CLASSIFICATION OF UNDER-SECURED DEFICIENCY CLAIMS IN SCHEMES OF ARRANGEMENT

Traditionally, for the purposes of voting in schemes of arrangement, secured creditors are classed separately from the ordinary unsecured creditors. However, a recent practice seems to have emerged in Singapore schemes of arrangement where under-secured creditors have, to the extent of their deficiency claims, been placed in the same voting class as the ordinary unsecured creditors. This article examines the case law and suggests guiding principles informing when such a form of classification may be appropriate.

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I. Introduction: an emerging practice in Singapore

1 In recent years, a practice seems to have emerged in Singapore schemes of arrangement where the secured claims of under-secured creditors[1] are bifurcated into secured and unsecured portions. The secured portion represents the amount of the claim which is covered by the assessed or estimated value of the security. The amount of the unsecured portion, sometimes referred to as the "deficiency claim", is derived by taking the shortfall of the value of security against the total amount of the claim. During the voting process, the under-secured creditors are, to

1 An under-secured creditor is a secured creditor whose claim against the debtor is of an amount larger than the value of security provided for the claim, and is sometimes referred to as a "partly secured creditor".

the extent of the amount of the unsecured portion of their claims, placed in the same class of creditors as the ordinary unsecured creditors.[2]

2 As regards the origins of this practice, some have pointed to the US where bifurcation of partly secured claims is statutorily provided for in respect of re-organisation plans proposed under the US Chapter 11 Bankruptcy Code.[3] The US Chapter 11 Bankruptcy Code specifically provides for the bifurcation of partly secured claims under § 506(a)(1). In essence, where there is an under-secured claim, the claim must be bifurcated into two portions: first, a secured claim to the extent of the value of the collateral, and second, an unsecured deficiency claim for the balance that exceeds the value of the collateral.[4]

3 Yet, whilst it may be that Singapore's insolvency practitioners might have drawn inspiration from the US Chapter 11 restructurings, the question remains as to whether this kind of practice can find sufficient legal grounding under Singapore's law on schemes of arrangement, particularly in relation to the classification of scheme creditors. In contrast to the US Chapter 11 regime, the common law jurisdictions (including Singapore) have statutorily provided for the scheme of arrangement mechanism but do not specifically provide for bifurcation of partly secured claims.

4 None of the reported Singapore decisions on schemes of arrangement have dealt with the issue of classification of deficiency claims. That said, the outcomes of the unreported decisions on Singapore schemes of arrangement that involved deficiency claims have gone both ways, with a majority of the scheme companies having successfully obtained court sanction of schemes of arrangement that classed deficiency claims with ordinary unsecured claims. On the other hand, in at least one unreported decision,[5] the High Court has, at the leave stage, refused to

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2 Some Singapore schemes of arrangement where this occurred include but are not limited to those proposed by Pacific International Lines (Pte) Ltd, Hoe Leong Limited, Nam Cheong Limited and Swissco Offshore (Pte) Ltd.

3 11 USC (US).

4 Although this is subject to various other mechanisms such as § 1111(b) of the US Bankruptcy Code which allows an under-secured creditor to elect to have the entire amount of its claim be treated as secured (even though the assessed value of the collateral is less than the claim amount) if several threshold requirements are fulfilled. It may also be noted that in Canada, in respect of restructuring plans proposed under the Companies' Creditors Arrangement Act (RSC 1985, c C-36), deficiency claims may be classed together with ordinary unsecured creditors – see, *eg*, *Re SemCanada Crude Co* 2009 ABQB 490 (though strictly speaking case law on these restructuring plans are not directly relevant to jurisprudence on schemes of arrangement).

5 In respect of Pacific International Lines International (Private) Ltd, see paras 8-12 below.

allow the applicant company to convene creditors' meetings with this sort of class composition.

II. Case studies

A. Hoe Leong Corporation Ltd

5 The pre-packaged scheme of arrangement proposed by Hoe Leong Corporation Ltd[6] ("Hoe Leong") serves as a good starting point for discussion. Hoe Leong's scheme creditors comprised seven bank creditors and a controlling shareholder. Of the seven bank creditors, four were secured creditors.

6 The scheme of arrangement involved two classes of scheme creditors:

> (a) The four secured creditors voted in one class to the extent of the secured portions of their respective scheme claims, though the determination and proportion of these portions were arrived at after negotiation between Hoe Leong and each of the four secured creditors.[7] Under Hoe Leong's scheme of arrangement, the secured vessel loans which gave rise to those secured claims were restructured into the respective amounts of the secured portions, though they would remain as secured vessel loans.[8]
>
> (b) All eight scheme creditors under Hoe Leong's scheme of arrangement voted together in the other class. The four unsecured creditors (three bank creditors and the controlling shareholder) voted in respect of the value of their respective scheme claims, and the four secured creditors voted to the extent of the unsecured portion of their respective scheme claims. Under Hoe Leong's scheme of arrangement, these scheme creditors would, in respect of their respective unsecured claims and unsecured portion of claims, receive ordinary shares in the capital of Hoe Leong.[9]

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6 Approved by the High Court on 22 January 2018 in HC/OS 14/2018.

7 *Circular to Shareholders* (Hoe Leong Corporation Ltd, 12 April 2018) at para 2.2.2 and Appendix A <https://links.sgx.com/FileOpen/HLC_EGM%20Circular.ashx?App=Announcement&FileID=501741> (accessed 4 July 2023).

8 *Circular to Shareholders* (Hoe Leong Corporation Ltd, 12 April 2018) at para 2.2.2(a) <https://links.sgx.com/FileOpen/HLC_EGM%20Circular.ashx?App=Announcement&FileID=501741> (accessed 4 July 2023).

9 *Proposed Scheme of Arrangement* (Hoe Leong Corporation Ltd, 23 November 2017) <https://links.sgx.com/FileOpen/20171123%20-%20Hoe%20Leong%20-%20Ann%20OverviewofSOA_FINAL.ashx?App=Announcement&FileID=479534> (accessed 4 July 2023).

7 In obtaining the High Court's approval for the scheme of arrangement, counsel for Hoe Leong had argued that:[10]

> (a) although the secured creditors were classified together with the unsecured creditors in respect of the unsecured portion of the secured creditors' claims, the legal rights of the secured creditors and unsecured creditors were the same or sufficiently similar as against the scheme company in respect of the unsecured portion of the respective claims of the secured creditors;
>
> (b) the secured creditors had no additional interest or incentives in relation to the unsecured portion of their claims against the scheme company as compared to the unsecured creditors; and
>
> (c) the scheme of arrangement did not favour nor prejudice any particular group of the unsecured creditors, as in a liquidation all these claims would be similarly unsecured.

B. Pacific International Lines (Private) Limited

8 Unlike the scheme of arrangement proposed by Hoe Leong (and other earlier Singapore cases),[11] in respect of the scheme of arrangement proposed by Pacific International Lines (Private) Limited[12] ("PIL"), the High Court did not allow the secured creditors to vote in respect of their deficiency claims together with the ordinary unsecured creditors.

9 Under PIL's scheme of arrangement, the ordinary unsecured creditors would, in respect of their scheme claims, receive redeemable perpetual securities under which creditors would receive certain cash distributions over time.[13]

10 PIL's secured creditors were lenders whose claims against PIL were not fully covered by the value of security collateral. Under PIL's scheme of arrangement, the portions of the secured creditors' claims that were covered by the value of the security collateral were re-sized to

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10 Debby Lim, "Singapore's First 'Pre-Packaged' Scheme of Arrangement" *Singapore Global Restructuring Initiative Blog* (5 February 2021) <https://ccla.smu.edu.sg/sgri/blog/2021/02/05/singapores-first-pre-packaged-scheme-arrangement> (accessed 4 July 2023).

