Omnibus Insolvency, Restructuring and Dissolution Act: Its Effect on Ipso Facto Clauses and Other Matters

The long-awaited omnibus Insolvency, Restructuring and Dissolution Act 2018 (**IRDA**) comes into force on 30 July 2020.

As an omnibus Act, the IRDA collates the disparate provisions on insolvency, restructuring and dissolution applicable to corporate entities and individuals and consolidates them into one statute. While the IRDA is substantially a consolidating statute preserving most of the provisions that have been collated under its ambit, it does effect a number of significant changes. One of these is the establishment of a new licensing and regulatory framework for insolvency practitioners. Other changes, in particular those relating to the provisions on corporate insolvencies and restructurings, are also of equal, if not more, significance for enhancing the role of Singapore as a hub for corporate restructurings and insolvencies.

We discuss the noteworthy changes in greater detail below. These changes include the following:

– Introducing a new stay on the use of ipso facto clauses;

– Allowing for a company to be placed under judicial management by way of creditors' resolution instead of by a court order;

– Extending liability for wrongful trading; and

– Permitting a liquidator or judicial manager to assign the right to bring an action under the various avoidance provisions and insolvency offences to third party funders.

Restrictions on Ipso Facto Clauses

Section 440 of the IRDA imposes a stay on the use of ipso facto clauses. This provision has however been crafted so that its effect has been carefully targeted to prevent a contractual counterparty from terminating or modifying a contract upon the occurrence of certain trigger events only, including the insolvency or restructuring of a company. The impact of the drafting is that companies may be incentivised to apply for restructuring via a scheme of arrangement or judicial management before a default has occurred under their contracts, rather than wait for the default to occur.

What are ipso facto clauses?

These are clauses that allow a party to terminate or modify a right (among other things) under a contract or accelerate payment obligations thereunder upon the occurrence of certain specified events. Section 440 prevents a party from relying on its right under such clauses where it seeks to do so by reason only that the company is insolvent or has commenced proceedings for judicial management or a scheme of arrangement. Accordingly, where some other event of default has occurred (eg a failure to pay for example) that triggers the right, the right may still be exercised. This provides an important practical limit on the effect of the stay provision in section 440.

As a result of this practical limit, a corporation that delays applying for a scheme of arrangement or judicial management until after it has defaulted on its obligations will be unlikely to be able to rely on the section 440 protection. On the other hand, one that applies for restructuring via a scheme of arrangement or judicial management before defaults arise will benefit from the section 440 protection. By preventing creditors and contractual counterparties from pulling the plug on the corporation seeking restructuring or judicial management in Singapore, the provision seeks to aid such corporations by giving them the breathing space to reorganise their affairs. This, however, is provided they do so early enough that there has been no failure to perform obligations otherwise entitling the counterparty to terminate or modify the contract.

What contracts and financial instruments are affected?

The section will apply to most contracts entered into after 30 July 2020 except for a somewhat narrow list of scheduled contracts which will be set out in the Insolvency, Restructuring and Dissolution (Prescribed Contracts under Section 440) Regulations 2020. The contracts excluded include derivatives, debentures (including bonds and perpetual securities), covered bonds and other financial instruments. Section 440 is therefore not expected to have any impact on such financial instruments and (for some of them) any other agreements which are directly connected with them. Importantly, however, there is no exception granted for syndicated loans (see, in contrast, the Australian and recent English ipso facto legislation) nor for bilateral loans.

The section also does not expressly confine its effect to contracts governed by Singapore law. The extent to which this will be effective if counterparties seek to sue outside Singapore remains to be seen.

Does it apply to foreign companies?

The section will also apply where a foreign company that has a substantial connection to Singapore seeks restructuring or judicial management under the IRDA. Therefore, section 440 could apply to any Singapore law loan agreement entered into with a foreign company, since one way to demonstrate a substantial connection is to govern loans by Singapore law. The ability of such foreign companies to make use of Singapore's restructuring and insolvency framework was introduced in 2017 when the Companies Act was amended to introduce the debtor-in-possession restructuring framework. The introduction of section 440 will enhance the attractiveness of Singapore as a restructuring and insolvency hub for the region.

