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The Cross-class Cramdown – Global Perspectives

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Introduction

Since its inception by way of Chapter 11 of the United States Bankruptcy Code (“**Chapter 11**”) in 1978, cross-class cramdowns have recently been added to the restructuring toolbox of a number of jurisdictions globally.[1] The United Kingdom and Singapore are two jurisdictions which have implemented cross-class cramdowns in 2020 and 2017 respectively, yet their experiences post-implementation have been different. This article engages in a comparative exploration of the reception of cross-class cramdowns in the United States, United Kingdom, and Singapore, in that order, and attempts to identify the similarities and differences which may give rise to such reception.

The US cramdown regime

The regime of cross-class cramdowns was first codified in Chapter 11, which forms a natural starting point for a discussion on the topic. Under Chapter 11, a plan can be sanctioned if at least two-thirds in value and half of the number of creditors of each class votes in favour of the plan, in effect an intra-class cramdown. The cross-class cramdown is an inter-class extension of the intra-class sanctioning of plans despite the objections of entire class(es) of dissenting creditors, on the condition that it does not unfairly discriminate, and is fair and reasonable. It should be noted that neither of these conditions are fully defined in Chapter 11, and their precise content has been left to the interpretation of the US courts.

The condition that the plan does not unfairly discriminate is a somewhat nebulous concept with which courts have, by their own admission, struggled to give a precise standard.[2] Nonetheless, the golden thread that runs though most decisions has been that the condition “*ensures that a dissenting class will receive relative value equal to the value given to all other similarly situated classes*.”[3]

The fair and reasonable condition has been interpreted to involve absolute priority rule,[4] which dictates that “*the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.*”[5] Practically, this means that debts owing to senior creditors must be paid off, in full, before junior ones, even if it means divesting equity-holders from their stakes.

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[1] A number of EU member states e.g. Austria, France, Germany, Greece and the Netherlands have implemented cross-class cram downs as well, but the case law is the most developed in the UK.
[2] Collier on Bankruptcy ("Collier") at ¶ 1129.03[a] (16th ed. 2020).
[3] In re Tribune Co., 972 F.3d 228 (3d Cir. 2020) at 240
[4] Bank of Am. Nat. Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 469, 119 S. Ct. 1411, 1429, 143 L. Ed. 2d 607 (1999).
[5] 1129(b)(2)(B)(ii)

In the context of secured creditors, another manner in which the fair and reasonable condition can be satisfied is through the realisation of the “"indubitable equivalent" of their claims. As what has become a recurring theme, the term “indubitable equivalent” is also undefined within Chapter 11, and while there is some disagreement as to its exact scope, courts have interpreted it to mean "*the unquestionable value of a lender's secured interest in the collateral*." Practically, courts have held that the following scenarios do provide a secured creditor with its indubitable equivalent: (1) providing the present value of the claim, (2) ensuring the safety of the principal,[6] (3) deferred cash payments[7] and (4) substitute collateral and retention of liens with modified loan terms.[8]

Deferred cash payments, in particular, pose an additional layer of complexity as to the length of deferment. Courts have held that deferred payment plans to secured creditors exceeding 10 years fall short of the “indubitable equivalent” standard,[9] whereas a 7-year deferment was acceptable.[10]

Given the uncertain nature of the “indubitable equivalent”, it comes as no surprise that much litigation centres around the applicable interest rates and the indubitable equivalent standard.[11]

UK cramdown regime

Cross-class cramdown regimes in the UK, Singapore and elsewhere in the world have been inspired, at least in part, by Chapter 11. However, the UK has taken a slightly different approach, most notably that the cross-class cramdown is an informal company-initiated restructuring, as compared to the formal proceedings in Chapter 11. It focuses on two Conditions:

> *Condition A: none of the members of the dissenting class would be any worse off under the restructuring plan than they would be in the event of the “relevant alternative”; and*
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> *Condition B: at least one class of creditors or members who would receive payment, or have a genuine economic interest in the company, in the event of “the relevant alternative” has voted in favour of the restructuring plan.*

It should be noted from the outset that the fulfilment of these two Conditions does not necessarily mean that the cram-down will proceed; the court retains the discretion to sanction such cram-downs.

Condition A entails a three-step exercise. First, the relevant alternative must be identified. Second, the outcomes for creditors under the relevant alternative must be identified. Finally, the outcomes under the relevant alternative must be compared to those if the plan were to be sanctioned. The plan may only be sanctioned if it offers a better outcome than the relevant alternative. Importantly, the relevant alternative refers to what the court considers to be the most likely scenario if the plan were not sanctioned, which may not always be insolvency. This is a key point given that the relevant alternative features in both Conditions A and B.

