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LEGAL UPDATE

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High Court considers scope of Court's power to grant Third Party Releases in Schemes of Arrangement

Synopsis

In the case of ***In the Matter of Empire Capital Resources Pte Ltd*** [2018] SGHC 36, the High Court considered whether a guarantor of certain Notes could seek to restructure its liabilities thereunder and to seek, as part of the scheme, third party releases for the Note Issuers. The Honourable Justice Aedit Abdullah held that the Court had the power to allow a meeting to be convened to consider such a scheme.

Facts

Berau Capital Resources Pte Ltd ("**BCR**") was the issuer of US$ 450,000,000 12.5% guaranteed senior notes due 8 July 2015 ("**the 2015 Notes**"). PT Berau Coal Energy Tbk ("**BCE**") was the issuer of US$500,000,000 7.25% guaranteed senior secured notes due 13 March 2017 ("**the 2017 Notes**"). Empire Capital Resources Pte Ltd ("**the Applicant**") was a guarantor of the 2015 Notes and the 2017 Notes. All 3 companies are within a group of companies known as the "**Berau Group**".

BCR and BCE had brought prior separate applications under sections 210 (10) and 210 (1) of the ***Companies Act (Cap 50)*** ("**the Act**"). A moratorium was granted under section 210(10) of the Act in respect of BCR on 7 July 2015. The moratorium was extended on various occasions until 3 March 2016 but the Honourable Justice Aedit Abdullah declined to allow any further extensions on 3 March 2016. Applications were subsequently made under section 210(1) of the Act to convene scheme meetings in respect of BCR and BCE, but these applications were withdrawn prior to hearing.

Following this the Applicant made a single application to convene a scheme meeting under section 210(1) of the Act, such as to restructure the debts owing under both the 2015 Notes and the 2017 Notes. A group of objecting institutional noteholders of both series of notes ("**the Objectors**") objected to the application. Affidavits were filed as to the efficacy of the proposed scheme and the projected returns to the Noteholders.

The Objectors' Arguments

The Objectors argued that what was proposed was not in fact a compromise between the Applicant and its creditors; instead the proposed scheme improperly released third parties, ie the BCR and BCE ("**the Notes Issuers**"). Reference was made to the

case of ***Daewoo Singapore Pte Ltd v CEL Tractors*** [2001] 2 SLR (R) ("**Daewoo**") in which the Court of Appeal considered that third party releases were permissible in schemes of arrangement. That case involved a scheme in which a guarantor was to be released on a scheme application brought by a principal debtor. The Objectors argued that there were limits to the Court's jurisdiction to allow third party releases in schemes of arrangement, and relied on the case of ***Re Lehman Brothers International (Europe) (No 2) [2009] EWCA Civ 1161 ("Re Lehman Brothers").*** The Objectors argued that the proposed scheme failed the requirements as (1) it was proposed by a mere guarantor and was intended to dilute the vote of opposing creditors; (2) the Notes Issuers' debt was not contingent or ancillary to the debt owed by the Applicant, rather the Applicant's debt was ancillary or contingent to the Notes Issuers' debt; (3) the release of the Notes Issuers was not necessary to the compromise with the Applicant; (4) there was no genuine give and take in the proposed scheme; and (5) the rights of creditors against the third parties were proprietary and not personal.

The Objectors also argued that the 2015 and 2017 Noteholders (collectively, "**the Noteholders**") should be placed in different classes if leave were granted to convene a scheme meeting because the 2 sets of notes were separate but interdependent arrangements; they were issued by different Notes Issuers in different jurisdictions (one in Singapore and one in Indonesia), and that under the scheme the 2015 Noteholders would get a higher recovery than the 2017 Noteholders.

Other arguments made by the Objectors were that insufficient financial disclosure had been given in that the information given was insufficient to allow an assessment as to the returns from the proposed scheme and the commercial viability of its implementation; that no moratorium should be allowed as the moratorium period prayed for in the application had already expired by the time the Application came up for hearing and that in any event the moratorium should not have extra territorial effect; and that the Berau Group had made repeated applications such that the application was an abuse of process.

The Decision

The learned Judge emphasized that at the leave stage, the Court does not generally consider the merits or otherwise of the scheme. However the Court will consider the proper classification of creditors for the purposes of voting and whether or not there is a realistic prospect of the proposal being approved. Abuse of process may be an additional reason for the court declining to approve the calling of the meeting.

