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ANALYSIS and INSIGHT

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**RESTRUCTURING and INSOLVENCY**

# DIP FINANCING – THE SINGAPOREAN WAY

SINGAPORE, THURSDAY 20 AUGUST 2020 – In 2016 the Ministry of Law unveiled plans to strengthen Singapore as an international centre for debt restructuring. Pursuant to these plans, numerous complex legislative changes were introduced to Singapore's debt restructuring and insolvency laws. These changes primarily related to the 2017 amendments to the Companies Act (Cap 50).

Instead of addressing all of the relevant legislative changes to Singapore's debt restructuring and insolvency laws, this article focuses on Singapore's experience of transplanting the US Chapter 11 debtor-in-possession financing (DIP financing) provisions into the 2017 amendments to the Companies Act.

**Super-priority financing – Section 211E of the Companies Act**

The Singapore DIP financing provisions are found in Section 211E of the Companies Act.

Section 211E of the Companies Act was introduced to Singapore's insolvency regime as it was recognised that such super-priority provisions would enhance the rescue options available to insolvency practitioners. The Insolvency Law Review Committee, which was tasked to study the challenges and downsides of the proposed legislative reforms to Singapore's insolvency regime, had also deemed that the courts were fully capable of assessing the appropriateness of granting super priority and dealing with any risk of abuse.

Section 211E of the Companies Act provides that a company which has applied to a court to convene a scheme meeting or moratorium may seek an order of court that the debt arising from 'rescue financing' must:

- be treated as if it were part of the costs and expenses of winding up (Section 211E(1)(a));
- have priority over preferential and all other unsecured debts (Section 211E(1)(b));
- be secured by a new security interest over unsecured property or a subordinate security interest on a property that is subject to an existing security interest (Section 211E(1)(c));
- or be secured by a new security interest over already-secured property, of the same priority as or higher priority than that security interest (Section 211E(1)(d)).

On satisfying the relevant conditions stipulated in Section 211E, the Singapore court has the power to grant super-priority status to the new financiers. This would consequently have the effect of disrupting the order of priority for existing creditors of the company.

**Re Attilan Group Ltd**

The first case in Singapore involving an application under Section 211E of the Companies Act was the Singapore High Court case of Re Attilan Group Ltd,(5) which dealt with Sections 211E(1)(a) and 211E(1)(b) of the Companies Act.

The Honourable Judicial Commissioner Aedit Abdullah (now Justice Abdullah) in Re Attilan helpfully laid down the requirements for an application under Sections 211E(1)(a) and 211E(1)(b).

First, the financing sought must fall within the definition of 'rescue financing' under Section 211E(9) of the Companies Act.

Next, and while not an express condition in an application under Section 211E(1)(a) that rescue financing would not be obtained but for the grant of super priority, it remains a relevant and important

factor to be considered by the court.(7) In Re Attilan, this factor alone was sufficient to undermine the applicant's application under Section 211E(1)(a) of the Companies Act as the applicant had failed to show that no financial aid could have been reasonably received without any offer of super priority.

With respect to Section 211E(1)(b), the Singapore High Court further observed that several factors laid down by the US courts were relevant considerations for the Singapore courts in the exercise of its discretion in adjudicating an application for super priority. This, as highlighted by the Singapore High Court, was because Singapore's DIP financing provisions were originally inspired by Section 364 of the US Bankruptcy Code (the Code).(9) In particular, Justice Abdullah considered the following factors relevant:

- no alternative financing is available on any other basis;
- the proposed financing must be in the exercise of sound and reasonable business judgement;
- such financing is in the creditors' best interest;
- no better offers, bids or timely proposals are before the court;
- the proposed credit transaction is necessary to preserve the assets of the estate and is necessary, essential and appropriate for the continued operation of the debtors' businesses;
- the financing agreement's terms are fair, reasonable and adequate in light of the circumstances of the debtor and proposed lender; and
- the financing agreement was negotiated in good faith and at arm's length between the debtor on the one hand and the agents and the proposed lender on the other.

