Singapore court weighs in on whether lock-up fees fracture scheme classes

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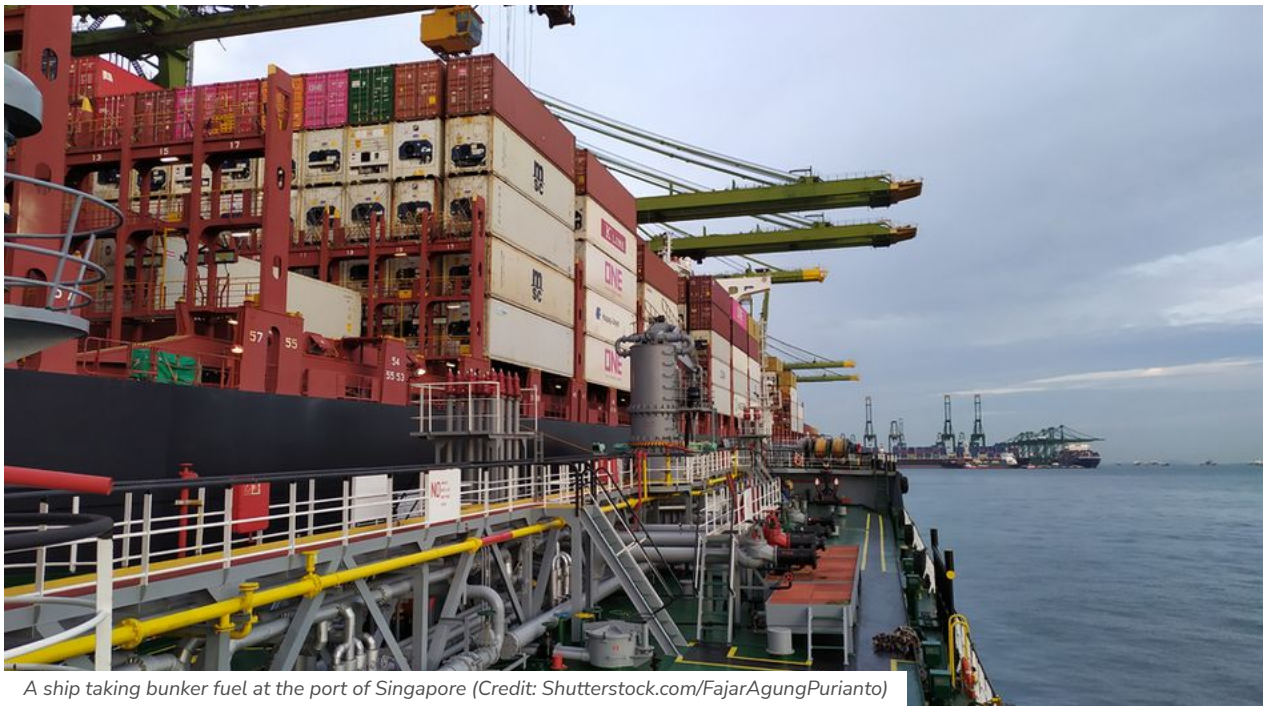

A ship taking bunker fuel at the port of Singapore (Credit: Shutterstock.com/FajarAgungPurianto)

A Singapore court has examined for the first time whether lock-up fees can have the effect of fracturing a class of creditors in a scheme of arrangement, relying on English and Hong Kong authorities to set out a trio of principles that judges should look out for.

On 18 February, **Justice Aedit Abdullah** issued the first published Singapore High Court **decision** on whether creditors who enter lock-up agreements with consent fee benefits should be placed in a separate class from other scheme creditors for voting purposes.

The written grounds follow an oral decision that Justice Abdullah handed down on 25 January, approving an uncontested, single class scheme under section 71 of the Insolvency, Restructuring and Dissolution Act 2018 (IRDA) for locally-incorporated trading and bunkering company Brightoil Petroleum Singapore (BPS).