The Court went on to consider the applicable test for release of third party liabilities in schemes of arrangement. In doing this, the Court considered **Daewoo**, as well as English and Australian authorities including in particular **Re Lehman Brothers** and **Re**

Opes Prime Stockbroking Ltd [2009] FCA 813 ("**Re Opes**"). The Court concluded that the general approach in Singapore is that it is for the creditors to weigh what is in their interests, and conversely it is for the company to propose an attractive enough proposition for creditors to agree to the proposed releases. Hence a third party release is not in itself something that is to be guarded against and restricted. The fact that in this case the Applicant was a guarantor did not make a difference in this analysis.

What matters, the Court found, is the nexus or connection between what is proposed and the liability of the applicant company. In other words there must be some connection between the applicant company's debt and what is sought to be released. If there is no such connection, then the proposal would fall outside the ambit of the statute. What amounts to a sufficient connection cannot be laid out with any definitiveness: but a wholly unconnected debt would certainly fail.

The Court also held that so long as the relevant connection could be made, it would seem immaterial whether the creditors' rights against the third parties were personal or proprietary.

On the basis of the above, the Court granted an order that a scheme meeting be convened. The Court observed that this approach was consistent with the approach of the Court in **Daewoo** and also coincides with the test developed in the Australian case of **Re Opes**, which the learned Judge believed should represent the law. The learned Judge said that if the English cases lead to a different conclusion, His Honour declined to follow them.

The Court went on to consider the issue of classification. The Court found that the fact that the Notes were issued by different companies within the Berau Group (and that one was an Indonesian entity) did not necessarily mean that they should be classed differently. As for the difference in returns between the 2015 and 2017 Noteholders, the Court held that some difference in levels of returns was tolerable. What matters is whether that difference is such that the two sets of noteholders cannot reasonably deliberate as a group. The Court found that while there was some difference in returns between the two groups in this case, this was not sufficient to conclude that it was inappropriate to have a single class. However the Court held that in this case the 2015 and 2017 Noteholders should vote in separate classes because the creditors had rights exercisable against different entities and that the considerations that come into play in weighing whether any release was to be given, and what should be the price of such release, would seem to be the sort that could attract different results, such that there would be little common interest.

The Court noted that the Objectors held 25.28% of the outstanding principal of

the 2015 Notes (or more than the 25% blocking minority), but held that this did not necessarily indicate that the scheme is doomed to failure, and declined to bar the calling of the meeting on that ground. The Court held that what is required is at least having a proportion of support that puts the scheme within "striking distance" of obtaining the requisite statutory approvals. The Court also considered the fact that there had been some fluctuation in the composition of the opposing creditors and observed that there may be further changes by the time of the meeting.

As for financial disclosure, the learned Judge held that, while some failure to provide information could amount to an abuse of process, the present case was far from such a situation, and that the information provided was sufficient.

The Court also found that that there was nothing that amounted to an abuse of process by either side to the Application.

Finally, the Court considered the issue of the moratorium. The Court held that any inherent jurisdiction of the Court should not generally be exercised to affect proceedings overseas. The Court thus granted a moratorium only within Singapore.

Conclusion

The case is an important decision on the Court's power to grant third party releases in schemes of arrangement. It makes clear that the approach taken in Singapore is a commercial one – so long as there is a sufficient connection between the applicant company's debt and what is sought to be released, the Court has the power to order that a scheme meeting be convened. It is up to creditors to decide if they are satisfied with what is being offered in exchange for the release. It is suggested that this is a sensible, commercial approach, and is consistent with Singapore's push towards further establishing itself as a hub for restructuring activity.

The decision also makes clear that the mere fact that a blocking minority of creditors may insist that they will oppose a scheme does not of itself mean that leave will not be granted to convene a scheme meeting. So long as there is sufficient support from creditors to put the statutory approvals within "striking distance", the Court may allow a scheme meeting to be convened.

Finally, the Court made clear its reluctance to exercise its inherent jurisdiction to grant a moratorium with extraterritorial effect under section 210(10) of the Act.

The Applicant was represented by Nair & Co's Suresh Nair and Nicole Foo.

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