It is a material condition under Section 211E(1)(b) that an applicant demonstrates that reasonable efforts have been undertaken to explore other types of financing which did not entail a super priority over all preferential debts and other unsecured debts. However, in Re Attilan the applicant failed to demonstrate that such reasonable efforts had been made. Thus, the Singapore High Court refused the application under Section 211E(1)(b) on this basis and did not have to consider the application of the above enumerated factors.

**Asiatravel.com Holdings Ltd and AT Reservation Network Pte Ltd**

The second Singapore case involving an application under Section 211E of the Companies Act was an unreported decision in April 2019.

The authors acted for Asiatravel.com Holdings Ltd (ATH) (SGX: 5AM) and its subsidiary, AT Reservation Network Pte Ltd (ATRN) (collectively, the applicants) and obtained an order for super- priority rescue financing, making this the first successful application under Section 211E of the Companies Act.

It was observed that the presence of the following factors distinguished this case from Re Attilan, thereby resulting in a successful application under Section 211E(1)(b):

- there was evidence that the applicants had approached their existing lenders, which were unwilling to provide further financing;
- DHC Capital Pte Ltd, a third-party investment advisory firm engaged by the applicants, had sought potential financing, but none of the nine potential lenders that DHC Capital approached were willing to provide the applicants with any financing; and
- the applicants had explained in their affidavits why rescue financing was crucial to their rehabilitation.

**Swee Hong Limited**

Another Singapore case involving the successful application under Section 211E of the Companies Act is the unreported decision in February 2020 by Justice Ang Cheng Hock.

In this case, Swee Hong Limited (SGX: QF6) successfully obtained an order for super-priority financing under Sections 211E(1)(b) and 211E(1)(c) of the Companies Act.

This case raised an interesting issue as to whether the Singapore courts can grant super-priority status to financiers pursuant to Section 211E(1)(c) where financing of approximately S$2.9 million was disbursed to the company prior to any order being made by the court under Section 211E.

Financing of the approximate sum of S$2.9 million had been made to the company on the basis that such financing was urgent and necessary to fund the company's day-to-day operations.

The company then sought to obtain an order for rescue financing on a super-priority basis for a total debt of S$6 million, relying solely on Section 211E(1)(c). The application was made on the basis that part of this S$6 million would be used to repay the interim financing of approximately S$2.9 million that had been earlier disbursed by the financier.

The objecting creditor submitted that under Section 211E(1)(c), the company could not obtain super-priority status for any rescue financing that had already been disbursed to the company prior to a Section 211E order being made.

Reference was made by the objecting creditor to 211E(1)(c) of the Companies Act – which expressly refers to a "debt arising from any rescue financing to be obtained by the company". The wording of Section 211E(1)(c) was contrasted with the wording of Sections 211E(1)(a) and 211E(1)(b) of the Companies Act which related to any "debt[s] arising from any rescue financing obtained, or to be obtained, by the company".

Reference was further made to the Companies (Amendment) Bill 13/2017, where the explanatory statement to Section 211E provided that:

> *[t]he company may apply for an order under new section 211E(1)(a) or (b) either before or after obtaining the rescue financing concerned. However, if the company wishes to obtain an order of the Court under new section 211E(1)(c) or (d), the company must make the application under new section 211E(1)(c) or (d) before obtaining the rescue financing.*

Justice Ang agreed that the wording of Section 211E(1)(c) of the Companies Act precluded the court from granting an order for the total debt of S$6 million. However, after an oral application was made by the company to amend the application to refer to Sections 211E(1)(b) in addition to Section 211E(1)(c), the court granted an order for super priority to the S$2.9 million under Section 211E(1) (b) and the remaining S$3.1 million under Section 211E(1)(c).

