Scheme of Arrangement : Classification of Creditors

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Areas covered

1. **TREATMENT OF RELATED PARTY CREDITORS**

- Classification (rights vs interests)
- Weight of votes

2. **STAGE OF DETERMINATION OF CLASSIFICATION OF CREDITORS**

MDSA Resources Sdn Bhd v Adrian Sia Koon Leng [2003] 1 LNS 1386

- Proposed Scheme involved unsecured creditors with more than RM374 million of debt ("**Scheme Creditors**").
- The Scheme Creditors consist of third-party creditors as well as creditors that are related to MDSA Resources ("**Related Party Creditors**"). The Scheme Creditors were all placed in a single class.
- Third-party creditors (636) – 26.2%, Related Party Creditors (19) – 73.8%.
- In September 2020, MDSA Resources obtained leave from the High Court to convene the scheme meeting.
- The Proposed Scheme was approved by 90.4% (in value) of the Scheme Creditors.
- In January 2021, the High Court dismissed the sanction application.

MDSA Resources Sdn Bhd v Adrian Sia Koon Leng [2003] 1 LNS 1386

- High Court:

"…I am of the considered view that given the "special interest" between the Hatten Group Creditors and the applicant and the enormous difference in debt value between the Third Party Creditors and the Hatten Group, Hatten Group Creditors' views (although majority in value) at the meeting "cannot be regarded as fairly representative of the class in question" ***and therefore should be disregarded totally****….*

`It must be stressed that this is not a question of merely wrong classification. The "related parties" and "special interest" elements were prevalent in the circumstances of this case to the extent that the Hatten Group Creditors had stifled the voice of the minority Third Party Creditors. In such a situation the Hatten Group Creditors ***should not even be allowed to vote****…"*

MDSA Resources Sdn Bhd v Adrian Sia Koon Leng [2003] 1 LNS 1386

- Court Appeal:

"There is little or no doubt at all that the composition of this class of creditors, comprising the third-party creditors and the HGS creditors to constitute a single class of the scheme creditors ***is unfair, uneven and downright lopsided****. They should not have been lumped together in a single group. The total debt value of HGS creditors attending the meeting was 88% of the total value of the scheme creditors. But the total debt value of the third-party creditors attending the same meeting was only 12%. Metaphorically, the latter would have been eaten alive by the former."*

MDSA Resources Sdn Bhd v Adrian Sia Koon Leng [2003] 1 LNS 1386

- Federal Court (majority decision):

"…No doubt that all creditors have the same rights in the creditor's scheme but we should not disregard the interest of the group of creditors in the said class. After all, the class of creditors should uphold their common interests. The class of creditors must be fairly represented by the meeting of the proposed scheme…

a wholly-owned subsidiary or related party of a company that proposed a scheme of arrangement under the CA should not be placed in a single class of creditors due to their special interest in promoting the scheme. There is no community of interest between the subsidiary and the other creditors. Further, I am of the view that the weight to be attached to the related parties' votes is also pertinent in the classification of the class of creditors…

the votes of the related parties must be discounted or given less weight as they have a special interest in promoting the proposed scheme with the propensity to disregard the interests of the other creditors in the scheme."

MDSA Resources Sdn Bhd v Adrian Sia Koon Leng [2003] 1 LNS 1386

- Federal Court (minority decision):

"…(i) Firstly, on the issue of classification of creditors, the authorities speak with one voice, i.e. that related party creditors who have similar legal rights against the company as other creditors, not based on interests. If they are all unsecured creditors, generally they should all be grouped within the same class; and

(ii) secondly, on the appropriate weight to be given to the votes, it is an exercise of discretion by the court at the sanction stage, to determine whether the class was fairly represented. The "but for" test provides a useful guide to determine whether there were adverse interests of the related party creditors which had driven their votes."

Treatment of Related Party Creditors – Classification (pre MDSA Resources)

Re Sateras Resources (Malaysia) Bhd [2005] 6 CLJ 194

- the petitioner had convened only one creditors' meeting grouping the petitioner's secured creditors, unsecured creditors together with the petitioner's subsidiaries.

- "*…Separate meetings for shareholders and creditors have to be called and convened. Where there are different classes of creditors, class meetings may have to be held.* ***Classes will be viewed as separate if their interests are so different that they will not be able to consult together with a view to their common interests***".

