DHC | CAPITAL

Guide to super priority rescue financing in Singapore

Second edition

The Guide summarises the legislative landscape under the new law and recent cases involving super priority rescue financing in Singapore, including Design Studio Group Ltd's “roll-up” super priority rescue financing

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Insights | Thought Leadership Series
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INTRODUCTION

Welcome to the second edition of the DHC Capital "Guide to super priority rescue financing in Singapore".

The Guide is intended to provide interested parties with summarised information on the legislative landscape and recent cases involving super priority rescue financing in Singapore. This is a developing area and we intend to continue to provide updates as the law and cases evolve.

The Guide forms part of our comprehensive series of "Insights | Thought Leadership" publications. DHC Capital published long form thought leadership articles on "Rescue Financing – First successful super priority rescue financing completed in Singapore" and "Chief Restructuring Officers in Asia – Is the appointment of a CRO the way forward for debtor led restructurings?" and short form thought leadership articles on topical issues facing the industry. Please refer to our website at www.dhccapital.com to read or download a copy.

We trust that the Guide will prove to be a useful resource for understanding the landscape and recent cases relating to super priority rescue financing. We welcome any feedback from readers. Please contact me if you have any suggestions or comments.

David Chew
Partner
DHC Capital

THE LEGAL REGIME

Introduction

Singapore introduced major reforms to its debt restructuring regime with the Companies (Amendment) Act 2017 coming into effect on 23 May 2017. The reforms based on the US Chapter 11 regime were introduced to support debtor-led restructurings through a "turbo charged" scheme of arrangement regime and includes rescue financing provisions allowing the grant of super priority status.

The Insolvency, Restructuring and Dissolution Act 2018 ("**IRDA**") was passed by the Singapore Parliament on 1 October 2018 and came into effect on 30 July 2020 is the latest major phase of reforms to carry to fruition Singapore's ambition to become an international debt restructuring hub.

The IRDA consolidates Singapore's insolvency laws for both personal bankruptcy and corporate insolvency under a single piece of "omnibus" legislation and incorporates the amendments to the reforms that came into effect in May 2017, including the provisions relating to super priority rescue financing. The IRDA also includes several new features including, inter alia, establishing a regulatory regime for insolvency practitioners and restrictions on operation of ipso facto clauses.

The rescue financing provisions – Section 67

The rescue financing provisions under Section 67 of the IRDA (formerly Section 211E of the Companies Act ("**Act**")) allow the Court to grant an order that the rescue financing be afforded super priority where a company has made an application to convene a meeting for the purposes of a scheme of arrangement under Section 210(1) of the Act or a moratorium under Section 64(1) of the IRDA (formerly Section 211B(1) of the Act).

In summary, the Court can make one or more of the following orders in respect of any debt arising from any rescue financing obtained (4 levels of priority):

- **Section 67(1)(a):** Treated as part of the costs and expenses of the winding up mentioned in Section 203(1)(b) of the IRDA;
- **Section 67(1)(b):** Priority over all the preferential debts specified in Section 203(1)(a) to (i) of the IRDA and all other unsecured debts;
- **Section 67(1)(c):** Secured by a security interest on property not otherwise subject to any security interest or that is subordinate to an existing security interest; and
- **Section 67(1)(d):** Secured by a security interest on property subject to an existing security interest, of the same priority as or higher priority than that existing security interest.

