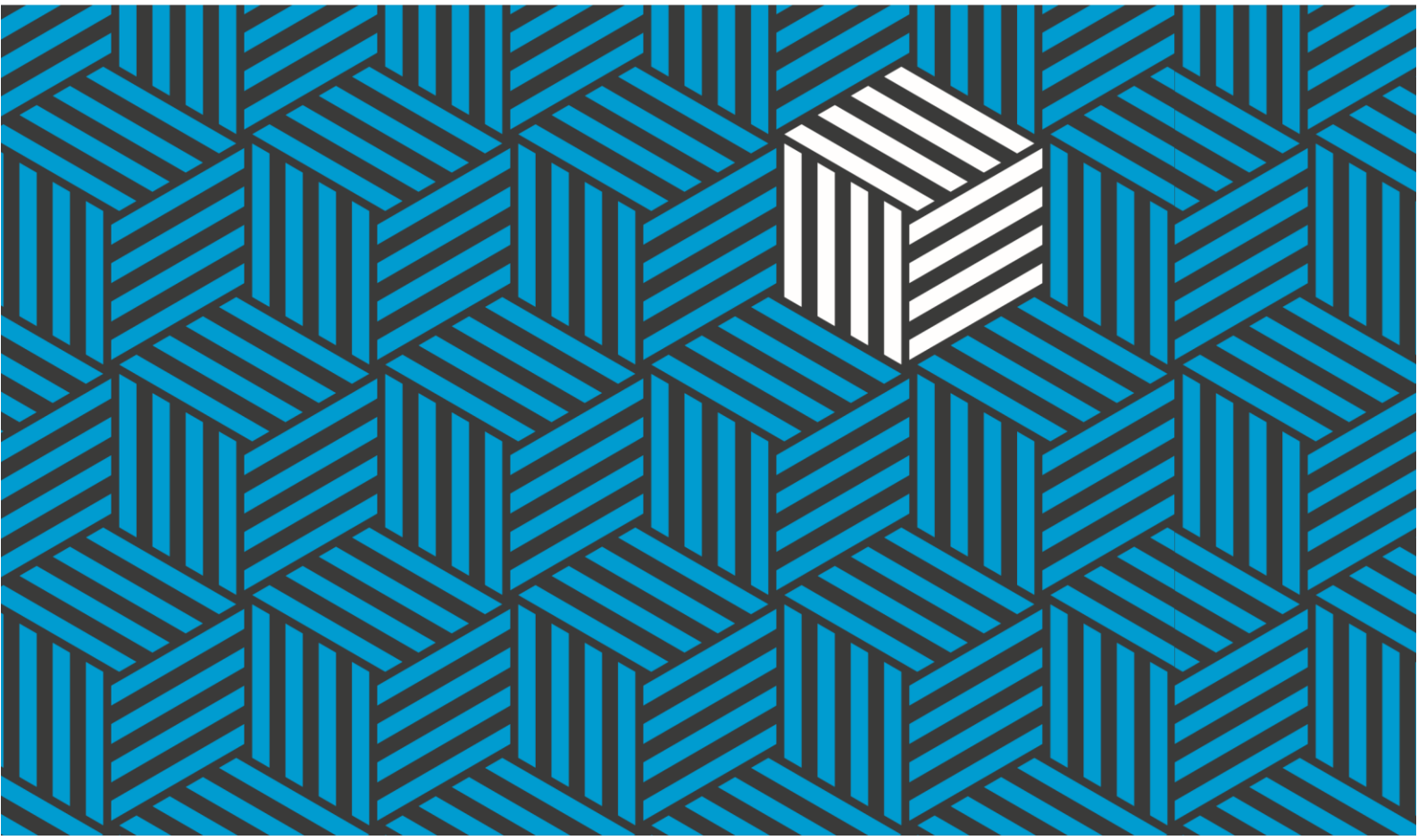
Singapore Academy of Law
Law Reform Committee

Report on Bond Restructuring

March 2023



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An electronic copy of this report may be accessed from the Singapore Academy of Law website: *https://www.sal.org.sg/Resources-Tools/Law-Reform*.

About the Law Reform Committee

The Law Reform Committee of the Singapore Academy of Law makes recommendations to the authorities on the need for legislation in any particular area or subject of the law. In addition, the Subcommittee reviews any legislation before Parliament and makes recommendations for amendments to legislation (if any) and for carrying out law reform.

Comments and feedback on this report should be addressed to:

Law Reform Committee
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EXECUTIVE SUMMARY

A. OVERVIEW

1. The bond restructuring Subcommittee (the "**Subcommittee**") of the Law Reform Committee of the Singapore Academy of Law comprises individuals of diverse backgrounds representing different stakeholders in a bond restructuring context:

   (a) trustees;

   (b) Securities Investors Association (Singapore) ("**SIAS**") (*i.e.*, the body representing individual investors);

   (c) institutional investors;

   (d) lawyers practicing in bond origination; and

   (e) restructuring and insolvency lawyers.

2. The Subcommittee first determined a list of key issues that commonly arise in bond restructuring contexts, and identified the following areas for possible reform:

   (a) the formation and co-ordination amongst creditor committees;

   (b) dealing with material non-public information ("**MNPI**");

   (c) the roles of trustees;

   (d) beneficial bondholders' direct enforcement rights; and

   (e) voting structures in the context of a bond restructuring.

B. RECOMMENDATIONS

3. As regards the coordination of creditors and formation of ad hoc committees, the Subcommittee generally does not recommend any legislative reforms. However, the Subcommittee is of the view that it may be beneficial to introduce a legislative framework to assist with the recognition of an ad hoc committee's authority and representation. This would include a provision in substantially the same form as Section 201(1)(a) of the Insolvency, Restructuring and Dissolution Act 2018 ("**IRDA**") to be included in the IRDA for schemes of arrangement and judicial management.

4. In relation to the treatment of restructuring and committee costs, the Subcommittee considers that there are two possible proposals, aside from best market practices:

(a) To consider if it would be appropriate for sections 67 and 101 of the IRDA, regarding super priority, to be utilised by the Singapore Courts to confer priority to supporting stakeholders who fund such costs out of their own pocket; or

(b) For any Court orders to recognise the contractual priority that a trustee has under the relevant contractual documentation and any order to remunerate the ad hoc committee will be subject to such contractual priority.

5. In respect of the handling of MNPI, the Subcommittee's position is for autonomy to prevail whilst allowing the Courts to intervene where necessary to facilitate the resolution of any commercial roadblocks in the restructuring of a company. Accordingly, the Subcommittee has made the following recommendations in both the context of schemes of arrangement and judicial management:

(a) drafting new legislation to be built into section 64 and section 107 of the IRDA respectively, that specifically deals with MNPI in restructuring – this includes allowing the Singapore Courts to order debtor companies to cleanse MNPI;

(b) giving the Singapore Courts the power to furnish orders similar to "comfort orders" granted in the United States of America (the "**USA**"); and / or

(c) legislature to consider granting the Singapore Courts extended powers in a summary process to make directions and / or advisory orders, so that the Singapore Courts can make directions / advisory orders on, amongst others, whether the non-public information would possibly be deemed MNPI.

6. The Subcommittee sees merit in creating a supplementary statutory route for bondholders, together representing a material proportion of the bonds in issue, in a default scenario to apply to Court to replace the incumbent trustee. To ensure that such a right is not opened to abuse, the Subcommittee proposes, amongst others, that the Singapore Courts consider the following non-exhaustive factors:

(a) the conduct of the applicant bondholder(s), including in particular whether, before making the application, they have first sought to use any mechanisms available under the trust deed to replace a trustee, and/or made reasonable efforts to resolve any disagreement with the trustee without recourse to the courts;

(b) related thereto, whether the trustee (in its "personal' capacity", rather than in its capacity as representative of all the bondholders) supports or opposes its replacement;

(c) the views (if known) of non-applicant bondholders regarding the proposed replacement;

(d) the extent to which the applicant bondholders comprise (or represent) a representative sample of the different types or classes of bondholders in the issue (e.g., including both "institutional" and "individual" investors, and/or the holders of several different classes of bonds), and/or whether the applicants include or represent bondholders who have separate interests (e.g., also as a shareholder of the Issuer); and

(e) the identity of the proposed replacement trustee, in particular whether that trustee (i) has the track record and demonstrated financial standing to carry out the role of trustee effectively, and (ii) is free of conflicts of interest in relation to that role.

7. With regard to the enforcement rights of bondholders, the Subcommittee does not see the need for any urgent legislative reform of the existing statutory regime.

8. Finally, on the issue of who should exercise the bondholder's voting rights in a scheme of arrangement or a judicial management, the Subcommittee does not propose any legislative reform but recommends the adoption of global best practices.

CHAPTER 1

ISSUES IN BOND RESTRUCTURING

A. NEED FOR REFORM

1.1 Unlike most other jurisdictions, there is a relatively high proportion of individual investors[1] in Singapore's bond market. This presents a unique set of problems in the bond restructuring context.

1.2 Pertinent issues include the co-ordination among the many individual investors and their representation in restructuring negotiations.

1.3 Aside from such distinct issues, Singapore continues to grapple with and navigate the complexities of bond restructuring. For instance, there is little guidance on how material non-public information should be dealt with, or clarity as to who ultimately exercises voting rights.

1.4 More structure and a clear framework are also required in relation to the roles of trustees – their duties, rights and liabilities.

1.5 At present, much is left to market. Consequently, the terms of the bond instruments are largely favourable to the bond issuer (the "**Issuer**") and there is no fair level playing field between the different investors.

B. COMMITTEE'S APPROACH

1.6 The Subcommittee reviewed market practices relating to bond restructuring contexts and legislation in leading foreign jurisdictions were then explored and considered. The foreign jurisdictions focused on were the USA, United Kingdom (the "**UK**"), Australia and Hong Kong given their developed bond market and common law background.

1.7 Finally, the Subcommittee identified areas from the foreign jurisdictions that could be adapted as recommendations for the reform of Singapore's bond restructuring laws.

1.8 Ultimately, the Subcommittee was of the view that an incremental approach should be adopted. As such, less legislative amendments were recommended and more best practices were suggested.

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[1] In this Report, the Subcommittee refers to both (1) non-accredited retail investors and (2) individual retail investors as "individual investors".

CHAPTER 2

CREDITOR COMMITTEES

A. EXISTING FRAMEWORK

I. Bondholder identification and organisation

2.1 Unlike syndicated loans, letters of credit or certain other forms of debt whereby the debtor company can often definitively and exhaustively identify its creditors, due to the nature of the way bonds are typically constituted and traded, this may well not be possible for a debtor company which has issued bonds in a global form which are traded through clearing systems. This can make cooperation among the company's bond creditors more difficult, particularly when the debtor faces financial distress.

2.2 It has long been well understood that participants in different sections of the capital structure of a company may have different aims and risk appetites and may have different investment theses, particularly in a default scenario. When secondary investors are added to this mix, it is easy to see why coordination between a group of creditors with such diverging motivations can be challenging in a default. This is particularly the case where the debtor company has issued bonds because the debtor company has no formal way of identifying its bondholders.

B. ISSUES ARISING / ENCOUNTERED IN PRACTICE

I. Coordination of creditors and ad hoc committees

2.3 For there to be any successful restructuring of a debtor, cooperation between multiple creditors and creditor constituencies remains crucial. Ad hoc committees are self-formed groups of creditors that have managed to identify themselves, either through bilateral contacts between institutions or through the out- reach of financial or legal advisers, and that will coordinate among themselves and the debtor on the implementation of the proposed restructuring. For debtors, particularly those that have issued bonds, a proactive ad hoc committee is often the only available representative of the broader bondholder community with whom the parameters of a restructuring can be negotiated before being more widely disseminated to the market.

2.4 From a debtor's perspective, the purpose of an ad hoc committee during the initial phase of a restructuring is critical. With no obligation to represent a wider class than their own participants, ad hoc committees can move quickly and flexibly to meet the specific circumstances of the relevant debtor. In the initial phase of the restructuring of a debtor, where speed is often crucial to ensure the upcoming restructuring is set on the right path, the ad hoc committee can play an invaluable role.

2.5 For example, if a debtor is facing liquidity pressure, one of the most important objectives of approaching the ad hoc group, in the initial phase, is to create stability for the debtor business. The goal is to avoid any stakeholders, particularly creditors, taking precipitous action against the debtor which could be value destroying. This need is particularly important if there are, or will imminently be, events of default that will permit creditors or creditor groups to take action against the debtor.

2.6 The main role of the ad hoc committee from the debtor's perspective is to act as a representative for the wider creditor group to negotiate the restructuring. The dynamics of any such negotiation will depend heavily on the ad hoc committee's size, constituents and the range of restructuring options that the ad hoc committee is able to implement without the consent of any third party.

2.7 For instance, if the ad hoc committee controls enough of the debtor's capital structure such that, with its consent (whether or not supplemented through some form of cram down mechanism), a sufficiently wide-ranging restructuring of the debtor's liabilities could be implemented, negotiating with the ad hoc committee essentially allows the debtor to finalise the terms of a restructuring with a limited group of market participants, with confidence that the restructuring would likely be successfully implemented.

2.8 Although ad hoc committees often resist any implication that they represent any constituency wider than their own members, they can nonetheless be useful to the debtor as a means of communicating with the wider creditor group. In the restructuring of widely held bonds, the ad hoc committee can be the primary conduit by which additional members are contacted and persuaded to support the proposed restructuring.

2.9 This will particularly be the case as, although the debtor may be familiar with its relationship lenders, this may be of limited utility in a distressed situation, given that the original underwriters may have syndicated widely and that a significant portion of the debt may have been traded to distressed investors (being the most likely buyers of such debt). Furthermore, many debtors and their management teams may not have experience of stressed or distressed situations, and, therefore, may not have relationships with common participants in such scenarios (such as the distressed debt investors, law firms and financial advisers that operate in this space).

2.10 In contrast, ad hoc committees will usually contain participants who are familiar with restructuring processes and other stakeholders, and will be important in communicating and coordinating with the wider creditor group. In this regard, ad hoc committees can also be useful in encouraging other creditors to engage with the debtor, rather than taking any form of unilateral action.

2.11 In the most active restructuring jurisdictions, the flexibility in the constitution of creditor committees is absolute – led by the economics of the company's situation and capital structure and no attempt has been made to interfere with this legislatively or judicially. This is primarily the case as it works well, and does not need to be addressed by way of legislation. The flexibility and limited legislative or judicial interference allows the market and economics of a given bond default dictate how and with whom the debtor company negotiates. Institutional investors who hold bonds issued by a debtor company want the ability to associate with, and align their positions with, similarly situated investors for the purposes of obtaining a sufficient level of support (or creating a cornerstone of support on which a broader consensus can be built) amongst the relevant group of creditors, and make any negotiation with the company credible.

2.12 The process works well in these active restructuring jurisdictions as the parties with the economic interests in the debtor company tend to find each other and collaborate to negotiate a restructuring with the company. A key element of the success of this model and approach is the fact that only parties with an economic interest in the company are generally involved in the negotiations and "out of the money" creditors or stakeholders are typically not (or form a separate committee of their own, e.g., where there are multiple bonds which have been issued by the debtor). This allows for a streamlined negotiation for the company with greater prospects of retaining value.

II. The role of ad hoc committees

2.13 Aside from the issue of co-ordination amongst the various creditors, and as stated above, another common issue which arises in the restructuring context is the mandate and authority of the ad hoc committee to represent the wider bondholder group. Particularly, in court proceedings in Singapore and overseas.

2.14 At present, SIAS plays a pivotal role in assisting to organise individual investors into an ad hoc or informal steering committee in distress or special situations. Typically, this is done at a townhall meeting organised by SIAS with the Issuer. At such townhall meetings, SIAS also assists in the appointment of professional advisers for the ad hoc committee / informal steering committee. Upon the formation of the ad hoc committee / informal steering committee, SIAS will typically step away from the situation but continue to assist the ad hoc committee / informal steering committee in any way that they are able to.

2.15 However, there is a tendency for the institutional investors to avoid participating in the ad hoc committee due mainly to (a) the restrictions on trading (given the likelihood of being in possession of material non-public information), and (b) remuneration issues relating to professional advisers' fees (as will be elaborated below).

2.16 Parties to the insolvency proceedings (including the Issuer) often raise concerns as to (a) the authority of the ad hoc committee, and (b) the value of creditors it represents. There are often questions raised as to who exactly the ad hoc committee represents – whether it is just their own members, or a wider constituency such as the whole body of bondholders.

2.17 The legitimacy of the ad hoc committee's representation of the wider constituent can and has also been called into question (even in Court proceedings), especially if other creditor groups and / or the Issuer question the ad hoc committee's voice to represent the wider constituency. This is particularly the case where the value of the holdings of the ad hoc committee is small compared to the total value of the bond issue. This tends to happen when there are only a few institutional investors sitting on the committee and / or such institutional investors do not wish to sit on the committee for the reasons stated above at paragraph 2.15. These issues are raised even when the ad hoc committee was formed in a full (e.g., at a townhall) meeting of the bondholders.

2.18 The lack of clarity as to the ad hoc committee's representation consequently impedes the representation of the views of the wider group of individual investors. This in turn defeats the purpose of having an ad hoc committee which forms a bridge between the debtor and the broader bondholder committee.

2.19 Separately, another issue that arises in practice concerning the ad hoc committee is the level of influence that the Issuer or bond trustee has over the choice of the appointment of professional advisers for the ad hoc committee. Whilst the Issuer and bond trustee are consulted on the choice of professional advisers (whether at the townhall meeting when the ad hoc committee is formed, or such other avenues if the appointment is made after the ad hoc committee is formed), the preference of the ad hoc committee is often to have advisers whom the ad hoc committee or bondholders are comfortable with and have no actual or apparent conflict. As such, apart from issues of costs and limited reasons, the Issuer and/or the bond trustee should allow the choice of the appointment of professional advisers to be left to the ad hoc committee or the bondholders.

C. ANALYSIS OF THE ISSUE

I. Limited role for legislation

2.20 Inserting legislation or specific judicial guidance as to which parties must (or must not) be incorporated into an ad hoc committee of bondholders for the purposes of negotiating a restructuring with the debtor company would likely be contrary to this concept and economic/market drivers and this is why, we believe, no developed and active restructuring jurisdiction has such measures or requirements. In contrast, the jurisdictions which have attempted to legislate for such matters have attracted less restructuring activity.