11 See n 2 above.

12 HC/OS 1149/2020.

13 *2nd Informal Meeting for Noteholders* (Pacific International Lines (Private) Limited, 15 January 2021) <https://links.sgx.com/FileOpen/PIL%20-%202nd%20Informal%20Meeting%20for%20Noteholders%2015%20Jan%202021%20v3.ashx?App=Announcement&FileID=645359> (accessed 4 July 2023) at pp 9–11.

100% of the respective collateral value. The restructured secured scheme debt would be repaid over time and would be subject to, amongst other standardised terms and conditions, a debt service waterfall. The portions of the secured creditors' claims that were not covered by the value of the security collateral, however, would be treated the same as the unsecured creditors in that those secured creditors, in respect of the unsecured portions of their claims, would receive perpetual securities on the same terms as the unsecured creditors.[14]

11 On the basis that the ordinary unsecured creditors and the secured creditors (to the extent of the under-secured portions of their secured scheme claims) would be subject to similar treatment under the scheme of arrangement, PIL sought to class the secured creditors (to the extent of their deficiency claims) together with the ordinary unsecured creditors. Reference was made to the fact that this kind of classification and treatment of secured creditors in respect of their deficiency claims was consistent with precedent schemes of arrangement in Singapore. The High Court, however, ordered that the secured creditors (in respect of their deficiency claims) were to be classed separately from the ordinary unsecured creditors.[15]

12 It may have made a difference in PIL's case that an ordinary unsecured creditor had opposed PIL's attempt to class the unsecured and deficiency claims together. Relying on *Re Bond Corporation Holdings Ltd*[16] ("*Re Bond Corporation*"), the opposing creditor had argued that the overall recovery for the secured creditors far outweighed that of the unsecured creditors, that the secured creditors would act to protect the secured component of their claim, and that the liquidation scenario would be particularly destructive to the value of the secured creditors' security.[17]

13 An examination of *Re Bond Corporation* and reported cases from other common law jurisdictions is therefore helpful.

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14 *2nd Informal Meeting for Noteholders* (Pacific International Lines (Private) Limited, 15 January 2021) at p 13 <https://links.sgx.com/FileOpen/PIL%20-%202nd%20Informal%20Meeting%20for%20Noteholders%2015%20Jan%202021%20v3.ashx?App=Announcement&FileID=645359> (accessed 4 July 2023).

15 Orders made in HC/SUM 20/2021 on 20 January 2021. See *Updates to Scheme: HC/SUM 20/2021* (Pacific International Lines (Private) Limited, 22 January 2021) <https://links.sgx.com/FileOpen/PIL%20Announcement%20-%2022%20Jan%202021%20v3.ashx?App=Announcement&FileID=645972> (accessed 4 July 2023).

16 (1991) 5 ACSR 304.

17 None of these arguments seem to be the reasoning in *Re Bond Corporation Holdings Ltd* (1991) 5 ACSR 304. See paras 14–19 below.

C. Australia

14 In *Re Bond Corporation*, the insolvent applicant company put forward a scheme of arrangement proposing scheme distributions of ordinary shares and preference shares in the company. The preference shares would be redeemed over time to give scheme creditors a cash return. In doing so, the proposed scheme of arrangement, if implemented, would compromise and discharge the entirety of creditors' claims against the applicant company, except for the secured portion of the claims of secured creditors.

15 The proposed scheme of arrangement had two classes of creditors. The first class comprised ordinary unsecured creditors as well as various partially secured creditors. The second class comprised subordinated creditors.

16 The secured creditors' claims would only be subject to the scheme of arrangement to the extent of the unsecured portions of their claims.[18] In this regard, a partly secured creditor would have the following options to elect from (and the under-secured portion of its claim would be determined in the following manner):[19]

> (a) It could surrender its security and prove in the scheme of arrangement for the whole of its claim against the applicant company.
>
> (b) It could realise its security and, subject to the scheme administrator being satisfied that the realisation was *bona fide* and effected in a proper manner, prove for the balance of its claim against the applicant company.
>
> (c) It could choose to neither realise nor surrender the security, and instead, submit a statutory declaration in accordance with the scheme of arrangement, upon which it could prove for the under-secured portion of its claim, being the balance of its claim against the applicant company after deducting the estimated value of its security (as determined in the manner contemplated under the scheme). There were also provisions pertaining to the applicant company's right to redeem the security on payment of the estimated value, the creditor's right to require the applicant company to decide whether to redeem the security, and a mechanism to vary the estimated value of the security.

18 *Re Bond Corporation Holdings Ltd* (1991) 5 ACSR 304 at 311–312.
19 *Re Bond Corporation Holdings Ltd* (1991) 5 ACSR 304 at 312.

(d) It could retain its security, stand outside the scheme of arrangement and refrain from submitting a statutory declaration. The under-secured portion of its claim against the applicant company would be extinguished by the scheme of arrangement. By ignoring the scheme of arrangement, such secured creditor would run the risk on the adequacy of its security at the time it seeks to realise the security.

17 These options under the proposed scheme of arrangement mirrored the provisions of the then-prevailing Australian insolvent liquidation laws, so such procedure under the proposed scheme that a partly secured creditor would have to go through was therefore "very nearly identical" to proving for a shortfall in a hypothetical liquidation of the applicant company.[20]

18 Some of creditors argued that the partially secured creditors ought to vote in a separate class from the ordinary unsecured creditors. The applicant company argued that the similarity of rights test ought to be viewed from a comparison of the choice confronting the creditors between the scheme of arrangement and a liquidation, and that the relevant scheme provisions pertaining to the treatment of secured creditors merely mirrored those secured creditors' rights in a liquidation under Australian insolvency law to prove for a shortfall.[21]

19 The Supreme Court of Western Australia held that there was a sufficient dissimilarity of rights between the partly secured creditors and the ordinary unsecured creditors to make it impossible for them to consult together with a view to their common interest, and as such they had to vote in separate classes. In coming to its decision, the court explained that the answer did not lie in a comparison of the rights which the partly secured creditor would have in a liquidation to the rights which it would have in the scheme of arrangement, but in a comparison of the rights of the partly secured creditor under the scheme of arrangement to recover the shortfall portion of its claim and the rights of the other unsecured creditors under the scheme of arrangement. Before they could prove their debts and subject themselves to the same regimen that applied to the ordinary unsecured creditors, the partly secured creditors would be required to shed or abrogate part of their security rights by submitting to the control of the scheme administrator in the ways outlined above.[22] In contrast, this would not be a choice or election which would confront the

20 *Re Bond Corporation Holdings Ltd* (1991) 5 ACSR 304 at 318.
21 *Re Bond Corporation Holdings Ltd* (1991) 5 ACSR 304 at 318.
22 See para 16 above.

ordinary unsecured creditors, who never possessed such security rights and simply had to lodge their scheme claims.[23]

D. Hong Kong

20 Although decisions from the Hong Kong courts appear to have gone both ways on this issue, in the majority of cases, the Hong Kong courts have approved a number of schemes of arrangement under which secured creditors have been classed together with unsecured creditors to the extent of the deficiency claims.

