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REPORT : SESSION 4

COVID-19: IMPLICATION ON INSOLVENCY REGIME IN SINGAPORE

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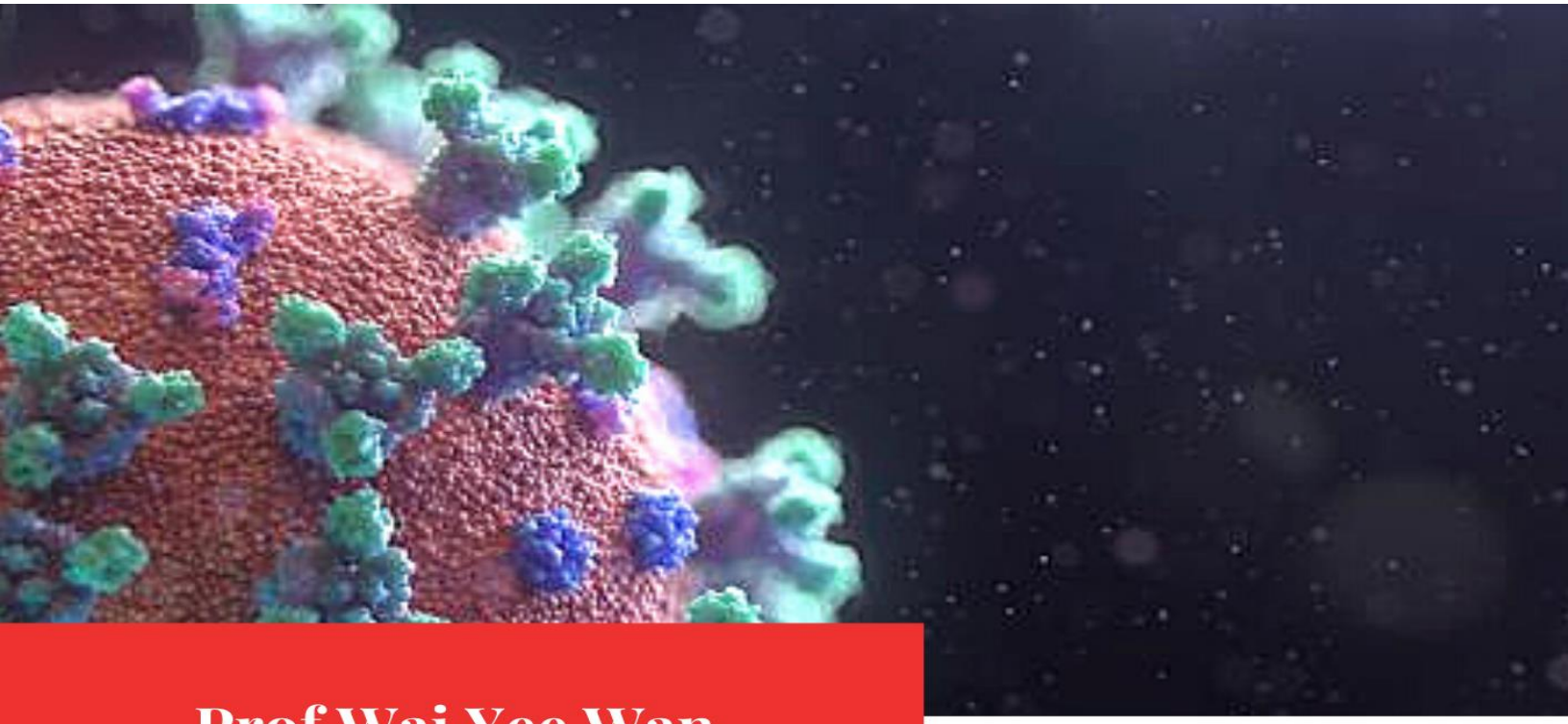

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About the Speakers

Prof. Wai Yee WAN is Associate Dean (Research and Internationalisation) and Professor, School of Law, City University of Hong Kong. Prior to joining City University of Hong Kong in January 2020, she was at Singapore Management University (SMU), where she last held the positions of Dean of Post-graduate Research Programmes and Professor of Law. She has also been a partner at Allen & Gledhill in Singapore.Her main areas of research are in corporate law, mergers and acquisitions, securities regulation, financial consumer regulation and global restructuring and insolvency.