2.21 For example, prevailing legislation such as in both Indonesia and Saudi Arabia provide the appointed bankruptcy administrators or manager with the right to select whichever stakeholders they may see fit to choose as the creditor committee members, and these are often made to reflect an even mix of the debtor company's stakeholders irrespective of whether those parties may have a return coming to them in any restructuring based on the value of the assets of the company. This has the effect of requiring parties without an ongoing economic interest in the company to be involved in the process, potentially burdening the restructuring negotiations and process.

2.22 Generally, if a debtor company is of sufficient size to be issuing cleared bonds through the clearing systems, they may have other traditional forms of debt and equity which includes instruments such as perpetual bonds and/or preference shares (which are generally characterised as equity rather than debt from an accounting perspective). These can be held widely by very different stakeholder groups and often are adding further complexity to negotiations. Often when an Issuer is in financial distress, it brings these disparate groups together who have differing interests in the company and levels of experience addressing such situations. Singapore has taken a market leading role in acknowledging this and has taken steps to ensure that all parties are sufficiently represented and participate in the restructuring process when constituting SIAS. SIAS has to date taken an active role in the most high profile and complex bond restructurings in Singapore and serves the purpose well to ensure those voices and opinions are heard by the debtor company and other stakeholders during the restructuring process.

II. Consideration of restructuring costs

2.23 One area of ad hoc bondholder committees which should be given further consideration is the treatment of the costs of the restructuring, which are incurred by the committee as part of the restructuring process. A single coordinated committee can assist in reducing the overall costs and fees of a given restructuring at a time when the debtor company can least afford to pay multiple sets of fees. It is common (see recent Noble Group & Codere restructurings in England & Wales, China Singyes in Hong Kong and Boart Longyear in Australia) in most active restructuring jurisdictions and in the Asia market that the debtor company pays the costs of creditors and their advisers in connection with any restructuring. Obviously, the debtor is keen to minimise these fees, given its financial situation. As such, the debtor can indicate to any small lenders that an ad hoc committee has been formed and is being advised. This obviates the need for the debtor to cover the cost of any additional advisers for smaller creditors, as the company can inform other creditors that any enquiries or requests should be made to the ad hoc committee. Whilst a restructuring which incorporates the payment by the debtor company of the professional adviser fees of an ad hoc committee of bondholders may appear to create fairness and/or class issues (*i.e.,* a benefit is given to one sub-set of creditors over others) in other jurisdictions, courts[2] have looked to the overall value, provided to the debtor company, of the work undertaken by the relevant legal counsel or financial adviser in terms of achieving the agreed terms of the proposed restructuring that commands significant creditor support.

2.24 Certain jurisdictions such as the USA have legislated to recognise that a creditor which incurs costs in acting for the benefit of the entire bankruptcy estate rather than its own economic interests only should be compensated by the estate for the fees incurred by it doing so. Section 503(b) of the U.S. Bankruptcy Code sets out a variety of creditor claims that are entitled to an elevated priority of payment in any restructuring as administrative expenses of the process. These include "actual, necessary expenses" incurred by a creditor, indenture trustee, equity holder, or unofficial committee "in making a substantial contribution" to a Chapter 11 case, which includes the professional fees incurred of legal and financial advisers. As the debtor company (and thus effectively other stakeholders) are footing the bill, the standard applied in determining whether a creditor's expense qualifies is a rigorous one and courts narrowly construe what constitutes a substantial contribution and prevents any abuse of process.

2 See *Codere 2* [2020] EWHC 2441 (Ch).

2.25 As the ad hoc committee in bond restructurings typically goes to great lengths to negotiate a suitable restructuring with the debtor company, which in turn is likely to benefit the company's other creditors and stakeholders further thought should be given as to whether this could be provided for legislatively as presently such matters are resolved through bilateral negotiation with the debtor company and does in certain instances deter stakeholders from engaging to negotiate a transaction which would deliver a restructuring which preserves value.

D. CONSIDERATIONS FROM OTHER JURISDICTIONS

I. USA

2.26 As set out above, the USA has legislated to recognise creditor costs in certain limited circumstances where such costs are incurred for the benefit of the wider restructuring.

2.27 However, there is no legislative support or guidance for ad hoc committee formation, process or requirements under USA laws.

II. Hong Kong

2.28 Presently in Hong Kong, a distressed company can only try to rescue its business using (a) a non-statutory workout agreement with its creditors, or (b) a scheme of arrangement under the Companies Ordinance (Cap. 622). However, these options are not entirely effective as they do not provide for a stay on creditor action and in the context of bond restructurings, there is no legislative requirement or guidance around the formation and operations of creditor committees. If a stay is required, a company which is based in Hong Kong but incorporated in an offshore jurisdiction may seek protection via the appointment of "light-touch" provisional liquidators in its place of incorporation followed by an application to the Hong Kong courts for recognition of the provisional liquidators and the corresponding stay to facilitate restructuring efforts in Hong Kong.

2.29 Given the inadequacies of Hong Kong's statutory regime, bond restructurings are typically conducted consensually through a workout at first instance (in the absence of the threat of creditor action). In these circumstances, bond restructurings are driven mainly by bondholders which collectively hold a significant amount of the bond (typically at least 25% in aggregate principal amount or more) and have an economic interest in the company. These bondholders would generally seek agreement with the company on the terms governing the formation, operations and fees incurred by the creditor committees early on in the restructuring, prior to the commencement of any substantive restructuring discussions. Often, the company (under the guidance of its professional advisers) would act in good faith and be commercial in its approach towards discussions on the terms governing creditor committees so as to secure the support and cooperation of substantial bondholders during negotiations.

2.30 Although the Hong Kong government had announced that it would be proposing a bill in 2021 to introduce an enhanced corporate rescue procedure, the major legislative proposals do not address the intricacies of creditor committees in bond restructurings. In Hong Kong, it is expected that such terms would continue to be dictated by market dynamics and internationally accepted norms as described above in the foreseeable future.

III. Australia

2.31 There are no legislative requirements or guidance around the formation or operation of informal creditor committees in Australia. Creditors' committees are usually formed at the invitation of the debtor company and are a consensual process where major creditors agree to participate in the committee, with the terms on which the committee operates (authorised representatives, information sharing, confidentiality, conflicts of interest, majority voting rules, etc.) dealt with by agreement between the participant creditors. With respect to bondholders (referred to as debenture holders in Australia), it is common for the interests of the debenture holders to be represented by a trustee who would usually participate in the creditors' committee to represent the interests of the debenture holders, rather than the individual debenture holders participating directly.

2.32 On the treatment of restructuring fees, there is no set way or requirements that fees are dealt with in informal creditors' committees. The payment of fees is the subject of negotiation between the participating creditors and the debtor company, and can range from immediate payment of agreed fees in full to making provision for the payment of fees in the future (post restructure) under any amended financing / subscription documents, or no payment of fees at all. The appropriate mechanism for the payment of fees depends upon the level of the debtor company's financial distress at the time of the restructuring activity. With respect to debenture holders, it is common for the fees incurred by the trustee in participating in the committee (and taking advice etc.) to be paid by agreement with the debtor company, but the time/costs incurred by the individual debenture holders to consider and take advice on their own position is not usually something that is paid by the debtor company.

E. RECOMMENDATIONS

2.33 For the reasons set out above, the Subcommittee recommends the following:

(a) Bondholder committee formation and operations would not benefit from legislative assistance in Singapore. Rather, any attempt to provide structure or requirements through legislation or other regulations may make Singapore an unattractive venue for restructuring activity. As set out above, there are no international examples of legislative assistance which have been beneficial to the operation of the bondholder committee process. In fact, those jurisdictions that have attempted to provide legislative assistance are not considered favourable restructuring jurisdictions.

(b) However, it may be beneficial to introduce a legislative framework for the restricted purpose of assisting the recognition of an ad hoc committee's authority and representation. The Subcommittee recommends that a provision in substantially the same form as Section 201(1)(a) of the IRDA be included in the IRDA for schemes of arrangement and judicial management. The provision should be drafted with the appropriate adjustments to account for the particular requirements for schemes of arrangement and judicial management. Additionally, it should provide for the Singapore Courts to consider the manner in which the ad hoc committee was formed and guidelines to assist the court to determine if the ad hoc committee's views represent that of the wider group of individual investors. Whilst the Subcommittee does not propose to provide the specific wording at this juncture, the Subcommittee suggests that the underlying test should be "*whether the ad hoc committee is fairly representative of the interests of the bondholders*". In the Court's determination of whether the criteria have been fulfilled, the following factors should be taken into consideration: (1) the manner in which the ad hoc committee was formed; (2) the percentage holding of the bondholders who supported the formation of the ad hoc committee; (3) the percentage holding of the constituents of the ad hoc committee; (4) the value in number that the ad hoc committee purports to represent; and (5) whether there are any divergent interests between the ad hoc committee and the bondholder community. It should be noted that the factors should be considered wholly, and there is no single determinative factor.

(c) The Subcommittee also proposes that guidelines / a list of best practices be provided to guide the formation and conduct of the ad hoc committee. This includes guidelines to ensure that the ad hoc committee is able to make their own choice of professional advisers, save for limited input by the Issuer or bond trustee on issues such as costs.

(d) One area of restructuring which should be given further discussion is the treatment of costs which are incurred by the ad hoc committee as part of the restructuring process. As with the USA, legislative and judicial support for the treatment of costs which are incurred for the benefit of the overall restructuring would be a favourable development and deserves further consideration.

(e) In respect of the treatment of costs, rather than proposing new legislation to address whether it may be possible to confer priority to supporting stakeholders who fund out of their own pocket restructuring costs and or committee costs, consideration should be given to determine if it would be appropriate for the existing provisions set out in sections 67 and 101 of the IRDA regarding super priority to be utilised by the Singapore Courts for the same purpose. It is noted that there are established rights of trustees to rank at the top of waterfalls under trust deeds, such that the trustees' fees, costs and expenses rank first in priority. This is the contractually agreed and market standard position. However, such orders are not intended to displace such existing priorities and senior ranking that trustees enjoy under the waterfall structures in trust deeds. Instead, such orders are to give the court flexibility to remunerate the ad hoc committee, which will facilitate co-ordination efforts that will eventually facilitate the overall restructuring. The Subcommittee has received initial feedback that trustees would be uncomfortable with the Singapore Courts granting such orders in the absence of express protection of the trustees' priorities under trust deeds. As such, an alternative recommendation would be to expressly provide that such orders will at all times recognise the contractual priority that a trustee has under the relevant contractual documentation and any order to remunerate the ad hoc committee will be stated to be subject to the contractual priority of the trustee in respect of its fees, costs and expenses. Here, for example, the priority may be out of the recoveries for the bondholders rather than the assets for distribution to the general body of creditors. This is less objectionable as the general body of creditors are not prejudiced, but at the same time enable funds to be provided for the benefit of the body of bondholders. Also, if the funding benefits the general body of creditors, recourse can be had to section 204 of IRDA which confer a measure of advantage for the funding. Utilising and building on existing provisions of established legislation could be a path forward on this issue. Given the diverging views in the Subcommittee as regards this recommendation on remuneration to the ad hoc committee, the recommendation will be subject to feedback from industry stakeholders, particularly institutions which provide trustee services.

(f) The Subcommittee would clarify that the proposal in paragraph (e) above is not strictly confined to the bondholder committee, and other creditor ad hoc committees may also be provided with such priority. This can be assessed on a case-by-case basis, especially when considering the logistical difficulties in the context and the value-add provided by such committees. However, given that the scope of this Report is confined to bond restructuring, the Subcommittee has not provided any general suggestions for the other creditor committees.

(g) Another approach to address the matter of the committee costs and an option that would not require legislative assistance would be to include, as a matter of best market practice, additional cost allocation in the relevant primary debt documents themselves. In particular, bond indentures and trust deeds could be drafted to reflect committee or enforcement costs as higher priority items in the waterfall of payments as alongside the bond trustees' costs. As this is largely market driven, the onus would be on investors and advisers to structure new bond financings in this manner to provide for this.

CHAPTER 3

MATERIAL NON-PUBLIC INFORMATION

A. EXISTING FRAMEWORK

I. What is material non-public information

3.1 When considering what constitutes MNPI under Singapore law, the emphasis is on the price-sensitive aspect of the information. Persons dealing with information that is not generally available (but if the information were made generally available, a reasonable person would expect it to have a material effect on the price or value of the publicly traded financial product in question) are imposed with strict statutory restrictions relating to the dealing and / or communication thereof.

3.2 Generally, the information[3] would relate to publicly-traded securities,[4] securities-based derivatives contracts,[5] or collective investment scheme units[6] (collectively, "**Securities**").

3.3 The insider trading law landscape arguably changes when instruments are in distress, or a restructuring is contemplated. This leads to issues of balancing between the interests of the debtor company and creditor investors as discussed in the paragraphs below.

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3 This includes: (a) matters of supposition and other matters that are insufficiently definite to warrant being made to the public; (b) matters relating to the intentions, or the likely intentions, of a person; (c) matters relating to negotiations or proposals relating to (i) commercial dealings; or (ii) dealing in capital markets products that are Securities, Securities-based Derivatives Contract ("**SD Contract**") or Collective Investment Scheme units ("**CIS**") – see S214(1) SFA.

4 This means: (a) shares, units in a business trust or any instrument conferring or representing a legal or beneficial ownership interest in a corporation, partnership or limited liability partnership; (b) debentures; or (c) any other product or class of products as may be prescribed, but does not include (i) any unit of a CIS; (ii) any bill of exchange; (iii) any certificate of deposit issued by a bank or finance company, whether situated in Singapore or elsewhere; or (iv) such other product or class of products as may be prescribed – see S2(1) SFA.

5 Any derivatives contract of which the underlying thing or any of the underlying things is a security or a securities index, but does not include derivatives contract that are, or that belong to a class of derivatives contracts that are, statutorily excluded from such definition – see S2(1) SFA.

6 This means: (a) a right or interest in a CIS, and includes an option to acquire any such right or interest in the CIS; or (b) a contract or arrangement under which (i) a party to the contract or arrangement is required to, discharge its obligations under the contract or arrangement at some future time; and (ii) the value of the contract or arrangement, is determined (whether directly or indirectly, or whether wholly or in part) by reference to, derived from, or varies by reference to any of the following: (A) the value or amount of units in a CIS; (B) fluctuations in the values or amounts of units of a CIS – see S214(1) SFA.

II. Handling and cleansing of MNPI

3.4 Currently, there is no existing framework whether in legislation or case law, to govern (a) the handling of MNPI; (b) the cleansing of MNPI; and (c) any other positive obligations in relation to MNPI, in the context of a company's restructuring. As such, there is little guidance available for debtor companies and creditor investors (*i.e.,* the bondholders) in the event of bond restructuring.

3.5 While the Securities and Futures Act (Cap. 289) (the "**SFA**") provides for the prohibition against using MNPI to trade Securities, it does not account for the complexities in a restructuring context. Similarly, while section 64(6) of the IRDA provides for sufficient disclosure of information relating to a company's financial affairs to enable creditors to make an informed decision, it fails to provide for how MNPI should be dealt with in a restructuring context.

3.6 Rather, matters relating to MNPI are currently dealt with by ad hoc committees (including the SIAS) dictated by market practices. It is common for ad hoc committees to negotiate the protection around disclosure of information.

3.7 A common way that ad hoc committees deal with MNPI is through non-disclosure agreements ("**NDA**"). The debtor company enters into an NDA with the ad hoc committee whereby the ad hoc committee members will agree not to trade the bonds based on any information that may be provided to them in the course of the restructuring.

3.8 Alternatively, the ad hoc committees appoint advisers who then enter into the NDAs and receive such confidential information. After processing the information received, the advisers accordingly provide the ad hoc committees with suggestions and recommendations without the ad hoc committee ever having to be in receipt of the MNPI. This allows the ad hoc committees to continue trading freely without the need for MNPI to be cleansed.

B. ISSUES ARISING / ENCOUNTERED IN PRACTICE

3.9 Preliminarily, the Singapore bond restructuring landscape is unique due to the higher proportion of individual bondholders as compared to institutional investors. As such, individual investors stand to have a bigger say or stake (should they successfully organise themselves) unlike other jurisdictions where institutional investors make up the main proportion of investor-creditors.

3.10 This demographic affects the expeditious conduct of the restructuring as it is difficult to organise the numerous individual bondholders. Furthermore, the institutional bondholders tend to refrain from sitting on creditor committees to avoid being stuck in a long and protracted restructuring, which restricts them from trading in the long haul. The lack of institutional bondholders on creditor committees in turn results in creditor committees lacking the sophistication, maturity, innovation, and knowledge that is required to facilitate an efficient and effective restructuring.

3.11 Whilst trading on the Singapore Exchange may be suspended when a company is undergoing restructuring, trading of its bonds can still be done over the counter often by institutional bondholders. Therefore, it is still crucial for MNPI which a group of creditors and / or the wider group of creditors may be in possession of, due to restructuring proceedings, to be cleansed and released to the wider group of creditors and / or the wider market where it is relevant and appropriate to do so, to prevent liability for insider trading.

3.12 A failure to cleanse the MNPI, especially where a company would otherwise be required to cleanse the same but for any then current suspension of trading in its listed securities, has the potential to, and often in practice does, restrict the creditors and / or members on the ad hoc committees from trading such bonds, as they risk breaching insider trading laws and being found liable under section 234 of the SFA. This restriction can often carry on for long periods of time as restructuring discussions with the company drag on. Without clear guidance from the legislation, institutions and investor-creditors may choose to adopt a more cautious approach and refuse to receive non-public information that is potentially MNPI, so as not to be subsequently restricted from trading the debt. This could affect the feasibility of a restructuring proposal.

3.13 Difficulty arises in a restructuring context due to the need for a delicate balance between the competing interests of bondholders and debtor companies. Aside from the ability to carry out debt trading, there is the more fundamental issue of disclosing sufficient information to bondholders, to facilitate the brokering of a viable restructuring proposal and to procure the requisite support for the restructuring plan.

3.14 Certain information which might not be deemed material where the company is a going concern, could be essential to bondholders in a distressed situation in deciding whether to give support for the plan, as such information could be key in determining the potential for the recovery of the debtor company. Yet, it is as important to ensure that commercially sensitive and confidential information which should not be disclosed to the public, is not so disclosed. This is illuminated in the restructuring of Hyflux Ltd ("***Hyflux***"), where certain information deemed necessary by the creditors was deemed to be commercially (and politically) sensitive by Hyflux.

3.15 Further complications arise in a bond restructuring due to the different groups of creditors who may / can require different levels of disclosure. Besides bondholders, there might be other creditors such as those who provide loan facilities to the debtor company. Within the group of bondholders themselves, there are institutional bondholders, accredited investors individual bondholders and those who are hybrids. The different levels of disclosure could arise due to contractual obligations, different kinds of leverage, or merely by virtue of voting powers allowing a group of creditors to demand for more disclosure.