Four levels of super priority

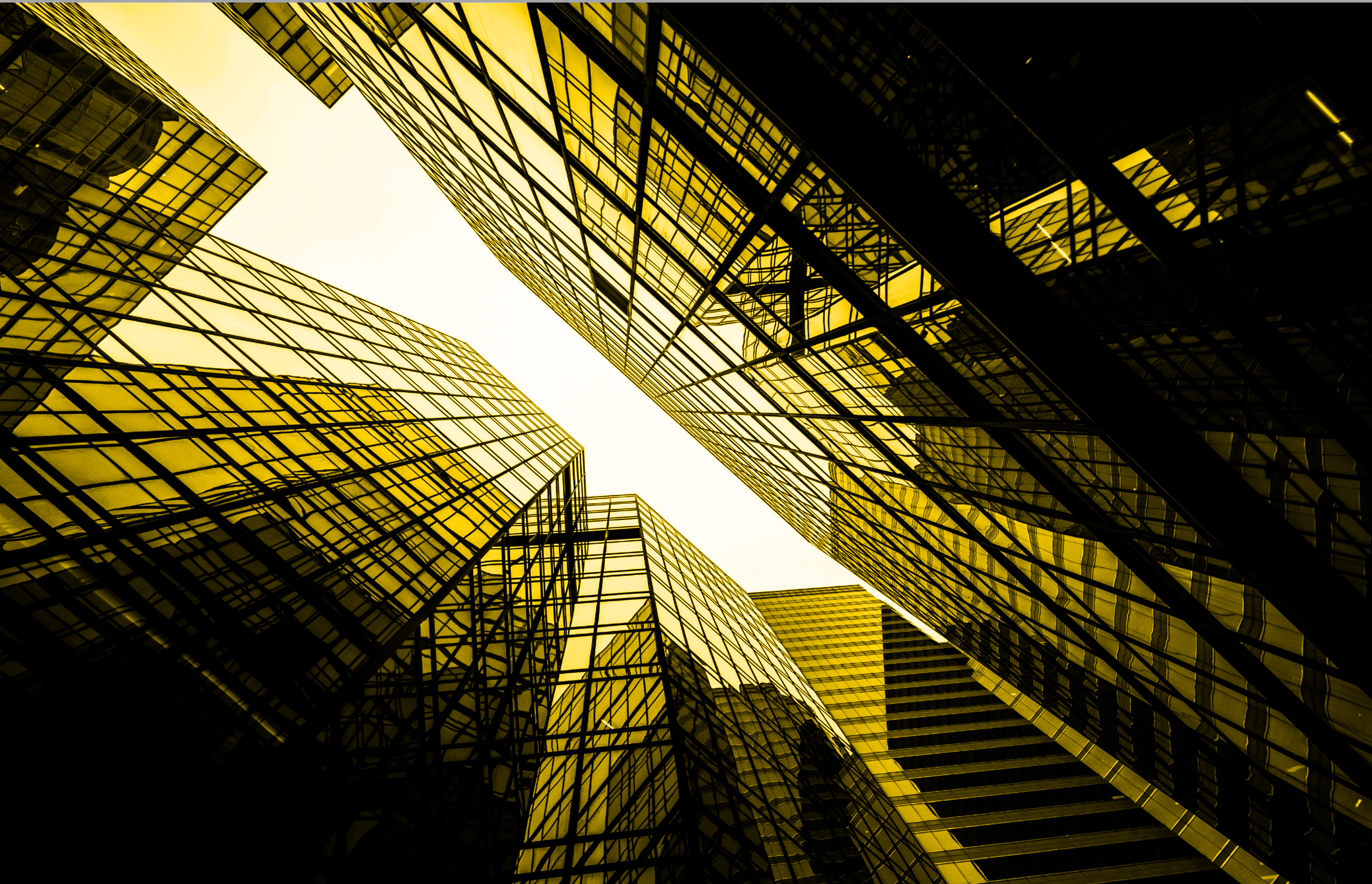
LEVEL OF SUPER PRIORITY (Lowest → Highest)

S.67(1)(a)
Treated as part of the costs and expenses of the winding up

S.67(1)(b)
Priority over all the preferential debts and all other unsecured debts

S.67(1)(c)
Secured by a security interest on property not otherwise subject to any security interest or that is subordinate to an existing security interest

S.67(1)(d)
Secured by a security interest on property subject to an existing security interest, of the same priority as or higher priority than that existing security interest (known as "priming")



The Court's approval for a rescue financing order is subject to the following core pre-conditions being met:

- **Reasonable efforts made to secure rescue financing without super priority**
  The company would not have been able to obtain the rescue financing unless super priority was given – statutorily applies only to Section 67(1)(b) to (d) of the IRDA (formerly Section 211E(1)(b) to (d) of the Act) and is expected under Section 67(1)(a) of the IRDA (formerly Section 211E(1)(a));

- **Adequate protection**
  There is adequate protection for the interests of the holder of the existing security interest (in the event the security is "primed") – applies only to Section 67(1)(d) of the IRDA (formerly Section 211E(1)(d) of the Act); and

- **Meets definition of rescue financing**
  The proposed financing must constitute "rescue financing" as defined in Section 67(9) of the IRDA (formerly Section 211E(9) of the Act) – (i) financing necessary for the survival of a company that obtains the financing and/or (ii) financing necessary to achieve a more advantageous realisation of the assets than on a winding up.