Aurelio Gurrea-Martínez is an Assistant Professor of Law at Singapore Management University.He is also the head of the Singapore Global Restructuring Initiative and co-chair of the SMU-3CL Cambridge Roundtable on Corporate Insolvency.He is a member of the Steering Committee of INSOL International's Academic Group, as well as a member of the European Corporate Governance Institute, the American Law and Economics Association, and the International Insolvency Institute´s NextGen Group. Aurelio is also the director of the Ibero-American Institute for Law and Finance and head of the research group on fintech at the SMU Centre for AI and Data Governance.

Background

The global economy is facing severe economic damage from the COVID-19 pandemic that could arguably be much more disastrous than the '2009 Financial Crisis'. According to the latest forecast by Oxford Economics (April,14,2020), global GDP is expected to contract by almost 7% in the first half of the year i.e. almost double the decline recorded during the global financial crisis. Even the most viable businesses are in deep waters. Certain Sectors such as travel, tourism, hospitality have been heavily hit. Insolvency laws across the globe need to rapidly adapt to change, and reemerge in a position of strength. Governments worldwide have been taking unprecedented measures to bring changes in their insolvency laws to prevent the outbreak of insolvencies post-crisis.

At this point in time, it is pertinent to understand the country's perspectives on insolvency laws across the globe and COVID-19's impact on business. In this backdrop the Centre for Insolvency and Bankruptcy, IICA is organizing a series of webinars, bringing together academicians from top notch universities across the world to deliberate upon the Impact of COVID-19 on Insolvency laws in their home country and share insights on measures adopted across nations while navigating through this new normal. The speakers will be from countries such as India, Australia, Japan, Netherlands, Singapore, China, Israel, Germany, Sweden, United Kingdom, & USA.

The fourth session of the series was with Prof. Wai Yee Wan & Prof. Aurelio Gurrea-Martinez on Covid 19 and its impact on the Insolvency Laws in Singapore.

INTRODUCTION

Corporate insolvency in Singapore have been primarily governed by the Companies Act, supplemented by the Companies (Winding Up) Rules and the Companies Regulations.[1] Certain provisions of the Bankruptcy Act and the Bankruptcy Rules also apply to corporate insolvency in Singapore. Apart from the general corporate insolvency provisions, Singapore has also provided for industry-specific insolvency or winding up rules for certain industries, including the banking industry. These rules apply to the relevant industry in addition to the insolvency provisions under general company law. Singapore's Companies Act of 1967 provides for a range of insolvency and reorganization options for companies in distress, namely liquidation, judicial management and receivership, as well as schemes of arrangement between companies and their creditors and shareholders.

In 2018, however, the Singapore Parliament passed the Insolvency, Restructuring and Dissolution Act. This new piece of legislation consolidates the existing regimes for corporate and personal insolvency in Singapore, and includes various changes to the insolvency legislation, including the reforms implemented in 2017-2018 with the purpose of enhancing Singapore's profile as an international hub for debt restructuring.

GENERAL ECONOMIC IMPACT OF COVID-19

As per the International Monetary Fund ("IMF"), the Covid-19 crisis has led to the worst economic crisis since the Great Depression. The inability of businesses to generate revenues and cash flows has had a profound impact on not just one but multiple segments of the economy ranging from employees to landlords to suppliers of goods and/or services to financial creditors. In order to contain the effects of such an unprecedented health crisis, the governments usually come out with measures on three broad fronts – economic measures, for instance wage

[1] The Insolvency Review – Edition 7, Singapore, The Law Reviews, available at https://thelawreviews.co.uk/edition/the-insolvency-review-edition-7/1211473/singapore.

subsidies; financial measures, for instance modifications to the fiscal and monetary policies; and legal responses to contract, insolvency, corporate and financial regulation laws.

