Published on 18 February 2020

RESCUE FINANCING IN SINGAPORE: NAVIGATING UNCHARTED WATERS

[2020] SAL Prac 1

Rescue financing is a relatively novel concept to Singaporean insolvency practitioners. Few applications have been made since its introduction in 2017 and there remains much uncharted territory to be covered. However, Singaporean insolvency practitioners can look to the Americans' history and experience with debtor-in-possession ("DIP") financing for guidance and illumination. This article looks at the nascent state of rescue financing jurisprudence in Singapore, the Americans' history and experience with DIP financing, and some key lessons for our local jurisprudence.

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I. Introduction

1 The introduction of rescue financing (also known as "debtor-in-possession financing" or "DIP financing") in 2017 with the Companies (Amendment) Act 2017[1] has been lauded by insolvency practitioners and corporates alike as a welcome (and some may say overdue) addition to Singapore's arsenal of restructuring laws.

1 Act 15 of 2017.

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2 The Companies (Amendment) Act 2017, which introduced not only rescue financing for distressed companies but a myriad of other amendments to schemes of arrangement in general, was presaged by the Insolvency Law Review Committee ("ILRC") in its Final Report in 2013.[2] Comprising pre-eminent members from the Bar, academia, public service and industry, the ILRC considered the US Bankruptcy Code provisions, particularly Chapter 11, and observed that it would not be preferable to adopt the Chapter 11 style debtor-in-possession model in Singapore but to, instead, refine the scheme of arrangement with the refinements and enhancements adapted from the debtor-in-possession model.[3] The ILRC concluded that, "super-priority provisions enhance the rescue options available to insolvency practitioners".[4]

3 What ultimately followed was the enactment of the rescue financing provisions in s 211E (for schemes of arrangement) and s 227HA (for judicial managements) of the Companies Act.[5] Shortly after the enactment of these provisions, the first reported decision to consider s 211E of the Companies Act was published: *Re Attilan Group Ltd*[6] ("*Re Attilan Group*").

4 This article seeks to chart various "lighthouses" that will illuminate in understanding the concept of rescue financing in Singapore. The first of these lighthouses casts light on the genesis of DIP financing by looking to American history. We will then look towards the modern American experience of DIP financing and its evolution as a tool for creditor control. Finally, we will return to Singapore to consider the development of our jurisprudence in the light of the Americans' experience as we look towards the horizon.

2 Insolvency Law Review Committee, *Report of the Insolvency Law Review Committee: Final Report* (2013) (Chairman: Lee Eng Beng SC).
3 Insolvency Law Review Committee, *Report of the Insolvency Law Review Committee: Final Report* (2013) at p 107 (Chairman: Lee Eng Beng SC).
4 Insolvency Law Review Committee, *Report of the Insolvency Law Review Committee: Final Report* (2013) at p 112 (Chairman: Lee Eng Beng SC).
5 Cap 50, 2006 Rev Ed.
6 [2018] 3 SLR 898.

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II. The state of rescue financing in Singapore

A The statutory scheme

5 "Rescue financing" is defined as any financing that satisfies either or both of the following conditions:[7]

(a) financing that is necessary for the survival of a company that obtains the financing, or of the whole or any part of the undertaking of that company, as a going concern; and/or

(b) financing that is necessary to achieve a more advantageous realisation of the assets of a company that obtains the financing, than on a winding up of that company.

6 Rescue financing allows the debtor company to continue doing business, and pay suppliers and other trade debtors. Rescue financing is particularly important for debtor companies in financial trouble who often face higher costs of borrowing, as banks and financial institutions become more wary of advancing fresh funds to a distressed company without some form of protection or assurance that these fresh funds will be repaid.

7 Underpinning the ethos of rescue financing is the premise that companies are often more valuable to creditors and the economy as a whole as an ongoing business, rather than a storehouse of assets waiting for liquidation.[8]

7 Section 211E(9) of the Companies Act (Cap 50, 2006 Rev Ed) or s 67(9) of the Insolvency, Restructuring and Dissolution Act (Act 40 of 2018) ("IRDA") for rescue financing in the context of schemes of arrangement, and s 227HA(10) of the Companies Act and s 101(10) of the IRDA for rescue financing in the context of judicial management. For the purposes of this article, we focus primarily on rescue financing in the context of schemes of arrangement.