3.16 These issues, should they remain unresolved, will inhibit the development of the market in distressed debt and rescue financing if no guidance is provided to creditors.

C. ANALYSIS OF THE ISSUE

3.17 The Singapore Courts have not had an opportunity to lay down principles governing the handling of MNPI in a restructuring context, although such issues have been encountered in restructurings, such as in the restructuring of *Hyflux*.

3.18 In Singapore, MNPI is usually raised as a peripheral issue to the insolvency disputes before the Singapore Courts. For example, debtor-companies have raised MNPI handling as a defence or argument for their failure or refusal to disclose information sought by the creditors. Thus far, there has not yet been a judicial pronouncement as to where lines should be drawn in order to find the balance between adequate disclosure, the management of MNPI, and the peculiar issues that arise in restructuring for creditor committees.

3.19 There is also little or no local academic discourse or commentary (a) proposing how MNPI ought to be handled, and (b) regarding cleansing obligations of MNPI, in a restructuring context.

3.20 Further insight can therefore be sought from other jurisdictions.

D. CONSIDERATIONS FROM OTHER JURISDICTIONS

I. USA

(1) Handling MNPI – Legislation and judicial enforcement

3.21 USA does not legislate how MNPI should be dealt with in a restructuring context. While the Securities Exchange Act of 1934 and federal laws extensively governs trading of securities on the basis of MNPI, it has been left to the courts to decide how such information should be dealt with in the context of an insolvent company.

3.22 The inclination towards ready access to information concerning an entity that files for bankruptcy protection, in the US bankruptcy regime, is evident in the approach taken by the Supreme Court in *re Washington Mutual Inc 461 B.R. 200* (Bankr.D.Del.2011) *("**WaMu**").* The Court relied on a broad interpretation of an earlier case to hold that the bondholders may have become "temporary insiders" of the company upon receipt of confidential information which allowed them to participate in settlement negotiations with other parties. Judge Walrath took the position that, it was only fair that:

> creditors who want to participate in settlement discussions in which they receive material non-public information about the debtor must either restrict their trading or establish an ethical wall between traders and participants in the bankruptcy case.

3.23 It bears noting that *WaMu* was subsequently vacated in part as parties had come to an agreement. However, this does not diminish its authority or significance. This case had a "chilling impact" on the market, and creditors were wary about serving on creditors committees' or instead participated in discussions with little information being shared.[7]

[7] Hon. James M. Peck, "Settlement Talks in Chapter 11 After "WaMu": A Plan Mediator's Perspective", 22 Am. Bankr. Inst. L. Rev. 65 (2014) at 66 and 71.

3.24 In recent years, creditors have explored new ways beyond the traditional measures (e.g., establishing ethical walls) to circumvent the far-reaching consequences of the decision in *WaMu*. One such notable method is to seek a "comfort order" from the US Bankruptcy Courts. While the scope of this "comfort order" varies in each instance,[8] these orders are essentially judicial determinations made by the US Bankruptcy Court that the relevant creditor can continue trading even it comes into receipt of MNPI during settlement discussions, typically as long as certain conditions are complied with.[9] These conditions include honouring any confidentiality obligations and setting up ethical walls.[10] There remains uncertainty as to the criteria that need to be met before the US Bankruptcy Courts are willing to grant such "comfort orders", and the guiding principles determining the scope of such orders.[11] For example, there have been instances where the US Bankruptcy Courts have declined to grant a "comfort order" due to the presence of appearance of impropriety, despite the implementations of Chinese walls.[12] It remains unclear to creditors the overarching principles that guide the US Bankruptcy Court in considering which factors may be given more weight (or not) by the court. Nonetheless, creditors continue to seek these "comfort orders".

3.25 However, these recent approaches have not been without criticism. Preliminarily, these orders do not bind any governmental authority and so creditors relying on such comfort orders are still at risk of being found liable by the U.S. Securities and Exchange Commission / other governmental authority bodies. Bankruptcy judges do not have the authority to directly decide criminal or civil liability under federal securities law. Accordingly, the orders are toothless insofar as they do not reduce civil or criminal liability arising under statutes or other regulations, for creditors.[13] Further, it is inappropriate and too abstract to decide beforehand whether information shared during the negotiations constitute MNPI. The materiality of information depends on the specific facts and context.[14]

3.26 The US Bankruptcy Courts have also reinforced certain market practices by expressly permitting reliance on such measures.[15] One such judicially recognised approach is the implementation of a proper ethical wall. The US Bankruptcy Courts have laid down guidelines on what constitutes an effective wall, including:[16]

(a) requiring that members who have access to non-public information in the bankruptcy proceeding acknowledge that they may receive MNPI and that they are aware of the information screening procedures;

(b) prohibiting the sharing of non-public information with other employees;

(c) requiring that individuals keep all files containing non-public information in areas inaccessible to other employees;

(d) prohibiting the restricted individual's receipt of information about its firm's trades related to the debtor in advance of the trades; and

(e) requiring that the firm's compliance department review the trades in a debtor's securities to confirm they comply with the information screening procedures.

(2) Handling MNPI - Market Practice

3.27 As mentioned above, implementing an ethical wall is a common measure adopted by creditors[17] and recognised judicially. However, this may be costly for, and may not be feasible in, smaller institutions. It is typical in small institutions for one person to perform various roles, which could include a trading role. This may make it practically impossible or difficult to ensure that those responsible for trading do not come into receipt of MNPI.[18]

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8 Ronald L Rose, Stephen M. Gross, Kimberly J. Robinson, the Hon, Thomas J. Tucker, "'Disclose, Disclose, Disclose!!!' Ethics Issues in Business Cases: Protective Information Orders and Comfort Trading Orders", American Bankruptcy Institute Central States Bankruptcy Workshop, 11 June 2009 (the "**Comfort Trading Orders Article**"); *In re Smurfit-Stone Container Corporation*, No. 09-10235 (BLS) (Jointly Administered) (Bankr. D. Del. Mar. 8, 2010).

9 *See, e.g., In re Calpine Corp., No. 05-60200 (Bankr. S.D.N.Y. Feb. 15, 2006)*; *In re the Bon-Ton Stores, Inc.*, No. 18-10248 (Bankr. D. Del. Apr. 11, 2018); *In re Innatech, LLC,* No. 10-49380 (Bankr. S.D. Mich. May 11, 2000); *In re Jevic Holding Corp.,* No. 08-11006 (BLS) (Bankr. D. Del. Aug. 18, 2008).

10 *Stern v Marshall*, 564 US 462, 508 ("***Stern v Marshall***") cited in Andrew Verstein, "Insider Trading: Are Insolvent Firms Different?" (2018) 13 Brook. J. Corp. Fin. & Com. L. at 23; *In re Residential Capital, LLC,* 2013 WL 1618327 (S.D.N.Y. Apr. 12, 2013)*; In re Vitro, S.A.B. de C.V.,* 473 B.R. 117 (Bankr. N.D. Tex. 2012) (No. 11-33335-hdh-15)*; In re Federated Dep't Stores, Inc., No. 1-90-00130, 1991 Bankr.* LEXIS 288, *2-*4 (Bankr. S.D. Ohio Mar. 7, 1991).

11 The Comfort Trading Orders Article.

12 *In re Spiegel,* 292 B.R. 748 (Bankr. S.D. N.Y. 2003) cited in the Comfort Trading Orders Article.

13 Verstein, "Insider Trading: Are Insolvent Firms Different?", above, n 10 at 23; *Stern v Marshall.*

14 Eric B. Fisher, Katie L. Weinstein. "The Aftermath of "WaMu": A problem still in search of a solution", (2014) Symposium: Hedge Funds in Bankruptcy, American Bankruptcy Institute Law Review (Winter).

15 *In re Motors Liquidation Co.*, No. 09-50026 (Bankr. S.D.N.Y. June 11, 2013).

16 *In re Federated Dep't Stores*, Inc., No. 1-90-00130 (Bankr. S.D. Ohio Mar. 7, 1991).

17 US Securities and Exchange Commission, Division of Market Regulation, *Broker-Dealer Policies and Procedures Designed to Segment the Flow and Prevent the Misuse of Material Nonpublic Information* (1990) <*https://www.sec.gov/divisions/marketreg/brokerdealerpolicies.pdf*> (accessed 19 September 2022).

18 Adam C. Harris & Howard Godnick, "Out-of-Court Restructurings, the Bankruptcy Context, and Creditors' Committees" in Harry S. Davis (ed), *Insider Trading Law and Compliance Answer Book 2011-12,* (Practising Law Institute, 2011).

3.28 Creditor investors may also send a "Big Boy" letter to the counterparty giving a warning / notifying the counterparty that it may have non-public information concerning the debtor company and seeking a waiver of liability for such non-disclosure. A major issue with this approach is that the trading counterparty has no authority to release the creditor investor from liability under any statutory laws. At most, the counterparty can only agree to not bring any claims in its personal capacity against the creditor investor.

3.29 Another common practice is for investor-creditors and debtors to enter into NDA with disclosure or "blow-out" provisions which provide that debtors will make public the MNPI shared, by an agreed upon date.

(3) Duration of access and cleansing of MNPI

3.30 As gleaned from above, neither the legislation nor the courts have made any pronouncements on how long creditors are able to access MNPI before such information has to be cleansed. The duration of access and related blow-out dates, and commercial decisions are left to be determined contractually by parties.

3.31 The quality of cleansing is similarly determined by parties, and typically dependent on the accuracy or specificity of the provisions inbuilt in the NDAs on the information to be disclosed. It is also common for NDAs to provide recipients of MNPI to publish the MNPI to be cleansed should the debtor fail to do so in a timely manner.

II. United Kingdom

(1) Handling MNPI - Regulations and judicial enforcement

3.32 The UK is (currently) subject to the European Market regulations, namely the Market Abuse Regulation (Regulation 596/2014),[19] which regulates insider trading, unlawful disclosure of inside information and market manipulation.

[19] The UK will continue to be regulated by MAR post-2020. Ross Miller & Alex Ainley, "The Insider/Outsider Conundrum" (3 December 2020) Global Restructuring Review, <*https://globalrestructuringreview.com/guide/the-art-of-the-ad-hoc/edition-2/article/the-insideroutsider-conundrum*> (accessed 19 September 2022).

(2) Duration of access and cleansing – Market Practice

3.33 It is market practice for investor-creditors to form a committee and subsequently enter into confidentiality agreements / non-disclosure agreements which includes a 'sunset' date.[20] Should the restructuring eventually not take place, information will be cleansed. Market convention for information becoming stale is 180 days[21] and the length of which creditors will be restricted is down to negotiation between parties.

3.34 A common solution is to link the sunset date to the next key reporting date in the debtor's financial calendar.

3.35 There also remains room for extensions on the sunset date, although what level of consent (i.e. unanimous or majority) is not prescribed.

3.36 What information needs to be disclosed is similarly subject to creditors' input. Creditors will also tend to insist on being consulted as to the content of disclosure, and to have the right to "self-cleanse" or "blow-out information".[22]

III. Australia

(1) Handling MNPI – Legislation and judicial enforcement

3.37 Australia requires continuous disclosure of MNPI, with the laws regulating the disclosure of MNPI applying equally even in restructuring.

3.38 The Australian Securities Exchange ("**ASX**") recognises that for a listed entity in financial difficulties, the requirement to disclose materially negative market sensitive information immediately can be an impediment to completing a financial restructure or reorganisation necessary for its survival. However, the ASX has made clear that:

> the proper course for the entity in such a situation is not to disregard its continuous disclosure obligations but instead to approach ASX to discuss the possibility of a trading halt or, if the situation is unlikely to resolve itself within two trading days (the maximum period for which a trading halt may be granted), a voluntary suspension.[23]

3.39 However, there is a statutory defence provided for under s 1043F of the Corporations Act 2001 (Cth) ("**Corporations Act**") allowing investors to continue trading despite receipt of MNPI, if sufficient Chinese wall arrangements are implemented.

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20 *Ibid.*

21 *Ibid.*

22 *Ibid.*

23 ASX Listing Rules: Continuous Disclosure: An Abridged Guide at [16].

(2) Handling MNPI - Market Practice

3.40 Unlike the USA, the market in Australia does not adopt the practice of using NDAs.

3.41 Rather, creditor investors adopt the common measure of implementing an ethical wall. As elaborated above, the use of ethical / Chinese walls is provided for in the legislation.

(3) Duration of access and cleansing of MNPI

3.42 Given that continuous disclosure is mandated, there is no duration of access to MNPI before cleansing is required.[24]

IV. Hong Kong

(1) Handling MNPI - Regulations and judicial enforcement

3.43 The Securities and Futures Ordinance ("**SFO**") governs listed companies' disclosure of inside information in Hong Kong.

3.44 As with the situation in Singapore, the SFO governs the use of MNPI in non-distressed situations.

(2) Handling MNPI - Market Practice

3.45 The use of an ethical wall / Chinese wall is a recognised approach in the Hong Kong market for corporate finance advisers, to adopt in fulfilling their duty of not disclosing confidential information / avoiding conflict of interest.[25]

3.46 However, the use of an ethical wall / Chinese wall in the context of settlement negotiations appears to be unchartered territory.

(3) Duration of access and cleansing of MNPI

3.47 No framework exists governing duration of access to MNPI in Hong Kong in a restructuring context.

3.48 Neither does any framework exist governing quality of cleansing in Hong Kong.

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[24] ASX Listing Rules; Corporations Act 2001 (Cth).

[25] Section 4.3 of the Corporate Finance Adviser Code of Conduct by the Securities and Futures Commission of Hong Kong.

E. RECOMMENDATIONS

3.49 Returning to the fundamental principle for the need to regulate MNPI, any suggested reform should be implemented to achieve the ultimate goal of ensuring that the process of restructuring is effective and expeditious, whilst maintaining a rigorous insider trading regime to ensure market confidence.

3.50 Debtor companies are likely to refuse to bind themselves to any contractual obligations to disclose sensitive information which could negatively affect the business. Conversely, creditors are forced to choose between receiving such information at the expense of their freedom to trade, often for very long periods of time, which many would be unwilling to for commercial reasons and refusing such information but making uninformed decisions.

3.51 Further, creditors in receipt of such information are generally not well equipped to determine the standard or quality to be adopted when deciding to cleanse such MNPI.

3.52 Given the difficulties posed to parties on both sides of the restructuring, a lack of any guidance could deter companies from restructuring in Singapore or investors from investing in bonds listed on SGX or investing in local companies. Thus, it is advisable for a framework to be established providing guidelines as to how MNPI should be dealt with in a distressed situation. Particularly, our recommendation is that it is critical to have in place cleansing mechanisms so that bondholders can fully engage in confidential plan negotiations without being deemed insiders for extended periods of time, to allow them to form a view as to the debtor company's performance and prospects for any restructuring. The Subcommittee notes the wide-ranging implication of this recommendation, and the necessary consultations with the relevant bodies and authorities will be made at the appropriate juncture.

3.53 The Subcommittee is of the view that party autonomy should prevail, while allowing Courts to intervene where necessary to ensure that the restructuring of a company is not unnecessarily delayed by commercial deadlocks.

I. Scheme of Arrangement

3.54 To strike a balance between practicality and protection of investors, a good starting point would be to impose positive cleansing obligations on distressed companies. This can be done by (a) drafting new legislation to be built into section 64 of the IRDA that specifically deals with MNPI management in restructuring, or (b) the introduction of guidelines on positive market practices and interpretation of any new legislation pertaining to MNPI.

3.55 Proposed legislative amendments include amending section 64(6) of the IRDA to allow the Singapore Court to order debtor companies to cleanse MNPI (the "**Cleansing Order**"). Dates can be stipulated by the Singapore Courts mandating disclosure of MNPI by a certain time period, with the option to extend or reduce the duration if necessary. These orders can be sought as a last resort if parties fail to reach an agreement on the duration of cleansing or quality of cleansing during their commercial negotiations, for instance when entering into an NDA.

3.56 Additionally, the Singapore Courts can be granted the power to furnish orders similar to that in the USA, upon application by the creditors / creditor committee(s) – clarifying that the creditors can in certain situations continue to trade despite receipt of MNPI, or to go a step further and determine that the non-public information is not deemed to be MNPI, and in the event it is MNPI to order for cleansing of such information. Legislation should also provide guidance as to the scope of such "comfort" or "trading" orders, the criteria for giving such orders and the conditions that have to be fulfilled by such creditors before being allowed to trade.

3.57 Alternatively, the Legislature could consider granting the Singapore Courts extended powers in a summary process to make directions and / or advisory orders in Singapore Insolvency proceedings in the event of a controversy. The Singapore Court can then make directions and / or grant advisory orders, upon application by the creditors / creditor committee(s) on (1) steps that creditors can consider undertaking to allow them to continue to trade despite receipt of MNPI, and (2) whether the non-public information would possibly be deemed MNPI. Where such advice is sought to be imposed in foreign insolvency proceedings, the JIN protocol should be followed.

II. Judicial Management

3.58 We repeat the recommendations in the case of judicial management, save that the new legislation be built into section 107 of the IRDA where appropriate, and that the Cleansing Order can be sought at any stage of the judicial management proceedings.

3.59 Cause papers and documents filed in the applications referred to in paragraphs 3.55 to 3.58 above are recommended to be sealed, unless otherwise directed by the Court.

3.60 Finally, should any recommendations be implemented, it is imperative that the Courts and regulators engage closely with each other in individual cases.

CHAPTER 4

TRUSTEES

A. EXISTING FRAMEWORK

I. Introduction

4.1 It is common practice in bond issuances in Singapore, whether "retail" or "institutional", for an Issuer to appoint a trustee to represent the interests of bondholders.[26] Entities typically acting as trustees in such a bond issue include both banks ("***bank trustees***") and non-bank corporate trustee service providers ("***non-bank trustees***").

4.2 The trustee holds the benefit of the Issuer's obligation to pay principal and interest on trust for the bondholders – known as the covenant to pay. The trustee may also, and shall if so, instructed by the requisite percentage of bondholders, declare that an event of default has occurred and take any resultant enforcement action against the Issuer for repayment of the principal due on the bonds. Notwithstanding that the trustee is appointed and remunerated by, and has a contractual relationship with, the Issuer, its primary duty is to the bondholders collectively.

4.3 Such a trustee structure creates numerous efficiencies, both for bondholders (principally avoiding the need for each to have to take individual action against a defaulting Issuer) and Issuers (for example, a trustee may agree to exercise discretion on certain prescribed matters for which the Issuer would otherwise have to obtain the express sanction of a sufficient number of individual bondholders).