The first UK case involving a cross-class cramdown was DeepOcean, which sheds light on a number of key issues. In agreeing to sanction the plan, the court identified insolvency to be the relevant alternative, and held that the dissenting creditors would be better off under the proposed plan. The court also noted that, while there is no absolute priority in the UK regime, it retained the discretion to not approve a plan if it is not “just and equitable”, which entailed an assessment on whether the assets have been fairly distributed between consenting and dissenting classes.

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[6] In re Sparks, 171 B.R. 860, 866 (Bankr. N.D. Ill. 1994)
[7] In re Nat'l Truck Funding LLC, 588 B.R. 175 (Bankr. S.D. Miss. 2018)
[8] In re Murel Holding Corp., 75 F.2d 941 (2d Cir. 1935)
[9] In re Miami CenterAssociates Ltd; In re VIP Motor Lodge Inc
[10] In re Inv. Co. of the Southwest Inc
[11] In re Charter Commc'ns, 419 B.R. 221 (Bankr. S.D.N.Y. 2009); In re Young Broadcasting, Inc., 430 B.R. 99 (Bankr. S.D.N.Y. 2010); In re DBSD N. Am., Inc., 419 B.R. 179 (Bankr. S.D.N.Y. 2009)

In the more recent case of *Houst Limited,*[12] the court held that in deciding whether the plan is just and equitable, it may be relevant to take into account of the source of benefits to be received under the relevant alternative. *Houst Limited* involved a situation where, in the relevant alternative, there would only be two creditors in the money: HMRC (dissenting) and the Bank. As the court succinctly elucidated, "*In contrast, under the plan, the HMRC could expect to receive a higher dividend than in the relevant alternative and the Bank was to receive a significantly higher increase on its dividend.*[13] *However, in addition, ordinary unsecured creditors would receive a dividend and the shareholders have the prospect of, over time, owning an interest (albeit a very heavily diluted interest) in a solvent company, and the class of critical creditors will receive payment in full. The Court was satisfied that the better treatment afforded to critical creditors is justified on the basis that the Company's ability to generate additional funds to pay an enhanced dividend to HMRC, and to other unsecured creditors, depends on its continued trading and that without paying critical creditors, the Company would be unable to trade. This is not, therefore, a case where assets that would have been available in the administration of the Company are being applied in a manner inconsistent with the order of priorities applicable in that administration."* In practice, it seems highly unlikely that the court would countenance an unmitigated subordination of senior creditors' interests to those of junior creditors.

Condition B may appear benign at first glance. However, whether a class of creditors has genuine economic interest can and has been an issue of controversy. This was so in *Smile Telecoms*.[14] There, the court identified the relevant alternative to be the company entering liquidation, under which only one creditor would receive any pay-outs. As a result, whether the other creditors consented to the restructuring plan was irrelevant; they were out of the money and had no genuine economic interest in the relevant alternative. The Court confirmed that "*the fact that out of the money creditors have participated in a meeting which votes against the plan should not weigh heavily or at all in the decision of the Court as to whether to exercise the power to sanction the plan and cram them down*".[15] The policy considerations of Condition B are clear – a plan should not be unreasonably held up by creditors simply fishing for a better deal but who otherwise have no real economic interest.

Another scenario where Condition B could be litigated upon is where there are issues with creditor classification. In *Houst Limited*, the court remarked that "*attempts artificially to create an in-the-money class for the purposes of providing the "anchor" to activate the cross-class cram-down power should be resisted, particularly where such a class is not impaired by the plan*".[16] Evidently, the UK courts remain committed to a robust approach to creditor classification it first espoused in *Re Hawk Insurance* which results in fewer classes.[17]

The UK regime seems popular despite its relative youth. To date, there have been at least 11 restructuring plans since the inception of the new insolvency regime in June 2020, including 5 cross class cramdowns sanctioned by the courts. By contrast, Singapore has not had a single case (both reported and unreported) where cross-class cramdowns were even considered.

Singapore cramdown regime

Singapore's implementation of cross-class cramdowns is a juxtaposition between Chapter 11, from which much of its text is borrowed, and the UK scheme regime from which Singapore's own scheme regime was created. Focusing solely on cross-class cramdowns, two key differences exist when compared to Chapter 11. First, the scheme must be approved by at least one class of creditors and by a majority in number representing at least three-quarters of value of all the claims subject to the scheme. Second, Singapore has now abolished certain aspects of the absolute priority rule.

