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Rehabilitating Ailing Malaysia Companies Using The New Corporate Rescue Mechanism

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Abstract

This paper focuses on the Malaysia Corporate Rescue Mechanism 2016, which is a relatively new rescue mechanism to the Malaysian corporate environment. The Companies Commission of Malaysia introduces the mechanism as part of the insolvency framework to help small companies facing financial difficulties to be rehabilitated. There are two options available for owners of small companies to rescue their companies' businesses. The first option is corporate voluntary arrangement (CVA), and the second option is judicial management (JM). This paper has two main objectives: (i) to outline the characteristics of CVA and JM; and (ii) to identify and analyse the weaknesses of the revised corporate rescue schemes. This paper is a perspective, opinion and commentary article on the recent implementation of corporate rescue mechanism.

Keywords: corporate rescue mechanism, corporate voluntary arrangement, judicial management, financial distress, moratorium.

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INTRODUCTION TO THE EVOLUTION OF CORPORATE RESCUE MEASURES

Under the Companies Act 1965 (CA 1965), the common outcome of insolvency process is either receivership or liquidation. There is no provision under the old Companies Act which can assist small companies in rehabilitating its business to normal condition. However, the CA 1965 does provide a restructuring scheme for financially distressed companies. This scheme is also known as corporate rescue arrangement. It has been used by most of the companies experiencing financial distress during the 1996-1997 Asian Financial Crisis to prevent creditors from taking actions against the company. This corporate rescue arrangement is only available and suitable for larger companies.

There are two main weaknesses of the old corporate rescue arrangement. Firstly, there is a possibility where a company may abuse a restraining order application to defer a debt payment and a compromise plan. Secondly, the old Act allows the current management to continue to manage its business without proper protection for creditors against misappropriation of assets and cash. Due to the weaknesses of the current corporate rescue arrangement, the Companies Commission of Malaysia has introduced a

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new corporate rescue mechanism. The new corporate rescue mechanism consists of corporate voluntary arrangement (CVA) and judicial management (JM). The next section presents the review and analysis of the new legal framework of corporate rescue mechanism.

NEW CORPORATE RESCUE MECHANISM

Corporate voluntary arrangement (CVA) structure almost resembles the previous restructuring scheme arrangement under the old Companies Act 1965. The only difference is that the implementation of the CVA process is monitored by an insolvency practitioner. Besides, the CVA does not apply to larger public companies and companies that have created charges. The application for CVA shall be made by either the director, liquidator, judicial manager or official receiver of the company. The proposal for CVA shall be submitted together with a statement made by an insolvency practitioner that provides his view that the proposed debt restructuring has the potential to be approved and implemented. Also, the statement shall explain the possibility of whether the company has enough funds to continue its business during the moratorium period.

The proposal shall then be presented for approval at the members and creditors meetings. To make the proposal binding on all the creditors and members, the proposal shall obtain at least 75% of the vote of those present and voting at the creditors meeting. In contrast, for members meeting, at least a simple majority of votes of those members present shall be obtained. The nominee or new insolvency practitioner will then act as the supervisor to monitor the implementation of the proposed CVA. The moratorium period will end once the creditors' meeting is held. The extension of the moratorium period may be extended up to 60 days, provided that 75% majority of creditors' consent is obtained. Figure 1 shows the process flow of CVA.