8 Jarrod B Martin *et al*, "Freefalling With A Parachute That May Not Open: Debtor-In-Possession Financing in the Wake of the Great Recession" (2009) 63 U Miami L Rev 1205.

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8 There are four levels of priority that the court can grant:[9]

(a) to treat the debt as if it were a cost or expense of the winding up;

(b) to elevate the debt in priority over all preferential debts and other unsecured debts if the company would not have been able to obtain such financing without it being granted such priority;

(c) for the debt to be secured by a security interest not otherwise subject to any existing security or to confer a subordinate security interest on the debtor company's property already subject to an existing interest; and

(d) for the debt to be secured by a security interest of the same or higher priority than an existing security interest (also known as a "priming lien").

9 The greater the level of priority, the greater the scrutiny by the courts since the conferment of super priority disrupts the order of priorities and prejudices other creditors waiting in line. For a debt to be elevated above the costs and expenses of a winding up, the court has to be satisfied that the company would not have been able to obtain the rescue financing from any person *unless the debt arising from the rescue financing is given such priority*. In granting a "priming lien", the court not only needs to be satisfied that all other types of rescue financing are unavailable, it must also be satisfied that the interests of pre-existing secured lenders are adequately protected, before a priming lien is granted.

10 To date, there has only been one reported decision on s 211E: *Re Attilan Group*. This decision was reported in 2017 and the court in that case denied the applicant's prayer for super priority. Since then, there have been no reported decisions on rescue financing in Singapore. However, in April 2019, it was announced by Asiatravel.com Holdings Ltd (a Catalist-listed company) that it

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9 Sections 211E(1) and 227HA(1) of the Companies Act (Cap 50, 2006 Rev Ed), or ss 67(1) and 101(1) of the Insolvency, Restructuring and Dissolution Act (Act 40 of 2018).

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had successfully obtained an order for super priority over rescue financing. We go on to consider these developments.

B Re Attilan Group Ltd

11 Much ink has been spilt discussing the case of *Re Attilan Group* and it is likely that insolvency practitioners are familiar with the case and its implications. It would suffice to briefly summarise the case and its implications in this article.

12 In *Re Attilan Group*, the applicant (Attilan Group Ltd) sought leave to convene a creditors' meeting for a proposed scheme of arrangement under s 210(1) of the Companies Act and also sought an application for super priority to be granted to rescue financing to be obtained. The court declined to grant super priority status to the rescue financing primarily because the court was not convinced that the applicant had taken "reasonable efforts" to secure financing on a normal basis.

13 The following points may also be gleaned from *Re Attilan Group*:

(a) As a starting point, US authorities serve as a useful guide to illuminate the construction of Singapore's rescue financing provisions, but the Singapore courts may depart from the US position depending on the arguments put before the Singapore Courts (at [51]).

(b) While not a statutory requirement under s 211E(1)(*a*), the applicant should still make some reasonable attempt to secure financing on a normal basis before the court will exercise its discretion to grant priority under s 211E(1)(*a*) (at [61]).

(c) Additional financing from an existing creditor pursuant to a prior funding agreement may still be considered "rescue financing" under s 211E(9) of the Companies Act (at [76]–[79]).

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C *The case of* **Asiatravel.com Holdings Ltd**

14 In April 2019, Asiatravel.com Holdings Ltd ("ATH") and its subsidiary AT Reservation Network Pte Ltd ("ATRN") obtained Singapore's first order for super priority for rescue financing under s 211E(1)(*b*) of the Companies Act. Unfortunately, at the time of writing, there is no written judgment explaining the court's reasoning. It also appears that ATH and ATRN did not face any creditor opposition to its application for super priority.

15 One of the reasons accounting for the success of ATH and ATRN's application for super priority appear to be the substantial efforts they undertook to obtain financing on an unsecured basis, even engaging a financial adviser to identify potential lenders. However, the potential lenders were not prepared to extend any rescue financing to ATH and ATRN. In addition to meeting the threshold statutory requirement of attempting to secure rescue financing on an unsecured basis, the court in *Re Attilan Group* had previously alluded to various factors derived from US authorities in guiding the court's discretion on whether to grant super priority under s 211(1)(*b*).