Therefore, it is pertinent to examine the measures taken by the Singapore government to curb the impact of Covid-19 on various sectors of the economy.

SINGAPORE'S RESPONSE TO COVID-19

The Singapore Government has enacted the ***Covid-19 (Temporary Measures) Act, 2020*** **("the Covid-19 Act")**, which came into effect from 20th April, 2020 and is intended to serve as a "pause button", thereby giving individuals and businesses temporary protection from lawsuits and making it difficult for creditors to initiate winding up petition against debtors. In addition to this, the Singapore Government has adopted a variety of **economic and financial measures** to support businesses, employees and households equivalent to S$92.9 billion aprox – that is, almost 20% of Singapore's Gross Domestic Product. These measures include wage subsidies, cash payouts and Government-supported loans. The combination of these legal and economic measures seek to keep businesses alive or in a "hibernation mode", till the time the global pandemic is over, by aiming to avoid the closure of businesses, layoffs and also reduce the burden on the judicial system that would otherwise had been imposed, had the insolvency processes being allowed to carry on as usual.

COVID-19 (TEMPORARY MEASURES) ACT, 2020

The objective of the Singapore Government, behind enacting the Act, is to protect the most vulnerable actors and sectors during the Covid-19 crisis, namely individuals, households, self-employees, and small and medium-sized enterprises ("**SMEs**"). It is pertinent to note here that SMEs account for nearly 72% of the employment in the Singapore's economy.

The Covid-19 Act serving as a moratorium for inability to perform contracts or "legal circuit breaker", covers only those contractual obligations within its ambit, which are to be performed on or after 1st February, 2020, for contracts entered into or renewed before 25th March, 2020. It is presumed that the parties, entering into contracts after 25th March, 2020, would be aware of the implications of Covid-19 crisis or the global pandemic and hence, such contractual obligations are kept out of the scope of the protections provided under the Covid-19 Act. Further, the Act empowers the Singapore Government to enact relief measures for five broad areas pertaining to leases for commercial or non-residential properties, construction and supply contracts, event and tourism related contracts, hire-purchase and conditional sales agreements, and secured loan agreements to SMEs.

Moreover, the Covid-19 Act will remain in force for a period of six months from the date of coming into effect, which is extendable to one year. The reliefs under the Covid-19 Act do not extend to all those parties in a contract that refuse to perform their contractual obligations but are to be provided to those parties in contracts, who are unable to perform contracts to a material extent due to the Covid-19 crisis and accordingly a notification for relief has been duly served on the counter party. Thereafter, the counterparty must wait till the expiry of the prescribed period to take enforcement action against the other party. This will incentivise the parties in a contract to work together and resolve the disputes, if any. For instance -

- In leases of commercial or non-residential properties, landlords cannot terminate the lease until 19 October 2020, if the tenant is unable to pay rent due to Covid-19 crisis. However, this is effectively a suspension as rent will continue to accrue and become payable after the circuit-breaker ends.
- In construction contracts, contractors have an extension of time to complete their works.

In cases, where there is a dispute between the parties to a contract, pertaining to the fact that the inability to perform the contract to a material extent is not due to the Covid-19 crisis, the dispute will not be adjudicated in court. With a view to streamline the adjudication of disputes and reduce the time involved in

litigation, the Singapore's Ministry of Law has appointed assessors, which will resolve disputes arising from the application of the Covid-19 Act.

Postscript: The Covid-19 Act is amended in early June 2020 to provide further rental relief from SMEs, in the form of co-sharing of the obligation to pay rent among the landlords, the SME tenants and Singapore Government assistance. SME tenants can receive up to 4 months' waiver of rent for commercial properties and up to 2 months' waiver of rental for non-residential properties. Other kinds of enhanced relief are also provided in respect of certain kinds of contract.