CASE STUDY – ATTILAN GROUP LTD

The Court considered the Section 211E (now Section 67 of the IRDA) super priority rescue financing regime in *Re Attilan Group Ltd* [2017] SGHC 283 ("**Attilan**").

The Court declined to grant the super priority order in Attilan. The primary reason was that there was insufficient evidence of any efforts, let alone reasonable efforts being expended to secure financing without any super priority.

The Court's written judgment provides clarity and guidance on the approach the Court will use in assessing an application for super priority rescue financing. We do not intend to cover all the points raised and instead provide a summary of the key points below:

- **Reasonable efforts**
  Demonstrate that reasonable efforts were undertaken to secure the financing without the type of super priority sought and provide credible evidence of the same. The undertaking of reasonable efforts does not mean it is necessary to source credit from "every possible source";
- **Pre-conditions**
  There can be pre-conditions stipulated by the rescue financier in the grant of its rescue finance;
- **Pre-existing financing arrangements**
  The proposed rescue does not have to be entirely "new". The financing can be additional financing from an existing creditor so long as it is at the option of the creditor and its exercise of that option can be made contingent on obtaining super priority status;
- **Type of priority**
  Application should state the type or level of super priority sought under Section 211E(1) of the Act (now Section 67(1) of the IRDA) and the rationale; and
- **Other factors**
  Factors that the Court will consider include: (i) the proposed financing is an exercise of sound and reasonable business judgment, (ii) no alternative financing is otherwise available, (iii) such financing is in the best interest of the creditors, (iv) that no better offers, bids or timely proposals are before the Court, (v) necessary to preserve the assets and is necessary, essential and appropriate for the continued operations, (vi) terms are fair, reasonable and adequate in light of the circumstances of the debtor and proposed lender and (vii) the financing agreement was negotiated in good faith and at arm's length.

"*The Court declined to grant the super priority order in Attilan. The primary reason was that there was insufficient evidence of any efforts, let alone reasonable efforts being expended to secure financing without any super priority*"

CASE STUDY – ASIATRAVEL.COM HOLDINGS LTD

Asiatravel.com Holdings Ltd (SGX: 5AM) ("**ATH**") is an online travel company established in 1995 and is listed on the Catalist Board of the Singapore Stock Exchange.

ATH faced cash flow difficulties once a convertible note subscription with Chinese investor Zhonghong Holding Co Ltd ("**Zhonghong**") fell apart. The convertible note would have seen Zhonghong invest S$10 million (US$7.39 million) in ATH in exchange for a 26% equity stake. Considering the cash flow difficulties, ATH filed a Court application for a moratorium under Section 211B of the Act (now Section 64(1) of the IRDA).

On 8 April 2019, the Court granted ATH priority over all the preferential debts specified in Section 328(1)(a) to (g) of the Act (now Section 203(1)(a) to (i) of the IRDA) and all unsecured debts pursuant to Section 211E(1)(b) of the Act (now Section 67(1)(b) of the IRDA). This is the first successful application for super priority rescue financing under Section 211E of the Act (now Section 67 of the IRDA).

ATH successfully showed that that it would not have been able to secure rescue financing from any person or entity without giving them super-priority status and they had undertaken "reasonable effort" to explore alternative types and sources of financing that did not entail super priority. This included appointing a financial advisor to seek financing on their behalf. ATH also demonstrated that the rescue financing from the white knight investor was in ATH's best interests, necessary and essential to preserve their assets and continue as a going concern.

DHC Capital acted as financial advisor and Oon & Bazul LLP acted as legal counsel to Asiatravel.com Holdings Ltd on the super priority rescue financing.

Asiatravel.com – Key factors to establish

1. Importance of establishing that reasonable efforts were undertaken to obtain financing on a non super priority basis and provide evidence of such efforts. Credible evidence includes preparation of an information memorandum outlining the terms of the financing sought and correspondence with potential rescue financiers
2. Importance of establishing that reasonable efforts were undertaken to obtain the best available terms of financing and/or that no alternative financing is available
3. Importance of establishing that the proposed financing is critical and essential to the survival of the company as a going concern
4. It is possible for rescue financing to be given on non-monetary terms as the white knight's financing took the form of inventory for sale

CASE STUDY – SWEE HONG LTD

Swee Hong Ltd (SGX: QF6) ("**Swee Hong**") is a civil engineering contracting firm and is listed on the Main Board of the Singapore Stock Exchange.