16 These factors include, *inter alia*, whether:[10]

(a) the proposed financing is an exercise of sound and reasonable business judgment;

(b) there is any alternative financing otherwise available;

(c) such financing is in the best interest of the company and its creditors; and

(d) the terms of the financing agreement are fair, reasonable and adequate in the light of the circumstances of the debtor and the proposed lender.

17 The court in *Re Attilan Group* decided to leave a closer consideration of these factors to a future case where the issue specifically arises. That future case would have been that of ATH

10 *Re Attilan Group Ltd* [2018] 3 SLR 898 at [65]–[67].

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and ATRN but unfortunately, we are not aware of the court's reasoning in granting super priority under s 211E(1)(*b*) in ATH and ATRN's case.

18 Nevertheless, in our view, once a debtor has met the threshold requirement of attempting to obtain financing on a normal basis (as required under s 211E(1)(*b*)), these factors are applied disjunctively and the court ought to take a broad-brush approach. Ultimately, we think that the courts should bear in the mind the circumstances of each debtor and the policy goals of rehabilitating distressed companies.

19 Having considered the present state of rescue financing in Singapore, it will be useful for local insolvency practitioners to understand the historical underpinnings of DIP financing and its evolution in the US as lighthouses to guide the way forward.

III. History of debtor-in-possession financing

20 The history of DIP financing dates back to large-scale railroad corporations in the early 1900s in the US. In the industrialising early 1900s before the Great Depression, American railroad corporations operated tracks that crossed several state lines.

A Equity receiverships

21 To raise finance, these railroad corporations would issue stock and bonds over the years. If the railroad failed to make the requisite interest payment on its bonds, a creditor would first file a "creditor's bill", asking the American courts to appoint a receiver to oversee the defaulting railroad's property. This was known as the "equity receivership", which has been described as one of the "great innovations of the common law in nineteenth-century America".[11]

11 David A Skeel, Jr, "The Past, Present and Future of Debtor-In-Possession Financing" (2004) 25 Cardozo L Rev 1905 at 1910.

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22 During the reorganisation process, the underwriters of the railroad's bonds would form committees to represent the various classes of bondholders in the negotiations. These committees were typically led by Wall Street banks like J P Morgan. Investors would "deposit" their bonds or stocks with the respective committees, thereby giving the committees control over the bonds for the duration of the negotiations. However, if the bondholder did not agree to the reorganisation plan, he had the right to withdraw his bond. The goal of the negotiations was to restructure the railroad's capital structure and reduce its obligations so that it could get back on track financially. These reorganisation plans became what we know today as the scheme of arrangement.

B Receiver's certificates

23 Prior to, and during, the receivership process, railroads had to pay their suppliers to keep the railroads running. These suppliers provided coal to keep the trains running and iron and steel for track works. Understandably, suppliers were very reluctant to deal with railroads on credit and would demand dealing on a cash-on-delivery basis.

24 In order to meet the liquidity gap and fund operations during the equity receivership process, the American courts permitted receivers to issue a "receiver's certificate",[12] a promissory note issued by the receiver, "by which the railroad borrowed from investors against the credit of the 'whole estate' of the railroad on a short term basis".[13]

25 The receiver's certificates had priority over all of the railroad's other obligations, secured and unsecured. Payments to mortgagees were not made until the receiver's certificate obligations were paid first. These receiver's certificates had a high

12 Prior to the "receiver's certificate", American courts developed the "six months rule" which permitted railroads to pay their suppliers in full for supplies provided six months before entering receivership. See *Fosdick v Schall* 99 US 235 (1878).

13 Peter Tufano, "Business Failure, Judicial Intervention, and Financial Innovation: Restructuring U.S. Railroads in the Nineteenth Century" (1997) 71 Bus Hist Rev 1 at 8.

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probability of repayment and investors were happy to invest in these receiver's certificates, thereby financing the reorganisation of the railroad.

26 The prevailing judicial opinion was that secured creditors must submit to the impairment in so far as such impairment was necessary for the conservation of the road, although secured creditors should not suffer more than what was actually necessary for conservation and due operation of the system.[14]

27 From a brief overview of the US's history of DIP financing, it is apparent that American financiers have a lot more confidence in post-petition credit and have invested in post-petition credit since the early 1900s. More crucially, there is a deep-seated belief that companies are worth more as going concerns rather than a storehouse of assets to be broken up and sold at distressed value. As a result, American financiers are far more likely to provide rescue financing and American suppliers are also far more likely to continue doing business with financially distressed companies.