CHANGES TO CORPORATE INSOLVENCY LAW

Considering the Covid-19 crisis, there have been certain modifications to the corporate insolvency law of Singapore. The "trigger" or the "threshold" for the creditor to file the winding up petition against the corporate debtor lies on the inability of the corporate debtor to pay debts of a certain amount or the existence of a default. The existence of default is determined on the creditor serving a statutory demand notice to the corporate debtor to pay the requisite debt within 21 days, which if not paid, the creditor then has the right to file a winding up petition against the corporate debtor.

Prior to the enactment of the Covid-19 Act, the threshold of the debts was fixed at S$10,000, which has now been temporarily increased to S$100,000, with the enactment of the Covid-19 Act. Further, the period to pay the debt for the corporate debtor, after the statutory demand notice is served, has now been increased from 21 days to 6 months. These changes are meant to provide a buffer period to the companies facing difficulties during Covid-19 crisis and make it difficult for the creditors to push corporate debtors into insolvencies.

Additionally, the Covid-19 Act has temporary suspended the liability for wrongful trading so long as the new debt has been incurred in the ordinary course of business. However, the liability for fraudulent trading, which involves cases of fraud, remains unchanged.

CONTENTIOUS ISSUES ASSOCIATED WITH THE COVID-19 ACT

There are certain contentious issues associated with enactment of the Covid-19 Act, thereby making it debatable. At the outset, the Covid-19 Act is an unusual piece of legislation, which tries to interfere with the sanctity of the contracts and the expectation of parties in a contract, in a bid to contain or deal with the unprecedented Covid-19 crisis.

Firstly, the Covid-19 Act does not extinguish any claims arising out of contracts, but only suspends the other party's obligation to pay the debt or amount arising out of contract. Further, the relief under the Covid-19 Act is available only if there is an inability to perform obligation on part of a party to a contract and that inability to perform must be to a material extent caused by Covid-19. If there is a dispute pertaining to the determination of the aforesaid condition, then the application of the relief would be contingent on the resolution of the dispute by the assessor. This limits the scope of the relief severely and makes it contentious.

Secondly, rental suspension for commercial property is bound to have an impact on the business of Real Estate Investment Trusts ("**REITs**"), for which rental payments are considered to be a source of stable payouts. REITs had raised this issue before the Singapore Government, to which the Singapore Government replied to stating that a balance has been achieved by only suspending the payment obligations and not fully discharging them. Further, the Singapore Government mentioned that the relief is only limited to those people who satisfy the condition mentioned in the Act i.e. *inability to perform contracts to a material extent caused by the Covid-19*, and not otherwise, and hence, the relief will only be provided if there is causation shown by the respective party.

SIGNIFICANCE OF INSOLVENCY LAW DURING COVID-19 CRISIS IN THE ECONOMY

The fundamental role of an insolvency law is to reduce or minimize the destruction of value generated in a situation of insolvency, through a variety of restructuring tools like moratorium, avoidance actions, priority of rescue financing, restriction of ipso facto clauses, etc. and to efficiently allocate the debtor's assets. If a company is economically viable, this efficient allocation of

assets will take place by keeping the firm alive. For that purpose, insolvency law can be a very useful tool since, in addition to minimizing the destruction of value, provides several mechanisms to facilitate an adjustment of debts. Therefore, companies can emerge from insolvency with a new financial structure which is more suitable to the company's generation of cash-flows. As a result, corporate insolvency law can indeed play a very valuable role in the current situation.

Despite the value and power of insolvency law, there are *certain limitations* associated with the use of insolvency law in the current situation. For example:

a. First, if an insolvency law is not accompanied by an efficient judiciary, debtors can die during a long-drawn court process, what it can be harmful not only for the reorganization of viable businesses but also for the maximization of the returns to creditors. Due to the sophistication and efficiency of the judiciary in Singapore, this is not a problem. However, the lack of an efficient judicial system is a critical issue for many jurisdictions around the world, particularly for emerging economies.
b. The Covid-19 crisis may lead to a wave of insolvency cases that the judicial system may not have the capacity to absorb. For these reasons, some measures need to be implemented to minimize the use of the judicial system (e.g., promotion of out of court restructurings), or to allocate more resources to the judiciary. For example, in the United States of America ("**USA**"), a group of insolvency law experts have written to the US Congress, requesting them to appoint more bankruptcy judges in the US so as to aptly handle the rise in the number of insolvency cases.
c. Insolvency law in many jurisdictions may not be suitable for small businesses. For this reason, some of the extraordinary measures adopted in the COVID-19 Act have focused on SMEs, and some countries (e.g., Colombia) have even adopted special insolvency rules for SMEs as a response to the COVID-19 crisis.

