Restructuring & Insolvency

Schemes of Arrangement and the Requirement of Disclosure

Introduction

Schemes of arrangement are often the preferred option for companies seeking to restructure their debt, allowing for a compromise with the creditors while the debtor remains in control of the company. To balance this, the statutory regime has in place safeguards to protect the interests of the creditors.

In *Pathfinder Strategic Credit LP and another v Empire Capital Resources Pte Ltd and another appeal* [2019] SGCA 29, the Singapore Court of Appeal had to consider, among other things, the extent of disclosure that is required of the applicant company in a scheme process, as well as issues concerning the validity of third party releases, classification of debtors and abuse of process.

The Court set out guidelines for assessing the adequacy of disclosure at the stage where the company applies for the permission (or leave) of the court to convene a creditors' meeting to approve a scheme of arrangement, and found that the applicant in this case had failed to meet the relevant disclosure requirements.

This Update provides a summary of the key aspects of the Court's decision.

Brief Facts

The applicant in this case was Empire Capital, a member of the Berau Group of companies, which is based in Indonesia and one of the world's biggest coal producers. Empire Capital was the guarantor for two note programmes, one issued by Berau Capital Resources ("**BCR**") and one by PT Berau Coal Energy ("**BCE**"). Both companies were also part of the Berau Group.

BCR and BCE were both unable to make payment under their respective note programmes. Empire Capital applied for leave to convene a meeting of creditors to consider a proposed scheme of arrangement under section 210 of the Companies Act. Under the proposed scheme, the liabilities of Empire Capital and that of related entities including BCR and BCE under the existing notes would be discharged. In exchange, new notes would be issued to the existing noteholders by PT Berau Coal and guaranteed by BCE.

Certain minority creditors sought to oppose Empire Capital's application. The minority creditors were noteholders under the note programmes which were to be compromised. The High Court allowed the scheme meeting to be convened, but with the BCR noteholders and the BCE noteholders grouped into two separate classes.

In the subsequent appeal, the Court of Appeal had to consider four main issues:

(i) What is the extent of an applicant company's disclosure obligations?
(ii) What are the limits of the court's jurisdiction where the proposed scheme releases liabilities between the company's creditors and third parties?
(iii) How should the creditors be classified for the purpose of scheme meetings?
(iv) Does the present application amount to an abuse of process?

Holding of the Court of Appeal

The Court of Appeal found in favour of the minority creditors, allowing their appeal. Accordingly, the High Court's order granting leave for Empire Capital to proceed with the creditors' meeting was set aside.

Schemes of arrangement

The Court of Appeal first set out the general law regarding the statutory framework for schemes of arrangement. The overall procedure is as follows:

(i) The company must apply to the court for leave to convene a meeting of creditors to consider a proposed scheme of arrangement (the "**leave stage**").
(ii) If leave is granted, the company may conduct the meeting to obtain the creditors' approval of the proposed scheme.
(iii) Once the requisite majority approval is obtained, the company must then apply for court approval of the scheme (the "**sanction stage**").

From existing case law, the Court set out the following principles regarding schemes of arrangement at the leave stage:

(i) The company must present a restructuring proposal that need not be ready for presenting to creditors, but with sufficient particulars for the court to assess that it is feasible and merits due consideration.
(ii) Issues that will be considered at the leave stage generally involve the court's jurisdiction, but also include the classification of creditors, whether there is a realistic prospect of the scheme being approved, and any allegation of abuse of process.
(iii) The company bears a duty of disclosure and must unreservedly disclose all material information to assist the court in determining how the creditors' meeting is to be conducted.
(iv) The leave application should be heard on an expedited basis, and the court generally should not consider the merits and reasonableness of the proposed scheme.

Disclosure obligations at leave stage

At the sanction stage, an applicant company must have disclosed sufficient information to ensure that the creditors are able to exercise their votes meaningfully. However, at the leave stage, a less onerous standard of disclosure applies.

The Court held that, at the leave stage, there must at least be sufficient disclosure to enable the court to determine the issues that it must properly consider at that stage. Further, the applicant company must provide financial disclosure in such a manner and to such an extent as is reasonably necessary for the court to be satisfied that fair conduct of the creditors' meeting is possible.

The Court acknowledged that oppressive disclosure obligations would fetter genuine attempts at restructuring, particularly for smaller companies lacking resources. The Court thus set out the following guidelines:

(i) It is only in clear and obvious cases that the court should intervene at the leave stage solely on the ground of inadequate disclosure.
(ii) The sufficiency of disclosure depends on what is reasonable in the circumstances, and the relevant factors include the size and resources of the company, the size of the debt, the urgency of the application, and the reasons for the company's inability to provide further disclosure.
(iii) Unless there are complications such as significant legal issues to be considered, the leave stage will remain a largely expedited process.