- "*The court is of the view that it would be highly unfair to group the petitioner's subsidiaries in the same class of creditors with the petitioner's unsecured creditors as* ***there is a divergence of interest between the petitioner's subsidiaries and the other unsecured creditors and that both these classes of creditors will not be able to consult together with a view to their common interests****. It is undeniable that the petitioner having full control of the subsidiaries would cause the subsidiaries to vote in support of the Scheme. There is no community of interests such in so far as the subsidiaries and the other creditors are concerned…*"

***Re UDL Holdings Ltd & Ors* [2002] 1 HKC 172 ("*UDL Holdings*")**

*"Persons whose **rights are so dissimilar that they cannot sensibly consult together with a view to their common interest must be given separate meetings. Persons whose rights are sufficiently similar that they can consult together with a view to their common interest should be summoned to a single meeting**.*

*(3)**The test is based on similarity or dissimilarity of legal rights against the company, not on similarity or dissimilarity of interests not derived from such legal rights. The fact that individuals may hold divergent views based on their private interests not derived from their legal rights against the company is not a ground for calling separate meetings."***

AirAsia X Bhd v BOC Aviation Ltd & Ors [2021] 10 MLJ 942 (“*AirAsia X*”)

- *“There was an objection made that related creditors should not be put in the same class as other creditors. However this was not seriously pursued. In any case, for the present moment,* ***there is nothing to suggest that their rights as unsecured creditors are any different from the other creditors in its class to warrant putting them in a different class****. There is precedent for this in Transmile Group Bhd v Malaysian Trustee Bhd & Ors [2012] MLJU 130.”*

Transmile Group Bhd & Anor v Malaysian Trustee Bhd & Ors
[2012] 9 CLJ 1071

- The company made no distinction between the 15 creditors (including related party creditors) and has placed them all into a single class of creditors.

Transmile Group Bhd & Anor v Malaysian Trustee Bhd & Ors
[2012] 9 CLJ 1071

- *"**The possibility that some of the creditors may procure an advantage from additional benefits does not, ipso facto, necessitate separate classification**... In like manner, the fact that the STL lenders and CB SPV may well enjoy additional benefits by reason of the additional security they enjoy vis a vis TGB, does not in itself warrant different classification. The finding of the court that the entire group of unsecured creditors are to rank pari passu places them in one class in so far as their legal rights are concerned and the issue of a 'special interest' or benefit neither arises on the factual matrix here nor warrants separate classification. It cannot be reasonably concluded that such unfairness or oppression on the part of the majority has been demonstrated so as to warrant the withholding of sanction."*

Top Builders Capital Bhd & Ors Seng Long Construction & Engineering Sdn Bhd & Ors [2022] 8 MLJ 604 ("*Top Builders*")

- Single class of unsecured creditors (external unsecured creditors and intercompany and other related party creditors to the Top Builders Group).

- *"All of the unsecured scheme creditors and the related company creditors have the* ***same legal right of recourse against the applicants.*** *Similar to my finding at para [336] of AirAsia X, there is nothing to suggest that the related company creditors' rights are any different from the other creditors in its class to warrant placing them in a different class."*

Treatment of Related Party Creditors – Weight of votes (pre-MDSA Resources)

United Kingdom

1. **Re Apcoa Parking Holdings GmbH and others [2015] 2 BCLC 659**

2. **Re Lehman Brothers International Europe (in administration) [2018] EWHC 1980 (Ch)**

Re Apcoa Parking Holdings GmbH and others [2015] 2 BCLC 659

- But for test
- *"…if an allegation is made that a creditor had improper regard to interests other than those of the class to which he belonged, it is necessary for there to be a 'but for' link between the collateral interest and the decision to vote in the way that he did.* ***The person challenging the relevant vote must therefore show that an intelligent and honest member of the class without those collateral interests could not have voted in the way that he did. It is not sufficient simply to show that the collateral interest is an additional reason for voting in the manner in which he would otherwise have voted****."*

Re Lehman Brothers International Europe (in administration) [2018] EWHC 1980 (Ch)

- *"…A special interest which merely provides an additional reason for supporting the scheme (without clashing or conflicting with the interests of the class as a whole) does not undermine the representative nature of the vote…"*

- *"Further, and particularly as to (b) in paragraph [89] above, I agree also with Counsel for the Administrators that the bare existence of an adverse interest is not enough to impugn a creditor's vote as being unrepresentative of the class.* ***There must be a strong and direct causative link between the creditor's decision to support the scheme and the creditor's adverse interest such that it is the adverse interest which drives the creditor's voting decision. In the absence of such a link, there is simply no sufficient reason to treat the creditor's vote any differently from those of the rest of the class.***"

Hong Kong

1. **Re UDL Argos Engineering & Heavy Industries Co Ltd [2000] 3 HKC 405**

2. **UDL Holdings**

3. **Re Century Sun International Limited [2021] HKFCI 2928**

Re UDL Argos Engineering & Heavy Industries Co Ltd [2000] 3 HKC 405

- *"…What is the rationale for disregarding the votes of non-scheme subsidiaries? In deciding how their votes should be cast, their respective boards must consider what would be in their best interest as creditors.* ***Unless I am to assume that the directors of the non-scheme subsidiaries were all acting in breach of their fiduciary duties and voted in a manner that was not in the best interest of the relevant non-scheme subsidiary as creditors, their votes should not be discounted. There is no evidence before the court to warrant such an inference, much less conclusion****. Therefore I see no basis for making the assumption that I am implicitly invited to make. It must follow that no valid reason exists for disregarding the votes of non-scheme subsidiaries…"*