[12] Re Houst Limited [2022] EWHC 1941 (Ch)
[13] Re Houst Limited [2022] EWHC 1941 (Ch) at 34.
[14] Re Smile Telecoms Holdings Ltd [2022] EWHC 387 (Ch)
[15] Re Smile Telecoms Holdings Ltd [2022] EWHC 387 (Ch) at [75]-[76]
[16] Re Houst Limited [2022] EWHC 1941 (Ch) at 20.
[17] [2001] EWCA Civ 241

Legislatively, the regime of cross-class cramdowns was first brought into Singapore by way of amendments to the Companies Act in 2017 (which included absolute priority), then subsequently transposed to the Insolvency, Restructuring and Dissolution Act ("**IRDA**") in 2020 (which did away with absolute priority).

The current formulation under the IRDA reads:

*"[The scheme]… must not provide for any creditor with a claim that is subordinate to the claim of a creditor in the dissenting class, or any member, to receive or retain any property **of the company** on account of the subordinate claim or the members' interest."*

The words in bold highlight were absent in the initial 2017 formulation under the Companies Act. This addition did away with the absolute priority rule's protection of dissenting unsecured creditors, by allowing shareholders to retain their shares in the company without the dissenting unsecured creditors being paid in full. The change came about as a result of feedback on the difficulties in implementing cross-class cram downs in Singapore with the absolute priority rule in place. Unlike under Chapter 11, there is no mechanism under Singapore law to compulsorily divest shareholders of their shares under a scheme. Instead, shareholders had to voluntarily give up their shares in order to cram down dissenting unsecured creditors. Some commentators have noted that this would have been difficult to achieve in practice, with many large regional companies having a closely held shareholding structure, whose shareholders were unwilling to give up control of their companies to creditors, in turn giving rise to protracted litigation.[18] Without the absolute priority rule, unsecured creditors could now be crammed down without the need for shareholders to give up their shares.

However, under the current formulation, the same commentators have noted that there is a theoretical possibility of the senior creditors and shareholders colluding to cram down junior creditors, in effect inverting the ranking between creditors and shareholders. However, there exist safeguards in both the majority requirements[19] as well as the requirement mandating that no dissenting class receives an amount lower than what the creditor is estimated by the Court to receive in the most likely scenario apart from the scheme (*c.f.* unfair discrimination in Chapter 11 and relevant alternative in UK).[20]

Alas, the safeguards against the abovementioned scenario may themselves present additional problems. The elephant in the room remains that there has been no case involving cross-class cramdown in Singapore, despite the regime being introduced earlier than in the UK, where there have been a good number of cases. This could possibly be attributed to the majority requirements in Singapore, which are more onerous than any other jurisdiction examined in this article. Another reason could simply be that secured creditors in Singapore wield considerable clout and they often have a relatively large proportion of the total debt which makes it more difficult to utilise this mechanism to cram them down.

While some commentators have posited that "*an important reason [for the lack of cases involving cross-class cramdowns in Singapore] was that Singapore followed the robust approach to classification of creditors enunciated by the English Court of Appeal in Re Hawk Insurance Co Ltd, which was designed to prevent minority holdup of deserving schemes*,"[21] the multitude of cross-class cram down cases in the UK is testament that the *Re Hawk Insurance* approach resulting in fewer classes is not anathema to the deployment of cross-class cramdowns. Rather, as alluded to earlier, it may be a problem unique to Singapore, its law being a combination of English scheme law and US Chapter 11 cross-class cramdowns, which may prove to be strange bedfellows sometimes.

[18] Wee Meng Seng, Hans Tjio, "Singapore as International Debt Restructuring Center: Aspiration and Challenges" 2021, NUS
[19] Section 70(3)(b) IRDA 2018
[20] Section 70(4)(a) IRDA 2018
[21] Wee Meng Seng, Hans Tjio, "Singapore as International Debt Restructuring Center: Aspiration and Challenges" 2021, NUS

As it stands, the jury is still out on whether the current formulation of cross-class cramdowns in Singapore is workable, and if not, whether further amendments would be introduced. Singapore's lawmakers and courts may wish to consider taking a leaf out of the UK's playbook, given the success of the UK's recently introduced cross-class cramdown regime. Nevertheless, this is an important reminder that as with the transposition of any restructuring tool from other jurisdictions, such tool would have to be modified to suit Singapore' social and economic milieu.

That said, there have been successful restructurings in Singapore even without the cross-class cram mechanism being deployed. It could also be said that negotiations with creditors to resolve any issues, especially under the aegis of formal mediation, may be a more commercial alternative to a Court application for a cross-class cramdown. Such an out-of-court approach would avoid protracted litigation, especially over valuation disputes, that ultimately results in the destruction of value for the stakeholders.

Conclusion

a. Cross-class cramdowns as a concept has garnered attention in many jurisdictions lately, no doubt spurred at least in part by the COVID-19 pandemic and the attendant economic fallout. With the impending global recession, this is certainly an interesting space to watch in the coming months.

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