28 In Singapore, rescue financing is a relatively new concept not just to insolvency professionals but also to lenders. In the authors' experience, often times, upon the onset of insolvency, lenders are anxious to realise their security and then prove the balance in the winding up of the company. Lenders, suppliers and even insolvency professionals alike often have little patience in seeing distressed companies through difficult periods and are wary of extending further credit to distressed companies for fear of throwing good money after bad.[15]

29 Although DIP financing's humble roots began with keeping railroads afloat while they reorganised, DIP financing has evolved to become a tool for creditors to gain control and, in some cases, even acquire the debtor's business.

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14 *American Brake Shoe & Foundry Co v Pere Marquette R Co* 205 F 14 (6th Cir, 1913).

15 Indeed, the Singapore insolvency regime has been described by commentators as having largely been "pro-creditor and in particular, pro-secured creditor": see Wan Wai Yee & Gerald McCormack, "Transplanting Chapter 11 of the US Bankruptcy Code into Singapore's Restructuring and Insolvency Laws: Opportunities and Challenges" (2018) *Journal of Corporate Law Studies* Research Collection School Of Law, at 24.

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IV The state of debtor-in-possession financing in the US

30 Section 364 of Title 11 United States Code governs DIP financing and provides for post-petition credit. Similar to the levels of super priority under the Companies Act, there are also four levels of priority available under § 364.

A Debtor-in-possession lender intervention

31 Over the decades, DIP financing has evolved from simply being a financial investment to a tool for gaining control of the debtor. One commentator has even described DIP financing as the "most important corporate governance lever".[16]

32 In practice, DIP lenders would often insist on the company making changes to the management and operations of the company. One of the key ways in which DIP lenders dictate the course of Chapter 11 proceedings is influencing the choice of the debtor's chief restructuring officer ("CRO"), by either providing a shortlist of acceptable candidates or approving the person proposed by the debtor's management. Alternatively, a DIP lender may stipulate that an event of default occurs if their appointed CRO is replaced.

33 While the reorganisation is underway, DIP lenders keep the debtor on a tight leash by requiring the debtor company to meet strict cash flow requirements as a condition of continued financing. In some cases, DIP lenders force the debtor company to liquidate its assets by reducing the amount of cash made available in subsequent disbursements of funds under the DIP loan agreement. The debtor company then finds itself liquidating more and more assets in order to meet its cash flow requirements and what began as an attempt at reorganisation becomes a slow liquidation.

34 DIP lenders may also use their bargaining power to demand extortionate terms that amount to improving their position, often at the expense of the body of unsecured lenders.

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16 David A Skeel, Jr, "The Past, Present and Future of Debtor-In-Possession Financing" (2004) 25 Cardozo L Rev 1905 at 1919.

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35 DIP lenders may require the debtor company to "roll up" the lender's pre-petition debt to be repaid with the proceeds of the new post-petition DIP financing, thereby refinancing the pre-petition debt with DIP financing. However, roll-ups may also be structured less abusively by obliging the DIP to use cash generated post-petition to repay the DIP lender's pre-petition debt.[17]

35 Another abusive practice is the use of cross-collateralisation in which the debtor company grants the pre-petition lender a security interest in a previously unencumbered asset for both of the DIP lender's pre-petition and post-petition debts. Cross-collateralisation deprives the debtor company's unsecured creditors from obtaining the proceeds of previously unencumbered assets while improving the DIP lender's position in the process.[18]

36 These provisions go beyond the mere provision of finance and see the DIP lender being involved in the management of the debtor.

B Loan-and-control

37 The Chapter 11 practice in the US has evolved from what was originally intended to reorganise and rehabilitate companies into a tool for mergers and acquisitions. One commentator declared in 2002 that "[c]orporate reorganizations have all but disappeared".[19] The case of Trans World Airlines illustrates how the DIP lender did not just provide financing but used the DIP financing agreement as a mechanism to transfer control of the distressed company to the DIP lender.