In allowing the approximately S$2.9 million debt to be given super-priority status pursuant to Section 211E(1)(b) of the Companies Act, Justice Ang appeared to consider that the company had shown:

- evidence that it had, through its independent financial advisers at DHC Capital, approached other potential financiers (including existing creditors to specialist distressed and special situation funds) on both super-priority or non-super-priority terms, which were unwilling to provide company with any financing; and
- the rescue financing was crucial for the company's survival and would provide essential liquidity for the company's business operations (including its revenue generating projects) while the company worked with the financier for the implementation of a proposed scheme of arrangement which appeared to benefit the creditors (compared with a liquidation scenario).

**Design Studio Group Ltd**

The third – and most recent – successful application for super-priority rescue financing in Singapore under Section 211E of the Companies Act was an application by Design Studio Group Ltd (Design Studio) (SGX: D11). This is another unreported decision of the Singapore High Court where Justice Abdullah granted approval for S$62 million super-priority rescue financing pursuant to Section 211E(1)(b) of the Companies Act.

Design Studio was a leading interior fit-out provider to the residential, hospitality, commercial, food and beverage, retail, themed works, corporate office and cruise sectors, but had experienced liquidity issues due to competition in the industry.

The super-priority loan to Design Studio had been agreed to by HSBC (Singapore branch) (HSBC) and Design Studio's controlling shareholder, Depa United Group (Depa). As previously explained, this means that if Design Studio were to be wound up, the new loans extended by Depa and HSBC would have priority over all preferential and unsecured debt.

However, what set this loan apart from the others was that prepetition debt (ie, debt already owed to HSBC and Depa) would also have priority if Design Studio was wound up. This is known as a debt roll-up, which elevates the priority of prepetition debts. This decision was the first time that a debt roll- up was approved in Singapore.

Previously, in Swee Hong, although the rescue financing over which super priority was sought had been extended before the super-priority application was heard, that rescue financing was a post- petition debt incurred after insolvency proceedings had commenced. The court in the Design Studio case goes one step further, granting super priority over the prepetition claims of Depa and HSBC which were incurred even before insolvency proceedings had commenced.

**Takeaways from Singapore cases on Section 211E**

**Section 211E(1)(b)**
The above cases provide some helpful assistance as to the relevant factors that the Singapore courts will consider in an application for super-priority rescue financing under Section 211E(1)(b) of the Companies Act, which has so far been the most common application for super-priority rescue financing in Singapore.

**Section 211E(1)(a)**
However, there remains some uncertainty with respect to Section 211E(1)(a).

Apart from an applicant having to show that it expended reasonable efforts to obtain financing on an unsecured basis, it is unclear whether the requisite evidentiary threshold would be the same as that in Section 211E(1)(b).

An argument could be made that the evidentiary threshold under Section 211E(1)(a) should be lower than that of Section 211E(1)(b). This is because under Section 211E(1)(b), rescue financing is granted priority over "all the preferential debts specified in section 328(1)(a) to (g)". Such super-priority rescue financing granted under Section 211E(1)(b) would thus rank above that granted under Section 211E(1)(a), where the rescue financing is given the same priority as the administrative costs of winding up.

Indeed, this argument was raised in the US courts in the case of Re Limitless Mobile LLC.(22) The debtor there argued that the threshold ought to be lower for DIP financing bearing the title of an administrative expense, as administrative priority does not rank as highly as 'super priority' under Subsection (c). In this regard, the debtor did not have to show that it was otherwise unable to obtain such credit, which is an express requirement under Subsection (c).

However, the parties eventually settled and therefore the matter did not come before the US courts.

**Section 211E(1)(c)**
In relation to Section 211E(1)(c) of the Companies Act, Swee Hong affirms the plain reading of the provision that an applicant cannot under Section 211E(1)(c) obtain super-priority status for any rescue financing that had already been disbursed prior to a Section 211E order being made.