4.4 However, in the event of default by the Issuer ("***a default scenario***"), certain practical challenges may arise – in particular, for present purposes, from the (currently limited) mechanisms by which the trustee may resign or be replaced (whether due to the lack of indemnity given to it[27] or for other reasons). In this chapter, we assess these issues further, and make recommendations regarding such mechanisms that we consider would benefit bondholders, trustees and the broader administration of situations of Issuer default.

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[26] Appointment of a trustee by the issuer is also expressly required by the SGX-ST Listing Manual Mainboard Rules for any SGX-listed bonds (the "**SGX Listing Rules**"), unless the bonds are (a) offered only to 'specified investors' (that is, institutional or accredited investors under s.274 and 275 of the Securities and Futures Act (Cap 289)("**SFA**")) or (b) traded in a minimum board lot size of S$200,000 (See SGX Listing Rule 308(1)-(2)). <*http://rulebook.sgx.com/rulebook/308*>.

[27] See further paragraph 4.16 – 4.17 below.

II. The Role and Responsibilities of Trustees

4.5 Most of the trustee's rights, responsibilities, powers and discretions will be set out in the trust deed between the Issuer and trustee. That deed also therefore effectively defines the parameters within which the trustee must exercise its powers and duties to the bondholders. As noted above, while an Issuer appoints the trustee, a trustee only owes legal, fiduciary and contractual obligations to bondholders, and not to the Issuer itself.

4.6 The contractual provisions in the trust deed are then supplemented by certain statutory provisions (some of which may be expressly excluded by the trust deed)[28] and the common law.[29]

III. Standard Provisions Under Trust Deeds

4.7 A standard form Singapore law-governed trust deed includes various provisions of relevance for present purposes. These include, among other matters, provisions that the trustee:

(a) must hold the benefit of (i) the covenant to pay under the bonds; and (ii) any other financial and other covenants, on trust for the bondholders;

(b) may act on the instructions of a specified percentage of bondholders, subject to the trustee being indemnified to its satisfaction;[30]

(c) may exercise its discretion to waive certain breaches or modify provisions of the trust deed without the consent of the bondholders;

(d) may declare an event of default under the bonds (whether at its own discretion or upon receiving instructions from a specified percentage of bondholders); and

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28 See, for example, Trustees Act (Cap 337, 2005 Rev Ed), section 3A (Trustees' statutory duty of care); SFA, section 266 (Duties of Trustees); and SGX-ST Listing Manual, Mainboard Rules, rule 308(5) (Trustee & Trust Deed).

29 Including, for example, fiduciary duties of loyalty and tortious duties of care. It should be noted, however, that, pursuant to the terms of standard Singapore law-governed trust deeds, the trustee's role generally remains an administrative and passive one – it is not obliged, for example, to actively monitor whether any event of default has occurred.

30 Trust deeds typically provide that *prior to* a default, it is the issuer who is responsible for paying the trustee's fees and expenses, and for indemnifying it against other liabilities incurred in carrying out its duties (save where they result from the trustee's fraud, negligence or misconduct). *Post*-default, however, it is the bondholders from whom the trustee will require an indemnity, pre-funding or other form of security to protect it against any costs and losses it may incur in bringing an action in relation to the default. The type and extent of indemnity to be given to the trustee (including, for example, the source of funds) are not typically prescribed in standard form trust deeds (see further paragraph 4.17 below).

(e) has generally the primary right to bring proceedings against the Issuer on behalf of all of the bondholders (commonly referred to as a "no action clause").

4.8 Thus, while bondholders may collectively instruct the trustee, they cannot take action against the Issuer – for example, commencing enforcement action – themselves, unless the trustee has itself failed to take action within a reasonable time.[31] The "specified percentage" of bondholders required to instruct a trustee will vary between trust deeds: however, in Singapore, market practice is for such percentage to be in the range of 20-25% of bondholders (by value).

4.9 However, it bears mention that there are limited circumstances in which bondholders may enforce directly against the Issuer.

(a) The *Vandepitte* procedure in the event the trustee refuses to sue after having received satisfactory indemnification and instruction as required by the documents, the bondholder, being the beneficiary, may bring an action directly against the Issuer by joining the trustee to the action. The right to sue remains as a right of the trustee and the bondholder merely uses this procedural rule to commence action against the Issuer.

(b) Section 267A of the SFA – Alternatively, holders of debentures may apply to the Singapore court for a court order to compel the trustee of the holders of such debentures to perform his duties as set out in the trust deed relating to those debentures.

4.10 Certain matters, however, require the passing of an extraordinary resolution at a duly convened meeting of the bondholders. The trust deed will specify the particular procedure and thresholds required to pass such an extraordinary resolution. Typically, however, approval of bondholders representing at least 75% (by value) of the votes cast at a bondholders' meeting is needed (the quorum for such a meeting commonly being two or more bondholders holding in aggregate a clear majority (*i.e.*, over 50%) of the relevant securities).[32]

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31 Some trust deeds will specify a number of days, such as 60 days.

32 Bondholders may pass a written resolution in lieu voting at a meeting. However, such a written resolution must be signed by or on behalf of holders of not less than a specified percentage (typically 90%) in principal amount of the bonds.

IV. Trustee replacement under the trust deed

4.11 One matter that typically requires an extraordinary resolution is the replacement of the trustee.

4.12 Market-standard Singapore law trust deeds will typically provide that:

(a) a trustee may resign its position on giving the prescribed notice (commonly 30, 60 or 90 days, or such shorter period as agreed with the Issuer). The resignation will not take effect, however, until a replacement trustee is appointed.[33] That appointment must be approved by an extraordinary resolution of the bondholders of all the series; and

(b) the bondholders may remove a trustee by passing an extraordinary resolution at a duly convened bondholders' meeting. Such removal takes effect when a replacement trustee is appointed (again, subject to bondholders' approval by extraordinary resolution).

4.13 As such, even where the trustee chooses to retire, an extraordinary resolution of the bondholders is required to appoint a replacement.

B. ISSUES ARISING / ENCOUNTERED IN PRACTICE

I. Replacement of Trustees – Issues arising in a default scenario

4.14 As a *matter of law*, the nature of the trustee's relationship with Issuers on the one hand, and bondholders on the other, does not itself change on the occurrence or declaration of an event of default. In *practice*, however, whereas the trustee's pre-default role will be largely passive (and primarily Issuer-facing), post-default it will be required to take a more active role on behalf of bondholders, in particular in determining whether to take enforcement action against the Issuer.

4.15 Consequently, it is also post-default that there will be greater focus from bondholders on how the trustee exercises its discretion. In turn, it is in such default scenarios that divergence or disagreement between the trustee and bondholders is most likely to arise as to, among other matters, whether and what form of enforcement action to take.

[33] The replacement trustee will be appointed by the issuer. However, if the issuer fails to do so, the outgoing trustee may nominate a replacement.

4.16 As noted at paragraph 4.8 above, under a typical Singapore law-governed trust deed, a specified percentage (typically 20-25%) of bondholders may together instruct a trustee to take the enforcement action. However, such ability remains subject to the trustee's right, before it agrees to take action, to be indemnified *to its satisfaction* by the bondholders[34] against any costs and losses it may incur in so doing.

4.17 The form and coverage of the indemnity, pre-funding or other form of security that a trustee will require from bondholders will depend on the level of risk that it is willing (or able, within its internal risk management policies) to bear, taking into account factors such as the identity of the bondholders, the nature of the Issuer's default, the kind of recovery / enforcement action bondholders are seeking to take,[35] the jurisdiction where bondholders want the trustee to take action, and the extent and likelihood of ultimate recovery by the trustee from the Issuer.[36] Broadly speaking, bank trustees often have a lower risk tolerance and / or tighter risk controls than "non-bank" trustees. Standard form trust deeds do not typically prescribe the form or extent of indemnity to be given (including, for example, the source of funds). This allows flexibility for parties to consider the most appropriate means of financial recompense for the trustee in a given circumstance, including in light of the various risk-related factors above.

4.18 Given this, it may be in the interests of all bondholders for the trustee to be replaced with a trustee better prepared or willing to take enforcement action (for example because they are more willing to bear the risk that that action entails). Indeed, the Subcommittee expects, based on its experience of market practice, that the incumbent trustee would typically be unlikely to seek to oppose its replacement in those circumstances (and may be willing to resign pursuant to the terms of the trust deed).

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34 Typically, any funds advanced or indemnity given by the bondholders will ultimately be reimbursed out of any amounts recovered by the trustee from the issuer. However, if such recovery is insufficient to cover the amount of any prepayment to the trustee, it is bondholders who remain liable there for.

35 A higher risk jurisdiction, where court action could be prolonged or there is a higher risk of frivolous counter-litigation, could result in higher amounts of pre-funding being sought by trustees.

36 Although trustees must not act unreasonably in demanding an indemnity (for example seeking indemnification against risks that are merely fanciful), it is submitted that this is likely to give them significant latitude to require indemnification against risks that might arise (see *Concord Trust v Law Debenture Trust Corp Plc* [2005] UKHL 27; [2005] 1 W.L.R. 1591 (UK HL)).

4.19 However, as noted at paragraph 4.12 above, any replacement of a trustee in these circumstances – even with the incumbent trustee's acquiescence or following its resignation – must generally in practice be approved by an extraordinary resolution of the bondholders. It is the subcommittee's experience that, given the number and diversity of holders of a given bond issue (potentially including a large proportion of individual investors), it is in practice often challenging to meet the necessary quorum and/or vote levels required to pass such an extraordinary resolution, even where it has the support of a significant number of major bondholders and / or where the trustee agrees that it would be in the best interests of all the bondholders.

4.20 In view of the above, there presently exists a risk of "deadlock" or, at a minimum, significant delay in bringing enforcement action, to the potential detriment of bondholders and the broader expeditious resolution of situations of Issuer default.

C. CONSIDERATIONS FROM OTHER JURISDICTIONS

4.21 Broadly stated, comparable common law jurisdictions – including the UK, Hong Kong and New Zealand – similarly appear to provide only limited scope for a trustee to be replaced directly at the behest of the bondholders (e.g., requiring the support of a super-majority of bond holders), whether under the terms of standard trust deeds utilised in those jurisdictions, or under statute.

4.22 That said, the Subcommittee notes that in Australia, section 283AE(2) of the Corporations Act provides (for present purposes) that, in relation to debentures that are issued to investors other than solely professional or sophisticated investors (i.e. including 'individual' issuances):

> (2) The Court may:
>
> […]
>
> (b) terminate the existing trustee's appointment and appoint a person who may be a trustee under section 283AC as trustee in the existing trustee's place on the application of the borrower, the existing trustee, a *debenture holder* or [the Australian Securities and Investments Commission] if:
>
> […]
>
> (ii) the existing trustee *fails, or refuses, to act.*
>
> (Emphasis added)

4.23 This power is supplementary to any powers of removal included in the trust deed. However, to the Subcommittee's knowledge based on discussions with practitioners, section 283AE appears to have been little used in practice to date, and little guidance appears to exist as to how the Australian court should or would exercise its termination powers.[37]

4.24 The Subcommittee also notes that whilst Sections 289(4)(i) and 289(4A) of the SFA allows for the Monetary Authority of Singapore ("**MAS**") to direct the appointment of a new trustee, or revoke the approval granted to the approved trustee, this avenue for replacement of trustees is restricted to that for trustees of a collective investment scheme and does not extend to corporate bond issuances.

D. RECOMMENDATIONS

4.25 In the Subcommittee's view, the foregoing demonstrates:

(a) that potential benefits exist for bondholders, in a default scenario, in being able to appoint a trustee more willing or better able – for risk appetite or other reasons – to act on their behalf in such circumstances; and

(b) the present challenges of so doing, as a result of, among other factors: (i) the need in practice to obtain an extraordinary resolution of bondholders to approve such replacement; and (ii) the difficulties, given the typically diffused ownership of the bonds in an issue, of obtaining the necessary quorum and votes required to pass such a resolution.

4.26 As such, we see merit in creating a supplementary, statutory route for bondholders in a default scenario to seek replacement of the trustee without the need for an extraordinary resolution. The Subcommittee recognises that there may be scenarios where the incumbent trustee is willing and prepared to continue to act on behalf of the bondholders, if not for the lack of funding. The Subcommittee agrees that if such necessary funding is provided, the trustee should be given the option and opportunity to continue acting. In this regard, the Subcommittee is of the view that the safeguard provided for in paragraph 4.36(a) below sufficiently provides the incumbent trustee with such an opportunity – the Singapore Courts will take into consideration whether reasonable efforts have been taken to resolve any disagreement which would include whether the bondholders and trustee have attempted to resolve any funding issue.

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[37] In *O'Keeffe and Another v Hayes Knight GTO PTY LTD* [2005] FCA 389, the applicant debenture holders applied for the trustee's removal pursuant to s 283AE on conflict of interest grounds. The trustee did not oppose the removal application (the issue before the Court related to costs, rather than the merits of the s 283AE application). To our knowledge, there is limited other case law on s 283AE.

4.27 On a similar note, to assuage any concerns that trustees may face stigma due to their replacement, the Subcommittee also suggests that incumbent trustees be given notice before an application is made to the court for its replacement. This gives the incumbent trustee a chance to respond, if it so wishes or raise objections in court subsequently. Such acts will again be considered as part of the factors set out in paragraph 4.36 below. However, the Subcommittee is of the view that such notice is not required in exceptional circumstances where concerns or allegations of dishonesty or fraud arise.

4.28 Specifically, we recommend the introduction of an express statutory right for bondholders together representing a material proportion of the bonds in an issue to apply to the Singapore Courts, following the occurrence and continuation of an event of default, for an order that the incumbent trustee be replaced by a trustee nominated by those bondholders. It would therefore ultimately be for the Singapore Court to determine both whether replacement of the incumbent trustee was appropriate in the circumstances, and whether the replacement trustee nominated by the applicants was suitable. The Singapore Court should be given broad discretion where the application is made in good faith and there are reasonable prospects that such appointment would be in the best interests of the bondholders.

4.29 In formulating this recommendation, we have been mindful of the need to strike a balance between:

(a) on the one hand, making such a route sufficiently accessible to bondholders to address the identified limitations in the current system, and

(b) on the other, avoiding the risks, disruption, costs and potential misalignment of incentives that may arise if a trustee is able to be replaced too readily or without sufficient safeguards, including safeguards to ensure that the replacement trustee is fit and proper to act in that role.

4.30 Evidently, a key aspect of that balance will be the proportion of bondholders that is specified as being necessary to support an application to the Singapore Court.

4.31 In this regard, the Subcommittee considers that an appropriate threshold would be that any application must be made by, or on behalf of, at least:

(a) the proportion of bondholders required to instruct the trustee to declare an event of default (as noted above, this is typically the holders of 20-25% of the bonds by value, but may be higher or lower under certain trust deeds); or

(b) where the trust deed is silent on such matters, the holders of at least 25% by value of the bonds.

4.32 We note that, as the application to court could be made by a minority of bondholders, there may be a concern that such a minority could act against the interests of the majority of bondholders, or that applications to replace trustees will be made unduly frequently (and possibly repeatedly in respect of the same issue).

4.33 However, we consider that:

(a) the need to obtain approval of the court both for the application and the nominated replacement trustee (see further paragraphs 4.36 and 4.37 below); and

(b) the right of other bondholders (and indeed the existing trustee in its own right or on behalf of the bondholders generally) to oppose the application,

should provide sufficient protection in this regard.

4.34 Further, it should be recalled that, once appointed, the replacement trustee will still have a duty to act in the interests of *all* bondholders collectively, and not merely those bondholders who nominated it for appointment.[38] It is notable also that s 283AE(2) of the Corporations Act – which on its face enables applications to be made by a single bondholder in non-institutional issuances – does not seem to have resulted in a flood of applications to court or the unduly frequent replacement of trustees (see paragraphs 4.22 to 4.23 above).

4.35 Finally, we consider that there should also be disclosure by the applicant of any connection with the Issuer group so that the court can take into account the independence of the applicant when determining whether to allow the application.

4.36 In order to further ensure that the right is not open to abuse, it is submitted that the court in considering whether to grant the application should have regard to, among other factors, the following matters:

(a) the conduct of the applicant bondholder(s), including in particular whether, before making the application, they have first sought to use any mechanisms available under the trust deed to replace a trustee, and/or made reasonable efforts to resolve any disagreement with the trustee without recourse to the courts;

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[38] Further, we note that even at present, an extraordinary resolution may be passed by bondholders representing only a minority of the bondholders of all the series (insofar as the 75% threshold for such a resolution is calculated on the basis of those bondholders present at the meeting, and only the holders of 50% + 1 of the bonds need be present for the meeting to be quorate).

(b) related thereto, whether the trustee (in its "personal' capacity", rather than in its capacity as representative of all the bondholders) supports or opposes its replacement;

(c) the views (if known) of non-applicant bondholders regarding the proposed replacement;

(d) the extent to which the applicant bondholders comprise (or represent) a representative sample of the different types or classes of bondholders in the issue (e.g., including both "institutional" and "individual" investors, and/or the holders of several different classes of bonds), and/or whether the applicants include or represent bondholders who have separate interests (e.g., also as a shareholder of the Issuer); and

(e) the identity of the proposed replacement trustee, in particular whether that trustee (i) has the track record and demonstrated financial standing to carry out the role of trustee effectively, and (ii) is free of conflicts of interest in relation to that role.

4.37 We consider that it should ultimately be for the Singapore Courts to determine, on a case-by-case basis, whether a given replacement trustee should be approved. However, guidance as to factors that the court may take into account in making that assessment can be drawn from comparable requirements already provided for in domestic and foreign trusts law.

4.38 For example:

(a) Under the Trust Companies Act (Cap 336), a company (unless exempted)[39] must be licensed by the MAS. In assessing licence applications, MAS will take into account, inter alia:

(i) the fitness and propriety of the applicant and its officers;

(ii) its track record and expertise;

(iii) its ability to meet prescribed minimum financial and professional indemnity insurance (PII) requirements, namely (1) maintenance of a minimum paid-up capital or qualifying assets of S$250,000 and (2) adequate PII commensurate with its business' level of risk;

(iv) the strength of its internal compliance systems and processes; and

[39] Although certain bond trustees may be exempted from the TCA's licensing requirement (see Trust Companies (Exemption) Regulations (Rev Ed 2006) (G.N. No. S 833/2005), Reg 4), that Act's provisions (and MAS' practice under it) still provide a useful guide as to the standards and financial position required in order to act effectively as a trustee.

