Legal Update

Rescue Financing in Singapore

7 October 2022

The Insolvency, Restructuring and Dissolution Act 2018 ("**IRDA**") was passed by Singapore's Parliament on 1 October 2018, and came into effect on 30 July 2020. While the IRDA has introduced several new changes to Singapore's insolvency regime, the IRDA also serves as an "omnibus" legislation that consolidates Singapore's pre-existing corporate and personal insolvency laws.

In this legal update, we set out to examine in particular §67 of the IRDA (formerly §211E of the Companies Act 1967 ("**CA**")), which sets out the concept of rescue financing, as well as the requirements (both mandatory and discretionary) for granting super-priority to such rescue financing.

Rescue Financing and Super-Priority Explained

Inspired by the US Bankruptcy Code, the rescue financing provisions were introduced into Singapore's insolvency regime in 2017 by way of the Companies (Amendment) Act 2017, on the recommendation of the Insolvency Law Review Committee ("**ILRC**") in its 2013 report.

Under §67(9) of the IRDA, "rescue financing" means any financing that satisfies <u>either or both</u> of the following conditions:

(a) the financing is necessary for the survival or a company that obtains the financing, or of the whole or any part of the undertaking of that company, as a going concern;

(b) the financing is necessary to achieve a more advantageous realisation of the assets of a company that obtains the financing, than on a winding up of that company.

In other words, rescue financing consists of new loans aimed at providing a company with working capital during a restructuring. These funds may be used by the debtor company to continue doing business, as well as pay its suppliers and trade creditors even while in the midst of distress, administration, or restructuring.

In order to attract and incentivise "white knights" to step forward and undertake such rescue financing, "super-priority status" is accorded to loans granted under such rescue financing packages. This means that even if the scheme of arrangement or judicial management should eventually fail to rescue the company from distress, the loans granted for purposes of the rescue financing will be repaid <u>in priority</u> to all other claims in the company's winding up, including potentially all other secured and unsecured debts in certain appropriate cases, if the company is wound up.

The grant of such super-priority status for rescue financing is important because it provides the lender with assurance that the rescue financing will be paid out of the unsecured assets of the borrower company first, ahead of all unsecured claims and other administrative expenses, and potentially even rank equal or in priority to existing secured debts in certain appropriate cases, should the restructuring fail. This will make lenders less reluctant to provide additional financing to troubled companies, and enable viable companies a second chance at restructuring and rehabilitation.

Mandatory Requirements to Grant Super-Priority

Where a company in financial distress has made an application to convene a meeting for the purposes of a scheme of arrangement under §210(1) of the CA, or a moratorium under §64(1) of the IRDA, the distressed company may then make an application under §67 of the IRDA to have the debt obtained by way of rescue financing to be accorded super-priority status.

Under §67(1) of the IRDA[1], there are four "levels" of super-priority that the court can grant (laid out in ascending order of priority from (1)(a) to (d)). For example, the court can treat the debt as if it were a winding up cost or expense, or elevate the debt in priority over all preferential debts[2] and other unsecured debts.

The greater the level of super-priority, the greater the scrutiny by the courts. The reason for this, as stated in the case of *Re Attilan Group Ltd* [2017] SGHC 283 ("*Attilan*") at [61], is that giving super priority disrupts the expected order of priority of the various creditors of the company. The grant of super priority should thus not ordinarily be resorted to, and the courts should be slow to do so unless it is strictly necessary.

From the above, the mandatory requirements to grant super-priority may be summarised as follows:

(a) An application must have been made for a scheme meeting under §210(1) of the CA, or a moratorium under §64(1) of the IRDA;
(b) The proposed financing must constitute "rescue financing" under §67(9) of the IRDA;
(c) It must be the case that the company would not have been able to obtain the rescue financing from any person unless the debt arising from the rescue financing is given the priority mentioned in the provision (according to *Attilan* at [61], this is a hard requirement under §67(1)(b) of the IRDA, but not §67(1)(a)).