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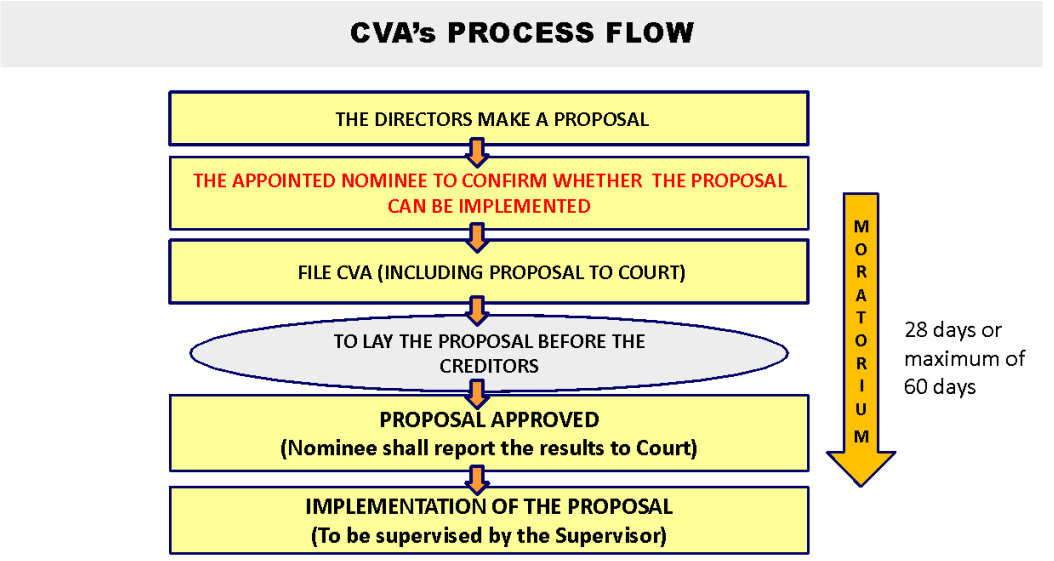

Figure 1: CVA's Process Flow

Judicial management (JM) is an arrangement where it places the company under the supervision of the court. Similar to CVA, an application for Judicial Management (JM) may be made by a company, its director or a creditor. A qualified insolvency practitioner will be responsible for managing the operation of the company's business if the court approves the application. The appointment of the insolvency practitioner is valid for six months from the date of the court order, and a further six-month extension is possible. During the period of application of JM to the approval of the JM by the court, a moratorium will be in force which prevents any winding-up application or legal proceeding being taken against the company without the approval of the court (Foo & Lee, 2017).

The judicial manager is responsible for preparing and presenting a restructuring plan for creditors' approval. The judicial manager will monitor the implementation of the restructuring plan if it is approved by 75% in value of creditors. Besides, the judicial

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manager has similar authority to a liquidator in a winding-up and also subject to a degree of control and monitoring by the court.

There are three possible situations for a JM application to be approved. First, the company's ability to pay its debts. Secondly, the company has a reasonable probability of rehabilitating and preserving all, or the company can continue its business as a going concern. Thirdly, the restructuring proposal has a better advantage to creditors compared to winding-up. To have a better understanding of the flow process of JM, please refer to Figure 2.

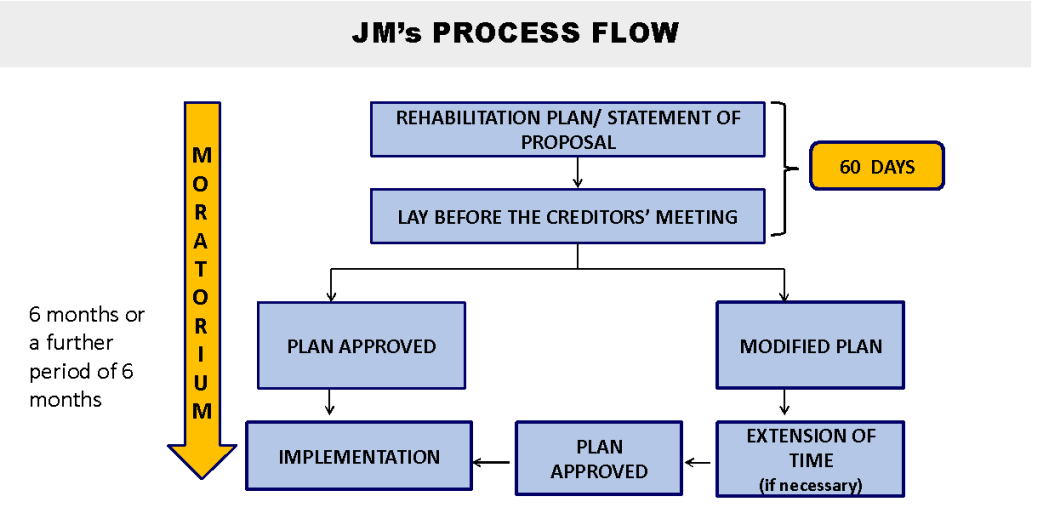

Figure 2: JM's Process Flow

The application for a JM order may be rejected by the secured creditor by requesting to proceed with the appointment of receiver or managers, provided the court allows with the condition to protect the interest of the public. The secured creditor may also appoint an interim judicial manager and apply a moratorium. This will take effect from the date of the application of the JM order until the court grants or rejects the order. However, the Companies Commission of Malaysia (CCM) has yet to clarify the meaning of "public interest".