21 *Re UDL Holdings Ltd (No 3)*[24] concerned schemes of arrangement proposed by 25 related companies, each scheme of arrangement having identical terms. Under each scheme of arrangement, the preferential creditors of that scheme company would be paid the amount of their preferential claims in full and would be treated as ordinary unsecured creditors in respect of any balance. The secured creditors would be required to realise their security within two years of the respective scheme of arrangement becoming effective and would be entitled to claim any shortfall after realisation *pari passu* with the general unsecured creditors. If a secured creditor did not realise its security within the two-year period, the security would be valued and the secured creditor could claim the shortfall *pari passu* with the general unsecured creditors. The unsecured creditors (and the unsecured portions of the claims of the secured creditors and preferential claims described above) would receive dividends consisting of a mixture of cash and new shares in the scheme company.

22 Each scheme company called for one scheme meeting comprising a single class of all the creditors. Some of the creditors opposed the sanction of the scheme of arrangement on the basis that they, as former employees, would have been preferential creditors in respect of unpaid wages and other employee-related benefits if their respective employers had been put into liquidation. One of their arguments was that they, as preferential creditors, should have been placed in a separate class.

23 At first instance, the Hong Kong court (*per* Le Pichon J) sanctioned the schemes of arrangement, holding that no objection could be taken to the preferential and secured creditors voting as part of the same class as the unsecured creditors since each scheme of arrangement in essence only affected the unsecured portion of their debts. Therefore, in relation to the unsecured portions of their debts, these preferential

23 *Re Bond Corporation Holdings Ltd* (1991) 5 ACSR 304 at 318–319.
24 [2000] 3 HKC 405.

and secured creditors were held to have the same rights as the unsecured creditors.[25]

24 The appeal against the sanction order was dismissed.[26] The Hong Kong Court of Appeal observed that the preferential creditors and secured creditors would have the same rights in respect of their preference or security as in a liquidation. The excess of the claim (over the preferential portion of the claim or value of security) would rank *pari passu* with the claims of the unsecured creditors, so the secured creditors and preferential creditors would have the same rights in respect of the excess. The creditors had a community of interest as well as of rights, and would be able to properly consider and discuss the relevant matters in a single meeting even if their motivations were varied.[27]

25 On a further appeal by some of the preferential creditors,[28] the Hong Kong Court of Final Appeal held that the status of the preferential creditors was preserved by the schemes of arrangement, and the manners in which they were affected by the schemes of arrangement were the same as every other creditor, so they could readily consult with the other creditors as to their common interest.[29]

26 The reasoning of the Hong Kong Court of Final Appeal in *Re UDL Holdings Ltd*[30] was applied in *Re Wireless InterNetworks Ltd*,[31] which involved a scheme of arrangement with a single class of creditors. Some of the creditors were noteholders who held security over all the assets of the company.[32] Despite holding such security, the noteholders voted in that single class to the extent of the excess indebtedness over the value of the security. In sanctioning the scheme of arrangement, the Hong Kong Court of First Instance (*per* Yuen J) held that the noteholders did not have different legal rights as to the excess indebtedness such as would require them to vote in a separate class from the ordinary unsecured creditors. This was despite that the noteholders would receive an additional payment under a separate note restructuring in relation to the secured portion.[33]

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25 *Re UDL Holdings Ltd (No 3)* [2000] 3 HKC 405 at 417I–418F.
26 *Re UDL Holdings Ltd* [2000] 4 HKC 778.
27 *Re UDL Holdings Ltd* [2000] 4 HKC 778 at 786F–787B.
28 *Re UDL Holdings Ltd* [2002] 1 HKC 172.
29 *Re UDL Holdings Ltd* [2002] 1 HKC 172 at 185D–185E.
30 [2002] 1 HKC 172.
31 [2002] 2 HKC 701.
32 *Re Wireless InterNetworks Ltd* [2002] 2 HKC 701 at [20].
33 *Re Wireless InterNetworks Ltd* [2002] 2 HKC 701 at [15]. Whilst not entirely clear from the written judgment, it appears that the amount that the noteholders were to receive under the note restructuring ($38.2m) would be less than the estimated value of their security – the indebtedness to the noteholders was described to be

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27 In *Re Ocean Grand Holdings Ltd*,[34] the scheme of arrangement consisted of a single class of creditors, and although described as consisting of a class of all creditors with non-preferential claims against the applicant company,[35] the majority in value of the scheme creditors were noteholders who taken some security.[36] There was an estimate taken of the potential realisation from the security that the noteholders could have had recourse to, and they were allowed to participate in the scheme of arrangement in respect of the unsecured portion of their claims.[37] The other scheme claims were unsecured, and the creditors with preferential claims were contemplated to be paid in full (to the extent of their preferential claims).

28 The Hong Kong Court of First Instance approved the scheme of arrangement, finding that the single class of scheme creditors had been properly constituted. Interestingly, notwithstanding that the noteholders did in fact hold some security (albeit with very little value), the scheme of arrangement was described as one between the scheme company and "its unsecured creditors"[38] with the implication that the secured noteholders were considered to be unsecured creditors to the extent that their claims were not adequately covered by the value of their security.

29 Notwithstanding the previous decisions and particularly the decision of the Hong Kong Court of Final Appeal in *Re UDL Holdings Ltd*,[39] in at least one case, a Hong Kong court seemed to have come to a contrary conclusion. In *Re KB (Asia) Ltd*[40] ("*Re KB (Asia)*"), a creditor opposed the sanction of the proposed scheme of arrangement on the basis that one of the scheme creditors should not have voted together with the unsecured creditors. That scheme creditor had taken security in the form of a floating charge over the scheme company's receivables.[41] The scheme of arrangement sought to allow the secured creditor to have the value of its security interest be appraised, and to vote in respect of the unsecured portion of its scheme claim.[42]

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more than $63m (at [21]) and the unsecured portion of their scheme claims was $23.2m (at [15]).

34 [2008] HKCU 610.

35 *Re Ocean Grand Holdings Ltd* [2008] HKCU 610 at [13].

36 *Re Ocean Grand Holdings Ltd* [2008] HKCU 610 at [5] and [14].

37 *Re Ocean Grand Holdings Ltd* [2008] HKCU 610 at [14].

38 *Re Ocean Grand Holdings Ltd* [2008] HKCU 610 at [1].

39 [2002] 1 HKC 172.

40 [2014] HKCU 1683.

41 *Re KB (Asia) Ltd* [2014] HKCU 1683 at [13]. There was also a dispute as to whether the security had been released, but the court found that it had not (at [16]).

42 *Re KB (Asia) Ltd* [2014] HKCU 1683 at [14].