Discretionary Requirements to Grant Super-Priority

[1] *Where a company has made an application under section 210(1) of the Companies Act or section 64(1), the Court may, on an application by the company under this subsection, make one or more of the following orders:*

(a) an order that if the company is wound up, the debt arising from any rescue financing obtained, or to be obtained, by the company is to be treated as if it were part of the costs and expenses of the winding up mentioned in section 203(1)(b);
(b) an order that if the company is wound up, the debt arising from any rescue financing obtained, or to be obtained, by the company is to have priority over all the preferential debts specified in section 203(1)(a) to (i) and all other unsecured debts, if the company would not have been able to obtain the rescue financing from any person unless the debt arising from the rescue financing is given the priority mentioned in this paragraph;
(c) an order that the debt arising from any rescue financing to be obtained by the company is to be secured by —
(i) a security interest on property of the company that is not otherwise subject to any security interest; or
(ii) a subordinate security interest on property of the company that is subject to an existing security interest,
if the company would not have been able to obtain the rescue financing from any person unless the debt arising from the rescue financing is secured in the manner mentioned in this paragraph;
(d) an order that the debt arising from any rescue financing to be obtained by the company is to be secured by a security interest, on property of the company that is subject to an existing security interest, of the same priority as or a higher priority than that existing security interest, if —
(i) the company would not have been able to obtain the rescue financing from any person unless the debt arising from the rescue financing is secured in the manner mentioned in this paragraph; and
(ii) there is adequate protection for the interests of the holder of that existing security interest.

[2] A preferential debt refers to any debt that is to be paid in priority to all other unsecured debts.

In the case of *Re Design Studio Group Ltd and other matters* [2020] SGHC 148 ("*Re Design Studio*") at [23], the court stated that even if the mandatory requirements are met, the court retains discretion to determine whether to grant super-priority.

Following an analysis of parliamentary debates on the Companies (Amendment) Bill 2017, the 2013 ILRC report, and United States insolvency cases, the court in *Re Design Studio* laid out at [33] the various factors to be considered by the court in exercising its discretion:

(a) **Creditor's interests**: whether the other creditors will be unfairly prejudiced from the arrangement, or whether the arrangement will be beneficial to them. This involves weighing the risk to creditors against the possible benefit to them, to determine what would be in their best interests. The court should also assess whether creditors are adequately protected, and whether the risks entailed can be managed. The degree of creditor opposition can also be considered.

(b) **Viability of restructuring**: whether there is a good probability that the restructuring will succeed. The court should assess how the rescue finances are proposed to be used, whether it would create new value for the company, whether stable returns are expected, or whether they would be used in risky investments.

(c) **Alternative financing**: whether better financing proposals are available. The court should consider if there were better proposals, offers or bids before the court, in particular, whether there were proposals which would not require super-priority. The court should also assess if the applicant had made reasonable efforts to procure such offers. Evidence of such reasonable attempts can include failed negotiations with other potential lenders; however, it is not necessary to show that financing was sought from every possible source.

(d) **Terms of proposed financing**: whether the terms were reasonable and in the exercise of sound business judgment. The court should assess the terms and conditions of the financing to consider if it was made in good faith, was for a proper purpose, and is fair, reasonable and adequate.

The court, however, emphasized that these factors are not conditions or requirements, but merely considerations that the court should consider. It was also noted that as the proceedings in *Re Design Studio* were uncontested, a more definitive statement on the non-statutory factors would have to await a contested hearing (*Re Design Studio* at [34]).

What Does This Mean For You: Our Views

Rescue financing is a viable alternative to the more common fund-raising methods of rights issues, private placements, and working capital financing. It may also be critical to a company which is facing the imminent possibility of not being to even continue daily operations by reason of lack of funds.

§67 of the IRDA should therefore be of interest to any "white knights" wishing to rescue a distressed company.

Such individuals or entities should consider applying for super-priority status pursuant to §67(1) of the IRDA, before injecting a troubled company with cash.

At the same time, it remains an open question as to whether or not a rescue financing loan can take priority over a secured debt.

The priming lien described in §67(1)(d) of the IRDA, which seemingly allows a rescue financing loan to rank on par with, or even ahead of, an existing security interest, remains subject to the safeguards in §67(1)(d)(i) and (ii). In particular, §67(1)(d)(ii) of the IRDA requires that "there is adequate protection for the interests of the holder of that existing security interest".

As there has been no reported decision on §67(1)(d) to date, there is room for argument as to what such "adequate protection" entails.

In the absence of judicial interpretation however, it is the opinion of the writers that an order for super-priority under §67(1)(d), if granted, should not affect the interests of the secured creditor in question.

This means that a "white knight" may be granted security over property that is already subject to an existing security interest, as long as the interests of the existing security interest holder remain fully protected by its existing security.

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