The Conchubar Split—A Scheme Split Apart by the Court on Grounds of Suspected Vote Splitting

Following the seminal case of *The Royal Bank of Scotland NV (formerly known as ABN Amro Bank NV) and others v TT International Ltd and another appeal* [2012] 2 SLR 213 ("***TT International***") concerning the sanction of schemes of arrangements, the Court of Appeal has, in the case of *SK Engineering & Construction Co Ltd v Conchubar Aromatics Ltd and another appeal* [2017] SGCA 51 ("***Conchubar***"), not only clarified the guiding factors that could go towards establishing the existence of a relationship between a creditor and a scheme company but has suggested that the position in *TT International* of applying a partial discount to related creditor votes should be departed from in favour of a more certain approach of discounting such votes in full.

Further, the Court of Appeal held that the existence of vote-splitting in relation to creditors' schemes of arrangements was a relevant concern in a judge's exercise of discretion in sanctioning a scheme and could potentially result in the non-sanction of a scheme even if the statutory numerical requirements have been met.

Relevant Facts

Conchubar arose from two appeals against the High Court's decision in *Re Conchubar Aromatics Ltd and another matter* [2017] 3 SLR 748 sanctioning two schemes of arrangements (the "**Schemes**", each a "**Scheme**") proposed by Conchubar Aromatics Ltd ("**Conchubar**") and UVM Investment Corporation ("**UVM**"). The appeals were made by SK Engineering & Construction Co Ltd ("**SKEC**"), the only creditor of Conchubar and UVM that voted against the Schemes at the relevant creditors meetings.

The Schemes were proposed as a result of the financial difficulties faced by Jurong Aromatics Corporation ("**JAC**") which Conchubar and UVM each held shares in. JAC had been incorporated as a joint venture vehicle to own and operate an integrated condensate splitter and aromatics complex on Jurong Island (the "**JAC Project**") but subsequently ran into substantial financial difficulties and went into receivership. As their shareholding in JAC were their primary assets, Conchubar and UVM also found themselves in financial difficulties.

In order to preserve the JAC project, Jurong Energy International Pte Ltd ("**JEI**") was incorporated and a restructuring proposal involving JEI was submitted to the receivers and managers of JAC ("**Restructuring Proposal**"). The Restructuring Proposal provided, amongst other things, that JEI would inject funds into JAC in exchange for a 60% equity interest in JAC. The injection of funds would then allow JAC to repay its debt owed to a syndicate of secured lenders who held charges over 95% of JAC's shares.

Each of Conchubar and UVM then proposed the Schemes (in substantially identical terms) to their respective creditors. Broadly, each Scheme provided that:

(a) The scheme company would sell its shareholding in JAC to JEI in exchange for shares or convertible bonds in JEI of greater or equal value to the scheme company's stake in JAC;
(b) within 30 days after the completion of the sale and purchase of the shares in JAC by JEI, the scheme company would distribute the JEI shares or convertible bonds to its creditors *pari passu*; and
(c) in the event that the receivers and managers of JAC rejected the Restructuring Proposal or if one year had passed from the commencement of the Schemes, whichever earlier, the scheme company would have to make certain failsafe payments to its creditors and would have the option to propose a new scheme.

TT International criteria for the sanction of schemes

The seminal Court of Appeal decision of *TT International Ltd* had set out the conditions (reproduced in full below) that must be satisfied before a court can sanction a scheme of arrangement:

(a) The court must be satisfied that the statutory provisions have been complied with. For example, the court must be satisfied that the resolution is passed by the requisite statutory majority at a meeting of the company's creditors or members (as the case may be) duly convened and held in accordance with the court order convening the meeting.
(b) The court must be satisfied that those who attended the meeting were fairly representative of the class of creditors or the class of members (where applicable), and that the statutory majority did not coerce the minority in order to promote interests adverse to those of the class whom the statutory majority purported to represent. In relation to UVM.
(c) The court must be satisfied that the scheme is one which a man of business or an intelligent and honest man, being a member of the class concerned and acting in respect of his interest, would reasonably approve.

(*TT International* at para. 70)

Additionally, as regards related party creditors, the Court of Appeal had held that the votes of wholly-owned subsidiaries should be discounted to zero on the basis that wholly-owned subsidiaries are entirely controlled by their parent company and the parent company can elect to wind up such wholly-owned subsidiaries and thereby extinguish all debts owed to such subsidiaries.

As regards other related party creditors who are not wholly-owned subsidiaries of the company to be subject to the scheme of arrangement, the Court of Appeal opined that a partial discount should be applied to votes of such related creditors.

The High Court Decision

At the sanction proceedings before the High Court, SKEC sought to wholly discount the votes of all the other creditors who had voted in favour of the Schemes on the basis that they were related to the scheme companies. However, the High Court declined to do so and instead took the view that any discount to be applied was not to exceed 25% of the value of the debt owed to such creditor.

The High Court also found that such discount did not "sufficiently tilt the balance" and the requisite statutory majority for approval of schemes of arrangements was still met. Accordingly, the Schemes were sanctioned and the scheme companies granted a one year moratorium under s.210(10) of the Companies Act.

SKEC appealed against the whole of the judgment of the High Court and contended, *inter alia*, that the High Court should have applied a higher discount rate to the related creditors.