How will this affect lenders and loan transactions?

For all practical purposes the impact of this on structured loan transactions with a full covenant package often negotiated in respect of borrowers may be limited or mitigated on the basis that one or more of the covenants or events of default may already have been or could be capable of being triggered irrespective of whether or not a judicial management or scheme of arrangement proceeding is underway. Lenders should, however, consider what impact the ipso facto restriction should have on the ability to call on a guarantee or third party security. Financing documents may need to be modified such that the guarantee or secured obligations become immediately due and payable once an ipso facto restriction is triggered.

Judicial management by creditors' resolution

The IRDA will now also allow corporations to seek judicial management by way of a creditors' resolution instead of by way of a court order. In this way, the new provision aligns the judicial management regime with that for schemes of arrangement: a company may enter judicial management if it obtains the approval of a majority of its creditors in number and value. A court order is not required. A corporation can therefore propose to its creditors that it enter judicial management and if the majority of them in number and value agree, the corporation will come under judicial management.

The process for relying on this new method for entering judicial management is set out in the IRDA, the key steps of which include the following:

- The corporation must give at least seven days' notice of its intention to propose to be placed under judicial management to its proposed interim judicial manager and any person who holds a floating charge over the whole (or substantially the whole) of the corporation's assets.
- The members of the corporation resolve to appoint the interim judicial manager.
- The holder(s) of the floating charge agree(s) to the appointment of the interim judicial manager.
- The interim judicial manager is appointed no later than 21 days from the date of the notice.
- Various documents and declarations must be lodged with the Official Receiver and Registrar of Companies by the interim judicial manager and the board of directors.
- The corporation must give notice to all its creditors of a creditors' meeting to be held within 30 days after the date of the lodgement by the interim judicial manager. The notice must contain the information prescribed in the IRDA.
- If the requisite majority of creditors resolves to place the corporation under judicial management, it will enter judicial management. If the requisite majority is not obtained, the process ends.

As with the standard method of applying for judicial management, there will be a moratorium over proceedings against the company during the period. In this case, the moratorium will commence upon the corporation lodging a notice of appointment of the interim judicial manager instead of upon the filing of an application for judicial management in court. The moratorium will not apply if the company had within the past 12 months sought to be placed under judicial management (either by creditors' resolution or by court application).

It is also worth highlighting that a holder of a floating charge over the whole (or substantially the whole) of the corporation's assets may block a judicial management by creditors' resolution as its consent is a precondition to the appointment of the interim judicial manager. By contrast, where an application to court for judicial management is made, the holder's opposition will only block the judicial management if the court is of the view that the prejudice that would be caused to it if the order is made is disproportionately greater than the prejudice that would be caused to unsecured creditors of the company if the application is dismissed.

What does this mean for potential restructurings?

Allowing a corporation to be placed under judicial management by creditors' resolution rather than by court application may make judicial management a more compelling form of restructuring, as it makes the process of entering into judicial management more efficient, as well as cheaper and quicker. The out-of-court approach may also reduce the negative stigma associated with obtaining a formal judicial management order through a court process. While judicial management has in the past been seen as a likely pre-cursor to winding-up, the new process could enhance its attractiveness as a viable option for debt restructuring.

Floating charge holder may appoint judicial manager

It should lastly be mentioned that the IRDA allows the holder of a floating charge over the whole (or substantially the whole) of the corporation's assets to appoint the judicial manager in a court application for judicial management. The IRDA provides that the court must appoint the person nominated by such a holder as judicial manager unless it would not be appropriate because of the particular circumstances of the case.

Winding-up

There are a few changes to the winding-up regime that are worth noting:

- The IRDA allows a director to bring a winding-up application on his or her own cognisance. Currently, those who may apply include the company itself or its creditors.
- The minimum amount of the statutory demand

has been raised from SGD10,000 to SGD15,000. The period of time of failure to meet the demand remains the same: three weeks. The failure to pay the statutory demand within the stipulated timeframe is one of bases on which a creditor may seek to show that the corporation cannot pay its debts and should be wound up. It should be noted that the Singapore government has currently enacted a number of temporary relief measures, which are under constant review, to help alleviate the financial impact of the Covid-19 pandemic for debtors. These relief measures include, among others, a temporary increase of monetary thresholds for insolvency.