30 The Hong Kong Court of First Instance (*per* Harris J) found that the secured creditor's legal rights and those of the unsecured creditors were so dissimilar that they could not sensibly be allowed to consult together over the merits of the scheme.[43] Harris J explained that the critical difference between the secured creditor and the unsecured creditors was that the secured creditor "did not have to concern itself with whether or not the accounts receivables proved to be recoverable in the future because if they did it would benefit".[44] It was also not a fanciful possibility that those accounts receivables could in fact be recovered.[45]

31 It may have made a difference in *Re KB (Asia)* that there appeared to be doubts as to the *bona fides* of the scheme company and the reliability of scheme document in the first place. The court had suggested that it might have been appropriate if a liquidator were appointed to investigate the affairs of the company, particularly in relation to receivables which had been written down by the scheme company and which might have been profitably pursued.[46] The court also doubted that the disclosed appraised value of the charged receivables was even nil in the first place.[47]

E. The UK

32 In the recent case of *Re Hong Kong Airlines Limited*[48] ("*Re Hong Kong Airlines*") the English High Court approved a restructuring plan under Pt 26A of the Companies Act 2006,[49] which allowed secured creditors to vote together in the same class as the unsecured creditors to the extent of the unsecured portions of the secured claims.[50] The class of unsecured creditors consisted of lenders, trade creditors and lessors of aircraft that were to be returned as part of the company's operational restructuring. Under the restructuring plan, the claims of the unsecured creditors were to be replaced by claims against a new entity. This entity would make scheme distributions out from new money injected.[51]

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43 *Re KB (Asia) Ltd* [2014] HKCU 1683 at [17].
44 *Re KB (Asia) Ltd* [2014] HKCU 1683 at [18]
45 *Re KB (Asia) Ltd* [2014] HKCU 1683 at [18].
46 *Re KB (Asia) Ltd* [2013] HKEC 1471 at [7]–[10] (concerning the prior leave application).
47 *Re KB (Asia) Ltd* [2014] HKCU 1683 at [14] and [18]. *Cf*, *Re Metinvest BV* [2017] EWHC 178 (Ch) at [17], where it was possible for a secured creditor to vote with the unsecured creditors where the receivables for which security had been given were considered by the court to be valueless.
48 [2022] EWHC 3210 (Ch).
49 c 46 (UK).
50 Hong Kong Airlines Limited also proposed a parallel scheme of arrangement in Hong Kong to deal with liabilities governed by Hong Kong law.
51 *Re Hong Kong Airlines Limited* [2022] EWHC 3210 (Ch) at [11].

33 The court observed that the appropriate comparator for the restructuring plan was a Hong Kong liquidation.[52] Unsecured creditors would be entitled to prove for their debts and receive a *pari passu* distribution. Secured creditors would either have to value their security and prove for the deficiency or surrender their security and prove for the entire debt.[53] Against this backdrop, the court found that under the restructuring plan, security rights would not be affected as they were not being compromised, released or varied. What was being compromised was the secured creditor's right to recover the deficiency, being the portion of its claim that exceeded the value of its security. Such deficiency would be the amount that it would lodge a proof of debt for in a Hong Kong liquidation. The court therefore held that there was therefore an identity of interest between these secured creditors and the other members of the class of creditors who were wholly unsecured, and they could meet together with a view to considering their common interest.[54]

34 Although this decision does not concern an English scheme of arrangement but an English restructuring plan under Pt 26A of the Companies Act 2006,[55] the principles for class composition under a Pt 26A restructuring plan are the same as those for English schemes of arrangement.[56] Indeed, in reaching its decision, the court in *Re Hong Kong Airlines* drew from the scheme of arrangement decisions of *Re Hawk Insurance Co Ltd*[57] ("*Re Hawk Insurance*") and *Re Anglo American Insurance Ltd*[58] ("*Re Anglo American Insurance*"):

> (a) *Re Hawk Insurance* involved an insurance company under provisional liquidation. Under the proposed scheme of arrangement, scheme creditors would be paid a portion of their valid claims out of the assets of the company available for distribution. The scheme claims excluded amounts which were to be set off, and there was a deduction of the amount of any applicable security.[59] The English Court of Appeal allowed the appeal against the lower court's refusal to sanction the scheme of arrangement.
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> (b) *Re Anglo American Insurance* was another case involving an insurance company under provisional liquidation. The provisional liquidators had proposed a scheme of arrangement

52 *Re Hong Kong Airlines Limited* [2022] EWHC 3210 (Ch) at [27].
53 *Re Hong Kong Airlines Limited* [2022] EWHC 3210 (Ch) at [28].
54 *Re Hong Kong Airlines Limited* [2022] EWHC 3210 (Ch) at [29].
55 c 46 (UK).
56 *Re Hong Kong Airlines Limited* [2022] EWHC 3210 (Ch) at [26].
57 [2002] BCC 300.
58 [2001] 1 BCLC 755.
59 *Re Hawk Insurance Co Ltd* [2002] BCC 300 at [35].

under which the scheme company's assets would be held on trust by the scheme administrators in order to be distributed to scheme creditors over a period of time.[60] The scheme of arrangement would apply to all liabilities of the insolvent debtor, save for, amongst others, the secured creditors to the extent of the value of their security. Specifically, the court held that the scheme of arrangement did "not affect the rights of secured creditors or holders under letters of credit or trusts".[61]

III. Discussion

35 Broadly, the appropriateness of classing deficiency claims together with ordinary unsecured claims may be considered at two stages. The first is that of jurisdiction: when a court determines if the scheme creditors have been correctly classed, that is not just a matter of form, and the court would not have jurisdiction to sanction the proposed scheme of arrangement.[62] The second stage pertains to the court's discretion to sanction a scheme. Amongst other things, this stage queries whether those who attended the meeting were fairly representative of the class of creditors, and that the statutory majority did not coerce the minority in order to promote interests adverse to those of the class whom the statutory majority purported to represent.[63]

36 On the jurisdictional question, the Court of Appeal observed in *Pathfinder Strategic Credit LP v Empire Capital Resources Pte Ltd*[64] that in practical terms, there are three broad steps to creditor classification:[65]

(a) First, identify the comparator. For the purposes of this article, the appropriate comparator is assumed to be an insolvent liquidation.

(b) Second, assess whether the relative positions of the creditors under the proposed scheme mirror their relative positions in the comparator. This implies that at least four positions must be identified and compared: the positions of

60 *Re Anglo American Insurance Ltd* [2001] 1 BCLC 755 at 760f.

61 *Re Anglo American Insurance Ltd* [2001] 1 BCLC 755 at 759h–760a and 767a. Presumably, however, the amount of the secured portion of the claim would have to have been re-sized to take into account that the fact that the unsecured portion was subject to the scheme.

62 *The Royal Bank of Scotland NV v TT International Ltd* [2012] 2 SLR 213 at [58].

63 *The Oriental Insurance Co Ltd v Reliance National Asia Pte Re Ltd* [2008] 3 SLR(R) 121 at [43(b)].

64 [2019] 2 SLR 77.

65 *Pathfinder Strategic Credit LP v Empire Capital Resources Pte Ltd* [2019] 2 SLR 77 at [88].

the two groups of creditors under the proposed scheme of arrangement, and their positions in the comparator.

(c) Third, if there is a difference between the creditors' relative positions identified in the second step, assess whether the extent of the difference is such as to render the creditors' rights so dissimilar that they cannot sensibly consult together with a view to their common interest. This raises a question of judgment and degree. If a creditor's (or a group of creditors') position will improve or decline to such a different extent *vis-à-vis* other creditors simply because of the terms of the scheme of arrangement assessed against the comparator, then it should be placed in a different voting class.

37 The following tables set out how the relative positions of the creditors under the proposed scheme of arrangement and in the comparator are assessed, according to reasoning adopted in the existing case law. On both approaches, the relative positions of the respective groups of creditors are to:

(a) prove in the hypothetical liquidation of the scheme company (as the appropriate comparator) for their respective unsecured claims (in the case of ordinary unsecured creditors) or deficiency claims (in the case of under-secured creditors), and receive a dividend from the liquidation; and

(b) prove in the scheme of arrangement for their respective unsecured claims (in the case of ordinary unsecured creditors) or deficiency claims (in the case of under-secured creditors), and receive a scheme distribution.