Who is a related creditor

While the Court of Appeal opined that given the fact sensitive nature in determination of whether one is a related creditor, it would not be possible or appropriate to give exhaustive guidance on the definition of a related creditor, it provided a non-exhaustive list of factors that could go towards establishing a relationship between a creditor and a scheme company:

"(a) The scheme company controls the creditor or vice versa. Alternatively, the scheme company and the creditor have a common controlling shareholder, ie, a shareholder who owns (directly or indirectly) 50% or more of the shares in each of these companies.

(b) The creditor and the scheme company have common shareholder(s) who hold a less than 50% but more than *de minimis* stake in both companies. In this regard, what would be considered *de minimis* would depend on the facts; for instance, the threshold would be higher in the case of a public listed company as opposed to a private company.

(c) The creditor and the scheme company have common director(s), in particular, director(s) who propose or support the scheme.

(d) The scheme company and the creditor do not have any common shareholder(s), but their controlling shareholder(s) are either: (i) related by blood, adoption or marriage; or (ii) where the controlling shareholder(s) are corporate entities, in turn controlled by individual(s) who are related by blood, adoption or marriage.

(e) The creditor is related by blood, adoption or marriage to the controlling shareholder(s) or director(s) of the scheme company."

(at para. 41 of this appeal)

Statutory declaration may overturn inference of relatedness

The Court of Appeal opined that if any one or more of the aforesaid factors are present, then a court could infer that a creditor had sufficient personal or special interest to be classified as a related creditor. However, it would still be open to such a creditor or the scheme company to adduce evidence to prove that their interests are not aligned.

Consequently, the Court of Appeal held that as regards one of the allegedly related creditors of Conchubar (which was wholly owned by the same parent company with Conchubar and shared a common director with the same), the statutory declarations made by (i) the ultimate beneficial owners of Conchubar and said creditor directly contradicting the conclusion of the relatedness of the creditor and Conchubar and (ii) the common director that he is merely a proxy director were sufficient to overturn the *prima facie* conclusion of the creditor being related.

Assignee of debts not related creditors

The Court of Appeal also held that an assignee-creditor would not be treated as a related creditor on the sole basis that the assignment of debt to it was not made at arm's length. Instead, it noted that the status of being a related creditor would depend on the factual analysis of that creditor's connection with the scheme company and not the claim against the debtor.

On the facts, the Court of Appeal found that contrary to the High Court's findings, none of the creditors that SKEC argued to be related creditors were in fact related.

Reservations against partial discounts

While no longer an issue to be determined given the factual conclusion that the creditors were not related, the Court of Appeal expressed strong reservations against the application of a partial discount to related creditors who are not wholly-owned subsidiaries of the scheme company, as done in *TT International*. It noted that the application of a partial discount had no parallel in any other jurisdiction and that the determination of an appropriate partial discount would be "arbitrary, subjective and not amendable to definitive guidance".

Instead, the Court of Appeal considered that it would be "more principled and certain" to simply wholly discount the votes of creditors once they are found to be related, stating simply that "*if the position of a creditor is in any way tainted, it should follow that that creditor's votes on the scheme should be entirely disregarded*".

While the Court of Appeal had made these comments obiter, given the firm language of the remarks, it does seem likely that the approach of discounting the entirety of related creditor votes will be part of Singapore's legal landscape in future. However, it remains to be seen how such a strict approach will be applied in practice given that this would effectively mean that shareholders who had previously extended loans to a company would have no say in the restructuring of its debts in a scheme of arrangement. Since shareholder loans are typically a distressed company's first line of rescue financing, this would be a hard pill to swallow for many shareholders who have already extended rescue financing and would likely pose additional hurdles in future restructurings.

Vote splitting in schemes of arrangements

The Court of Appeal observed that there has been a phenomenon of vote-splitting in the context of shareholders' schemes of arrangements where shareholders who do not form the requisite majority but represent more than three-fourths in value of the shareholders give away shares to parties who are willing to vote in line with them so as to achieve the requisite majority to pass the scheme. The Court of Appeal also considered that vote-splitting could occur in creditors' scheme of arrangements by way of assignment of debts. To this end, the Court of Appeal took the view that such arrangements would engage the concern in *TT International* of whether "those who attended the meeting were fairly representative of the class of creditors or the class of members (where applicable)" and held that even where the statutory majority and value requirements were met, the court could elect not to sanction the scheme where a vote splitting arrangement rendered the votes not reflective of the interest of the class of shareholders or creditors concerned.

On the facts, while the timing of the assignments (roughly a year before the Schemes were in serious contemplation) were found to be relatively innocuous, the Court of Appeal held that there was insufficient proof that the creditors to whom receivables were assigned were owned genuine debts from the relevant assignor. Accordingly, the Court of Appeal held that the High Court had erred in sanctioning the Schemes.

In other words, based on this appeal, assignments for the purpose of vote splitting would be scrutinised and such assignments may result in the relevant scheme not being sanctioned. Creditors trading in the secondary market and in distressed debt should be more careful to ensure that there is sufficient paper trail to prove that the assignments were genuine and at arm's length, or simply obtain an audited confirmation (which will likely be accepted by the court).

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