UDL Holdings

- *"…Internal creditors. The contention that internal creditors should have been treated as a separate class is contrary to the decisions in Re Jax Marine Pty Ltd and Re Landmark Corp Ltd which were in accordance with principle and which I have no doubt were rightly decided. The internal creditors, and particularly the companies which were putting their own schemes forward, undoubtedly had a special interest in promoting the schemes, but this did not disqualify them from being treated as ordinary creditors. The court was bound to take their presence into account when considering whether to exercise its discretion to sanction the schemes, but it was not debarred from doing so."*

Re Century Sun International Limited [2021] HKFCI 2928

- *"… I agree with Mr Ho that the focus is on why the creditor supports a scheme rather than why a creditor might not. For this reason one way of testing whether or not there is reason to think that the creditor was unrepresentative of the class, is to ask whether there is anything that suggests if the creditor, whose motive is impugned had not had the "special interest" in question, he would have voted differently. The Opposing Creditors have not pointed to anything, which suggests that Group creditors would have voted differently but for their relationship with the Company."*

Singapore

1. **Wah Yuen Electrical Engineering Pte Ltd v Singapore Cables Manufacturers Pte Ltd [2003] SGCA 23**

2. **The Royal Bank of Scotland NV (formerly known as ABN Amro Bank NV) and others v TT International Ltd and another appeal [2012] 2 SLR 213**

3. **SK Engineering & Construction Co Ltd v Choncubar Aromatics Ltd and another appeal [2017] 2 SLR 898**

Wah Yuen Electrical Engineering Pte Ltd v Singapore Cables Manufacturers Pte Ltd [2003] SGCA 23

- *"… Although related party votes are counted for purposes of determining whether the statutory majority has been reached,* ***the courts have consistently attributed less weight to such votes when asked to exercise their discretion in favour of a scheme.*** *This is because the* ***related party may have been motivated by personal or special interests to disregard the interests of the class as such and vote in a self-centered manner****. In the present case, we found no reason to abandon our traditional reserve because Wah Yuen's continued reticence on the related party debts prevented the court from making a competent assessment of the bona fides of the related party votes…"*

***The Royal Bank of Scotland NV (formerly known as ABN Amro Bank NV) and others v TT International Ltd and another appeal* [2012] 2 SLR 213 ("*TT International*")**

- *"…In our view, the **votes of wholly-owned subsidiaries should be discounted to zero**. **Wholly-owned subsidiaries are entirely controlled by their parent company**, ie, the Respondent in this case. Indeed, we view the Respondent's wholly-owned subsidiaries as extensions of the Respondent itself. If the Respondent were to wind up any of its wholly-owned subsidiary creditors, the debts owing to those wholly-owned subsidiary creditors (save for those debts owed by the wholly-owned subsidiary creditors to genuine third party creditors) would be extinguished and the assets of the wholly-owned subsidiary creditors would be the Respondent's. Significantly, the votes of the wholly-owned subsidiary creditors at creditors' meetings are undoubtedly entirely controlled by the Respondent."*

TT International

- Singapore Court of Appeal applied a partial discount on the votes of the related scheme creditors who were not subsidiaries of the scheme company. These related scheme creditors consist of a shareholder who provided loan to the scheme company and a bank with a security over the shares in the scheme company.

- The discount was based on the value of the shareholding as well as the shares under the security respectively.

SK Engineering & Construction Co Ltd v Choncubar Aromatics Ltd and another appeal [2017] 2 SLR 898

- What is a related creditor?
- Non-exhaustive list of factors to be considered.
  - Control
  - Common director(s)
  - Common shareholder(s)
- In this case, no related creditors.
- Obiter: Singapore Court of Appeal's discounting method in *TT International* is arbitrary and subjective.
- Solution: Wholly discount votes of related creditors.

***SK Engineering & Construction Co Ltd v Choncubar Aromatics Ltd and another appeal* [2017] 2 SLR 898**

*"From a broader perspective, it seems to us that the exercise of determining an appropriate **partial discount is inevitably arbitrary and subjective**, **and not amenable to definitive guidance**. This is hardly surprising, given the myriad fact situations in which a creditor may be found to be related to a scheme company in the context of voting on a scheme of arrangement. It seems to us **to be a more principled and certain approach to wholly discount the votes of creditors once they are found to be related to the scheme company: if the position of a creditor is in any way tainted, it should follow that that creditor's votes on the scheme should be entirely disregarded**."*

Stage of Determination of Classification of Creditors

Practice Statement (Companies Scheme of Arrangement) [2002] 1 WLR 1345 (Ch D) ("English HC Practice Statement")

TT International

AirAsia X

- Classification is to be determined at the convening stage.
- So that meetings do not end up being a futile exercise.

UDL Holdings

- Hong Kong Court of Final Appeal did not follow the English HC Practice Statement.
- Classification is to be determined at the sanction stage.
- Court’s concern was time and costs.

The effect of *MDSA Resources Sdn Bhd v Adrian Sia Koon Leng* [2003] 1 LNS 1386

- All related party creditors must be placed in a separate class and cannot vote together with third party creditors.

- Discount is to be given to related party creditors?

- What is the purpose of discounting votes by related party creditors?


The End.