A. Same-class approach

38 The following table summarises the kind of reasoning adopted in cases[66] where deficiency claims and ordinary unsecured claims have been placed in the same class.

66 See paras 21–25 above in relation to the *Re UDL Holdings Ltd (No 3)* [2000] 3 HKC 405, *Re UDL Holdings Ltd* [2000] 4 HKC 778 and *Re UDL Holdings Ltd* [2202] 1 HKC 172. See para 26 above in relation to *Re Wireless InterNetworks Ltd* [2002] 2 HKC 701. See paras 32–34 above in relation to *Re Hong Kong Airlines Limited* [2022] EWHC 3210 (Ch) and *Re Anglo American Insurance Ltd* [2001] 1 BCLC 755.

	Scheme of arrangement	Insolvent liquidation (comparator)
Unsecured creditor	Proof of debt: The ordinary unsecured creditor can prove its claim and obtain *pari passu* treatment under the scheme of arrangement.	Proof of debt: The ordinary unsecured creditor can prove its claim and obtain *pari passu* treatment in the hypothetical liquidation of the company.
Under-secured creditor	Proof of debt: The under-secured creditor can prove its deficiency claim together with the ordinary unsecured creditors and obtain *pari passu* treatment under the scheme of arrangement.	Proof of debt: The under-secured creditor can prove its deficiency claim together with the ordinary unsecured creditors and obtain *pari passu* treatment in the hypothetical liquidation of the company.
	Treatment of security rights: The under-secured creditor's rights in respect of its security are preserved and are not considered to be affected under the scheme of arrangement. The presence of these rights therefore does not affect the analysis of the creditors' relative positions.	Treatment of security rights: Save as otherwise required by insolvency law, the under-secured creditor has, and retains, its rights in respect of the security.

39 Under the same-class approach, if, under the scheme of arrangement, security rights are preserved such as to "mirror the position of undersecured creditors in a liquidation where they may realise their security and prove for the remainder together with the unsecured creditors",[67] then the scheme of arrangement is not considered to affect security rights. This is despite the fact that the deficiency claim, which forms part of the secured creditor's claim, is compromised by the scheme of arrangement.

40 In other words, for the purposes of assessing scheme classification, if the scheme of arrangement does not purport to affect security interests, the relative positions of the ordinary unsecured creditors and under-secured creditors can be taken into consideration

67 Stephanie Yeo, "Class Composition in Schemes of Arrangement" [2022] SAL Prac 13 at para 19.

to the extent that the scheme of arrangement proposes to deal with the unsecured (and under-secured portions of) claims. Since the ordinary unsecured and under-secured creditors receive the same treatment in respect of the ordinary unsecured and deficiency claims, the mere presence of the security interest is not seen as a dissimilarity that would make it impossible for the under-secured creditor to sensibly consult with the ordinary unsecured creditors in the same class. This is probably why in the majority of the decided cases the under-secured creditors were held to have been able to sensibly consult with the ordinary unsecured creditors with a view to their common interest.[68]

41 To be clear, this approach does not suggest that secured creditors and ordinary unsecured creditors can always be placed in a single class. Instead, it relates to the more limited question of whether secured creditors might be able to vote together with the ordinary unsecured creditors *to the extent of the amount of the secured creditors' deficiency claims*. In more complicated schemes of arrangement (such as the one proposed by PIL), the scheme of arrangement may also contain terms and conditions pertaining to the compromise and/or restructuring of the secured portion of claims. In such cases, regardless of the legal position on whether deficiency claims can be classed with ordinary unsecured claims, the secured creditors would at least be required to vote in a separate class to the extent of the secured portion of their claims.

B. Separate-classes approach

	Scheme of arrangement	**Insolvent liquidation (comparator)**
Unsecured creditor	Proof of debt: The ordinary unsecured creditor can prove its claim and obtain *pari passu* treatment under the scheme of arrangement.	Proof of debt: The ordinary unsecured creditor can prove its claim and obtain *pari passu* treatment in the hypothetical liquidation of the company.

68 See n 66 above.

Under-secured creditor	Proof of debt: The under-secured creditor can prove its deficiency claim together with the ordinary unsecured creditors and obtain *pari passu* treatment under the scheme of arrangement. Treatment of security rights: However, the under-secured creditor is compelled to shed some of its rights in respect of its security.	Proof of debt: The under-secured creditor can prove its deficiency claim together with the ordinary unsecured creditors and obtain *pari passu* treatment in the hypothetical liquidation of the company. Treatment of security rights: Save as otherwise required by insolvency law, the under-secured creditor has, and retains, its rights in respect of the security.

42 In contrast, under the separate-classes approach, deficiency claims should not be classed together with ordinary unsecured claims. The relative positions of the creditors are taken in account in a more inclusive manner. The under-secured creditors' security rights in the comparator, and the fact that the creditors will be compelled to shed some of those rights under the proposed scheme of arrangement, are seen as significant dissimilarities from the rights that the ordinary unsecured creditors have in the corresponding scenarios. In the comparator, the ordinary unsecured creditors do not have security rights. Likewise, the ordinary unsecured creditors will also not have to consider the potential impact of the proposed scheme of arrangement on security rights which will only be experienced by the under-secured creditors.

43 A more practical way to express this reasoning is that "[a]s a matter of commercial reality, creditors decide whether to support a scheme by reference to the whole package of rights received for releasing or varying their existing rights".[69]

C. Difficulties that splitting an under-secured claim creates for creditor class composition

44 One may explore the reasoning underlying the separate-classes approach further by examining the nature of the under-secured creditor's rights in the comparator of an insolvent liquidation, where the under-secured creditor essentially has three options:

69 *Re DSG Asia Holdings Pte Ltd* [2022] 3 SLR 1250 at [57]. See also Stephanie Yeo, "Class Composition in Schemes of Arrangement" [2022] SAL Prac 13 at para 17.

(a) the under-secured creditor can surrender its security and prove in the liquidation for its full claim;[70]

(b) if the under-secured creditor does not surrender its security, it can only submit a proof of debt for the balance (if any) due to it after deducting the value of the security held (*ie*, the deficiency claim);[71] and

(c) the liquidator can require the creditor to give up the security for the benefit of the company's creditors generally on payment to the creditor of 120% of the estimated value of the security.[72]

45 Whilst it is true that the under-secured creditor can realise its security and lodge a proof of debt for the balance, Singapore's statutory insolvency regime does not itself purport to bifurcate the under-secured creditor's claim against the insolvent company into separate secured and unsecured portions. Instead, what it does is to limit that creditor's right to claim against the general unsecured assets of the insolvent company according to the extent to which the claim is covered by the value of security.

46 In contrast, a scheme of arrangement that operates on deficiency claims involves the act of bifurcating the under-secured creditor's claim into secured and unsecured portions. This then allows the unsecured portion to be compromised and/or restructured under the scheme of arrangement. The act of bifurcation itself therefore affects the secured creditor's secured claim and security interest.

47 Further, even if the terms of such a scheme of arrangement express that the secured portion of the claim and the security asset or security are not affected,[73] it is difficult to see how the security can remain wholly unaffected. It must be remembered that the whole of the creditor's claim is secured by the security. The moment a scheme of arrangement compromises the unsecured portion of the claim, the creditor is, going

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70 Insolvency, Restructuring and Dissolution (Corporate Insolvency and Restructuring) Rules 2020 (S 603/2020) r 99.