**Section 211E(1)(d)**
The Singapore courts have as yet not been asked to determine an application for super priority under Section 211E(1)(d) of the Companies Act.

As set out above, if successfully obtained, Section 211E(1)(d) of the Companies Act allows a new financier to secure by a new security interest over already-secured property of the company the same priority as or higher priority than that existing security interest.

Given that Section 211E(1)(d) potentially, and most severely, disrupts the order of priority for existing creditors of the company, there are express statutory safeguards including the safeguard that an order under Section 211E(1)(d) will be made only if there is "adequate protection for the interests of the holder of that existing security interest".

This seeks to balance the rehabilitative purposes of the 2017 Companies Act amendments with the existing rights of secured creditors by ensuring that such creditors remain sufficiently protected with regard to new financing which a debtor may seek to undertake.

There is still much uncertainty as to what constitutes "adequate protection for the interests of the holder of that existing security interest" under Section 211E(1)(d)(ii) of the Companies Act.

While Section 211E(6) provides some guidelines as to what constitutes such adequate protection (eg, cash payments to compensate for any decrease in value,(24) additional or replacement security(25) or relief in the form of an 'indubitable equivalent'),(26) it remains to be seen how this provision would be interpreted and applied by the Singapore courts.

**US court guidance – adequate protection**
Given that the DIP financing regime in Singapore is inspired by the US Chapter 11 debtor-in- possession financing provisions, it is useful to look at how the US courts have dealt with issues relating to DIP financing, as this may well inform how the Singapore courts would deal with the same issues in the future.

**Interpretation of 'adequate protection' in Section 361 of US Bankruptcy Code**
Section 361 of the US Bankruptcy Code reads as follows:

> *11 U.S. Code § 361.Adequate protection*
>
> *When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by –*
>
> *requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;*
>
> *providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or*
>
> *granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.*

Like Section 211E(1)(d)(ii) of the Companies Act, Section 361 of the US Bankruptcy Code provides secured creditors with three categories of adequate protection – namely:

- cash payments;
- a replacement lien; or
- other protection that will result in the realisation of the indubitable equivalent of the creditor's interest in the property.

The first two categories appear fairly straightforward. The third category is openly worded, allowing for other means of providing adequate protection (eg, an equity cushion).(27) An equity cushion exists if the value of the security exceeds the value of the creditor's claim (ie, the creditor is over- secured). The excess value over the creditor's claim is treated as an equity cushion which sufficiently protects the creditor.

The term 'adequate protection' has been narrowly construed in the United States, with courts granting the status of super priority to new financing only where there is sufficient value in the property to support new and existing loans.

Naturally then, valuation often becomes an issue that arises in determining whether an objecting creditor's interest is adequately protected, with values such as liquidation value, going concern value and other market valuations being used.

In a 2014 report, the American Bankruptcy Institute (ABI) proposed that foreclosure values should be used. This refers to the net value that a secured creditor would realise on a hypothetical, commercially reasonable foreclosure sale of that secured creditor's collateral under applicable non- bankruptcy law.

Given the potentially severe disruption to the rights of existing secured creditors, it is likely that the Singapore courts will adopt the same approach as the US courts, such that a grant of super-priority status under Section 211E(1)(d) would be given only where there is sufficient value to support the new and existing loans. It is also likely that the Singapore courts will be more inclined to accept a more conservative approach in valuing security to ensure that existing creditors' rights are properly safeguarded.

**Looking forward: roll-ups and cross-collateralisation**

Importing the US DIP financing provisions opens Singapore's doors to the phenomena of roll-ups and cross-collateralisation. These include when a DIP seeks a post-petition financing facility from its pre-petition secured lenders. A roll-up involves the DIP drawing from the new DIP financing to pay off an existing loan, thereby 'rolling-up' a pre-petition debt. Cross-collateralisation involves the debtor granting an existing pre-petition lender a security interest in assets acquired after its bankruptcy, to secure both pre and post-petition debt.