38 Trans World Airlines ("TWA") was America's then eighth-largest airline. It filed its first Chapter 11 petition in 1992 and a

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17 Bankruptcy courts have approved roll-ups especially when a debtor has no other reasonable prospect of financing and the proposed facility is in the best interests of the debtor, its estate and its creditors. See *In re Lyondell Chemical Company, et al*, Ch 11 Case No 09-10023 (REG) (Bankr SDNY, 6 January 2009).

18 American courts have allowed cross-collateralisations in some cases but not others. See *Shapiro v Saybrook Mfg Co, Inc* 963 F.2d 1490, 1494–95 (11th Cir, 1992).

19 Douglas G Baird & Robert K Rasmussen, "The End of Bankruptcy" (2002) 55 Stanford Law Review 751.

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second one in 1995. In the early 2000s, American Airlines entered an agreement to buy TWA and Chapter 11 was used to implement the deal. TWA would file for Chapter 11 bankruptcy protection so that its leases and debt could be renegotiated. American Airlines would then buy over the assets and potential liabilities of TWA and provide a DIP loan of US$200m at an interest rate of 10% to TWA.[20]

39 The DIP loan agreement required an auction of TWA's assets with American Airlines as the expected buyer. American Airlines was both TWA's DIP lender and bidder for its assets. As lender, American Airlines would have access to TWA's finances and accounts and was in a position to know how much TWA's assets were really worth, thereby giving American Airlines an unfair advantage over other bidders.[21] It appears that the Chapter 11 proceedings allowed American Airlines to purchase TWA's assets free from encumbrances and remove TWA's unsecured creditors.

40 As such, when faced with a case where the plan is to sell the debtor's business at the outset and where rescue financing is being extended by an interested bidder, courts should rightly be sceptical and circumspect. It is also for this reason that the requirement that there be no alternative source of financing becomes crucial. While not every DIP finance agreement passes the American courts' scrutiny, it appears that some American DIP lenders are savvy enough to know which provisions can pass muster in a jurisdiction of their choosing through covenants that allow the DIP lender to decide which jurisdiction the Chapter 11 petition should be filed in.[22]

V The future of rescue financing in Singapore

41 In our view, there are three reasons why we are unlikely to see such abusive practices in Singapore in the near future:

20 See Susan Carey, "American Airlines' TWA Financing Plan Is Approved, Although Rivals Cry Foul" *Wall Street Journal* (29 Jan 2001).
21 Douglas G Baird & Robert K Rasmussen, "Private Debt and the Missing Lever of Corporate Governance" (2006) 154 University of Pennsylvania Law Review 1209 at 1249.
22 See Marcus Cole, "'Delaware is Not a State': Are We Witnessing Jurisdictional Competition in Bankruptcy?" (2002) 55 Vand L Rev 1845 at 1869.

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(a) Singaporean lenders are still coming round to the idea of DIP lending and have not reached the levels of sophistication as their American counterparts;

(b) it is questionable if "roll-ups" and "cross-collateralisation" advance the purposes of rescue financing; and

(c) the Singapore courts are prepared to scrutinise the rescue financing agreement.

42 First, it is clear that in Singapore, DIP lenders have yet to reach the sophistication of their American counterparts. In the case of *Re Attilan Group*, the subscriber's offer of DIP finance came in the form of a letter to the debtor company and was even called "vague" by the opposing creditor in that case.[23] There did not appear to be any attempt by the subscriber to gain control of the management of the debtor company in that case.

43 This is not unexpected given that rescue financing, as a concept, is still in its nascent stages in Singapore and we have not had the depth of experience that American lenders have had. Nevertheless, as Singapore's rescue financing provisions gain traction, Singaporean lenders are likely to incorporate increasingly sophisticated and perhaps even onerous conditions in their rescue financing agreements. Both creditors and debtors alike should be cautious of such attempts by a rescue financier to gain a foothold in the debtor's management and obtain a benefit at the expense of other creditors.

44 Second, a key difference between §364 USC and Singapore's conception of DIP financing is that such financing must be deemed as "rescue financing" as defined under the Companies Act.