(v) its business model/plans and projections and the associated risks.[40]

(b) In the USA, sections 310(a)(1)-(2) of the Trust Indenture Act requires at least one trustee to be an "institutional trustee" – that is, a corporation which (a) is either organised and doing business under US law or permitted to act as trustee by the US Securities and Exchange Commission, and (b) has a combined capital and surplus of at least US$150,000 (although typical market practice on Reg S/144A/Reg D deals documented under New York law is for this amount to be significantly higher, i.e., in the range of US$5mn – US$50mn).

4.39 We note that there may be benefit in such a non-exhaustive list of factors above being expressly set out in the relevant legislation creating the right of action.

4.40 It is acknowledged that under existing laws, bondholders are already able to bring actions seeking an administration order from the court in certain circumstances,[41] and the Singapore Court does, for example, have powers under section 42 of the Trustees Act 1967 (the "**Trustees Act**") to appoint replacement trustees where it is considered "inexpedient, difficult or impracticable to do so without the assistance of the court."[42] In scenarios such as those described above, however, courts may be reluctant to impose an order under such general powers, where a clear contractual mechanism for replacing the trustee already exists in the trust deed – especially if the trustee remains solvent and in principle able to carry out its duties.

4.41 As such, we consider that, as described in paragraph 4.26, there is benefit in giving express legislative "sanction" to such court applications by specifically providing for them in statute. Thereby, giving courts a clear legal basis on which to make an order for replacement that overrides a pre-existing contractual mechanism, and making it easier for them to make such an order in appropriate cases.

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40 MAS, 'Trust Business Licence' (2020). <*https://www.mas.gov.sg/regulation/capital-markets/Trust-Business-Licence*>; MAS, *Trust Companies Act (Chapter 336) – Frequently Asked Questions* (November 2019) <*https://www.mas.gov.sg/-/media/MAS/FAQ/FAQs-on-TCA—Amended-29-Nov-2019.pdf*>

41 Under Ord 80 of the Rules of Court (Cap 322, R 5, 2004 Rev Ed), for example, the holder of a beneficial interest in a trust (which would include a bondholder), may bring an action brought for "the determination of any question or for any relief which could be determined or granted, as the case may be, in an administration action", including "any question arising in the administration of the estate of a deceased person or in the execution of a trust."

42 Section 42 of the Trustees Act (Cap 337, Rev Ed 2005). It is notable that the non-exhaustive list of examples given in s.42(2) for when a court might order replacement of a trustee refer not to situations of deadlock or dispute between bondholders and corporate trustees, but rather to more 'existential' matters regarding the trustee, such as where it has gone into liquidation or been dissolved.

4.42 Indeed, there are further benefits in expressly providing for the recommended right in statute, rather than, for example, simply encouraging parties to include the recommended rights of replacement in future Singapore law-governed trust deeds (although we note that the two are not mutually exclusive). Not least, a statutory right in the form proposed could apply to both future bond issuances *and* past issuances (including those already in default), thus extending the benefits of that right to the widest constituency of bondholders. By contrast, recommending changes to standard form trust deeds would only impact deeds entered into in future bond issuances.

4.43 Finally, it is noted that the replacement of a trustee may entail in certain cases a novation of contracts (including contracts giving rise to security) to which the retiring trustee is party. A novation of contracts may be viewed as giving rise to a new contract with the incoming trustee. If so, the new contract (or security rights) may accordingly have to be tested against clawback or hardening periods, or limitations in dealings, that are applicable either (a) at the time of the novation, or (b) at / for a time calculated by reference to the time of that novation. Take, for example, a trustee that has a floating charge given several years ago by a chargor company and at a time when the chargor was solvent. Today, the chargor is insolvent and at risk of liquidation. If a novation of the floating charge is to take place today, section 229 of the IRDA may invalidate the novated floating charge to which the incoming trustee is a party.

4.44 Although there may be means to try to mitigate or reduce such risks of time running afresh, much would depend on the facts and the documentation. In this respect, while section 41 of the Trustees Act may in some instances be relied on to mitigate the risk, there are limitations in the scope of section 41 of the Trustees Act. Also, some counterparties may require fresh novation agreements to be entered into and if so, the risk of time running afresh for clawbacks may yet arise. This restarting of the clawback / hardening period may act as a disincentive to bondholders to seek replacement of the trustee.

4.45 As such, the Subcommittee recommends that consideration is given to providing that, where the court orders replacement of the trustee under the proposed power, it also has power to order that such replacement will not in itself subject contracts or transactions taken over by the replacement trustee to fresh clawback or hardening periods or other limitations which applied at the time of the replacement but not at the time the original contract or transaction was entered into.

I. Alternative approaches

4.46 As noted above, we believe that the recommended requirement to obtain approval of the court, combined with the possibility to oppose applications, provides an appropriate safeguard against:

(a) scenarios where replacement of the trustee would clearly operate against the interests of the majority of the bondholders; and

(b) risks of the minority bondholders appointing a trustee who was not fit and proper to act in such a capacity,

as well as guarding against other abuses of process.

4.47 To the extent that policymakers disagree, however, one alternative could be to require that the application is made by or on behalf of bondholders representing a majority of the bonds by value. This would, by definition, eliminate any concerns that a minority of bondholders could act to replace a trustee who the majority of bondholders wished to retain. But that would come at the expense of the availability of the mechanism, particularly where ownership of the bonds is highly diffused and thus obtaining the express approval to the application from a majority of bondholders may be difficult.

4.48 Further, similar alternatives may include, for example, requiring that the applicant bondholders represent at least 25% (or some equivalent proportion) of not only the bonds by value, but also of the number of bondholders.

4.49 Finally, for completeness, the Subcommittee notes that it also considered the possibility of creating a *direct* statutory right for bondholders to replace a trustee, without having to apply to court (*i.e.*, a right akin to that currently available under trust deeds, but exercisable without the need for an extraordinary resolution and by a lower proportion of bondholders). However, we concluded that such an approach would tip the balance too far, placing too much power in the hands of a minority of bondholders and risking creating unwelcome instability and uncertainty for trustees. It would also represent a significant departure from international standards in comparable common law jurisdictions. In line with our recommended reforms, we see the role of the court as central to ensuring that any new power is not vulnerable to misuse.

II. Implementation

4.50 There may be various mechanisms for codifying the recommended statutory right.

4.51 For example, provision might be made by amendment to the Trustees Act, which in section 42 presently provides a right for the court to make an order to appoint a replacement trustee in substitution of an existing trustee "whenever it is expedient to appoint a new trustee or new trustees, and it is found inexpedient, difficult or impracticable to do so without the assistance of the court."[43]

4.52 Alternatively, given that the right is proposed to apply only in a default scenario, it may be more appropriate for the right to be included within legislation specifically applicable in such scenarios, for example the IRDA.[44]

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43 See further, n 42 above.

44 Under s.6(1) of the IRDA, the Court has a broad power, when exercising its jurisdiction under the Act, "to decide all questions of priorities and all other questions, whether of law or fact, that may arise in any case or matter under this Act coming within the cognizance of the Court, or that the Court considers expedient or necessary to decide for the purpose of doing complete justice or making a complete distribution of property in any such case or matter."

CHAPTER 5

DIRECT ENFORCEMENT RIGHTS

A. EXISTING FRAMEWORK

5.1 The Subcommittee first sets out the existing rights of bondholders in Singapore generally, namely:

(a) their right to payment;

(b) their right to information; and

(c) their right to vote.

5.2 Issues relating to the enforcement of bondholders' rights under the bond documentation will be considered in a subsequent section.

I. Types of rights of bondholders

(1) Right to payment

5.3 A bondholder's right to payment is determined by the relevant bond structure. A bond trustee is required for any bond issuance that is accompanied by a prospectus: Section 265A of the SFA. In a bond structure which incorporates such a bond trustee, the bond documentation will typically provide that the Issuer's payment obligations are owed to the trustee (who will hold such obligations on trust for the ultimate beneficial bondholders), as opposed to being owed to the ultimate beneficial bondholders themselves. Such a bond structure was considered in *Re Swiber Holdings Ltd* [2018] 5 SLR 1358 ("***Swiber No.2***") at [5]. Where there is no bond trustee, the bondholder's right to payment will depend on the bond documentation with the Issuer.

(2) Right to information

5.4 A bondholder is not a member of a company and does not enjoy the rights of a member, for example, those under Section 39 of the Companies Act 1967 ("**Companies Act**") which would permit their attendance at general meetings of the company and their access to the information disclosed thereat.[45] The bondholder's right to information therefore principally arises from (a) listing rules, (b) the SFA, and (c) bond documentation with the Issuer.

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45 Hans Tjio, Pearlie Koh and Lee Pey Woan, "Corporate Law" (Academy Publishing, 2015) at [14.015].

II. Listing rules

5.5 An Issuer of a listed bond is subject to continuing listing obligations. In particular, an Issuer is obliged to immediately disclose, pursuant to Rules 323-326 of the Mainboard Rules:

(a) the redemption or cancellation of the debt securities, when every 5% of the total principal amount of those securities is redeemed or cancelled;

(b) details of interest payments to be made;

(c) appointments of replacement trustees;

(d) any information generally which may have a material effect on the price or value of its debt securities or on an investor's decision whether to trade in its debt securities; and

(e) additionally, for debt issuances for which no trustee is required under SGX rules as the issuance (i) is not offered only to institutional and accredited investors, *and* (ii) is traded in a minimum board lot size of S$200,000 (or foreign equivalent):

(A) where the issuer and/or guarantors (if any) also have their equity securities listed on the SGX-ST, the consolidated profit and loss account and balance sheet of such issuer and/or guarantors; and

(B) where neither the Issuer nor the guarantors (if any) have their equity securities listed on the SGX-ST, such Issuer's and guarantors' (if any) financial statements on the basis of an arrangement to be entered into with the SGX-ST.

III. SFA

5.6 In addition to the detailed financial information necessary under SGX listing rules, the SFA separately provides for the following disclosure obligations where there is a trustee of the debt issuance, and the Issuer is not a prescribed entity pursuant to Section 261(1A) of the SFA:

(a) First, whenever an Issuer or a guarantor creates a charge over its assets, it must report the particulars of such charge to the trustee within 21 days after the creation of the charge (whether or not the trustee makes any demand for the same). Where the amount to be advanced on the security of the charge is indeterminate, the relevant Issuer or guarantor must furthermore provide the trustee with particulars of the amount or amounts in fact advanced: Section 268(4) SFA.

(b) Second, the Issuer and every guarantor must lodge with the trustee that Issuer or guarantor's balance sheet and profit and loss account at every six-monthly interval. The balance sheet and profit and loss account for the first six months of that entity's financial year need not be audited and must be provided not later than three months after the expiration of the six-month period. The balance sheet and profit and loss account for the second six months of that entity's financial year (i) must be prepared on an annual basis, (ii) must be audited unless the trustee chooses to waive the obligation to audit, and (iii) must be provided not later than five months after the end of the relevant financial year: Section 268(6) and 268(10) of the SFA. The trustee is obliged to notify the MAS if such financial documents were not provided to the trustee: Section 268(9) SFA.

(c) Additionally, the Issuer of unlisted bonds must, if the unlisted bonds have a tenure of 12 months or longer, provide to the bondholders at 6-monthly intervals a semi-annual report of any information which may materially affect the risks and returns of the unlisted bonds and/or the price and value of the unlisted bonds. Further, the Issuer of an unlisted put bond (that is, a bond which is redeemable before maturity at the option of the bondholder) must make available bid or redemption prices of the put bond either at the frequency at which the Issuer had committed to buying back the unlisted bonds or once every fortnight, whichever may be more frequent, and furthermore ensure that the bid or redemption prices are determined in an independent and fair manner: Section 268A(1), (4) and (6) of the SFA.

IV. Bond Documentation

5.7 Typically, the trust deed for structures that have a trustee will contain certain basic covenants regarding information dissemination by an Issuer to the trustee and bondholders. Bondholders are not automatically entitled to all information that the trustee has access to (and some trust deeds may have confidentiality restrictions the trustee must comply with), but the bondholder can, as a first step, request the trustee to request the Issuer for more information on any particular matter they deem material to their investment.

V. Voting rights

5.8 It will at times be necessary for an Issuer to propose amendment or variation of the terms of the bond documentation. This can take place either in the context of an out-of-court workout, known as a consent solicitation exercise, or else in the context of court restructuring proceedings through the judicial management and scheme of arrangement regimes. The voting rights of bondholders will be considered in more detail in the next chapter.

5.9 In such consent solicitation exercises, the Issuer typically seeks to secure expressions of support from the contractually-specified proportion of bondholders present and voting. A super-majority is often required insofar as the consent solicitation exercise may require passage by special resolution of creditors. The relevant voting demographic is typically limited to registered owners of the bond, as opposed to the ultimate beneficial bondholders thereof.

5.10 There have been several prominent consent solicitation exercises in recent times. For instance, in April 2020, BreadTalk Group Limited sought and obtained bondholder consent to waive a technical breach of the financial covenants provided in respect of certain notes, which arose due to a drop in the consolidated tangible net worth of the group for FY 2019. At the same time, the Issuer also sought and obtained bondholder consent to lower the relevant thresholds to prevent further breaches. More recently in February 2021, KrisEnergy Ltd sought and obtained bondholder consent (which was inter-conditional with a concurrent scheme of arrangement sanctioned by the General Division of the Singapore High Court), for, amongst other things, an exchange of 45% of the aggregate principal amount of the notes held by each noteholder for equity in the Issuer.

B. ANALYSIS OF THE ISSUE

I. Extent to which individual beneficial bondholders can directly enforce their rights in their own capacity

(1) Structure of bond

5.11 A fiscal agent is appointed by an Issuer in respect of a bond where there is no trustee. The fiscal agent's role is essentially limited to administrative functions such as relaying information from the Issuer to noteholders and receiving interest and principal payments from the Issuer for distribution to noteholders. Unlike a trustee, a fiscal agent is an agent of the Issuer and does not owe any contractual obligations or duties to bondholders, who therefore retain rights of direct enforcement against the Issuer as a consequence. Where a bond does not provide for an appointed trustee, it will be for the individual bondholder to compel compliance from the Issuer in accordance with the terms of the bond documentation, if any.

(2) Role and powers of a Trustee

5.12 More generally, a bond will provide for an appointed trustee.

5.13 Where it does so, it is typical for that trustee to be vested with enforcement rights on behalf of all bondholders. Bonds may provide for instance that a trustee is entitled to demand immediate repayment of the principal amount upon certain defined breaches (most notably non-payment) or else to immediate repayment upon the expiry of a specified notice period after notice has been given of a default on some other term of the bond. It is however typical for bond documentation to expressly provide that trustees are not obligated to take such enforcement steps save on the occurrence of certain conditions. For instance, the trustee may be only compelled to demand immediate repayment if requested in writing to do so by holders of not less than certain specified proportions of the bonds then outstanding, or if so, directed by an extraordinary resolution of bondholders to do so. Furthermore, trustees may also be entitled under the terms of their respective trust deed to be indemnified, secured and/or prefunded to their satisfaction before taking such enforcement steps.

5.14 A bond trustee, where appointed, also has a specific right pursuant to section 270(3) of the SFA to demand that the principal amount of the bonds be immediately repayable to the party entitled to repayment. Such a right would arise by statute if the bond was issued together with a prospectus which contained a statement as to any particular purpose or project for which the bond monies were to be applied, and:

(a) it appears to the trustee that such purpose or project has not been achieved or completed either within the time stated within the prospectus for the fulfilment of that purpose or project, or, if there is no such time, then within a reasonable time;

(b) the trustee is of the opinion that it is necessary for the protection of the interests of the bondholders to issue a notice in writing to the Issuer to repay the principal amount; *and*

(c) the trustee issues such notice in writing to the Issuer and, within one month after such notice is given, thereafter lodges the notice with the MAS.

5.15 Further, pursuant to Sections 266(2), (3)(b) and (4) SFA, if a trustee comes to be of the opinion that the assets or the Issuer and any of its guarantors are insufficient to meet the bond principal amount, such trustee may apply to the MAS for a compulsory order that the trustee be in turn directed to apply to the court, or else directly apply to the court for an appropriate order under Section 266(5) of the SFA, which may include:

(a) directing the trustee to hold a meeting of bondholders to apprise them of the situation and obtain their directions as to how to proceed;

(b) stay all or any actions or proceedings before any court against the Issuer;

(c) restrain the payment of any monies by the Issuer to the bondholders, or any class of such holders;

(d) appoint a receiver over the assets secured in respect of the bond for the benefit of the bondholders; and/or

(e) give such further directions as may be necessary to protect the interests of the bondholders, the shareholders of the Issuer and the guarantors, and the public.

5.16 There does not appear to have been previous reported decisions involving this section, and it is uncertain how the Singapore Courts will interpret it. It is noteworthy however that section 266(5) of the SFA specifically requires the court hearing such an application to also take into account "the rights of all creditors of the" Issuer. This may be interpreted as requiring the court to tailor its relief, if any, so as not to offend the principle of *pari passu* distribution the assets of an insolvent entity.

5.17 Lastly, a trustee also has a right to apply to court for directions in relation to any matter arising in connection with the performance of its functions: Section 267(1) SFA. This section would permit a bond trustee to take directions from the Court as to how (if at all) it should respond to a breach, or threatened breach, of the bond documentation by an Issuer, if the bond trustee wishes to avoid any potential liability for failing in its statutory duties of diligence and vigilance.

(3) Statutory duties of a trustee

5.18 Separate from the bond trustee's obligations as set out in the relevant bond documentation and trustee deed, the bond trustee (if appointed) of a bond offered is also subject to the following statutory obligations in Section 266(1) of the SFA, namely to:

(a) exercise due diligence and vigilance in carrying out its functions and duties and in safeguarding the rights and interests of the bondholders;

(b) ensure that it has the ability and powers to fulfil its duties as set out in the trust deed;

(c) ensure that any trustee appointed for the holders of security provided for the bonds is itself subject to duties of diligence, vigilance and ensuring that it has the requisite ability and powers to fulfil its own duties; and

(d) to comply with all requirements as may be imposed by the MAS.

C. ANALYSIS OF THE ISSUE

5.19 In Singapore, the bondholder's rights of direct enforcement arise from statutory sources and common law, namely:

(a) direct action against the Issuer, where permitted;

(b) Section 267A of the SFA; and

(c) Section 216 of the Companies Act.