Swee Hong faced cash flow difficulties due to additional costs on projects due to delays in completion and lack of working capital to pay key suppliers to ensure that projects can continue. Considering the cash flow difficulties, Swee Hong filed a Court application for a moratorium under Section 211B of the Act (now Section 64(1) of the IRDA) on 17 May 2019.

On 17 February 2020, the Court granted the following orders:

- Debt of up to S$3.1 million shall be secured by way of a first fixed charge over the unencumbered plant and machinery and motor vehicle assets owned by Swee Hong pursuant to Section 211E(1)(c) of the Act (now Section 67(1)(c) of the IRDA); and
- In the event of a winding up, an amount of S$2.9 million shall have priority over all the preferential debts specified in Section 328(1)(a) to (g) of the Act (now Section 203(1)(a) to (i) of the IRDA) and all other unsecured debts pursuant to Section 211E(1)(b) of the Act (now Section 67(1)(b) of the IRDA).

This is the second successful applica-tion for super priority rescue financing in Singapore under Section 211E of the Act (now Section 67 of the IRDA) and first case involving super priority over assets not otherwise subject to any security interest under Section 211E(1)(c) of the Act (now Section 67(1)(c) of the IRDA).

Swee Hong demonstrated that they had undertaken "reasonable effort" to explore alternative types and sources of financing that did not entail super priority. Swee Hong also demonstrated that the super priority financing was in the best interests of the creditors, there were no better offers or proposals and that the financing was necessary for the continued operations of Swee Hong and to preserve the going concern value.

DHC Capital acted as financial advisor and Rajah & Tann Singapore LLP acted as legal counsel to Swee Hong Ltd on the super priority rescue financing.

Swee Hong – Key factors to establish

1. Importance of establishing that the super priority rescue financing is in the best interests of creditors

2. This includes assessing the proposed scheme against a *comparator*, which is the most likely scenario in the absence of the scheme being approved (this will often although not always be insolvent liquidation) and comparison of returns to creditors in a liquidation scenario analysis under different scenarios with or without the super priority rescue financing

CASE STUDY – DESIGN STUDIO GROUP LTD

Design Studio Group Ltd (SGX: D11) ("**Design Studio**") is an interior fit-out company and is listed on the Main Board of the Singapore Stock Exchange.

Design Studio faced cash flow pressures due to higher than expected project costs and together with 5 Singapore-incorporated subsidiaries filed a Court application for a moratorium under Section 211B of the Act (now Section 64(1) of the IRDA) on 20 January 2020. Three of Design Studio's wholly-owned subsidiaries filed restructuring applications in Malaysia on the same day.

On 28 May 2020, the Court ordered that the proposed rescue financing be granted super priority over the preferential debts specified in Section 328(1)(a) to (g) of the Act (now section 203 (1)(a) to (i) of the IRDA under Section 211E(1)(b) of the Act (now Section 67(1)(b) of the IRDA).

The S$62 million rescue financing comprised two separate financing facilities as follows:

- A single-drawdown term loan facility of up to S$12.08 million from an associate of Design Studio's controlling shareholder; and
- A multi-drawdown banking facility of up to S$50 million from an existing lender of Design Studio and its subsidiaries.

The rescue financing provided a fresh injection of capital to fund working capital and provide bonding facilities for customer projects. This was essential to allow Design Studio to continue business operations on a going concern basis.

This is the third successful application for super priority rescue financing in Singapore and first case involving a "roll-up" of an existing lender's pre-filing debt.

A "roll-up" upgrades the existing lender's pre-filing debt to post-filing super priority debt by permitting the existing lender to provide a new facility that repays the existing lender's pre-filing debt in full or in part.

DHC Capital Partner, David Chew was appointed to the Board of Design Studio as Non-Executive Chairman, member of the Audit Committee and as chairman of the Remuneration Committee and Nominating Committee to provide support at the Board level for the Court-supervised restructuring.