COMPARISON OF SINGAPORE INSOLVENCY LAW REFORMS WITH OTHER JURISDICTIONS DURING COVID-19

In terms of insolvency law reforms during Covid-19 crisis, it is significant to compare and take guidance from other jurisdictions' reforms. Notwithstanding the different legal and corporate systems in different jurisdictions, there have been certain common corporate insolvency law responses adopted around the world, which include –

a. Creditors' rights to initiate insolvency proceedings have been suspended or restricted in many jurisdictions. Countries temporary suspending this right include Spain and Italy, and those restricting creditors' rights include Singapore and, to a lesser extent, Australia.
b. In many European countries, corporate directors are required to initiate an insolvency proceeding once a company becomes insolvent. This obligation to initiate insolvency proceedings has been temporarily suspended in many countries, including Germany, France, and Spain. This reform does not apply to Singapore, where corporate directors are not required to initiate insolvency proceedings once the company becomes insolvent.
c. Some countries, including Singapore and the Czech Republic, have temporary suspended the running of the lookback period for avoidance actions, at least while the debtor is subject to a type of 'pre-insolvency moratorium' (like in Singapore) or not subject to the duty to initiate insolvency proceeding (like in the Czech Republic).
d. Some countries (e.g., Colombia) have implemented various measures to implement rescue financing for companies subject to an insolvency proceeding. In Singapore, the adoption of this measure does not apply since the insolvency legislation in Singapore already has provisions to facilitate rescue financing. They were adopted in the package of insolvency reforms implemented in 2017 with the purpose of enhancing Singapore's attractiveness as an international hub for debt restructuring. It will remain to be seen, however, how these provisions will be interpreted during the pandemic. In the US, where a similar system of rescue (DIP) financing exists, some authors have advocated for relaxing the conditions to use this financing available to companies subject to an insolvency proceeding.
e. Some countries have also implemented insolvency special rules for small companies (e.g., Colombia). Singapore has also adopted various legal

measures mainly focused on SMEs, although they are not part of the temporary changes to the insolvency legislation. Instead, these measures seek to support SMEs outside of formal insolvency proceedings.

f. Some countries have also adopted new measures to reduce the timing associated with duration and commencement of insolvency proceedings (e.g., Colombia), or have increase the use of electronic communications for insolvency proceedings (e.g., Singapore).
g. In many countries, particularly in Continental Europe and Latin America, shareholder loans are subordinated in insolvency proceedings. Many countries, including Italy, Germany, Colombia, Spain have temporarily suspended this subordination. Thus, they can encourage shareholders to provide new financing to companies affected by the COVID-19 crisis. This provision does not apply in Singapore.
h. In some countries (e.g., India), the debtor's right to initiate insolvency proceedings has been temporarily suspended. In my view, while this is an extreme measure , it could be desirable if: (i) the judicial system is not well-equipped to handle the wave of corporate insolvencies and the government cannot provide new resources to the judicial system; and (ii) some pre-insolvency mechanisms are put in place to support businesses and out-of-court restructuring.

In addition to these measures, many countries around the world, including Singapore, have encouraged workouts or out-of-courts restructurings, and have also adopted a form of pre-insolvency moratorium. In countries requiring corporate directors to 'recapitalize or liquidate' the firm if the company's assets fall bellows a certain percentage of the company's legal capital, this rule – mainly existing in Continental Europe and Latin America- has been temporarily suspended. Countries suspending this rule include Spain, Colombia and Italy.