71 Insolvency, Restructuring and Dissolution (Corporate Insolvency and Restructuring) Rules 2020 (S 603/2020) r 99.

72 Insolvency, Restructuring and Dissolution (Corporate Insolvency and Restructuring) Rules 2020 (S 603/2020) r 100(1).

73 As was the case in the *Re UDL Holdings Ltd (No 3)* [2000] 3 HKC 405, *Re UDL Holdings Ltd* [2000] 4 HKC 778 and *Re UDL Holdings Ltd* [2202] 1 HKC 172, *Re Wireless InterNetworks Ltd* [2002] 2 HKC 701, *Re Hong Kong Airlines Limited* [2022] EWHC 3210 (Ch), *Re Hawk Insurance Co Ltd* [2002] BCC 300 and *Re Anglo American Insurance* [2001] 1 BCLC 755.

forward, only able look to the security for recourse in respect of a smaller sum. The debt owed to the creditor is essentially re-sized, and the ability to appropriate the security as payment is now only permissible in respect of the reduced claim amount. Conceptually, a re-sizing of a secured claim must surely be taken as affecting the creditor's secured claim and its security rights given that the secured claim and the unsecured deficiency claim are delineated at the point where the value of the security assets exceeds the creditor's claim. On a more practical front, the secured creditor is also deprived of the benefit of a subsequent increase in the value of the security asset.

48 The upshot is that the substance of each of the secured and unsecured portions therefore cannot be analysed completely independently of each other. When assessing the creditors' relative positions for the purposes of creditor classification, it should no longer be ignored that the ability to appropriate the security as payment for the deficiency claim in future (in the comparator) or the subsequent increase in value of the security asset in a case of a bifurcation under the proposed scheme of arrangement of a secured creditor's claim, are in fact things that the ordinary unsecured creditors do not have to consider. Judicial language in past decisions stating that the proposed scheme of arrangement did not "affect" the secured portion of a secured creditor's claim and/or its security may therefore not be entirely accurate.[74]

49 Needless to say, if even the least intrusive of schemes of arrangement that purport to only affect deficiency claims and not the secured portion do in fact have a substantive impact on the under-secured creditor's security rights,[75] then all the more it is so for the more complex schemes of arrangement that spell out specifics of how the security asset is to be treated[76] and how the secured portion of the claim will be restructured.[77]

D. The dissimilarity test as a matter of degree

50 The above objections, however, should not necessarily make it impossible for an under-secured creditor to vote on its deficiency claim together in the same class as the ordinary unsecured creditors.

74 See n 73 above.

75 See, *eg*, paras 5–7 above in relation to the scheme proposed by Hoe Leong.

76 See, *eg*, paras 14–19 above in relation to *Re Bond Corporation Holdings Ltd* (1991) 5 ACSR 304. It may be arguable whether the court might have come to a different conclusion if the scheme company had been less zealous in specifying in great detail how all secured creditors would be compelled to treat their security under the scheme.

77 See, *eg*, paras 8–12 above in relation to PIL's scheme.

When a court considers whether the scheme classes have been properly constituted, it considers whether the extent of the difference between the creditors' relative positions is such as to render the creditors' rights so dissimilar that they cannot sensibly consult together with a view to their common interest.[78] This is a question of judgment and degree.[79] It is clear from scheme jurisprudence that courts should seek to take a broad, practical and objective approach and avoid an impractical mushrooming of classes that could potentially result in the creation of unjustified minority vetoes.[80] Overly technical or theoretical differences between a deficiency claim and an ordinary unsecured claim should not in themselves fracture a creditor class.

51 Although a scheme of arrangement which compromises the unsecured portion of a secured claim does in fact "affect" a creditor's security rights and re-sizes the secured claim, the substantial interest of the creditor in its secured claim and security interest would not be affected at that particular point in time. The better question to ask is the degree to which that affects the under-secured creditor's relative positions and rights in respect of that deficiency claim. This is where the reasoning adopted in the cases adopting the same-class approach becomes compelling (at least for the straightforward cases), that the under-secured creditor is considering its rights to recover the deficiency against an insolvent liquidation as the comparator, and in respect of which the treatment would be the same as an ordinary unsecured claim.[81]

52 Further, even if an under-secured creditor may conceivably consider its returns from the secured portion when determining how to vote in respect of the unsecured portion,[82] the same can be said for any scheme creditor with cross-holdings (having more than one type of claim against the scheme company) but yet such creditors with cross-holdings are typically allowed to vote in each separate class.[83] The better question to address one's mind to is the extent to which an under-secured creditor's rights in respect of the unsecured portion of its claim are in practical reality that much different from the claim of an ordinary unsecured creditor.

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78 *Pathfinder Strategic Credit LP v Empire Capital Resources Pte Ltd* [2019] 2 SLR 77 at [88].

79 *Pathfinder Strategic Credit LP v Empire Capital Resources Pte Ltd* [2019] 2 SLR 77 at [88].

80 *The Royal Bank of Scotland NV v TT International Ltd* [2012] 2 SLR 213 at [141].

81 See, *eg*, paras 32–34 above in relation to *Re Hong Kong Airlines Limited* [2022] EWHC 3210 (Ch).

82 See para 43 above.

83 *Re ColourOz Investment 2 LLC* [2021] 1 BCLC 5 at [88].

E. The need to scrutinise the valuation of the security

53 The key to correctly classifying deficiency claims probably begins with a thorough scrutiny of the valuation of the under-secured creditor's security assets.

54 Valuation is not a mere threshold issue. Its accuracy is central because the very act of splitting an under-secured claim into a secured portion and an unsecured portion presupposes that the value of the security has been properly determined. The potential injustice of inaccurate valuations is not hard to imagine, for it is not an uncommon scenario to find that much of a scheme company's debt is held by under-secured bank creditors. There may be an intention to rely on their votes on their deficiency claims to cram down on the votes of the ordinary unsecured creditors who are often trade creditors with claims of significantly smaller quantum.

55 To be clear, the cramming down of the minority dissenting creditors is itself contemplated under the scheme of arrangement mechanism. What should be guarded against, however, is paying short shrift to the accuracy and reliability of the valuation, particularly where a difference in the amount of the deficiency claims would result in a different voting outcome and whether the votes of dissenting ordinary unsecured creditors will be crammed down.

56 Where the value of security assets clearly exceeds the amount of the claim,[84] the claim is fully secured and the question of bifurcation does not arise. The opposite scenario is also easy to resolve: where the security asset is clearly valueless and the secured creditor can obtain no realisation from it, then that creditor, though nominally secured, may vote in the same class as the ordinary unsecured creditors.[85]

57 Scenarios in between, however, present greater challenge. The less accurate the valuation, the greater the risk of distorting the incentives operating (or perceived to operate) on the under-secured creditor, in turn skewing its considerations when deciding how to cast its vote. In this respect, it is useful to refer to the kind of reasoning that has been used by courts in more recent years when scrutinising scheme creditor

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84 *Eg*, where a bank creditor is the chargee of a fixed charge over the moneys standing to credit in the chargor's bank account with that bank creditor, and the account balance exceeds the amount of the bank's claim.