I. Direct action against Issuer where permitted

5.20 As a starting point, under Singapore law, non-action clauses are effective in transferring the right of enforcement from bondholders to the bond trustee.[46] However, it is not technically compulsory for a bond to provide for a trustee, for a trust deed, or for a no-action clause. Further, as mentioned above, bondholders are still able to commence enforcement actions directly through the *Vandepitte* procedure.

5.21 Prior to 22 December 2003, the SFA previously mandatorily required that *every* bond available to the public have a suitable trustee. Section 262(1) of the SFA (version effective prior to 22 December 2003):

> Subject to this section, every corporation and every other entity which makes an offer or invitation to the public in respect of debentures shall make provision in those debentures or in a trust deed relating to those debentures for the appointment of a trustee corporation as trustee for the holders of the debentures.

5.22 This was thereafter amended pursuant to the recommendations set out by the Report of the Company Legislation and Regulatory Framework Committee in October 2002 (the "**CLRFC Report**") and in particular, recommendation 2.13 thereof:

> The CLRFC recommends removing the statutory requirements pertaining to the appointment of trustees and prescribed covenants for public offerings of debentures. The requirements on the appointment of trustees, the duties of the trustees and the contents of the trust deed would be prescribed by Singapore Exchange Securities Trading Limited. The Securities and Futures Act should continue to address the liabilities of trustees where they are appointed.

5.23 As can be seen, the 2002 amendments to the SFA contemplated that the appointment of trustees would be limited only to listed bonds, with the requirements for off-market bond issuances relaxed to apply only to those issuances which were accompanied by a prospectus. The modern section 265A of the SFA therefore provides only that a trustee is required where an offer of debentures is made in or accompanied by a prospectus.

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[46] See, *inter alia*, the High Court decisions of *Swiber No.2* at [7] and *Oro Negro Drilling Pte Ltd v Integradora de Servicios Petroleros Oro Negro, SAPI de CV* [2019] SGHC 35 at [17]-[20].

5.24 As such, certain bonds may not have a trustee, a trust deed and / or a no-action clause. In such an event, the individual bondholder is free to directly enforce against the Issuer for any default on the bond. The possibility of such direct enforcement is expressly contemplated by section 265 of the SFA, but only where there is no trustee.

5.25 Alternatively, some bonds also expressly provide that bondholders retain direct rights against the Issuer upon the declaration of an event of default by the trustee. Such a clause was considered in *Swiber No.2* at [9].

5.26 Finally, it is also possible for bondholders to proceed in an action to compel the trustee to enforce their rights on their behalf, if the trustee has refused to do so. Such an action would have both the issuer and the trustee as co-defendants and is known as the *Vandepitte* procedure (as explained at paragraph 4.9 above). The Singapore Court of Appeal observed in *The State-Owned Company Yugoimport SDPR v Westacre Investments Inc* [2016] 5 SLR 372 that the *Vandepitte* procedure is intended to avoid a multiplicity of actions by allowing a beneficiary to sue a third party in exceptional circumstances where the trustee refuses to do so. However, it is a rule of procedure and does not grant substantive rights to the beneficiary against the third party.[47]

II. Section 267A of the SFA

5.27 The same amendments to the SFA in 2003 that removed the requirement for every bond issued to the public to have a trustee at the same time also provided each individual bondholder with a statutory right of recourse to the court, albeit against a non-performing trustee rather than against the Issuer itself. The MAS and SGX would also have similar rights. Recommendation 2.13 of the CLRFC Report:

> … In addition, the Securities and Futures Act should be extended to confer the rights on the Monetary Authority of Singapore, the Singapore Exchange Securities Trading Limited and debenture holders to apply to the court to compel a trustee to perform his duties as set out in the trust deed.

5.28 The CLRFC Report's recommendation was adopted *vide.* the new section 267A of the SFA:

> Without prejudice to any other right of action or remedy in any written law or rule of law, a holder of debentures, the Authority or an approved exchange (in a case where the debentures are quoted or listed for quotation on that approved exchange) may apply to the court for an order to compel the trustee for the holders of such debentures to perform his duties as set out in the trust deed relating to those debentures, and the court may either make the order on such terms as it considers appropriate, or dismiss the application.

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47 *The State-Owned Company Yugoimport SDPR v Westacre Investments Inc* [2016] 5 SLR 372; [2016] 5 SLR 372 at [117].

5.29 Section 267A of the SFA requires only the application of a single bondholder. By contrast, most trust deeds and bond documentation require the trustee to act only at the instance of certain defined minimum percentages of bondholder support. To date, however, there do not appear to have been reported decisions in relation to section 267A of the SFA, and it is difficult to anticipate how local courts will exercise their authority thereunder.

III. Section 216 of the Companies Act

5.30 Finally, Section 216 of the Companies Act is generally known for providing for relief against minority oppression in the context of the minority shareholders. However, Section 216(1) of the Companies Act actually provides that any "member *or holder of a debenture of a company*" (emphasis added) may apply for relief thereunder. It therefore appears to be theoretically possible for a bondholder to apply for relief under section 216 of the Companies Act directly as an independent ground of relief.

5.31 This interesting theoretical option was explored at length in "Bondholder Rights and the Section 216 Oppression Remedy" [2011] 2 SJLS 432 ("***Bondholder Rights***"). Noting that, in practice, no bondholder appears to have ever relied on such a power, the learned author set out at pp 434-435 therein a theoretical framework for understanding how section 216 of the Companies Act could be applied to the vindication of a bondholder's rights either (a) against the issuer on behalf of the bondholders as a class (which the author called a "Category 1" scenario), or (b) by a minority bondholder against the issuer and/or the majority of the bondholders (which the author called a "Category 2" scenario).

5.32 At pp 439-444, *Bondholder Rights* considered, but ultimately declined to endorse, the application of section 216 of the Companies Act in a Category 1 scenario, on the basis that (a) the contracting process was already adequate to protect bondholders, (b) market forces would already protect bondholders by providing for higher interest rates for bonds with weak contractual protections for bondholders, (c) the fact that individual investors generally held a small proportion of corporate bonds, (d) the application of Section 216 of the Companies Act would unduly restrain management discretion, and (e) the availability of other forms of protection for bondholders, such as the statutory prohibitions against insolvent trading, unfair preferences and undervalue transactions.

5.33 However, *Bondholder Rights* also argued at pp 448-454 that it might be appropriate to extend section 216's applicability to bondholders in the Category 2 scenario, that is, by a minority bondholder against the actions taken by other bondholders, with the relevant legal test being the question of commercial unfairness. This in turn was to be determined with reference to the question of whether the conduct of the majority bondholders rose to the level of breaching the reasonable expectations of reasonable, honest and impartial participants to the bond issuance that such an understanding ought to be an inherent attribute of their relationship with each other. Some examples would be (at pp 453-454):

(a) discriminatory acts by the Issuer itself in preferring the interests of certain bondholders over others;

(b) vote manipulation through secret payments to other bondholders; and

(c) undue coercion of minority bondholders to influence voting outcomes.

5.34 In this regard, it is relevant to note that remedies for oppression and/or injustice have also been extended to unitholders of REITs pursuant to Section 295C of the SFA, illustrating further the theoretical utility of the minority oppression regime outside of its traditional domain in shareholder disputes.

D. CONSIDERATIONS FROM OTHER JURISDICTIONS

5.35 We set out below an overview of how several other jurisdictions deal with the issue whether beneficial bondholders are able to directly enforce their rights under the bonds. In particular, the courts in such jurisdictions considered the effect of "no-action" clauses in bonds and where relevant, the effect of statute on the bondholders' rights.

I. New York

5.36 A "no-action" clause prohibiting bondholders from pursuing claims on the bonds save in accordance with the terms of the bonds and the conditions precedent thereto is effective under New York law. *Howe v Bank of New York Mellon* 783 F.Supp.2d 466 (S.D.N.Y.2011) ("***Howe***") states at 473 that:

> [i]t is well established that a "no action" clause bars claims by an individual bondholder who fails to comply with the conditions precedent recited therein… Courts strictly construe a "no action" clause in accordance with its terms.

5.37 The rationale is that as it is the trustee who is obliged to enforce substantive claims on the bondholders' behalf. So long as the trustee is capable of doing so in accordance with its obligations, it is the proper party to do so. Indeed, that is the "main function" of the no-action clause. As stated in *Peak Partners LP v Republic Bank* 191 Fed. Appx. 118 (3d Cir.2006) at 126:

> The main function of a no-action clause is to delegate the right to bring a suit enforcing the rights of bondholders to the trustee, or to the holders of a substantial amount of bonds… This function is a central feature of an Indenture, the primary purpose of which is to centralize enforcement powers by vesting legal title to the securities in one trustee (internal citations omitted).

5.38 In the insolvency context, a no-action clause likewise continues to be effective in prohibiting the bondholders, as opposed to the trustee, from constituting a "party in interest" for the purposes of § 1109(b) of the US Bankruptcy Code and therefore being permitted to be heard and to participate in bankruptcy proceedings.[48] This applies regardless of whether the no-action clause expressly names insolvency proceedings as being among those which it suppresses.[49]

5.39 Accordingly, the bondholders' right of remedy is only to compel the trustee to carry out its obligations (see also the discussion at paragraphs 4.9 and 5.26 above on the *Vandepitte* procedure under common law). As stated in *Feldbaum v McCrory Corporation* 1992 WL 119095 (Del.Ch. June 2, 1992) at 643-644 and affirmed under New York law in *Walnut Place LLC v Countrywide Home Loans Inc* 35 Misc.3d 1207A, 2012 WL 1138863 at 5:

> … no matter what legal theory a plaintiff advances, if the trustee is capable of satisfying its obligations, then any claim that can be enforced by the trustee on behalf of all bonds, other than a claim for the recovery of past due interest or principle, is subject to the terms of a no-action clause of this type… I do not mean to imply that courts will apply no-action clauses to bar claims where misconduct by the trustee is alleged. For the same reason that equity has long recognized that, in some circumstances, corporate shareholders will be excused from making a demand to sue upon corporate directors, but will be permitted to sue in the corporation's name themselves, bondholders will be excused from compliance with a no-action provision where they allege specific facts which if true establish that the trustee itself has breached its duty under the indenture or is incapable of disinterestedly performing that duty. … absent circumstances making application of a no-action clause inappropriate, such as those described above, courts systematically conclude that, in consenting to no-action clauses by purchasing bonds, plaintiffs waive their rights to bring claims that are common to all bondholders, and thus can be prosecuted by the trustee, unless they first comply with the procedures set forth in the clause or their claims are for the payment of past-due amounts.

5.40 Such an action can be brought as a derivative action to enforce rights relating to the bonds in two circumstances. First, it can bring a derivative action on the right of the trustee if the trustee acts in bad faith, or "abdicating its function", refuses to act at all, in relation to a claim which the trustee can and should bring against the Issuer but for some reason does not. It was noted in *Campbell v Hudson & Manhattan R Co* 277 AD 731, 102 N.Y.S.2d 878 at 881-882, that the enforcement of the no-action clause:

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48 *In re Innkeepers USA Trust* 448 Br 131 (Bankr. S.D.N.Y. 2011) at 144.

> … presuppose[s] a trustee competent to act, and exercising its judgment in good faith respecting what is best for the bondholders as a whole concerning the matter in issue. If a trustee under such an indenture acts in bad faith, or, abdicating its function with respect to the point in question, declines to act at all, bondholders for themselves and others similarly situated may bring a derivative action in the right of the trustee, rather than in their own individual rights as bondholders.

5.41 However, such derivative actions must be "brought on behalf of and for the benefit of all bondholders", and not to "vindicate their own individual rights as bondholders" (internal citations omitted): *Howe* at 475. Accordingly, the bondholder must show that (a) the trustee is unreasonably or in bad faith refusing to sue for a breach of the bond, and (b) that the proposed derivative action is in the interests of all bondholders. It is relevant in respect of the latter determination as to whether the bondholders in general body have voted to approve the trustee's impugned action.[50]

5.42 Alternatively, the bondholder can also bring a derivative action on behalf of a company to enforce a bond, if the bond is convertible into the equity of that company. This is on the basis of bondholder's rights as a putative shareholder thereof.[51]

II. Australia

5.43 The Australian position has been codified in the Corporations Act. Several aspects of the bond regime in Australia are noteworthy:

(a) the statutory requirement for a trustee and a trust deed;

(b) the statutory obligations of the trustee and the Issuer respectively; and

(c) the Court's power to make orders to assist the bondholders.

(1) Statutory requirement for trustee and trust deed

5.44 The Corporations Act not only permits but *mandates* that a suitable trustee be appointed and suitable trust deed entered into in respect of any issuance of bonds by a body corporate or an unincorporated body in Australia which either requires disclosure to investors, or which is exempted from disclosure as a roll-over bond or as a quoted security: Section 283AA(1) Corporations Act. Failure to appoint a trustee or enter into a suitable trust deed is a criminal offence with strict liability: Section 283AA(1A) Corporations Act.

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49 *In re American Roads LLC* 496 BR 727 (Bankr. S.D.N.Y. 2013) at 731: "*While the Bondholders are correct that 'no action' provisions must be clear, the Bondholders are incorrect to suggest that these provisions must contain specific language barring participation in bankruptcy proceedings.*"

50 *Howe v Bank of New York Mellon* 783 F.Supp.2d 466 (S.D.N.Y.2011) at 475.

51 *Hoff v Sprayregan* 52 F.R.D. 243 (S.D.N.Y.1971) at 247.

5.45 In particular, section 283AB(1) of the Corporations Act expressly provides that such trust deed must provide that the trustee will hold in trust for the trustee for the benefit of the bondholders:

(a) the right to enforce the borrower's duty to repay;

(b) any charge or security for repayment; and

(c) the right to enforce any other duties that the borrower and any guarantor may have under the bonds, the trust deed or the Corporations Act.

5.46 The trust deed must furthermore stay in effect until all amounts payable under the bond have been repaid: Section 283AA (2) Corporations Act. The trustee cannot be appointed if doing so would create a conflict of interest or duty. Failure to comply is also a criminal offence: Section 283AC(2) and (3) Corporations Act.

5.47 In the New South Wales Supreme Court decision of *Australian Securities and Investments Commission v Great Northern Developments Pty Ltd* (2010) 79 ACSR 684, the defendant Issuer, a property company, had issued unlisted promissory notes which each had a face value of more than A$50,000 to 27 individual lenders (at [3]). No trust deed had been entered into and no suitable trustee proposed (at [2]). The plaintiff, Australian Securities and Investments Commission ("**ASIC**"), the independent corporate regulator of Australia, accordingly brought an application for declarations that the defendant Issuer had breached Section 283AA of the Corporations Act for the winding up the defendant on the basis of such breaches (at [8]). The Supreme Court of New South Wales granted ASIC the declarations sought but accepted the Issuer's undertaking that the breaches would be remedied in lieu of granting a winding-up order (at [50]-[52]).

(2) Statutory obligations of a trustee and an Issuer

5.48 The Corporations Act also codifies the various obligations to which the Issuer and the trustee are subject to. Amongst other obligations, the Issuer must:

(a) carry on and conduct its business in a proper and efficient manner: Section 283BB(a) Corporations Act;

(b) make all of its "financial and other records" available for inspection by the trustee and its properly-authorised officers, employees or auditors, together with "any information, explanations or other assistance" that they may require: Section 283BB(c) Corporations Act;

(c) take all reasonable steps to replace the trustee if the trustee has ceased to exist, can no longer be a properly-appointed trustee, or has failed or refused to act as trustee: Section 283BD Corporations Act;

(d) inform the trustee of any security interest created within 21 days: Section 283BE Corporations Act; and

(e) provide quarterly reports to the trustee and ASIC, which must include details of any failure by the Issuer or guarantor to comply with the terms of the bonds or the trust deed, any event that could cause the bonds to be immediately enforceable, any circumstances that might materially prejudice the Issuers or any security interest relating to the bonds or trust deed, any substantial change in the nature of the business of the Issuer, its subsidiaries or the guarantors, and any other matters that may materially prejudice any security interests or other interests of the bondholders: Section 283BF(1) and (4) Corporations Act.

5.49 Among other obligations, the trustee must:

(a) exercise reasonable diligence to ascertain that the property of the Issuer and any guarantor available to repay the sum deposited or lent will be sufficient for such purposes: Section 283DA(a) Corporations Act;

(b) exercise reasonable diligence to ascertain whether the Issuer or any guarantor has committed any breach of the terms of the bond, the trust deed or the relevant provisions of the Corporations Act: Section 283DA(b) Corporations Act;

(c) "do everything in its power" (as opposed to the mere exercise of reasonable diligence) to ensure that the borrower or guarantor remedies any breach of the bond, the trust deed or the relevant provisions of the Corporations Act: Section 283DA(c) Corporations Act;

(d) comply with any directions given to it at a bondholder's meeting unless the direction is inconsistent with the terms of the bonds, the trust deed or the relevant provisions of the Corporations Act, or "is otherwise objectionable" *and* has either obtained or is in the process of obtaining an Order of Court setting aside or varying the bondholders' direction: Section 283DA(h) Corporations Act; and

(e) apply to the Court for an order under Section 283HB Corporations Act, if requested to do so by the Issuer: Section 283DA(i) Corporations Act. We will address Section 283HB Corporations Act at paragraph 5.53 below.

5.50 Bondholders have enforced the terms and requirements of the Corporations Act against trustees on numerous occasions. In the Federal Court of Australia case of *O'Keeffe v Hayes Knight GTO Pty Ltd* (2005) FCA 389, applicant bondholders sought to remove a trustee on the basis that the trustee had received information from which it knew or ought to have known that there was a real possibility that the Issuer would be insufficient to repay the bonds, yet the trustee took no steps to seek directions from the Court (at [3]). The trustee conceded the application shortly before the hearing and was discharged as trustee (at [8]), and was ultimately made to pay the applicant bondholders' costs on an indemnity basis (at [57]).

5.51 Likewise, in *Sandhurst Trustees Ltd v Clarke* (2015) 321 ALR 1; [2014] FCA 580, the Full Court of the Federal Court of Australia granted an application for pre-action discovery by bondholders against a trustee, following a default by the Issuer, on the basis that such information would assist them in determining whether the trustee had been negligent in the performance of its duties. The Federal Court noted that the fact of the default by the Issuer could be *prima facie* grounds for such a claim against the trustee (at [52]):

> It must not be forgotten that Wickham [the issuer] failed. It must be at least arguable that the mechanism provided by the Corporations Act in order to protect noteholders, the appointment of a trustee, also failed.