On the facts, the Court found that Empire Capital had failed to provide the scheme creditors with the minimum level of financial disclosure reasonably necessary to satisfy the court that fair conduct of the creditors' meeting was possible.

(i) There was a complete lack of updated financial information on the companies whose debts were sought to be compromised. No financial disclosure had been made in relation to any member of the Berau Group except for Berau Coal even though the proposed scheme sought to compromise the debts of 10 other obligors within the Berau Group.
(ii) Even in relation to Berau Coal, the latest set of audited accounts provided came from almost four years prior to the first hearing of the appeals.
(iii) Little weight could be placed on a position assessment by Deloitte, which was based on deficient primary financial information.
(iv) Although some updated unaudited statements of Berau Coal were belatedly disclosed, the information was so sparse and unreliable that it did not constitute meaningful disclosure.

Although this was sufficient for the Court to allow the appeal, the Court went on to consider the other issues which had been raised by the parties.

Third party releases

The parties disagreed on whether the court's jurisdiction to sanction a scheme of arrangement covers the compromise of a debt between the creditor and a third party, as was the case in the present situation.

The Court upheld the High Court's test of jurisdiction, which is that section 210 is broad enough to cover the release of claims against third parties, but there must be a sufficient connection or nexus between the release of the third party liability and the relationship between the company and the scheme creditors.

On the facts, the release of the debt owed by BCR, BCE and other members of the Berau Group was closely related to the creditor-debtor relationship between the noteholders and Empire Capital. The debts arose out of the same note issues and were effectively the same liability from the point of view of the creditors.

Therefore, the Court would have affirmed its jurisdiction to grant leave in respect of the proposed scheme notwithstanding that there were third party debts sought to be compromised.

Classification of creditors

The parties also disagreed on whether the noteholders under the two sets of note programmes should be classified as a single class of creditors for the purpose of considering and voting on the proposed scheme.

The Court here adopted the approach that, if a scheme favours or prejudices a group of creditors (as against other creditors) differently from how they would have been favoured or prejudiced in the situation of a comparator, then that group of creditors should be classed separately. The practical steps are thus as follows:

(i) Identify the comparator.
(ii) Assess whether the relative positions of the creditors under the proposed scheme mirror their respective positions in the comparator.
(iii) If there is a difference in the relative positions, assess whether the difference is such as to render the creditors' rights so dissimilar that they cannot sensibly consult together with a view to their common interest.

On the facts, the proposed scheme would not affect the two sets of noteholders to the same extent. The scheme would result in uniformity in the rights of all noteholders, whereas their positions in an insolvent liquidation would not be identical. However, the Court opined that the differences in the relative positions did not appear material, and expressed the provisional view that the noteholders would still be able to consult together with a view to their common interest.

Abuse of process

The minority creditors had alleged that Berau Group was abusing the scheme of arrangement regime to prevent or delay legitimate enforcement on the notes. However, the Court was of the opinion that there was insufficient evidence to warrant a finding of abuse of process.

The Court highlighted that the threshold for abuse of process is necessarily a high one, particularly in the context of scheme applications where the restructuring process is inherently dynamic.

Concluding Words

The Court of Appeal's decision has provided vital guidance on the scheme of arrangement regime. In particular, the current statutory framework does not prescribe principles underlying the granting of leave to conduct a creditors' meeting. Case law is thus necessary to develop the relevant principles and considerations.

Parties seeking to propose schemes of arrangement should thus be aware of their obligations when applying for the leave of court, including how to classify creditors and what constitutes an abuse of process. This decision focuses heavily on the disclosure requirements, and parties may glean insight on what financial information should be disclosed to scheme creditors.

For further queries, please feel free to contact our team below.

Contact

Raelene Pereira
Partner

D +65 6232 0401
F +65 6428 2027

raelene.pereira@rajahtann.com

Please feel free to also contact Knowledge and Risk Management at eOASIS@rajahtann.com

Our Regional Contacts

RAJAH & TANN | *Singapore*

Rajah & Tann Singapore LLP
T +65 6535 3600
F +65 6225 9630
sg.rajahtannasia.com

R&T SOK & HENG | *Cambodia*

R&T Sok & Heng Law Office
T +855 23 963 112 / 113
F +855 23 963 116
kh.rajahtannasia.com

RAJAH & TANN 立杰上海
SHANGHAI REPRESENTATIVE OFFICE | *China*

Rajah & Tann Singapore LLP
Shanghai Representative Office
T +86 21 6120 8818
F +86 21 6120 8820
cn.rajahtannasia.com