85 See *Re Metinvest BV* [2017] EWHC 178 (Ch) at [17]. *Re KB (Asia) Ltd* [2014] HKCU 1683 is readily distinguishable because in that case the court doubted the nil valuation provided by the scheme company, finding that there was a possibility that the accounts receivables held by the creditor as security could in fact be recovered.

classification. On a general level, courts will take a realistic commercial view of what rights are sufficiently connected so as to be relevant to creditor classification:[86]

> Thus, in determining the classification of creditors, the court looks at the scheme not in isolation but in the context of the restructuring as a whole. The court considers any rights conferred or to be conferred in other agreements that are provided for under the terms of the scheme or are conditional on the scheme: *Re Sunbird Business Services Ltd* [2020] EWHC 2860 (Ch) at [23]; *Re Stemcor Trade Finance Ltd* [2016] BCC 194 at [17]–[18]. In contrast, the court does not consider rights that are genuinely independent of the scheme and restructuring in a realistic commercial sense: *Re Codere* at [53]–[54], citing *Re Noble Group Ltd (No 1)* [2019] 2 BCLC 505 ('*Re Noble Group*') at [131]–[132] and *Re Telewest Communications plc (No 1)* [2005] 1 BCLC 752 at [54]. If the rights are technically not conditional on the scheme being implemented, but they are commercially part of the same transaction and are highly unlikely to be conferred unless the scheme is implemented, they are relevant to classification: *Re Codere* at [52]. Creditors would otherwise be able to enter into agreements that confer preferential rights without being classed separately, simply by making those agreements technically not conditional on the scheme being implemented: *Re Codere* at [52].

58 There are also specific examples:

(a) In relation to prior payments made to some but not all of the scheme creditors, the prior payments must have been made for legitimate reasons and be genuinely independent of the scheme of arrangement and restructuring, and should not amount to a disguised part of the consideration offered under the scheme of arrangement and restructuring.[87]

(b) In relation to lock-up agreements, courts will consider whether the benefit conferred by the lock-up agreement is so sizeable that it would have a significant influence on the decision of a reasonable creditor when voting for the proposed scheme. In assessing whether there was a significant influence, one would look at the relative size of the consent fee (or benefit) when compared to the forecasted returns to creditors under the implemented scheme of arrangement and the estimated recovery in liquidation (or another appropriate comparator).[88]

(c) In relation to cross-holdings (where a scheme creditor has more than one type of claim against the scheme company), they generally give rise to potentially different interests rather

86 *Re DSG Asia Holdings Pte Ltd* [2022] 3 SLR 1250 at [58].
87 *In re Noble Group Ltd* [2019] Bus LR 947 at [132].
88 *Re Brightoil Petroleum (S'pore) Pte Ltd* [2022] 5 SLR 222 at [46(a)].

than rights and do not require separate class meetings to be convened. However, the matter of cross-holdings may be taken into account at the stage when the court decides whether to exercise its discretion to sanction a scheme of arrangement, where it is asked if it can be ascertained whether the majorities in one class have been obtained as a result of creditors with cross-holdings voting so as to promote their interests in another class rather than in the interests of the class in which they are voting.[89]

59 Drawing from these, one may derive the following as guidance:

(a) The treatment of the security assets and secured portions of the under-secured creditors' claims under the proposed scheme of arrangement (if any) should be for legitimate reasons and be genuinely independent of the treatment of the deficiency claims, and should not amount to a disguised part of the consideration offered in respect of the deficiency claims. This analysis is relevant during both the stages of (i) determining if the court has jurisdiction to sanction the scheme, and (ii) exercising the discretion to sanction the scheme.

(b) If there is an additional benefit conferred by the scheme of arrangement to the under-secured creditors (whether expressed as being in respect of the secured portion or otherwise), it should be considered whether the additional benefit is so sizeable that it would have a significant influence on the decision of a reasonable under-secured creditor when voting on its deficiency claim together with the ordinary unsecured creditors. This analysis is relevant during both the stages of (i) determining if the court has jurisdiction to sanction the scheme, and (ii) exercising the discretion to sanction the scheme.

(c) Consider whether any matter raises a risk that the majorities in the class for ordinary unsecured claims have been obtained as a result of the under-secured creditors voting so as to promote their interests in another class rather than in the interests of the class for ordinary unsecured claims. This analysis is relevant at the stage when the court considers if it should exercise the discretion to sanction the scheme.

60 If the value ascribed to the security asset for the purpose of a proposed scheme of arrangement is higher than the independently ascertained realisable value, then after the implementation of the scheme

89 *Re ColourOz Investment 2 LLC* [2021] 1 BCLC 5 at [88].

of arrangement, the under-secured creditor retains a secured claim against the scheme company (which the creditor expects to eventually recover in full) that is greater than what the creditor could have actually realised on its security asset. Objections to scheme classification can then be made on the basis that the under-secured creditors:

> (a) are receiving disguised consideration in respect of the secured portion of their claims for their favourable vote in respect of their deficiency claims;[90] or
>
> (b) have been influenced to vote in favour of the scheme of arrangement so as to promote their interests as secured creditors rather than in the interests of the creditors holding ordinary unsecured claims.[91]

61 To illustrate, suppose a creditor ("creditor ABC") has a claim of $1m against a scheme company. Creditor ABC holds security over assets with an independently ascertained realisable value of $600,000. However, under the scheme of arrangement, creditor ABC's security asset is given a value of $700,000, so creditor ABC casts a vote together with the secured creditors for a value of $700,000, and votes together with the ordinary unsecured creditors to the extent of $300,000. Upon implementation of the scheme of arrangement, the secured portion of secured creditors' claims are retained and are paid off over a period of time. Unsecured claims are paid one cent on the dollar.

62 In this scenario, it might well be arguable that creditor ABC would receive an additional $100,000 in respect of the secured portion of its claim, and that the $100,000 serves as an additional incentive for creditor ABC to vote in favour in respect of the $300,000 unsecured portion (for which the scheme return would be a relatively insignificant $3,000). In other words, creditor ABC could be taken as receiving a scheme distribution of up to $103,000 (instead of $3,000) on its deficiency claim. This disparity would surely constitute a sufficient dissimilarity of rights from the ordinary unsecured creditors to make it impossible for them to consult together with a view to their common interest. Alternatively, creditor ABC's vote in respect of its deficiency claim might be taken as promoting creditor ABC's interests as a secured creditor rather than in the interests of the class for ordinary unsecured claims. A court may

90 See para 59(a) above. This is drawn from jurisprudence from the decisions on prior payments. Where objections can be made on this basis, it should then be considered whether the additional benefit conferred is material.

91 See paras 59(a) and 59(b) above. This is drawn from jurisprudence from the decisions on cross-holdings.

therefore also decline to exercise its discretion to sanction the proposed scheme of arrangement on the ground of this unfairness.

63 The illustration above, though simplistic, does its job at highlighting one instance of the kind of potential injustice that may result where insufficient regard is paid to the valuation of the security asset. The practical reality may not be too far off as well. When discussions take place between a scheme company and its secured creditors in the time leading up to the launch of a scheme of arrangement, the secured creditors, particularly those with the largest holdings of debt, are commonly given the opportunity to give feedback on the restructuring and the scheme of arrangement.[92] Where the secured creditors are under-secured, one of the common issues discussed is the value to be ascribed to the security asset under the proposed scheme of arrangement, since that tends to have the largest impact on the secured creditor's overall recovery under the restructuring.