Section 71 governs when a court may approve a compromise or arrangement without a meeting of creditors.

BPS is a subsidiary of Hong Kong-listed Brightoil Petroleum Holdings (BOHL), which embarked on a major restructuring for more than 90 of its direct and indirect subsidiaries in November 2018. As part of the restructuring, BPS and BOHL both applied for moratoria under Singapore's Companies Act, which have been extended multiple times – most recently at the scheme hearing in January.

Justice Abdullah explained that BPS has already resolved US$390 million of its liabilities and that the scheme was the penultimate step to restructuring its remaining debts with unsecured creditors.

Under the scheme, unsecured creditors will receive payments fixed at US$6 million, to be distributed on a *pari passu* basis, with an expected a recovery of around 12% of their debt's value, compared to 2% in a liquidation.

BPS invited 12 of the scheme creditors to vote for the purposes of tabulating what the notional votes in favour of the scheme would have been, had a meeting been held. Eleven creditors voted in a single class, with 10 or around 94.26% by value voting in favour, and one creditor or around 5.74% by value against.

Three of BPS' scheme creditors, SK Trading International, Global Energy Trading and TransAsia Private Capital, entered a lock-up agreement from BOHL to vote in favour of the scheme in return for a consent fee of 1% of their admitted debt.

TransAsia Private Capital's lock-up agreement was slightly modified to make its support conditional on BOHL paying an extra US$1.25 million to part-satisfy some guarantee obligations relating to loan facilities that the creditor had extended to BPS.

The question before Justice Abdullah was whether the three locked-in creditors should have been placed in a separate class to the other scheme creditors, and whether that brought the reliability of the notional vote in question.

In addition, the judge had to consider whether six scheme creditors who were indirect, wholly owned subsidiaries of BOHL should have their votes discounted.

He ultimately found that one class was sufficient and the six creditors' votes could be included.

Chan Wei Meng, a director at Drew & Napier in Singapore who advised BPS, says Justice Abdullah's decision is the first reported decision in Singapore on lock-up arrangements used in schemes of arrangement and provides guidance and clarity on the usage of lock-up arrangements in Singapore.

"Hopefully this decision will pave the way for more companies to consider lock-up arrangements as a restructuring tool for schemes of arrangement," he tells GRR. "This is definitely a step in the right direction in the development of Singapore as a regional restructuring hub."

BPS before the court

Counsel to BPS, Drew & Napier, argued that the notional voting outcome presented to the court had satisfied the statutory majority requirements under Singapore's Companies Act and that, as the scheme only sought to restructure unsecured debts, the creditors all fell into the same class.

The firm pointed out that all scheme creditors had been offered the chance to enter into the lock-up agreements in July 2021 before the scheme was despatched, and that the consent fee of 1% was not so substantial that it could have induced locked-in creditors to vote in favour of the scheme where they might not have done otherwise.

In respect of TransAsia Private Capital, the firm argued the additional payment did not warrant placing it in a separate voting class as its rights against BOHL under the guarantee were distinct and independent from its rights against BPS.

The firm also said that the six related creditors had ceased to be within BOHL's control as they were in a creditors' voluntary liquidation, and their votes in favour of the scheme had been made independent by their liquidators, so did not need to be discounted.

Three principles

Justice Abdullah said there were two essential elements to obtaining a court's approval for a scheme under section 71 of the IRDA: disclosure of information, which BPS had satisfied with a detailed explanatory statement; and satisfaction of the statutory majority requirements in the notional counting of votes. He said it was "implicit" in the second requirement that the creditors must be properly classified for the notional count.

The judge noted that the three locked-in creditors held 57.32% of the total debt value among the votes cast, so without their buy-in, a question might have arisen as to whether the statutory majority requirements would have been met. But he ultimately said he was satisfied that they were part of the same class as the other creditors.