– A company may be dissolved instead of being wound up where there are insufficient realisable assets to cover the expenses of the winding-up and there are no affairs to investigate. This allows for the faster resolution of such cases.

Avoidance provisions and offences for wrongful trading

Avoidance provisions

A liquidator and a judicial manager have the power to avoid certain transactions entered into by the corporation prior to winding-up or judicial management. Such transactions include transactions at an undervalue and unfair preferences. While the IRDA has redrafted these provisions into plainer English, their substantive effect remains generally the same. In the same manner, various insolvency related offences such as fraudulent trading have been redrafted without changing their substance.

One change to the avoidance provisions should be noted. Currently, floating charges entered into within six months of the company's winding-up or judicial management may be invalidated unless the company was, immediately after the creation of the charge, solvent. The timeframe has been extended to within one year of the company's winding-up or judicial management. Where the floating charge was granted to a person connected to the company, the timeframe has been extended to within two years of the company's winding-up or judicial management. It remains the case that the charge will be invalidated only if the company was insolvent (or became insolvent) at the time it was granted. It also remains the case that the charge is valid to the extent of any consideration given for it.

Wrongful trading – an extension of the current regime

Currently, it is an offence for an officer of a company to cause it to contract a debt if, at the time the debt was contracted, he or she had no reasonable or probable ground of expectation of the company being able to pay the debt. This offence remains in the IRDA but with the following significant extensions:

The IRDA extends liability for such wrongful trading to any person who was a party to such trading and not just the officer of the company who was knowingly a party to the wrongful trading. In addition, the officer (which includes any director, company secretary and person employed in an executive capacity by the company) may be liable for the wrongful trading if he or she ought, in all the circumstances, to have known that the company was trading wrongfully. This is a lower threshold than actual knowledge.

Under the current provision, the court may declare the officer personally responsible for the debt if he or she has been found guilty of the offence. Under the IRDA, an application for liability does not have to piggy-back on a finding of criminal liability. As the civil standard of proof (one of on the balance of probabilities) rather than the criminal standard of proof (one of beyond reasonable doubt) will apply, this will make it easier for liability to be established.

Directors, officers and other persons involved with managing distressed companies and entering into contracts on their behalf should therefore pay close attention to the extension of these liability provisions and seek appropriate advice where necessary.

Potential for third party funding

Finally, the IRDA allows a liquidator or judicial manager to assign the right to bring an action under the various avoidance provisions and insolvency offences to third party funders. The rights that may be assigned are specifically the actions for transactions at undervalue (section 224, IRDA), unfair preferences (section 225, IRDA), extortionate credit transactions (section 228, IRDA), fraudulent trading (section 238, IRDA), wrongful trading (section 239, IRDA) and damages against delinquent officers (section 240, IRDA). While a liquidator may assign the fruits of the company's claims to third parties under his or her powers as a liquidator, it has previously been held that this power does not extend to the rights to bring an action under the various avoidance provisions and insolvency offences as these actions are personal to the liquidator (*Neo Corp Pte Ltd (in liquidation) v Neocorp Innovations Pte Ltd* (2006), *Solvadis Commodity Chemicals Gmbh v Affert Resources Pte Ltd* (2018)).

The IRDA now specifically accords the liquidator and judicial manager this power which must be exercised in accordance with the Insolvency, Restructuring and Dissolution (Assignment of Proceeds of an Action) Regulations 2020 in order to be valid. This power allows insolvency practitioners the ability to fund the pursuit of claims that might otherwise not be pursued because of a lack of funding. Among the safeguards provided for in the regulations is the need for the liquidator or judicial manager to seek the approval of specified persons (eg the committee of inspection or the committee of creditors, as applicable) before entering into the assignment. The regulations also impose certain safeguarding duties on the liquidator and judicial manager, including prohibiting him or her from receiving any commission or share of proceeds from the third party funder of the action.

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