CONCLUSION

Even though insolvency law can be a valuable tool in the current situation, it is not the panacea. Therefore, any serious attempt to support business in the

current situation should comprise a combination of legal, economic and financial responses. Furthermore, due to the limitations of insolvency law, Governments should also incentivize the use of workouts and pre-insolvency proceedings. First, this solution is less costly for small businesses. Second, a cooperative solution outside of the formal insolvency system is easier to achieve in companies with a few creditors and simple capital structures. Third, promoting these out-of-court solutions can also avoid the harmful effects on the judicial system created by a wave of insolvency cases.

The Singapore's legal and economic response to the COVID-19 crisis has been one of the most ambitious and comprehensive ones observed internationally. Therefore, while it is still early to judge the effects of the response, we believe that it will significantly help minimize the harmful economic effects of the COVID-19 crisis.

Questions & Answers

Q1. Whether there can be a mechanism to facilitate cross-border restructuring of corporations during Covid-19?

A1. Preservation and priority to local interests of a country has been one of the major focuses of the insolvency law, which has, in turn, been one of the major impediments to unifying the substantive insolvency laws of various countries. Further, the countries need to incorporate provisions in their insolvency law, recognizing the foreign insolvency proceedings. The compliance with the provisions of UNCITRAL Model Law on Cross-Border Insolvency will have to be looked into, in this regard. Many jurisdictions have adopted a modified universalistic approach toward cross-border insolvency, according to which they will pay due regard to the insolvency proceedings of a corporation where its centre of main interests lie.

Q2. What will be the way forward with regard to the "super priority financing" or the Debtor-in-possession ("**DIP**") financing mechanism, as has been recently applied by the Singapore courts, post rejecting it several times?

A2. The DIP financing mechanism is very essential for a successful restructuring of the corporate debtor. Usually termed as rescue financing in Singapore, it refers to new financing of corporate debtors, once it is subject to insolvency proceedings. Owing to the concentrated shareholder structure in corporations in Singapore, corporations usually turn to the controlling shareholders for financing, when they are in distress. When the controlling shareholders are not willing to do the same, they approach the creditors, who require some incentive, before consenting to financing the corporation in distress, which takes the form of DIP financing mechanism. Under this mechanism, the new lenders enjoy a super priority. Thus, they will have more incentives to finance companies subject to insolvency proceedings.

Due to the perils associated with interpreting rescue financing provisions very generously, Singapore has adopted a very restrictive approach. However, there are already several cases authorizing rescue financing whenever this financing can create or preserve value and affected parties are properly protected. It will remain to be see how the current situation affects, if so, to the interpretation of the existing rules for rescue financing in Singapore.

Q3. Can insolvency law help in avoiding hostile takeovers in Covid-19 circumstances?

A3. In Singapore, owing to the concentrated shareholder structure in companies, hostile takeovers are rare. If a company is not undergoing insolvency proceedings, there are various measures that have been adopted by jurisdictions to avoid hostile takeovers, like poison pills, restriction of foreign investments, etc. However, if a company is undergoing insolvency proceedings, then the situation of avoiding hostile takeovers is unprecedented and might involve a balancing of various competing interests, like interests of providing liquidity for creditors/ debtors and other stakeholders and opportunistic behavior on part of investors, etc.

Q4. The Indian government is mulling on reforms to introduce pre-pack in the insolvency framework, during a time when both the creditor and debtor initiation rights of insolvency have been suspended. How will the stakeholders be prepared to deal with pre-pack?

