which perhaps are not best resolved in the adversarial cauldron of the court".

In recent years, insolvency mediation has gained traction in Singapore. In 2017, the Singapore Mediation Centre (SMC) expanded its panel of mediators to include a specialist Insolvency Panel. A trend towards the use of mediators to address insolvency issues is likely to continue, especially in the light of the economic impact of the Covid-19 pandemic. The Supreme Court, in collaboration with the SMC, launched the SGUnited Mediation Initiative to refer suitable cases in the Supreme Court for mediation at no charge to parties.

The Singapore International Mediation Centre (SIMC) has also introduced their SIMC Covid-19 Protocol which is described as "an expedited, economical and effective means for resolving disputes during the Covid-19 period".

Parties may be bound by settlement agreements resulting from mediation. With the Singapore Convention on Mediation coming in force since September 2020, a party to an international settlement agreement may apply to the High Court to record the agreement as an order of the court to enforce the settlement agreement in Singapore.

Towards more successful outcomes

In times of financial hardship, business leaders are actively seeking expedient ways to trade out of their financial difficulties. It is important to address issues head-on at the earliest available opportunity to yield a more successful outcome. Out-of-court insolvency dispute resolution mechanisms, such as pre-pack scheme of arrangements, out-of-court judicial management and insolvency mediation, should be more frequently deployed to maximise value for all stakeholders.

Companies that are pro-active in using these mechanisms will have a longer runway for negotiating with their creditors and have a better chance of achieving a comprehensive long-term solution to their financial difficulties. ■