WHEN WILL SUPER PRIORITY BE ACCORDED FOR RESCUE FINANCING?

The Singapore High Court's first decision on the new rescue financing provisions in the Companies Act (Cap. 50) provides useful guidance on when super priority status will be granted to new money financing

Key issues

- There is nothing preventing a rescue financier from stipulating conditions to the grant of rescue financing.
- The proposed financing can take the form of additional financing from an existing creditor, and it can even be premised on a prior obligation, so long as the injection of new monies *is at the option of the creditor, without the creditor being contractually bound to do so*.
- In order for rescue financing to be accorded any level of super priority, it is important that credible evidence be shown of reasonable efforts made to secure alternative financing on a normal basis.

Introduction

In the recent decision of the Singapore High Court in *Re: Attilan Group Ltd* [2017] SGHC 283 (Re Attilan), the Singapore High Court (per the Honourable Aedit Abdullah J) dismissed the applicant company's application for, among other things, super priority to be granted in respect of rescue financing sought to be obtained under the recently introduced s 211E of the Companies Act (Cap 50) (Companies Act).

While the Court declined to grant super priority on the facts of *Re Attilan*, the case is instructive as to the approach the Court will likely adopt in deciding whether to accord super priority status pursuant to s 211E of the Companies Act.

Executive Summary

The case of *Re Attilan* illustrates that given the grant of super priority entails a disruption to the established order of priority for creditors in an insolvency, the Court will require credible evidence to be shown of reasonable efforts to source for other less disruptive forms of financing, before super priority is granted.

It is likely that the higher the level of priority sought for the new financing provided, the more closely the Court will scrutinise these efforts.

It is, therefore, critical for rescue financiers and distressed companies to be aware of the necessary pre-requisites for the grant of super priority, for *e.g.* the need to show reasonable efforts at obtaining regular financing, and take the necessary steps to document this.

In this regard, some degree of forward planning and professional advice will certainly be helpful to ensure that super priority will ultimately be granted by the Court.

S 211E of the Companies Act – the Rescue Finance Provision

Under the amendments made the Companies Act earlier this year, where a company has applied to convene a meeting for the purposes of a scheme of

arrangement, or for a scheme moratorium, the company may apply for an order that the debt arising from any "*rescue finance*" be accorded four varying levels of priority:

- Treated as part of the costs and expenses of the winding up and, therefore, as a preferential debt payable in priority to all unsecured creditors
- Priority over all preferential debts and unsecured creditors
- Security given on property of the company that is either not subject to any security interest, or a subordinate security interest on property subject to an existing security interest
- Security given on property of the company that is equivalent in priority, or of higher priority, to an existing security interest

In the case of *Re Attilan*, the applicant company sought leave to convene a creditors' meeting to consider a proposed scheme of arrangement, as well as the grant of super priority status in respect of *future advances* to be provided by a fund, the Advance Opportunities Fund (AOF), pursuant to a pre-existing subscription agreement for certain structured convertible notes.

The Approach

US Chapter 11 jurisprudence is likely to provide guidance

The Court began its analysis by noting generally that as the concept of super priority status for rescue financing is alien to English Companies law-based regimes, and given s 211E of the Companies Act was inspired by the relevant provisions in the US Chapter 11 regime, US authorities and doctrine would be "*helpful*" and "*illuminating*" as the local jurisprudence develops in this area.

What is "Rescue Financing"?

Under s 211E(9) of the Companies Act, "*rescue financing*" is defined to mean financing that satisfies one or both of the following conditions:

- Financing necessary for the survival of the company, or the whole or any part of the undertaking of the company, as a going concern
- Financing necessary to achieve a more advantageous realisation of the assets of a company that obtains the financing, than on a winding up

There can be pre-conditions stipulated to the grant of rescue finance

In *Re Attilan*, an argument was put forth that as the offer of finance for AOF was subject to pre-conditions, it did not qualify as "*rescue financing*".

This was rejected by the Court. The Court found that the decision as to whether to extend financing and on what terms is ultimately a matter for commercial consideration, and *there is nothing in s 211E(9) that prohibits a rescue financier from stipulating pre-conditions in the grant of its rescue finance*.

Whether funds extended pursuant to a prior agreement can qualify as Rescue Financing?

As the rescue financier, AOF, in *Re Attilan* was party to a pre-existing subscription agreement for certain structured convertible notes with the applicant company, the question also arose as to whether "*rescue financing*" can be in the form of a proposed additional financing by an *existing* creditor.