(3) Court's power to provide relief to bondholders

5.52 Section 283HA of the Corporations Act provides that where a trustee applies to the Court for any direction in relation to the performance of his functions, or to determine any question in relation to the interests of the bondholders, the Australian court has wide-ranging general powers to make any direction, declaration or determination in relation to the performance of the trustee's functions or to determine any question in relation to the bondholder's interests. Section 283HA of the Corporations Act is comparable in substance to Section 267 of the SFA, which similarly provides for the right of a bond trustee to seek directions: see paragraph 5.17 above.

5.53 Furthermore, Section 283HB(1) of the Corporations Act provides further that the court can make any or all of the following orders (amongst others) on application by the trustee or ASIC:

(a) staying any proceedings against any borrowers or guarantors;

(b) restraining the borrower from paying any money to the bondholders;

(c) that any security be enforceable immediately or at any time that the Court may direct;

(d) appointing receivers over property constituting security; and

(e) any other order that would be appropriate to protect the interests of existing or prospective bondholders.

5.54 The powers under Section 283HB of the Corporations Act must statutorily be exercised with regard to the following considerations under Section 283HB(2) of the Corporations Act:

(a) the ability of the borrower and each guarantor to repay the amount deposited and lent as and when it fell due;

(b) any contravention of Section 283GA of the Corporations Act (on ASIC's powers to exempt and modify the application of Chapter 2L of the Corporations Act to any person) by the Issuer;

(c) the interests of the Issuer's members and creditors; and

(d) the interests of the members of each of the guarantors.

(collectively, the "**Mandatory Factors**").

5.55 The Australian case law has established the following principles relevant to Sections 283HA and 283HB of the Corporations Act.

5.56 First, Section 283HB confers a "broad remedial and protective jurisdiction on the court", though its powers are confined to the specific powers enumerated in Section 283HB(1).[52] Given this, it is not necessary for there to be a breach of terms of the bond or trust deed before it would be appropriate for the court to intervene under Section 283HA and 283HB. In *Australian Securities and Investments Commission v Bridgecorp Finance Ltd* [2006] 58 ACSR 499, the Supreme Court of New South Wales imposed an "enhancing monitoring and reporting regime" on the Issuer, notwithstanding that "there [was] no suggestion that BFL [the issuer] is in breach of the trust deed or the Corporations Act" (at [8]). Likewise, in *Perpetual Trustees WA Ltd v Elderslie Finance Corporation Ltd* [2008] FCA 1068, the Federal Court of Australia held at [31] that:

> … s 283HB(1)(c)… envisages that there may be circumstances in which a security is not yet immediately enforceable in accordance with the terms of the security and the general law, but it will be appropriate for the Court to make an order that the security be immediately enforceable. *An obvious example is a situation in which debentures have not fallen due for payment but all the evidence shows that the borrower is insolvent and will not be able to pay the debentures when the time for payment arises* (emphasis added).

[52] *Trust Co (Nominees) Ltd v Southern Finance Ltd* [2012] FCA 1339 at [16].

5.57 Second, though the court has a "broad discretionary power" in determining whether its powers under section 283HB should be exercised,[53] the Court is nonetheless obliged to have regard to the purposive intent of the Australian Parliament in enacting Chapter 2L of the Corporations Act generally (on the requirement for trust deeds and trustees in relation to issuances of debentures) when making any such order, namely to "provide protection for persons who have invested in companies that have raised funds by way of issuing debentures".[54] Put differently, the ultimate objective of Chapter 2L of the Corporations Act was pro-bondholder and pro-trustee and in particular were to "stock the armouries of trustees so that they may be active in the protection of debenture holders".[55]

5.58 Third, and in relation to the Mandatory Factors:[56]

(a) the fact that the Australian Court statutorily must consider the Mandatory Factors in making any order under Section 283HB does not mean that any other factors can be considered;

(b) notwithstanding the above, the Mandatory Factors and their weight should take priority over any non-mandatory factors also taken into account by the Australian Court; and

(c) as amongst the Mandatory Factors, the factor with the greatest weight ought to be the Issuer's ability to repay.

5.59 The Australian Court's power under Section 283HB has, in particular, been interpreted to be wide enough to encompass:

(a) the appointment of special purpose receivers of the Issuer company in respect of causes of action belonging to the Issuer company, notwithstanding that the Issuer company had already been placed in liquidation;[57]

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53 As the Federal Court of Australia put it in *Trust Company (Nominees) Ltd v Angas Securities Ltd* (2015) 107 ASCR 464; [2015] FCA 772 ("***Angas Securities***") at [81].

54 *Australian Executor Trustees Ltd v Provident Capital Ltd* (2012) 90 ACSR 650; [2012] FCA 728 at [78].

55 *Australian Securities and Investments Commission v Bridgecorp Finance Ltd* [2006] 58 ACSR 499; [2006] NSWSC 836 at [20].

56 *Angas Securities* at [82].

57 See the New South Wales Supreme Court decision of *Re Banksia Securities Ltd (in liq) (Recrs and Mgrs Apptd)* [2015] NSWSC 1378 at [13].

(b) subsequently to "perfect" the terms of that appointment by further providing for the remuneration of such special purpose receivers. The court justified its orders on the basis of what it found to be the "broad remedial and protective jurisdiction on the court" pursuant to the broad scope of Section 283HB Corporations Act, which "extends… to making *any order* that the court considers appropriate to protect the interests of debenture holders" (emphasis added); [58] and

(c) to direct the trustees to disregard the express directions of the bondholders passed at a bondholder's meeting to vote in favour of a scheme of arrangement by the issuer, on the basis of the trustee's "well founded… concerns" about the scheme's substance.[59]

III. United Kingdom

5.60 No-action clauses are also effective under English law.

5.61 In *Elektrim SA v Vivendi Holdings 1 Corp* [2009] 2 All ER (Comm) 213 ("***Elektrim***") at [1]-[2] and [4], the English Court of Appeal set out at length the background, effect and purpose of the no-action clause in English common law:

> … only the trustee of the issue is entitled to take enforcement action against the Issuer, and bondholders cannot proceed directly against the Issuer unless the trustee fails to take action in accordance with the bond documentation. Such clauses have been common in bond issues governed by English law since the nineteeth century… The use of a trustee is an effective way of centralizing the administration and enforcement of bonds. Bondholders act through the trustee, and share pari passu in the fortunes of the investment, and do not compete with each other. The trustee represents and protects the bondholders, who are treated as forming a class, and who give instructions to the trustee through a specified percentage of bondholders. Such a scheme promotes liquidity. Individual bondholders rely on the trustee as the exclusive channel of enforcement and can be confident that on enforcement principal and interest will be distributed pari passu. In the United States it has been said that a primary purpose of a no-action clause is to protect issuers from the expense involved in defending lawsuits which are either frivolous or otherwise not in the economic interest of the issuer and its creditors, causing expense to the issuer and diminishing the assets available to bondholders. In protecting the issuer such clauses protect bondholders. They can extend to non-contractual claims (other than fraudulent inducement of a purchase) because interpreting the no-action clause to exclude non-contractual claims would lead to inefficient claim-splitting.

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58 See the subsequent decision, in the same matter and also by the New South Wales Supreme Court, of *Re Banksia Securities Ltd (in liq) (Recs and Mgrs Apptd)* [2016] NSWSC 357 at [26].

59 *Re Permanent Nominees (Australia) Ltd* [2009] FCA 1576 at [17] and [36]-[37].

5.62 In a series of decisions, the English courts have considered the question of when a no-action clause is effective and have derived the following principles, the effect of most of which has been generally to interpret no-action clauses liberally in favour of the trustee / Issuer in accordance with the commercial intent of such clauses, namely, to seek to concentrate the enforcement power into a single entity and prevent a deluge of competing claims.

5.63 First, the applicability of the no-action clause will be determined based on whether the claim is in substance to enforce the trust deed or the bonds, regardless of how the claim is outwardly characterised. In *Elektrim*, the relevant bond had been issued by the Dutch subsidiary of a Polish conglomerate, with the Polish conglomerate by then in bankruptcy (at [5]). The trustee was English, and the bond itself was governed by English law and had a non-exclusive English jurisdiction clause (at [124]). The trustee had already commenced proceedings in England against the guarantor on unpaid aspects of the bond, when the bondholder commenced additional proceedings in the United States District Court for the Southern District of Florida against both (a) the trustee (for breach of fiduciary duty to the bondholders and failure to exercise due care in its obligations as a trustee) and (b) the guarantor (for fraud and misrepresentation to bondholders) (at [65]).

5.64 Both the trust deed and the bonds themselves contained no-action clauses providing that only the trustee had the right to enforce the terms of the bond against either the issuer or the guarantor, and that no bondholder was entitled to proceed directly against them (at [86]-[88]). Notwithstanding this, the bondholder sought to argue that its claim against the guarantor was purely in fraud, a Florida law tort, and it was not making any claim in contract against either the issuer or the guarantor. Accordingly, no claim to enforce the terms of the bond or the trust deed was being made in breach of the no-action clauses, and no breach of the no-action clauses therefore arose (at [96]).

5.65 The English Court of Appeal rejected the bondholder's argument and granted anti-suit injunctions jointly sought by the trustee and the bond guarantor against the continuation of the Florida proceedings. In doing so, Collins LJ giving the sole substantive judgment took an expansive view of the applicability of the no-action clauses, holding that they would be broadly applicable to any claims that were in substance to enforce the terms of the trust deed and the bond, however they were characterised (at [100]-[107]):

> … the commercial purpose of the no-action clause leads me to conclude that the no-action clause applies to claims which are in substance claims to enforce the trust deed or the bonds, as well as to claims which are in terms claims to enforce them… The no-action clause should be construed, to the extent reasonably possible, as an effective bar to individual bondholders pursuing, for their own account, what are in substance class claims. That can apply to tortious claims as well as to contractual claims. Although the cause of action is not for breach of contract but in tort, the object of the claim is to compensate it for the loss of a contractual right or entitlement under the bond conditions which it had by virtue of being a bondholder. The claim is, in effect, enforcing Everest's right as a bondholder to a share of the contingent payment. The loss of the contingent payment would be a loss which was suffered by all bondholders alike. It was a class loss, and not a loss which would be in any way peculiar to Everest. It is the same loss which the trustee is currently seeking to recover from Elektrim in proceedings in the Chancery Division.… Therefore… VH1's claims are the mirror image of contractual claims for breach of the trust deed: both the alleged wrongful acts and the alleged losses are identical.

5.66 Second, the no-action clause is also effective not only against a claim for recovery of the sums owed under the bond, but also against insolvency proceedings related to such recovery efforts. In *Highberry Ltd v Colt Telecom Group plc* [2003] 1 BCLC 290 at [10]-[14], the English High Court expressed the *obiter* view that a no-action clause would have prohibited petitions for administration order (the equivalent of a creditor application for a judicial management order in Singapore) for an administration order, although on the facts the respondent company chose for commercial reasons to respond to the administration petition substantively notwithstanding the no-action clause. The same result was also reached in the subsequent decision involving the same parties of *Re Colt Telecom Group plc* [2002] All ER (D) 347 (Dec), where the English High Court also considered and dismissed an objection from a bondholder that no-action clauses were contrary to English public policy on the basis that they fettered the rights of creditors to put defaulting issuers into administration or liquidation and hence affect the interests of third party creditors of the issuer, who would be affected by the insolvency of the issuer but were not themselves subject to the no-action clause(at [61]-[63]).

5.67 Likewise, in *Azevedo and Alvarez v Imcopa Importacao, Exportaacao e Industria de Oleos Ltda* [2012] EWHC 1849 (Comm) at [69] the English High Court struck out bondholders' applications for declarations, amongst other things, that certain extraordinary resolutions passed by the bondholders in respect of amendments to the trust deed were illegal, invalid and ineffective under English law. The English High Court's decision was on the basis that the bondholders' applications were prohibited by the no-action clause.

5.68 Third, no-action clauses however would not apply to actions for which the sole purpose was to achieve or assist in *restructuring* an issuer's liabilities, as opposed to directly *enforcing* such liabilities against the issuer. In *Elliott International LP v Law Debenture Trustees Ltd* [2006] All ER (D) 143 (Dec) ("***Elliott International***"), the English High Court was asked to issue a declaratory judgment on the proper effect and application of a no-action clause in a bond governed by English-law and English-jurisdiction clauses. The issue arose because the issuer was restructuring its liabilities in the Paris Commercial Court under the French insolvency procedure known as *procedure de sauvegarde* or "safeguard proceedings", a form of court-supervised debt restructuring for solvent debtors (at [13]). The bondholders had challenged the commencement of such proceedings in the Paris court through a procedure under French law in turn known as a *tierce opposition* or "opposition proceedings" (at [15]). The English High Court's declaratory judgment was therefore sought on the entitlement of the bondholders to bring such opposition proceedings despite the no-action clause. The court considered at [47]-[50] that neither the safeguard proceedings nor opposition proceedings were proceedings to enforce the terms of the bonds, but merely proceedings intended to assist a restructuring of the debt.

E. RECOMMENDATIONS

5.69 As can be seen, the New York, Australian and English positions are generally similar in that the allocation of the bondholder's rights of enforcement is generally permitted (or mandated, in the Australia). The commercial rationale for such clauses, being to prevent a multiplicity of claims and thereby encourage liquidity by permitting corporate Issuers greater access to debt capital markets, is also applicable in the Singaporean context.

5.70 The Subcommittee is of the view that there is no urgent necessity for legislative reform of the existing statutory regime relating to bondholders' rights of direct enforcement at this time.

CHAPTER 6

VOTING STRUCTURES

A. EXISTING FRAMEWORK

6.1 Bondholders typically hold their interests in Issuer companies through layers of intermediaries, such as trustees, nominees or custodians. This therefore raises the question of who should exercise the bondholder's voting rights in different insolvency situations, such as judicial management and schemes of arrangement. The key issue to be resolved is whether the voting entity should be:

(a) the entity with direct enforcement rights against the Issuer (*i.e.,* typically the trustee, nominee or custodian) (the "**accountholder**");

(b) the ultimate beneficial bondholder (the "**beneficial bondholder**"); or

(c) some intermediate party (e.g. a nominee of the ultimate bondholder one level removed from the registered bondholder) (the "**intermediate bondholder**") who may or may not be the beneficial bondholder.

6.2 We consider this question with reference to the position in schemes of arrangement and in judicial management (or equivalent) in different jurisdictions.

I. Voting in Schemes of arrangement

6.3 Both accountholders and intermediate bondholders are generally obliged to vote in accordance with the instructions of the beneficial bondholder. However, the question of who *specifically* is entitled to vote has practical significance because schemes of arrangement require the approval of creditors on a 'headcount test' (*i.e.,* approval by a majority in number regardless of value of the vote held) together with approval by 75% by value (the 'value test'): Section 210(3AB) Companies Act. It follows that the relevant voting demographic can be of great significance to the headcount test. If only the accountholder is entitled to vote, then <u>all</u> the bondholders' views would collectively be represented by only one vote for the purposes of the headcount test. As a matter of headcount, they may even effectively be represented by zero votes, in a case where the accountholder's vote is counted as being cast both for and against the scheme on the basis that some of the beneficial bondholders voted for and some against the scheme (the so-called "split vote" approach utilised in *Re Equitable Life Assurance Society* [2001] Lexis Citation1982 and adopted in Singapore in *Swiber No.2* at [69]-[72]).

6.4 It has been pointed out that for this reason, courts have generally sought to avoid defining the relevant creditor demographic as being limited only to the accountholder, owing to the distortionary effects that can arise as a consequence. See Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (Cambridge University Press, 2014) at 186-187:

> If the bondholders [meaning beneficial bondholders] are not regarded as creditors for scheme purposes, unfortunate consequences can follow. To determine whether the bondholders support the scheme, a meeting is needed, at which a majority in number and 75 per cent in value of the creditors or class of creditors present and voting in person or by proxy agree to the compromise. Imagine a company, A plc, that raises £100 million in a bond issue, and subsequently proposes a scheme of arrangement to compromise its bond. If it cannot treat the ultimate bondholders as creditors, then it would have only one creditor: the trustee. Generally, the trustee will have an omnibus proxy to allow it to vote and will solicit the views of the beneficial owners through the issue of sub-proxies. The vote is then treated as one vote, split as to value in accordance with the wishes of the beneficial owners… no majority can arise in this situation.

6.5 Other distortions can also arise in respect of the value test. There is no standardised way of determining the proxy vote of a trustee or custodian bank. As a matter of practice, some appear to use a "simple majority" rule by which only votes in favour of the position which ultimately passes are submitted, with votes against simply discounted. Others use an "offsetting" rule by which the votes against the position which does not pass are subtracted from the votes in favour.[60] As an example, if bondholders submit to their trustee or custodian bank a total of five votes in respect of a proposal, three in favour and two against, the custodian might issue either three votes in favour of the proposal (using the "simple majority" rule) or only one (using the "offsetting rule"). In the latter example, there will be potentially significant diminution of the views of minority voters.

(1) Traditional position at common law

6.6 The traditional position at common law had been that beneficial bondholders were not creditors of the Issuer as there was no contract between them and the Issuer. The party who was entitled to exercise rights as a creditor was the accountholder only. In *In re Dunderland Iron Ore Company, Limited* [1909] 1 Ch 446 ("*Dunderland*") at 452-453, the English High Court noted that:

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60 Rae Wee, "Time to revisit headcount test for scheme meetings: observers" *The Business Times* (15 January 2021) <*https://www.businesstimes.com.sg/companies-markets/time-revisit-headcount-test-scheme-meetings-observers*> (accessed 9 March 2023).

> In these circumstances are the petitioners, the debenture stockholders, creditors? There is no covenant by the company with them. The covenant in the trust deed is between the company and the trustees… In my opinion the true legal position is that the debenture stockholders, although cestuis que trust, are not creditors of the company. They have not any direct contract with the company. The contract is between the company and the trustees, and in these circumstances I am of opinion that the petitioners are not creditors entitled to present a winding-up petition…. The petitioners are merely the registered holders of debenture stock, and the only covenant to pay the principal and interest to the stockholders is a covenant made between the company and the trustees. On that state of facts, the stockholders as such are not creditors of the company.

(2) Singapore's Position

6.7 It appears *prima facie* that only the accountholder can vote at a meeting of creditors under Section 210 of the Companies Act for a scheme of arrangement (a "**scheme meeting**"), being the only direct creditor of the Issuer. As the beneficial bondholder generally has no direct contractual relationship with the Issuer, he will also not have any direct rights of enforcement against the Issuer, will not be a creditor of the Issuer, and accordingly will not be entitled to vote in respect of any scheme meeting.

