Nair & Co.

LEGAL UPDATE

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High Court considers scope of note trustee's role when the note issuer is in judicial management

Synopsis

2017 saw an unprecedented number of note defaults in Singapore. Some of these defaults were in respect of notes that were sold to retail investors. Among them was the default under 3 series of notes issued by Swiber Holdings Ltd (in judicial management).

How do noteholders (in particular retail noteholders) enforce their rights against insolvent note issuers? In many cases, trustees are in place ostensibly to protect noteholders' interests, but under the trust deed appointing them, they are only obliged to act if they get a satisfactory indemnity from noteholders and 25% of the noteholders instruct them to do so. In practical terms, organising retail noteholders such as to provide such an indemnity and to issue such an instruction is not realistically possible. What are the trustee's duties in such circumstances, and what are its entitlements especially with regard to voting in the context of a Judicial Management or a Scheme of Arrangement?

These, and other issues were addressed in the seminal case of ***Re Swiber Holdings Ltd*** [2018] SGHC 211. In particular, the High Court considered the following issues:

(1) Who was the proper party to cast the noteholders' votes at creditors' meetings under ss 227M – 227N of the Companies Act (Cap. 50) (the "**Act**") ("**JM Proposals Meetings**") or under s 227X read with s 210 of the Act ("**JM Scheme Meeting**") – the trustee or the ultimate beneficial owners of the notes? (the "**Right to Vote Issue**")

(2) If the trustee held the right to vote, how should the trustee's vote be determined in terms of value and number, given that the trustee represents the entire body of noteholders? (the "**Vote Count Issue**")

(3) Should the trustee be entitled to have its expenses in performing its duties as Trustee charged on and paid out of the property of the notes issuer in judicial management in priority to other creditors as part of the cost of the JM? (the "**Trustee Expense Issue**")

(4) Were other creditors who filed submissions in the Trustee's application entitled to costs for participating in the Trustee's application, to be paid by the notes issuer? (the "**Third Party Costs Issue**")

The Honourable Justice Kannan Ramesh held that:

(1) The proper party to cast votes on behalf of noteholders at JM Proposals Meetings was the trustee (and not the ultimate beneficial holder of the notes). As for JM Scheme Meetings the proper party could be either the trustee, or the ultimate beneficial owner depending on whether the trust deed entitled them to elect for direct rights against the issuer upon the trustee's issuance of a default notice.

(2) For the purposes of counting the trustee's vote, where there was no unanimity among the ultimate beneficial owners as to how the vote should be exercised, the trustee's vote should count as one for and one against for the purposes of the vote on number. For the vote on value, the trustee would vote "x" in terms of the vote in value for, and "y" in terms of the vote in value against, with "x" and "y" reflecting the value of the notes held by the ultimate beneficial owners who were in favour and against the scheme respectively.

(3) The trustee is not entitled to have its expenses charged on and paid out of the property of the notes issuer in judicial management in priority to other creditors as part of the cost of the JM.

(4) The creditors who filed submissions are not entitled to costs to be paid by the notes issuer.

Facts

Pursuant to a S$1,000,000,000 Multicurrency Debt Issuance Programme, Swiber Holdings Limited ("**SHL**") issued (among other things) 3 series of notes (the "**Notes**") due between 2016 and 2017. By a trust deed dated 20 July 2007 ("**Deed**"), British and Malayan Trustees Ltd ("**Trustee**") was appointed trustee of the Notes. Under the Deed, SHL covenanted to pay the redemption monies of the Notes to the Trustee.

The Trustee is however not the beneficial owner of the Notes. Instead, the Notes were issued by SHL in a "global" form, which involves the Notes being deposited in a depository who holds on behalf of clearing systems. The structure thus involves

various intermediaries who hold the rights under the Notes on trust for the ultimate beneficial owner, who may be a retail investor.

In the present case, the Trustee held the rights under the Notes on trust for "Noteholders" – here, the Central Depository (Pte) Ltd ("**CDP**") or persons whose names were registered in the register maintained by Citicorp Investment Bank (Singapore) Limited as Registrar, i.e. the Account Holders (as defined below) following an event of default. CDP, in turn, as both depository and clearing system, held its interests on trust for persons who held accounts with it (the "**Account Holders**"). The Account Holders in turn held the beneficial interest in the Notes on their own account, or for clients who are either the ultimate beneficial owners or intermediaries (such as private bank nominees) holding their interests for the ultimate beneficial owners. The ultimate beneficial owners are retail investors.