ASSEGAF HAMZAH & PARTNERS | *Indonesia*

Assegaf Hamzah & Partners

Jakarta Office
T +62 21 2555 7800
F +62 21 2555 7899

Surabaya Office
T +62 31 5116 4550
F +62 31 5116 4560
www.ahp.co.id

RAJAH & TANN | *Lao PDR*

Rajah & Tann (Laos) Sole Co., Ltd.
T +856 21 454 239
F +856 21 285 261
la.rajahtannasia.com

CHRISTOPHER & LEE ONG | *Malaysia*

Christopher & Lee Ong
T +60 3 2273 1919
F +60 3 2273 8310
www.christopherleeong.com

RAJAH & TANN NK LEGAL | *Myanmar*

Rajah & Tann NK Legal Myanmar Company Limited
T +95 9 7304 0763 / +95 1 9345 343 / +95 1 9345 346
F +95 1 9345 348
mm.rajahtannasia.com

GATMAYTAN YAP PATACSIL
GUTIERREZ & PROTACIO (C&G LAW) | *Philippines*

Gatmaytan Yap Patacsil Gutierrez & Protacio (C&G Law)
T +632 894 0377 to 79 / +632 894 4931 to 32 / +632 552 1977
F +632 552 1978
www.cagatlaw.com

RAJAH & TANN | *Thailand*

R&T Asia (Thailand) Limited
T +66 2 656 1991
F +66 2 656 0833
th.rajahtannasia.com

RAJAH & TANN LCT LAWYERS | *Vietnam*

Rajah & Tann LCT Lawyers

Ho Chi Minh City Office
T +84 28 3821 2382 / +84 28 3821 2673
F +84 28 3520 8206

Hanoi Office
T +84 24 3267 6127
F +84 24 3267 6128
www.rajahtannlct.com

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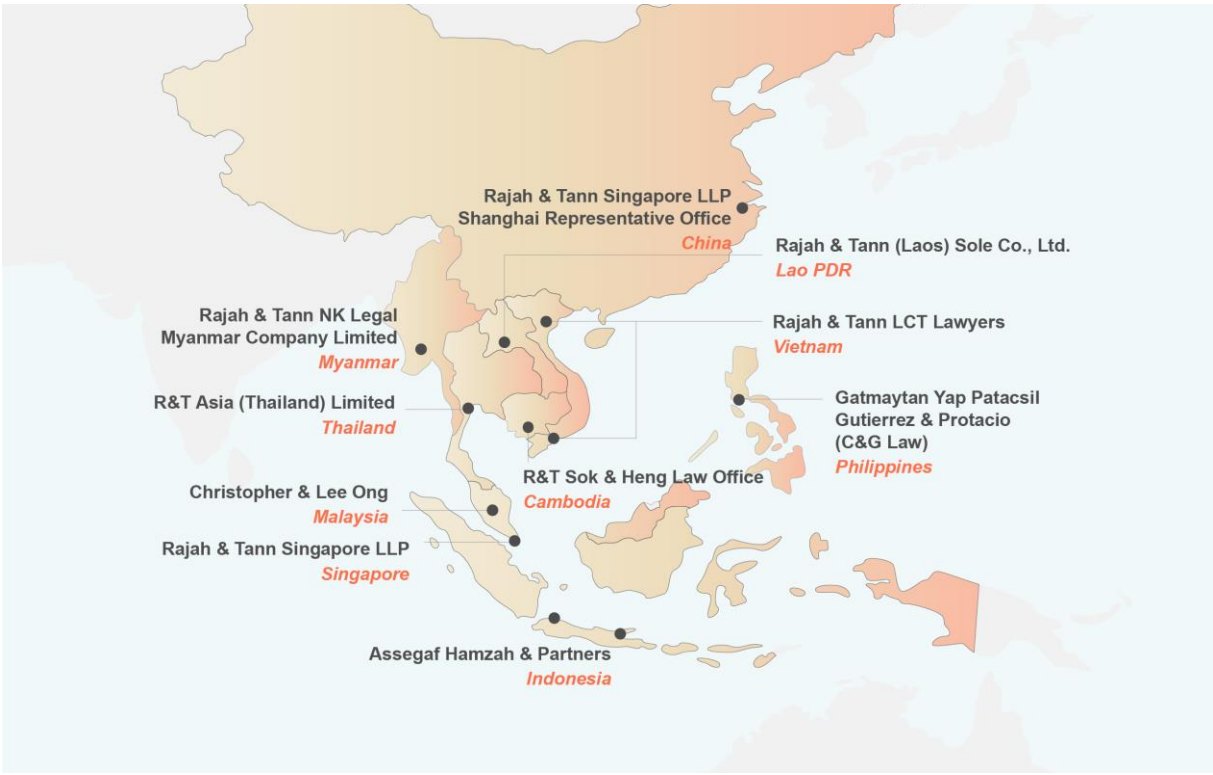

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