64 On the converse, if there is cogent evidence presented to the court that:

(a) the realisable value of the security asset has been accurately and independently estimated; and

(b) in respect of the secured portion of their claims, the under-secured creditors will not be treated materially better than what they could have realised their security asset for,

then a more compelling case can be made that the under-secured creditors are only receiving, in respect of their security asset, what they could have obtained in an insolvent liquidation, and that they therefore ought to be taken as standing in the same position in respect of their deficiency claims as the ordinary unsecured creditors. The objection that the under-secured creditor would consider its returns from the secured portion when determining how to vote in respect of the unsecured portion can then be justifiably overcome.

65 In more complex schemes of arrangement, the restructuring of the secured portions of the secured creditors' claims generally extend to more than just a re-sizing of the secured portion to match the collateral value.

92 See, *eg*, paras 5–7 above in relation to the case of Hoe Leong, where the determination and proportion of the secured portions of the partly secured creditors' claims were expressed to be arrived at after "negotiation".

66 For example, outstanding amounts owed to under-secured bank creditors under banking facilities may be subject to an entirely new set of terms and conditions (as was the case for PIL). There may be additional interest charged[93] and new payment mechanisms implemented such as monitoring accountant and cash sweep arrangements. Various intercreditor arrangements may be instituted through provisions in the scheme, such as debt service waterfalls and the entry into intercreditor agreements. There might also be provisions in the scheme of arrangement which may compel the under-secured creditor to realise its security asset in certain specified manner,[94] or perhaps to assign the secured portion to a third party purchaser on a fixed set of terms.

67 In these more complicated scenarios, it may not be clear if any particular aspect of the scheme of arrangement can be said to have afforded some kind of special treatment or benefit to the under-secured creditors in respect of the secured portion of their claims as would justify their voting on their deficiency claims in a separate class from the ordinary unsecured creditors. It might be more apt to resolve these sorts of cases as part of the court's discretion to refrain from granting sanction of the scheme of arrangement. Taken in totality, the various scheme provisions relating to secured creditors and their security assets, together with the process through which discussions and negotiations between secured creditors may have taken place, could support a finding that the under-secured creditors voting on their deficiency claims were not fairly representative of the class of ordinary unsecured creditors and the majorities obtained were as a result of the under-secured creditors voting so as to promote their interests in another class rather than in the interests of the class for ordinary unsecured claims. After all, the assessment of appropriate scheme classification ought to remain a fact-specific one with all the circumstances considered *in toto*.[95]

IV. Practical considerations and concluding thoughts

68 Some practical considerations for insolvency practitioners arise on the premise that deficiency claims can only be classed together with ordinary unsecured claims when the under-secured creditors do not receive any significant special treatment or additional benefit

93 Arguably, receiving interest can be justified on the basis that it represents the time value of money that the secured creditor could have earned from realising the proceeds of sale of the collateral.

94 It is arguable whether this was so in *Re Bond Corporation Holdings Ltd* (1991) 5 ACSR 304.

95 *Re Brightoil Petroleum (S'pore) Pte Ltd* [2022] 5 SLR 222 at [45].

over and above the independently ascertained realisable value of their security assets.

69 Apart from the additional costs which may be incurred in procuring more rigorous independent valuations, it may become more difficult to solicit the support of under-secured creditors by negotiating the value ascribed to their security assets. The agreement reached would have to be within an acceptable range of the valuation(s) obtained in respect of the collateral. Under-secured creditors may not be satisfied with only the prospect of saving on the additional time, uncertainty and cost of enforcement associated with realising their security assets, and may demand additional scheme payments believing they are entitled to something more than the valuation(s). Together, these circumscribe the utility of bifurcating under-secured claims. Going through the vote solicitation process on this basis might turn out to be a waste of time and cost for scheme companies, as there are fewer incentives that can be offered to the under-secured creditors.

70 Notwithstanding the above, one possible method may be to bifurcate the under-secured claims and subsequently compromise the deficiency claims under two separate schemes of arrangement in series. Under the first scheme of arrangement, under-secured debt is bifurcated and the amounts of the secured claims are re-sized to the value of the respective security collateral. The residual deficiency claims then become wholly unsecured claims, and can be subject to the subsequent scheme of arrangement together with the ordinary unsecured creditors. The downside of this approach is that the two schemes of arrangement cannot be made inter-conditional, otherwise they become in substance the same scheme, and the classification limitations remain. The previously under-secured creditors would also bear the execution risk of the second scheme of arrangement failing.

71 Turning to the treatment of existing case law where deficiency claims have not been allowed to be classed together with ordinary unsecured claims:

(a) Dissenting creditors who seek to rely on *Re Bond Corporation* to make the argument that deficiency claims should *never* be placed in the same class as ordinary unsecured claims might find this an uphill and difficult task in light of the more recent case law. It might be hard to reconcile the reasoning, particular with that of the *Re UDL Holdings Ltd* line of decisions where, like in *Re Bond Corporation*, a time frame was to be given for secured creditors to realise their security, failing which the security would be valued, but the Hong Kong courts held that the under-secured creditors did not have different legal rights as

to the excess indebtedness such as would require them to vote in a separate class from the ordinary unsecured creditors.[96] There might also be an attempt to distinguish *Re Bond Corporation* on the basis that the proposed scheme of arrangement in that case contained express provisions affecting the creditors' security rights.[97]

(b) The reasoning in *Re KB (Asia)*[98] may actually be consistent with the proposed framework in this article. On one perspective, the holding that the under-secured creditor in that case "did not have to concern itself with whether or not the accounts receivables proved to be recoverable in the future because if they did it would benefit" and that it is not "fanciful" that "accounts receivables may prove recoverable in the future" likely refers to the under-secured creditor's rights in the comparator.[99] If so, the scheme of arrangement would have resulted in a detriment to the under-secured creditor's security interest which would have been extinguished by the proposed scheme of arrangement. This detriment would not be something that the ordinary unsecured creditors would have had to consider. This would essentially be the inverse scenario of that presented in paras 61 and 62 above: as the under-secured creditors' security collateral is undervalued for the purpose of the proposed scheme of arrangement, they might be able to argue against being placed in the same class as the unsecured creditors even in respect of deficiency claims.[100]

72 Finally, the apparent departure in the case of PIL from previous schemes of arrangement approved by the courts in Singapore can be readily explained and reconciled. Companies hoping to class deficiency claims together with ordinary unsecured claims will, going forward, need to be careful to ensure that under their proposed schemes of arrangement, there is proper and objective basis for the ascribed value of the security collateral, and that the schemes of arrangement will not afford significant special treatment or additional benefits to the under-secured creditors which might be legitimately taken as influencing their votes in respect of their deficiency claims. Companies hoping to class deficiency claims

96 See paras 21–25 above.

97 See para 16 above. Do, however, note the limitations of this argument, as the court had also seemed to accept that these procedures were "very nearly identical" to the procedures that the under-secured creditors would have to go through in a liquidation (*Re Bond Corporation Holdings Ltd* (1991) 5 ACSR 304 at 318).

98 See paras 29–31 above.

99 *Re KB (Asia) Ltd* [2014] HKCU 1683 at [18].

100 Additional arguments might also be made about the fairness of the scheme as the under-secured creditors will obtain a lower return than they would obtain under the comparator.

together with ordinary unsecured claims should also be mindful that if there is detriment to the under-secured creditor's security interest as a result of a valuation of security assets under the proposed scheme of arrangement that is lower than the independently ascertained realisable value of the security assets, that would not be something that the ordinary unsecured creditors would have had to consider. This may also favour under-secured creditors being placed in a separate class from the unsecured creditors even in respect of deficiency claims.