The Deed also vested in the Trustee the right to institute proceedings against SHL to enforce SHL's obligations under the Notes after an event of default. The Trustee would however be bound to take steps to enforce SHL's obligations only if it was directed by holders of not less than 25% of the outstanding principal amount of the Notes or an extraordinary resolution is passed by a majority of at least 75% of the votes cast to do so **and** the Trustee is indemnified to its satisfaction by the Account Holders for its associated costs and expenses. The Account Holders would only be entitled to elect to obtain direct rights against SHL if such a direction had been given by the requisite number of Account Holders **and** if the requisite indemnification had been given **and still** the Trustee failed to take steps to enforce SHL's obligations within a reasonable period.

Another clause in the Deed provided for SHL to remunerate the Trustee for its services, and specifically required SHL to pay the Trustee "*such additional remuneration as may be agreed between them*" in the case of an event of default or potential event of default.

By 12 October 2016, SHL had been placed under judicial management upon its own application and had announced that it would be defaulting on the coupon payment and/or redemption of each of the 3 Notes.

Accordingly, on 13 October 2016, the Trustee wrote to SHL stating that it recognized "*Potential Events of Default and Events of Default*" relating to the Notes, and enquired whether SHL's judicial managers ("**JMs**") would be indemnifying the Trustee for all reasonable legal and other expenses incurred and for all work done in relation to the Events of Default. The JMs responded stating that it was not in a position to indemnify or remunerate the Trustee, and also disclaimed any personal

liability under the Deed pursuant to s 277I(2) of the Act.

The JMs subsequently called for an informal creditors' meeting and issued notices of the same to persons listed in CDP's records as holders of the Notes i.e. the Account Holders. The Trustee was however not issued a notice. This led to confusion on the part of the Trustee and the Account Holders over who was entitled to attend the informal creditors' meeting, and more generally, who would be entitled to participate as a creditor in the judicial management of SHL in respect of the Notes. The Trustee was subsequently allowed to attend the informal creditors' meeting upon request.

Confusion also arose as to the proper party to file a proof of debt in respect of the Notes. While the Trustee took the view that it was the proper party to file the proof under the terms of the Deed, the Trustee was informed by Account Holders that the JMs had requested that they complete and submit proofs of debt to be allowed to attend the informal creditors meeting.

Following the confusion, and in light of an announcement by the JMs at the informal creditors' meeting that they intended to propose a scheme of arrangement for approval by SHL's creditors, the Trustee decided to bring the present application to resolve the Right to Vote Issue, the Vote Count Issue and the Trustee's Expense Issue.

In the meantime, on 13 June 2017, the Trustee filed a proof of debt in line with its expectation that it would be declared as the proper party to vote at creditor and scheme meetings in respect of the Notes as provided under the Deed. The Trustee took the position that its vote at creditors' meetings would count for as many votes as there were ultimate beneficial owners, either for or against.

The JMs' Arguments

The JMs took the position that for JM Proposals Meetings, only the Trustee was entitled to vote in respect of the Notes. However, for JM Scheme Meetings, the JMs relied on several foreign cases where it was held that the ultimate beneficial holders of notes were entitled to vote directly in a meeting to approve a scheme of arrangement on the basis that they were contingent creditors, and submitted that it was accordingly open to the Court to direct either that the Trustee was to vote on behalf of the Noteholders (i.e. the Account Holders in an event of default), or that the Noteholders could vote directly subject to there being no double-voting.

The JMs also argued that for JM Proposals Meetings where the Trustee voted for the Noteholders, to the extent that the Noteholders were not unanimous on the Trustee's vote, the Trustee's vote should count as one vote for and one vote against in number, with the vote value split to reflect the value of notes held by the Noteholders voting for and against.

Finally, the JMs argued that the Trustee's expenses should not be treated as costs of the judicial management and charged on and paid out of SHL's property in priority to other unsecured debts as this would have the effect of subsidizing the costs of one group of unsecured creditors and confer priority status on an *in personam* claim for expenses.

The Trust Certificate Holders' Arguments

Another group of creditors, the Trust Certificate Holders, participated in the application on the basis that the issues raised by the Trustee were similar to those that arose under the Trust Certificates. The Trust Certificate Holders essentially aligned themselves with the JMs and sought that its costs of and incidental to the application be paid by SHL. This was the Third Party Costs Issue.