The Court held that it is not in principle necessary for the proposed financing to be entirely new to qualify as rescue financing; it can be additional financing from an existing creditor, and it can even be premised on a prior obligation.

So long as the injection of new monies *is at the option of the creditor, without the creditor being contractually bound to do so*, then the new monies can be accorded super priority status if the relevant conditions are met. The Court held that this is consistent with the legislative purpose of encouraging creditors to provide additional financing for distressed companies.

On the facts of the case, the Court found that as an event of default had arisen under the pre-existing subscription agreement between AOF and the applicant company, AOF was entitled to regard its obligations as terminated, and any further extension of funds by AOF to the applicant company would be additional funding that can constitute rescue financing.

When will "Rescue Finance" be treated as part of the costs and expenses of winding up?

S 211E(1)(a) of the Companies Act is the applicable provision governing the conferring of administrative expense status to rescue financing (*i.e.* for the rescue finance to be treated as part of the costs and expenses of winding up).

Unlike the provisions that apply to the granting of higher levels of priority, s 211E(1)(a) itself does not lay down any express requirements that must be satisfied before this level of priority is granted.

However, the Court in *Re Attilan* found that while it is not an *express* condition that it has to be shown that financing would not have been available but for the grant of super priority, *the applicant company is still obliged to "adduce some evidence of reasonable attempts at trying to secure financing on a normal basis, i.e., without any super priority*".

The Court held that this is consistent with the US position, and is one of the factors the Court will consider in exercising its discretion to grant this level of priority. The Court noted that it would not be fair and reasonable to upset the established order of priorities on winding up otherwise.

The Court acknowledged that it is open to an applicant company to argue that there is no need to demonstrate unavailability of regular financing where the circumstances reasonably dictate that such efforts would be to no avail.

However, on the facts of *Re Attilan*, the Court said that even if this had been argued the applicant had not shown that it was in objectively such an abysmal financial health that no financial aid could have been reasonably received without any offer of super priority.

When will "Rescue Finance" be given priority over all preferential and unsecured debts?

S 211E(1)(b) expressly provides that rescue finance can only be granted priority over all preferential and unsecured debts *provided that the company would not have been able to secure the rescue financing unless such priority is given*.

Specifically, the Court held that the applicant company "*must demonstrate that reasonable efforts have been undertaken to explore other types of financing that did not entail such a priority, i.e., financing that did not entail priority over all preferential debts…and all other unsecured debts*."

The Court found that the applicant company failed to meet this material condition.

On the facts of *Re Attilan*, the applicant had only made a purported request for rescue financing to one of its creditors (Philip Asia), which took place 11 days before the hearing.

Tellingly, the approach to Philip Asia was made only *after* the application to Court for super priority was made. Further, the approach to this creditor for financing was only on super priority terms, and not on the normal basis – and thus cannot amount to reasonable effort to explore financing other than on a super priority basis.

Accordingly, the Court found that the applicant company could not back up its claim that it had undertook reasonable efforts to source for regular financing with any credible evidence.

As to what constitutes "*credible evidence*", the Court said some evidence should have been deposed to show that alternative sources of financing were sought but rejected. This would include correspondence relating to rejection or negotiation with other financial institutions or possible rescuers. That said, this does not mean that the applicant company must show that it had sought credit from "*every possible source*" – it is a matter for the court's discretion as to what constitutes reasonable effort. However, the Court emphasised that "*mere unsubstantiated assertions cut no ice*".

The standard of proof and quality of evidence required to satisfy the requirement of reasonable efforts to source for alternative funding

The Court clarified that while the Companies Act is silent on this, the standard of proof applicable is that the court must be sufficiently satisfied on a balance of probabilities that the relevant requirements for the grant of super priority are satisfied.

However, the Court highlighted that it is not necessary to set a high threshold for the evidence. All that is required is that there is a minimum level of satisfaction, *i.e.* there is credible evidence before the court which, on the face of it, supports what is being sought.

Conclusion

While the Court did not grant the application for super priority to be accorded in *Re Attilan*, the decision of the Court provides useful guidance as to the approach the Court will take in deciding such applications.

The decision indicates that the Singapore Court is fully cognisant of the legislative policy of encouraging creditors to provide additional financing for troubled distressed companies, and will, in appropriate cases, grant super priority status to rescue finance.

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