Both roll-ups and cross-collateralisation have given rise to some controversy, as they disrupt general bankruptcy principles of equal treatment among the same class of creditors. However, the lack of legislative prohibition means that secured pre-petition creditors may utilise these mechanisms to 'get ahead of the queue'.

While a debt roll-up has recently been granted in the Design Studio application, the court has yet to publish its reasoning. Moreover, these mechanisms have yet to be discussed in Parliament and are absent from the 2016 report by the Committee to Strengthen Singapore as an International Centre for Debt Restructuring. Thus, guidance can be derived the US approach.

In recent years, the US courts have approved several roll-ups (eg, in Radioshack Corp (Re Radioshack), Re Constar Int'l Holdings LLC (Re Constar) and Re Lyondell Chemical Company). The following factors were held to be relevant to the grant of new financing which includes a roll-up clause:

- the proposed financing involves the exercise of reasonable business judgement;
- the financing is in the creditors' best interests;

- the financing is necessary to preserve the assets and continued operation of the debtors' business;
- the terms of the financing are fair, reasonable and adequate; and
- the financing is negotiated in good faith and at arm's length between the debtors and lenders.

Notwithstanding the above, there remains a cautious approach towards roll-ups and cross-collateralisation as evinced by the ABI commission's 2014 final report. The ABI proposed that courts should generally not approve any post-petition financing under Section 364 of the US Bankruptcy Code that rolls up a pre-petition debt into the post-petition facility unless the post- petition facility:

- is provided by new lenders (ie, does not directly or indirectly hold pre-petition debt linked to the new facility); or
- repays the pre-petition facility in cash, extends substantial new credit to the debtor and provides more financing on better terms than other offers the debtor has received.

With regard to the threshold for 'substantial new credit', the bankruptcy court in Re Constar approved a DIP financing that comprised a 16.7% roll-up; whereas the court in Re Radioshack approved DIP financing that rolled up 87.8% of pre-petition debt.

As seen from the Design Studio application, the Singapore High Court has already demonstrated its willingness to grant debt roll-ups as long as certain conditions and safeguards have been met. The court would most likely be willing to grant cross-collateralisations too, given its similarity to debt roll-ups. In determining the conditions and safeguards, the court would likely draw guidance from the above principles found in the US cases.

**Comment**

This article has identified several potential issues that may arise with Singapore's revamped debt restructuring and insolvency regime and provided insight on how these issues have been dealt with in the United States. These issues include:

- the ascertainment of whether there has been adequate protection; and
- the principles to be considered in approving debt roll-ups and cross-collateralisation clauses.

As much as Singapore's debt restructuring and insolvency laws have been inspired by Chapter 11 provisions, they must be interpreted and adapted to local conditions in Singapore for it to be a meaningful and effective transplant.

In the words of Justice Abdullah in Re Attilan:

> *I must emphasise that the US authorities and doctrine are referred to only as a useful guide as we develop our own law in this area. We may stick close to the US position, or we may depart from it: much will depend on the arguments put before us.*

While some principles laid down by the US courts have been deemed as relevant to the interpretation of Singapore's legislation, it remains to be seen whether our courts would choose to follow or diverge from the US position with regard to novel issues.

This is especially so in cases of complex and ingeniously structured rescue financing arrangements which continue to push the boundaries of traditional bankruptcy principles.

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**END OF THIS ANALYSIS and INSIGHT**

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Founded in 2002, Oon & Bazul LLP ("Oon & Bazul") is Singapore's largest conflict-free law firm and leading commercial legal practice. Oon & Bazul is known for delivering high-quality work as well as its commitment to helping clients achieve success.