45 Under §364 USC, the DIP is allowed to incur unsecured debt or obtain unsecured credit. There is no requirement that such financing must be financing that is necessary for the survival of the company as a going concern or that such financing must be necessary to achieve a more advantageous realisation of the assets

23 *Re Attilan Group Ltd* [2018] 3 SLR 898 at [54].

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of the company than on a winding up of that company as defined in the Companies Act.

46 Thus, it will be very much debatable if roll-ups and cross-collateralisations are terms that belong in a rescue financing agreement when the definition of "rescue financing" requires that such financing must be necessary for the survival of the company as a going concern or to achieve a more advantageous realisation of the assets of the company.

47 Third, it appears that the courts are prepared to review the rescue financing agreement and consider the terms of the agreement as the court did in *Re Attilan Group*. While the court in *Re Attilan Group* observed that it was sound for a rescue financier to stipulate conditions in the grant of its rescue financing and the terms of which are ultimately a matter for commercial consideration,[24] there are likely to be limits to how far a rescue financier can go, especially if the terms of the rescue financing agreement seek to undermine the policy reasons for allowing rescue financing in the first place.

48 Nevertheless, practices such as "roll-ups" and "cross-collateralisations" *may* be justifiable in some cases and the courts have to consider the facts and the parties' reasons for the inclusion of such terms. Courts should rightly be wary of rescue financiers using applications for super priority to steal a march on other creditors at their expense.[25] However, the issue becomes more complex if the choice is between the debtor going into liquidation or allowing the DIP to reorganise while the rescue financier improves its position. Alternatively, some prejudice suffered by unsecured creditors may be mitigated if the rescue financier allows unsecured creditors to participate in the process and cross-collateralise the unsecured debts as well.

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24 *Re Attilan Group Ltd* [2018] 3 SLR 898 at [54].

25 Nevertheless, a *bona fide* proposal for rescue finance that takes into account the interests of unsecured creditors may be less abusive and therefore less objectionable. For example, where the rescue financier allows the unsecured creditors to participate in the process of rescue financing and cross-collateralise their unsecured debts as well.

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A Priming liens

49 We also offer some tentative views on priming liens given that to date, no application for such super priority has been made. In considering whether to grant a priming lien (under s 211E(1)(*d*) of the Companies Act), the following principles may be drawn from the US authorities and provide future guidance as and when the issue arises:

(a) the courts are typically prepared to grant a priming lien when an existing secured lender has a sufficient equity cushion (*ie*, that value of its security exceeds the value of its claim);[26]

(b) the burden of proof is on the debtor to show that the security holder being subordinated has adequate protection;[27]

(c) the debtor may demonstrate adequate protection by supplying the existing secured lender with a new third-party guarantee or substitute collateral; however, the sufficiency of the guarantee would depend on the financial strength of the guarantor;[28] and

(d) adequate protection, not *absolute* protection, is the statutory standard.[29]

50 These principles are largely unobjectionable and intuitively acceptable. However, as it is typical of practice, the challenge is deciding how those principles should apply to the facts and circumstances of each case. The vicissitudes of life make it impossible for any single principle to be prescribed or a single answer to be obtained and it is for insolvency practitioners, industry players, and the courts to take guidance from the American jurisprudence to develop ours.

26 *In re Dunes Casino Hotel* 69 B R 784 (BC DC NJ, 1986).
27 *Resolution Trust Corp v Swedeland Dev Group* 16 F 3d 552 (3d Cir, 1994).
28 *Resolution Trust Corp v Swedeland Dev Group* 16 F 3d 552 (3d Cir, 1994)
29 *In re Beker Industries Corp* 58 B R 725 (Bankr SDNY, 1986).

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VI Conclusion

51 Singapore's rescue financing regime is, at the moment, a sea of uncharted waters for both local insolvency practitioners and lenders. It is only a matter of time before applications for priming liens are made and the courts are faced with the difficult task of deciding whether to allow such an application, especially when the rescue financier seeks to impose onerous conditions and take control.

52 Yet, we can look towards lighthouses in the distance to guide our understanding and chart a course to the future. Lighthouses do not only provide hope for wayward vessels, they also indicate pitfalls. We can take guidance from the evolution of DIP financing in the US to avoid the pitfalls of DIP financing and potential abuses by lenders, bearing in mind the legislature's stated intention: to provide more options for the rehabilitation of distressed companies.

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