Acknowledging the "dissimilarity principle" in the test for classification of creditors from the "seminal" 2012 Singapore Court of Appeal case *The Royal Bank of Scotland v TT International Ltd*, Justice Abdullah said the locked-in creditors' rights were not so dissimilar to the non-locked-in creditors' that they couldn't sensibly consult together with a view to their common interests.

He also reasoned that all of the creditors would see their position improved by a similar extent under the *pari passu* terms of the BPS scheme.

The judge ran through a series of English and Hong Kong authorities on lock-up agreements, from the English High Court's 2010 decision in *Re DX Holdings*, to **Mr Justice Snowden's 2018 decision** in *Re Noble Group*; via **Mr Justice Harris'** rulings in the Hong Kong Court of First Instance in *Re Winsway Enterprises* in 2017 and his very recent 19 January ruling in *Re Da Sen Holdings*.

Distilling his findings from the cases in England and Hong Kong, Justice Abdullah set down a "non-exhaustive" list of principles that he said were relevant in determining whether creditors that enter a lock-up agreement should be classed separately for the purpose of voting on a scheme, even where the votes are just notional.

The critical question in every case, he said, was whether the benefit conferred on locked-in creditors was so sizeable that it would have a significant influence on the decision of a reasonable creditor when voting. To assess whether the benefit was significantly influential he said courts should look at the relative size of the consent fee compared to the forecasted returns to creditors under the scheme and the appropriate comparator scenario – in BPS's case, a liquidation.

The judge also said that a lock-up agreement must have been made equally available to all scheme creditors within the relevant class on substantially the same terms; and that its use must be *bona fide*, not to mislead creditors for example.

Applying the principles to BPS's scenario, Justice Abdullah said the reliability of the notional majority vote had not been compromised and the votes solicited for the notional outcome had been fairly representative of the class to which they belonged.

He also said the 1% consent fee was not so significant compared to the potential 12% recovery under the BPS scheme or a 2% recovery in a liquidation as to sway a creditor: the 60-fold recovery of admitted debt value from the scheme versus the liquidation was sufficient commercial justification for a reasonable creditor to vote for it.

Justice Abdullah also found that BOHL's lock-up agreements were offered in a *bona fide* attempt to introduce certainty to the restructuring process and that the expected recovery presented in them – 8.8% to 18.1% in a scheme, or nothing in a liquidation scenario – was "not too far off" from what BPS's scheme eventually offered.

Separately, the judge also agreed that the additional payment to TransAsia Private Capital to part-satisfy BOHL's guarantee obligations did not change the creditor's legal rights against BPS – so it could still sensibly consult with creditors in the single class as to their common interests.

Justice Abdullah reasoned that BOHL's outstanding obligations would not be waived even if the BPS scheme was sanctioned: the former was not conditional on the latter and the court was not required to consider rights genuinely independent of the scheme, he said.

Finally, on the six related creditors, the judge said it was established in *TT International* that the votes of creditors who are wholly owned subsidiaries of the scheme company should be discounted to zero – but Singapore courts have taken divergent approaches on what to do with related creditors who are not wholly owned subsidiaries of the scheme company.

In BPS' scenario, the judge pointed out that the related creditors were not wholly owned subsidiaries of the scheme company, but of BOHL, and had been in creditors' voluntary liquidation since 16 August. He ultimately decided no discount should be applied.

The Brightoil Petroleum group operated three oil and gas fields in China's yellow sea, but suspended trading on the Hong-Kong Stock Exchange in 2017 after facing financial difficulties.

In April 2019, its chairman Sit Kwong Lam was **declared bankrupt** over a personal guarantee that he had granted for debts between Brightoil's Singporean bunker supply company and the Singaporean subsidiary of Vietnam's Petrolimex. His bankruptcy was **recognised** in Washington, DC later that year and **upheld on appeal** in November 2019.

Singapore High Court

Brightoil Petroleum (S'pore) Pte

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