A4. The connotations attached to pre-pack are different for different jurisdictions. Usually, pre-packs are meant to abridge the time involved in formal insolvency proceedings, provided that the requisite percentage of creditors would agree. In Singapore, pre-packs are common in companies with fewer creditors as it is more convenient to obtain the requisite percentage of majority to approve them. Pre-packs are controversial in the UK, because of the issue of phoenixism, wherein the corporate debtors are sold back to its controlling shareholders at a fairly low price. In the US, specifically in terms of Chapter 11 proceedings,[2] a pre-pack refers to an agreement amongst the creditors, prior to filing of bankruptcy proceedings, ensuring the expeditious completion of insolvency proceedings. As far as India is concerned, considering the fact that all forms of initiation of insolvency proceedings have been suspended, some simple reforms, as opposed to a completely new pre-pack, are required to supplement such suspension, like lowering the threshold of the percentage of creditor approval, which will not only promote debt restructuring but also ensure the requisite preparedness of the stakeholders involved to absorb such changes.

Q5. Is the suspension of the insolvency proceedings in India an appropriate measure, considering the fact that there were already a lot of companies which were highly leveraged?

A5. In my view, this extreme measure only makes sense (if so) if: (i) the judicial system is not well-equipped to handle the wave of corporate insolvencies and the government cannot provide new resources to the judicial system; and (ii) some pre-insolvency mechanisms are put in place to support businesses and out-of-court restructuring. Otherwise, suspending debtors' rights to initiate insolvency proceeding can do more harm than good for several reasons. First, viable companies will be unable to enjoy the protections and valuable tools provided by

[2] United States Bankruptcy Code, 1978, Chapter 11.

insolvency law. Second, insolvency law also plays a very important role *ex ante*. Thus, it affect the way debtors and creditors bargain. Therefore, abolishing the facto insolvency rules undermines the ability of insolvency law to facilitate *ex ante* bargaining. Third, if creditors can still enforce their claims, the suspension of debtors' rights to initiate insolvency proceeding not only can destroy economically viable businesses, but it can also be harmful for the creditors as a whole a result of the destruction of going concern value. Finally, this measure can just postpone the inevitable: a wave of insolvency cases. Therefore, many companies will end up initiating insolvency proceeding, from the perspective of the capacity of judicial system, it would seem more desirable to allow companies to file for insolvency during the pandemic. Otherwise, there will be a massive wave of insolvency cases once debtors are allowed to initiate insolvency proceeding again. And if so, courts may not have the capacity to handle this exponential increase in the number of insolvency cases.

Q6. Is the scrutiny of 'Avoidance Transactions' obfuscated during the Covid-19 circumstances?

A6. Singapore has in place a very strong system to control opportunistic behaviors in the 'zone of insolvency'. One of them is the existence of avoidance actions, which allows the reversal of certain harmful transactions entered into by the debtor once it is financially distressed but not still subject to a formal insolvency proceeding. The running of the lookback period to avoid these transactions has been suspended for debtors asking for the 'moratorium' provided under the Covid-19 Act.

Q7. How is Singapore's law geared up to resolve complex multinationals like airlines during Covid-19 circumstances?

A7. Singapore's insolvency law underwent a significant change in 2017, in terms of the availability of restructuring tools, in order to make Singapore a restructuring hub for multinational corporations. Even though the impact of Covid-19 circumstances remains to be seen, the presence of new restructuring tools like an enhanced moratorium not only putting a stay on the action against

the corporate debtor but also against certain companies within a corporate group, availability of rescue financing, etc. are expected to play a major role to support multinational companies seeking to restructure their debts in Singapore.

Q7. How will the insolvency law cope up with the transition in the consumer behavior and commercial practices towards digital platforms and the subsequent inability of other enterprises (solely brick and mortar stores) to regain the market share post Covid-19?

A7. The unusual Covid-19 circumstances are going to be a challenge for the jurisdictions' legislators to adjust the law optimally. So it is interesting to see the kind of changes and permanent changes, if any, would be made not only to the insolvency statute but also to the insolvency rules to suit the gradual change in the economy.

Q8. Would there be any permanent changes to the insolvency laws of various countries?

A8. The current situation is making us think twice about the design of our insolvency laws. Therefore, even if many countries are changing their insolvency legislations for a limited period of time, some of these changes may become permanent. At this stage, it is difficult to say which ones. I would probably say the implementation of special rules for SMEs as well rules the adoption of pre-insolvency proceedings.