The Decision

The Right to Vote Issue turned on whether the Trustee and/or the ultimate beneficial holders were creditors of SHL, given that the relevant meetings were creditors' meetings. As the Trustee had a monetary claim against SHL amounting to a debt once the amounts due under the Notes were payable, it was accordingly a creditor entitled to vote at the creditors' meetings.

As for the ultimate beneficial owners, the Court rejected the approach at common law – that the ultimate beneficial holders of a trustee's pecuniary claim did not render them creditors. Instead, the Court adopted the approach taken by the foreign courts in (among others) ***In the Matter of Castle Holdco 4 Ltd*** [2009] WHC 3919 (Ch), ***In the matter of Gallery Capital SA*** (21 April 2010) (HC, UK) and ***In the matter of Boart Longyear Ltd*** [2017] NSWSC 567 – that where the relevant security documents entitled the ultimate beneficial holders to require definitive securities to be issued to them, the ultimate beneficial holders were contingent

creditors regardless of whether the right was exercised (the "**Contingent Creditor Analysis**"). The rationale for this approach was twofold – first, where a scheme was proposed, it ought to be considered by those who had an economic interest in the debt, i.e. the ultimate beneficial holders of the Notes. Second, significant practical difficulties would arise if the trustee was the only creditor and there was no unanimity of votes amongst the ultimate beneficial holders – the trustee's one vote could not be cast to achieve a majority in number that is required to pass a scheme.

The Court thus adopted the Contingent Creditor Analysis and applied it to the present case. As regulation 73 of the Companies Regulations (Cap 50, Reg 1, 1990 Rev Ed) (the "**Regulations**") prevented contingent creditors from voting at JM Proposals Meetings and creditors' meetings summoned by the JMs, the Court found that only the Trustee was entitled to vote at JM Proposals Meetings in respect of the debt due under the Notes.

Regulation 73 did not however apply to JM Scheme Meetings as such meetings were not meetings convened by the JMs at their own discretion. Instead, they were meetings ordered by the Court. The Court thus found that it was open to it to apply the Contingent Creditor Analysis to such meetings.

On the facts of the present case, the Court found that as the Deed entitled the Noteholders i.e. the Account Holders to acquire direct rights against SHL, the Account Holders were entitled to vote at any JM Scheme Meeting in their capacity as contingent creditor, in place of the Trustee, in the event that the Noteholders were classified as a scheme creditor in SHL's proposed scheme. The ultimate beneficial holders on the other hand were not entitled to vote as the Deed did not give them a right to acquire direct rights against SHL.

On the Vote Count Issue, the Court considered the various approaches taken by foreign courts on the matter: (1) the "Split Vote" approach taken in England where the single trustee votes both for and against the proposed scheme if the beneficiaries were not unanimous; (2) the "Multiple Votes" approach adopted in the Cayman Islands which treated the trustee as a multiple-headed member for the purposes of the head-count requirement with the number of votes attributable to the trustee determined by the number of participants giving instructions to the trustee for the vote; and (3) the "Fractional Votes" approach adopted in Jersey, where the trustee's vote was to be subdivided into fractions of a vote in accordance with the number of ultimate beneficial holders voting for and against the scheme.

The Court decided that the Split Vote approach had a principled basis – that where

the ultimate beneficial owners take conflicting positions on a vote, the trustee's single vote had to be exercised in reflection of the opposing views of those it represents and should be cast both for and against the scheme.

In rejecting the Multiple Votes approach, the Court found that first, the trustee had only one vote and simply could not cast multiple votes. Second, the Multiple Votes approach undermined regulation 73 of the Regulations as it would in effect allow contingent creditors to be counted as if it had voted in its own name. Third, the adoption of this approach in the Cayman Islands had been based on specific provisions applicable under the law of that jurisdiction and there were no similar provisions under Singapore law. In any event doubts had been expressed in the Cayman Islands on the Multiple Votes approach in later Cayman cases.

As to value of the Trustee's vote, the Court agreed with parties that where there is a difference in the views of the ultimate beneficial owners, the difference should be reflected by way of a split in value along the lines of for and against.