Design Studio – Key factors to establish

1. Roll-up arrangements fall under the definition of rescue financing if they are necessary for the survival of the company as a going concern by supporting operational working capital needs or provide a more advantageous realisation of its assets than a winding up
2. Importance of establishing that reasonable efforts were undertaken to obtain financing that was not conditional on super priority being conferred and that the terms of the super priority financing is reasonable and in exercise of sound business judgement
3. Importance of establishing the viability of restructuring and whether there is a good probability that the restructuring will succeed and that the rescue financing would constitute new funding which could be used to create new value
4. Importance of establishing that the arrangement is in the creditors interests and whether other creditors would be unfairly prejudiced

CONCLUSION

The Design Studio "roll-up" financing is an important evolution in super priority rescue financing in Singapore and demonstrates the tools available for financially distressed companies to access new working capital in order to continue business operations and provides essential breathing room to engage with creditors on a restructuring proposal as opposed to filing for a value destructive insolvency proceeding. Lenders also now have options to extend new credit to financially challenged borrowers to continue business operations and to maximise recoveries by preserving the going concern value of the business and/or improving their relative security position vis a vis other creditors as opposed to taking immediate enforcement action.

Looking ahead – We highlight the potential areas to be addressed as super priority rescue financing evolves in Singapore:

- **Role of the Court**

The cases to date reinforce that the Court will take a commercial and practical approach to super-priority rescue financing applications provided the core pre-conditions have been met. The Court has also shown a willingness to take guidance from precedent cases from the US Chapter 11 regime on super priority.

The Design Studio financing was uncontested and the Court's view on commercial terms and conditions in contested "roll-up" cases remains to be seen and will likely involve balancing the need to protect the general body of creditors, the benefits under the proposed scheme against a comparator (likely a liquidation scenario) and the survival of the company as a going concern.

> ***This is the first case involving a "roll-up" super priority financing and a further step in developing a rescue culture in Singapore.***

- **Additional complexities associated with applications under Section 67(1)(d)**

We have not yet seen an application for rescue financing under the highest level of priority pursuant to Section 67(1)(d) of the IRDA (formerly Section 211E(1)(d) of the Act).

It remains to be seen whether new third-party lenders will aggressively challenge "adequate protection" with existing security holders (and by extension challenge security valuation and key assumptions to derive the valuation) or whether the market will follow the Chapter 11 model, whereby existing security holders work closely with the debtor company to agree terms and provide the rescue financing as a method to avoid being primed and to maintain control of the restructuring.

About DHC Capital

DHC Capital is an investment banking and financial advisory firm specialising in solving critical business challenges of companies facing liquidity pressures or financial stress.

DHC Capital provides independent and conflict-free advice on financial and operational restructuring to corporates, creditors, investors and other stakeholders, both in and out of Court. DHC Capital also advises clients on structuring and executing bespoke capital raising and accelerated M&A transactions to meet short term liquidity requirements, raise capital to unlock shareholder value or meet growth objectives. DHC Capital will further provide directors or executives into corporates, which are entering a restructuring process, being restructured, exiting a restructuring process or on behalf of creditors and investors to monitor and protect their investments.

Contact

David Chew
Partner

+65 6671 8021

david.chew@dhccapital.com

www.dhccapital.com

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About David Chew

David is a Partner of DHC Capital.

David has over 23 years of experience in restructuring, turnaround and special situations having worked as an advisor with Ernst & Young and Arthur Andersen, investment banker with Morgan Stanley, in senior management as a CRO, CFO and interim CFO and Board member to distressed companies.

David has worked with and advised private and publicly listed corporates, creditors, private equity and debt funds and investors across the full range of the restructuring transaction cycle, including crisis stabilisation, business and strategic reviews, strategic option analysis including planning and implementing in and out of Court solutions, operational turnaround, debt restructuring / schemes of arrangement, distressed M&A, rescue financing and refinancing. He also advises corporates requiring urgent financing during periods of market and sector specific dislocation or financial stress.

David has been involved in high profile and complex transactions across Asia Pacific, including transactions in Australia, Brunei, China, Hong Kong, India, Indonesia, Malaysia, Singapore, Thailand and Vietnam. He has experience across multiple sectors including, manufacturing, construction, mining and metals, oil & gas, real estate, tourism and leisure and shipping.

As an investment banker, David was involved in the sourcing, structuring and execution of high yield, stressed and distressed investment opportunities across Asia Pacific for Morgan Stanley prop books..