Oon & Bazul is also domiciled in Kuala Lumpur with its own associate firm – TS Oon & Partners – with both offices working closely together on matters involving Singapore and Malaysia law. The firm's strategy is to collaborate with the best lawyers throughout Asia, without exclusive tie-ups, to ensure that regional clients are served by the best suited professionals in their respective fields of expertise.
As part of Oon & Bazul's regional work scope, its league of lawyers are fluent in English, Mandarin, Bahasa Melayu, Bahasa Indonesia, Tamil, Japanese and Korean. The firm has a sterling international law practice dealing with matters across continents, enabling Oon & Bazul's lawyers to be particularly adept at coordinating matters involving multiple jurisdictions.

As a result of Oon & Bazul's deep dive client work, its lawyers are able to formulate winning strategies innovatively and effectively, while keeping to reasonable legal fees. Oon & Bazul's clientele include sovereign states, Fortune Global 500 corporations, large multinational corporations, financial institutions and high net-worth individuals.

**LEADERSHIP PROFILE**

**Meiyen Tan, Head, Restructuring and Insolvency**

Meiyen's main areas of practice include cross-border disputes, consensual and non-consensual insolvency and restructuring, corporate fraud and investigations. She has acted for and advised individuals, multi-national corporations, court-appointed administrators, distressed and special situations funds and banks in Singapore and abroad. Prior to joining Oon & Bazul, Mei Yen was a partner at one of the Big Four domestic law practices in Singapore. She is also the first female to lead a restructuring and insolvency legal practice in Singapore.

Meiyen graduated from the University of Warwick. She is admitted to the Singapore Bar, Malaysian Bar, the Roll of Solicitors of England & Wales and qualified as a Barrister-at-Law (Middle Temple).

She is one of the founding members of the Singapore Network of the International Women's Insolvency and Restructuring Confederation (IWIRC) and until March 2019, the Co-Chairperson of the Singapore

Network. She also spearheaded the establishment of IWIRC Malaysia together with members of the insolvency and restructuring practice areas in Malaysia. She sits on the board of directors of the Singapore chapter of the Turnaround Management Association, and is also a member of the Committee of the Middle Temple of Singapore, INSOL World Editorial Board, INSOL International Asian Advisory Council and INSOL International Taskforce 2021.

Meiyen continues to speak regularly at conferences in the Asia Pacific region, on an invitation basis. Her recent speaking engagements include various conferences and seminars organised by IWIRC, INSOL, ARITA, the Global Restructuring Review and the Asian Business Law Institute.

**Lionel Chan, Partner, Restructuring and Insolvency**

Lionel Chan is a Partner in the Firm's Litigation & Dispute Resolution Practice and Restructuring & Insolvency Practice.

Lionel has significant experience in dispute resolution and has been involved in numerous complex and high-value commercial litigation and arbitration disputes. Lionel appears at all levels of the Singapore courts, including the High Court and the Court of Appeal and has acted for clients in both institutional and ad-hoc arbitrations.

His work frequently involves significant cross-border elements and he has worked extensively with clients based in Bangladesh, China, Hong Kong SAR, India, the Middle East, Russia, Vietnam, as well as Singapore.

Prominent matters he has recently handled include successfully assisting a luxury yacht broker in the Singapore Court of Appeal to overturn the High Court's decision in respect of a deposit claim, successfully acting for a UAE entity in a SIAC international arbitration dispute involving issues of United States economic sanctions & export control laws and frustration of contract, as well as successfully securing a Mareva injunction against a BVI entity and its representatives in a share pledge dispute exceeding USD 250 million.

Lionel sat on the Law Society's Criminal Practice Committee from 2013-2015. Although he now focuses on commercial disputes, he still periodically volunteers as defence counsel with the Law Society of Singapore's Criminal Legal Aid Scheme (CLAS).

Lionel has been recognised as one of Singapore's top 20 most influential lawyers aged 40 and under by Singapore Business Review. Legal 500 Asia Pacific highlights Lionel as a name to note for his work in Dispute Resolution and clients have also praised him for his "*good knowledge of Singapore law*" as quoted in Asialaw Profiles.

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