In respect of the Trustee's Expenses issue, the Court found that the Trustee's expenses should not be paid in priority to other unsecured creditors given that neither of the limbs under s 227J(3) of the Act had been satisfied. Under s 227J(3)(a) of the Act, the contract was required to be entered into by the JMs. In the present case however, the contract had been entered into by SHL prior to its judicial management and had not been entered into by the JMs. As for s 227J(3)(b), the Court referred to the case of ***Centre Reinsurance International Co and ors v Freakley and ors*** [2006] 1 WLR 2863 and found that the principal function of this provision was to confer priority on claims by the JMs, and not third parties, against SHL for their remuneration and such expenses for which the JMs made themselves liable to third parties. It was thus not possible for the Trustee to avail itself of this provision.

The Court also rejected the Trustee's argument that its expenses ought to be treated as expenses of the judicial management under the liquidation expenses principle. While the Court recognised that the English Courts in ***Re Atlantic Computer Systems*** [1992] Ch 505 had applied the liquidation principle to administrations under the English administration procedure (with the necessary modifications), which the Singapore judicial management regime was based on, the Court found that the principle extended only to liabilities in respect of *property* that continued to be used by the administrators for the benefit of SHL. In the present case, the Court found that the Trustee's expenses incurred in carrying out its duties under the Deed fell outside the scope of the liquidation expenses principle even if applied to judicial managements.

The Court also rejected the Trustee's argument for its expenses to be paid on the basis of the principle in *ex p James*, which provides that monies paid under a mistake or in circumstances where it is unfair for the insolvent estate to retain monies should be returned to the paying party. The Court found that the first condition for the insolvent estate to be enriched by the claimant was not satisfied as the party who benefitted from the Trustee's execution of its duties was the ultimate beneficial holders, and not SHL. The Court also pointed out that the Deed provided that the Trustee was not bound to take any steps to enforce SHL's duties unless it had been indemnified to its satisfaction by the Noteholders.

It should be noted that in making the above finding, the Court also recognised that this mechanism was not a practically workable one given that the ultimate beneficial holders in the present case being retail investors could not realistically organise themselves to provide instructions and the required indemnity to the Trustee. The Court however indicated that this practical problem while an important one could not be solved by conferring priority on the Trustee's claim for its expenses to the detriment of SHL's other creditors. Instead, the Court noted that the issue required further consideration and suggested that ideally, the mechanism ought to be addressed by the parties at the point of issuance of the Notes.

Finally, the Court considered the Trust Certificate Holders' argument that its costs of and incidental to the Trustee's application be paid by the Company. The Trust Certificate Holders relied on the Australian case of ***Re NRMA Ltd No 5131 of 1999*** (2000) 33 ACSR 595 ("***Re NRMA***") for the proposition that the Company should be ordered to bear their costs since their submissions were not "*frivolous or without substance*". In declining to grant the order for costs sought by the Trust Certificate Holders, the learned Judge held that the court in ***Re NRMA*** was concerned with schemes of arrangement, and that the findings of the court relied upon by the Trust Certificate Holders did not extend beyond scheme cases. As the present case involved a judicial management, the principal in ***Re NRMA*** did not apply.

Given that no application had been filed by the Trust Certificate Holders, the Court also specifically stated that its rulings would be confined to the issues raised by the Trustee in respect of the Notes, and that it was not making any rulings on issues relating to the Trust Certificates.

Conclusion

The case is an important decision by the Singapore Courts clarifying the manner in which votes are to be cast and counted by or on behalf of ultimate beneficial noteholders in JM Proposals Meetings and JM Scheme Meetings.

The decision also recognizes the unsatisfactory trustee mechanism presently adopted in many trust deeds, where the trustee is not obliged to act unless instructed by a minimum of 25% holders of the relevant notes and indemnified to its satisfaction. The protection afforded by the trustee mechanism is thus stripped away during an event of default, which is when the mechanism is most required especially in cases involving retail investors.

It is hoped that this decision will prompt a review of the manner in which trust deeds are drafted, or a review by the authorities as to the expenses that ought to be included as costs of a judicial management or liquidation, and in particular, whether such costs should include the cost of the trustee. In the absence of such review, retail investors are likely to find that the trustee mechanism that gave them comfort at the point of investing fails them at the point of insolvency – which is the point at which the mechanism is most needed.

The Trustee was represented by Nair & Co LLC's **Suresh Nair** and **Nicole Foo**.

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