6.8 However, where the relevant bond documentation provides either that the intermediate or beneficial bondholder may have rights of direct enforcement against the Issuer upon the occurrence of some contingency, then the intermediate or beneficial bondholder (as the case may be) will also be entitled to vote at the scheme meeting as a contingent creditor: *Swiber No.2* at [45]. It is well-settled that the definition of 'creditor' in respect of a scheme will encompass a contingent creditor.[61]

6.9 Accordingly, an important question in determining a beneficial bondholder's entitlement to vote at a scheme meeting is whether the bond documentation provides for rights of direct enforcement, and if so, to whom. The bond documentation in *Swiber No.2* provided that such rights of direct enforcement were vested in the registered holders of notes in question, *i.e.,* the intermediate bondholder (because the registered noteholders might not also be the beneficial holders thereof). The court noted that this was different from simply vesting the right of direct enforcement in the beneficial bondholder, but nonetheless, the outcome was that only the intermediate bondholders could vote as contingent creditors (at [46]).

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61 *SAAG Oilfield Engineering (S) Pte Ltd v Shaik Abu Bakar bin Abdul Sukol* [2012] 2 SLR 189; [2012] SGCA 7 at [29]-[30] and [50].

II. Voting in Judicial Management

6.10 In Singapore, the passage of resolutions at meetings called by judicial managers ("**JM meetings**") are also subject to a headcount test (Regulation 34 of the Insolvency, Restructuring and Dissolution (Judicial Management) Regulations 2020 (the "**IRD(JM)R**")). The same concerns and considerations would therefore apply as in respect of schemes.

6.11 The position in Singapore is that beneficial bondholders are generally not permitted to vote in respect of JM meetings. This is because their rights against the Issuer, if any, would arise only as contingent creditors thereof where such beneficial bondholders have contingent rights of direct enforcement against the Issuer. However, contingent creditors are expressly not allowed to vote in JM meetings: Regulation 38(1)(a) of the IRD(JM)R.

6.12 The exception is for scheme meetings which are summoned on application to Court by a judicial manager. Such meetings are not in the first place JM meetings insofar as they are ordered by the court, not summoned by a judicial manager.[62] At such meetings, the IRD(JM)R thus have no application and beneficial bondholders would still be entitled to vote subject to having a contingent right of direct enforcement.

(1) Adjudication of debt

6.13 An intermediate bondholder or beneficial bondholder who is allowed to vote in a scheme meeting will lodge a proof of debt with the scheme manager for adjudication. It is not uncommon for the scheme manager to expressly state that the adjudication is only for purposes of voting at the scheme meeting, and that he reserves the right or option to call for another proof of debt for purposes of distribution under the proposed scheme if necessary.

6.14 To avoid double counting, the trustee or nominee of the bond will typically abstain from voting (see e.g., the order made in *In the Matter of Castle Holdco 4 Ltd* [2013] EWHC 3919 (Ch) ("***Castle Holdco***") which expressly stated as such (at [25])).

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62 *Re Swiber Holdings Ltd* [2018] 5 SLR 1130; [2018] SGHC 180 at [42]-[43].

6.15 In adjudicating the proof of debt, the judicial manager or scheme manager will review the supporting documents accompanying the proof. An issue is whether and how claims by the Issuer against the bondholder are taken into account or set off against the bondholder's claim against the Issuer. In the context of a judicial management, mutual debts and credits between the Issuer and the bondholder will be automatically set off such that the proof of debt should be for any net amount owed by the Issuer to the bondholder (section 219 of the IRDA). The treatment of such mutual debts and credits in the context of a scheme of arrangement will generally be subject to the terms of the proposed scheme.

B. CONSIDERATIONS FROM OTHER JURISDICTIONS

I. Voting in schemes of arrangement

(1) England, Australia

6.16 The position in England and Australia is generally similar to that of Singapore, though their cases have tended to consider bond documentation which provides voting rights to beneficial bondholders rather than intermediate bondholders. We begin first with the English position.

6.17 In *Castle Holdco*, the court considered a scheme for the resolution of certain bondholder liabilities (amongst others). The relevant bond documentation provided for direct enforcement by the beneficial bondholders against the Issuers. The Court accordingly found that the beneficial owners could vote (at [23]-[24]):

> When the Scheme of arrangement comes to be considered, *it ought obviously to be considered by those who have an economic interest in the debt, that is to say, by the ultimate beneficial owner or principal*.... However, the security documentation does contain a mechanism whereby the beneficial owner can upon request become a direct creditor of Castle Holdco. On the occurrence of an event of default, *there is a provision that the global security is to be transferred to the beneficial owners in the form of definitive securities upon the request by the owner of a book entry interest. It has been submitted to me, and I accept, that the ultimate beneficial owners may therefore be properly regarded as contingent creditors* of the company and indeed of each of the subsidiaries who have provided a guarantee (emphasis added).

6.18 As the court in *Swiber No.2* noted, however, the two underlined sentences above do *not* in fact necessarily lead to the same conclusion. In *Castle Holdco*, the relevant bond documentation provided for direct enforcement by the beneficial bondholders, and accordingly there was a coincidence of identity between the party with enforcement power and "*those who have an economic interest in the debt*". In *Swiber No.2* it was the intermediate rather than the beneficial bondholder which held the direct enforcement power. It is therefore not entirely certain whether the court in *Castle Holdco* was advancing the limited proposition that the creditor with contingent rights of direct enforcement against the Issuer ought to be taken as a creditor for the purposes of the scheme meeting, or the broader proposition that it was for "*those who have an economic interest in the debt*", *i.e.,* the beneficial bondholder, to do so, in cases where these were not the same entity.

6.19 Subsequent English decisions interpreting *Castle Holdco* have since clarified that the position in England is the former, that is, only the party with direct enforcement rights shall be entitled to vote, apart from the question whether that is also the party with an economic interest in the debt.

6.20 In *Re Co-Operative Bank plc* [2013] EWHC 4072 (Ch), the English High Court further considered a scheme structurally similar to that in *Castle Holdco* insofar as the direct enforcement rights were vested in the beneficial bondholders. Hildyard J made clear in his decision that the deciding factor was where the direct enforcement rights lay (at [40]):

> I have stressed that my conclusion in that regard is case-specific, it being the case here that the beneficiaries have an absolute right to require the Bank to issue definitive notes directly. *It seems to me that since there is such a mechanism to trigger a direct right and therefore obtain control over that contingency, which is defined, they are properly described as contingent creditors* and thus as creditors for the purposes of the relevant provision of the Act (emphasis added).

6.21 Snowden J reached the same conclusion in *Re Noble Group Ltd (No 1)* [2019] 2 BCLC 505; [2018] EWHC 2911 (Ch) (at [162]-[163]):

> … it is now well established that if the relevant instruments provide that beneficial Noteholders can acquire direct rights against the Issuer in some (even remote) circumstance, the underlying beneficial Noteholders can properly be classified as 'contingent creditors' of the company, and arrangements should be made to enable them to vote so as to enfranchise those with the ultimate economic interest in the debt: see e.g. Re Castle Holdco 4 Ltd… and Re Co-operative Bank plc… at [38]. *In the present case, each series of Notes contains provisions enabling beneficial Noteholders to acquire direct rights against the Issuer in certain circumstances. I am therefore satisfied that the beneficial Noteholders can and should properly be regarded as contingent creditors* (emphasis added).

6.22 Two recent decisions by Trower J have confirmed that the position remains the same. In *Re Lecta Paper UK Ltd* [2020] EWHC 382 (Ch) at [18], the English High Court noted that:

> … I am satisfied that the beneficial owners of the notes are also creditors of the company, albeit subject to a contingency. *This is because section 2.09 of each indenture entitles them to call for the issuance of definitive notes to replace the global notes in certain circumstances*, namely where Euroclear or Clearstream are unwilling or unable to act and no replacement is appointed within 120 days or, perhaps more probably, where an event of default is incurred or enforcement action is being taken. In those instances, a direct payment obligation owing by the company to the beneficial of the notes will be generated. *This state of affairs is sufficient to render the beneficial owners "creditors"…* (emphasis added).

6.23 Likewise, in *Re Castle Trust Direct plc* [2020] EWHC 969 (Ch) at [20]-[23]:

> The bond holders do not themselves have the legal right to payment under the bond. They simply have a beneficial interest with no direct legal claim against CTD. *They do, however, have quite widely drawn rights to request the exchange of a beneficial interest for legal title in the form of a definitive note* under clause 3.2… This right is not drafted as giving rise to a legal entitlement to an exchange on request… as a matter of law, any request for the exercise of the contractual power is subject to the company concerned considering it in accordance with the requirements of rationality and good faith… If that is correct, it is well-established that the bond holders, as beneficial owners, are to be treated as creditors… (emphasis added).

6.24 The Australian position appears to be consistent with the English one. In *Re Glencore Nickel Pty Ltd* (2003) 44 ACSR 210; [2003] WASC 18 ("***Glencore***", which predated *Castle Holdco*), the bonds in question were regulated by New York law and the bondholders were resident outside Australia. In determining whether the beneficial bondholders were entitled to vote in the scheme, the Supreme Court of Western Australia noted at [52] that "[i]*n this jurisdiction the entitlement is usually vested in the legal owner of the property*" (that is, the accountholder). However, the court was willing to make an exception on the basis that on the evidence before it, it was the position in the USA that custodian banks were equivalent to bare nominees on behalf of the beneficial bondholders, with the beneficial bondholders retaining the voting rights throughout. On this basis, the court was willing to accept that the relevant voting demographic was the beneficial bondholders (at [53]-[54]).

6.25 The same outcome was reached in *Re Boart Longyear Ltd* (2017) 121 ACSR 328; [2017] NSWSC 567 albeit by different means. In that case, the Supreme Court of New South Wales simply adopted the reasoning in *Castle Holdco* as being that the relevant creditor demographic was those who had the right to be issued with definitive of certificated securities in the event of default entitling them to proceed directly against the Issuer (at [29]). This remains the Australian position.[63]

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63 See *Re BIS Finance Pty Ltd* [2017] NSWSC 1713 at [40], adopting the same reasoning and reaching the same position.

(2) USA

6.26 In the USA, the focus appears to be the question of who is the "holder" of the claim as required by statute.

6.27 The starting point is 11 U.S.C. § 1126(a), which provides that it is the "holder" of the claim who can vote on a Chapter 11 restructuring plan: "[t]he *holder* of a claim… may accept or reject a plan" (emphasis added).

6.28 The Federal Rules of Bankruptcy Procedure (subsidiary legislation enacted to supplement the US Bankruptcy Code) provides that, where the claim arose from a "security" (a term which under the Bankruptcy Code encompasses both equity and debt instruments, including bonds: see 11 U.S.C. § 101(49)(iv)), it was the "holder of record" that was entitled to vote, that is, the recorded holder of the security. See Rule 3018 of the Federal Rules of Bankruptcy Procedure: "an equity security holder or creditor whose claim is based on a security of record shall not be entitled to accept or reject a plan unless the equity security holder or creditor is *the holder of record of the security* on the date the order approving the disclosure statement is entered" (emphasis added).

6.29 It seems unclear who are the entities entitled to vote in a Chapter 11 plan – whether it is the "holders" of the claim, as stated in 11 U.S.C. § 1126(a), or only the trustee (i.e., the accountholder), being the "holder on record"?

6.30 This tension was squarely confronted in the course of the reorganisation proceedings of the Southland Corporation (the former name of the US branch of the 7/11 international chain of convenience stores) in 1989-1991. In *In re The Southland Corp.*, 124 B.R. 211 (Bankr.N.D.Tex.1991) ("***Southland***"), the debtor company took the position that it was required only to count the votes of "holders of record" (*i.e.,* the accountholders) and did not provide any evidence that the "holders of record" in fact had authority to cast votes on the restructuring plan, on the basis that as "holders of record", they were in the first place the only entities entitled to vote (at 220-225).

6.31 Invalidating the vote, the US Bankruptcy Court of the Northern District of Texas held that the reference in Rule 3018 was an impermissible substantive change to Congress' intent as set out in 11 U.S.C. § 1126 (at 226-227):

> This Court finds that the references in Bankruptcy Rule 3018 to "holders of record" are substantive changes in the Statute… Taking the plain words of Congress in § 1126, only the holder of a claim, or a creditor, or the holder of an interest, may accept or reject a plan. *If the record holder of a debt is not the owner of a claim, or a true creditor, he may not vote validly to accept or reject*, unless he is an authorized agent of the creditor, and this authority is established under appropriate Bankruptcy law and rules. In this case the votes were not those of holders of claims. The references to record holders in Bankruptcy Rule 3018, are attempted, substantive changes, and of no effect (emphasis added).

6.32 The Court in *Southland* therefore found that the proper voting parties were the owners of the claim, that is, the beneficial bondholders, and not the accountholders. The principle in *Southland* appears to continue to be good law.[64]

6.33 The principle in *Southland* is subject to some exceptions. First, in a situation where the alleged beneficial bondholders in fact only had a beneficial interest in funds of the accountholder *itself* (as opposed to having a beneficial interest in the liabilities owed by the debtor to the accountholder), then the alleged beneficial bondholders will not be entitled to vote: *Bank of New* York *Mellon v Builders Financial Corp.* 2013 WL 1568171 ("***Builders Financial***") at 4-5. *Builders Financial* is better explained as not engaging the *Southland* principle at all rather than being a limitation thereof. Since, in such an event the alleged "beneficial bondholder" is not a creditor of the Issuer at all, but rather only has a claim against or equity interest in the accountholder. Such instances can arise where the relationship between the accountholder and the alleged beneficial bondholders are not in fact relationships of trustee and bondholder, but rather as between an investment vehicle and its investor. Second, where the bondholders expressly assign their entitlement to vote to a third party, such entitlement can be effective in subsequently curtailing their voting rights: *American Roads* at 731-732.

6.34 Having surveyed the positions in the different jurisdictions on the voting entitlement of bondholders in schemes of arrangement or its equivalent, it is suggested that the approach adopted in Singapore, which is in line with that in the UK and Australia, gives more clarity and certainty. The focus is whether the bond documentation provides direct enforcement rights to the voting entity (whether it is the intermediate bondholder of the ultimate beneficial bondholder). If it does, the voting entity can be regarded as a contingent creditor and should be entitled to vote.

6.35 An approach which requires an inquiry beyond that, and into the identity of the ultimate beneficial holder which holds the economic interest, is likely to result in uncertainty. It may be arbitrary how far such an inquiry should extend. For example, the party who holds the ultimate economic interest may hold such interest through several vehicles. The additional time and costs to be expended for an extensive inquiry into the ultimate economic interests may not be productive or helpful to the restructuring process, which often already operates under financial and time constraints.

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64 See e.g. *In re Tenn-Fla Partners* 1993 WL 151346 at 3-4 permitting beneficial bondholders to vote on a preliminary question in the restructuring; *In re Pioneer Finance Corp.* 246 B.R. 626 (Bankr.D.Nev.2000) at 633-636 denying confirmation to plan where voting had only taken place in respect of accountholders and not beneficial bondholders; *In re City of Colorado Springs Spring Creek General Improvement District* 177 B.R. 684 (Bankr.Ct.Dec.777) at 692 similarly denying confirmation to plan where there was substantial uncertainty as to whether the beneficial bondholders had received sufficient notice of the restructuring plan and ballot.

II. Voting in Judicial Management

6.36 As stated at paragraphs 6.10 to 6.12 above, a beneficial bondholder likely cannot vote in respect of a JM meeting in Singapore. It would appear that the position may differ in respect of meetings called by an English administrator. This is because contingent creditors are entitled to vote at such meetings. Rule 15.31(1) of the Insolvency Rules (England and Wales) 2016 (No. 1024) (the "**UK Insolvency Rules**") does not limit voting by contingent creditors. Voting is determined in accordance with the amount of each creditor's "*claim*", which in turn is defined at Rule 14.2(1) of the UK Insolvency Rules 2016 as expressly including contingent debts.

C. RECOMMENDATIONS

I. Voting in Scheme of Arrangement

6.37 One option for legislative reform in Singapore would be to permit ultimate beneficial bondholders to vote in scheme meetings, regardless of whether they are vested with rights of direct enforcement or otherwise. It is noted that in the restructuring of *Hyflux*, the Singapore court had allowed relevant intermediaries within the definition in the SFA the right to vote in addition to registered bondholders. However, the Court did not provide written grounds for the decision.

6.38 As a practical matter, such reform may remove the distortions to both the headcount test and the value test by the concentration of the votes of multiple beneficial bondholders into a single representative entity, the accountholder.

6.39 On the other hand, such reform may introduce practical difficulties in verifying the identity and voting intention of the ultimate beneficial bondholder, particularly if accountholders were not entitled to simply refer to and rely on the registered holder of the bond (*i.e.,* the intermediate bondholder) but are obliged to ascertain the true beneficial ownership thereof. The Committee understands that entities such as Euroclear, the European clearing system which specialise in the settlement of securities transactions generally keep records of the actual identities of bondholders. Notwithstanding this, some ultimate beneficial bondholders may keep their identities confidential or hold their interests through multiple layers of ownership. Such concerns were raised in the US case of *In re St. Therese Care Center, Inc* 1991 WL 217669 at 3-4, where the bankruptcy court in ordering disclosure of supporting materials for a restructuring plan had to carefully tailor its order so as to ensure that the confidentiality of beneficial bondholders was maintained.

6.40 On balance, the Subcommittee does not recommend reform. However, the Subcommittee recommends adoption of global best practices (which may be incorporated in the trust instrument) in respect of ensuring that a facility exists for bondholders to provide their instructions in relation to the insolvency or reorganisation of the issuer along the various layers of intermediaries, in order to ensure that information relevant to their rights are properly and efficaciously made available. Such best practices include:

(a) maintaining comprehensive and accurate lists of the names, communication avenues and addresses of registered noteholders; and

(b) mechanisms to ensure information flow.

6.41 In this regard, the Subcommittee notes that 15 U.S.C. § 77lll(a) presently requires bond trustees to receive, at six-monthly intervals, all information that is in the possession or control of the debtor relating to the names and addresses of the holders of that Issuer's securities, and furthermore requiring such trustees to maintain "in as current a form as is reasonably practicable" all such information received by it.

II. Voting in Judicial Management

6.42 The Subcommittee considered whether to propose amending the relevant legislation to allow contingent creditors to vote at JM meetings. JM meetings generally do not result in a substantive adjustment or compromise of creditors' claims against the company. If the judicial manager eventually proposes a scheme of arrangement, contingent creditors should be allowed to vote for the reasons mentioned above. As such, the Subcommittee does not see sufficient reason to propose allowing contingent creditors to vote at JM meetings.