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Based on the above discussion, there are a few differences between CVA and JM, which is presented in Table 1 below:

Table 1: Differences between CVA and JM

Differences between CVA & JM

Matter	CVA	JM
1. **Court approval**	Court approval for the proposal is not required. Only notify the Court of the result.	JMO need to meet conditions in s.405
2. **Period of moratorium**	28 days moratorium	6 months Judicial Management Order
3. **Extension of moratorium**	• Extension Order subject to 75% creditor approval • Maximum 60 days	• Extension Order subject to Court's discretion • 6 months
4. **Process manager**	Nominee (insolvency practitioner) is handling the process	Judicial Manager (insolvency practitioner) is handling the process
5. **Type of company**	For private company only	Private & Public company
6. **Mode of Application**	Filing form 1 (CRM Rules 2018) to the court	Originating summon

Since the implementation of the CRM in March 2018, there were eight cases reported from which two of the cases are for CVA, and the remaining eight cases are for JM. Among the notable case of JM is the case of CIMB Islamic Bank Bhd v Wellcom Communications (NS) Sdn Bhd & Anor [2019] 4 CLJ, and Leadmont Development Sdn Bhd v Infra Segi Sdn Bhd and another suit [2019] 8 MLJ 473 (Rabindra, 2020). In both of the cases, the application for judicial management order was set aside due to a number of reasons. In the first case, the court of appeal sets aside the judicial management order (JMO) on the ground of abuse of process on the part of the company which deprived the creditors' rights to take action against the company. For the second case, the JMO is set aside by the High Court because the applicant fails to provide full and frank disclosure

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during the application. Meanwhile, the cases for CVA involved two companies, which are M&M Consolidated Resources Sdn Bhd and Gorich Sdn Bhd. In both cases, the application of CVA has been approved at the meetings of members and creditors.

REVISED CORPORATE RESCUE SCHEMES

A moratorium scheme of arrangement and a compromise scheme of arrangement are the two types of corporate rescue schemes under the Companies Act 1965. The main difference between the two schemes is that the former scheme ensures that the creditors will be paid in full. In contrast, in the latter scheme, the creditors will not be paid in full for the amount owed (Chan, 2017) but the creditors are in a much better position compared to if the company is liquidated. However, both the moratorium and compromise scheme of arrangement require the creditors' approval before they can be implemented and bound by the creditors. This requirement is the main reason as to why the scheme of arrangement would generally stop at the application stage because of the difficulty to obtain the creditors' approval.

Under section 366 of the Companies Act 2016, the revised scheme of arrangement and compromise will bind all creditors, including those creditors who oppose the scheme. To avoid the abuse of the moratorium by the company and applicant, the period for the restraining order is limited to a maximum of three months with an extension of up to six months only. Furthermore, the court is allowed to appoint an approved liquidator to assess the viability of the scheme of restructuring and arrangement proposed. The independent liquidator will prepare a report for submission to the meeting of creditors and members. It is expected that the independent liquidator will be more objective in assessing the commercial viability of the proposed scheme and provide the required assistance to the court. All these improvements are taking into account some limitations of the old corporate restructuring and arrangement scheme under the previous Companies Act 1965. The new corporate rescue scheme aims to strengthen and enable a company to rehabilitate more efficiently and operatively.

LIMITATIONS OF THE NEW CORPORATE RESCUE MECHANISM (CRM)

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The new corporate rescue mechanism was introduced by the CCM after the revised Companies Act 2016 was implemented in February 2017. However, the provision and guidelines of the new CRM are only implemented on 1st March 2018. Even though the CRM is still at an infant stage, the effectiveness of the new scheme seems to be overshadowed by some limitations of the CRM. As discussed earlier, both options available under CRM are only for small companies. Public companies, licensed institutions and companies operating under designated payment system of Bank Negara Malaysia (Central Bank of Malaysia), and companies subject to Capital Market Services Act 2007 are excluded from resorting to CVA and JM. This new CRM is restricted to a company that has not created a charge to protect secured creditors. The secured creditors also have a veto power to reject an application for JM. This restriction limits the effectiveness of the new CRM (Foo and Lee, 2017).

Issues to Ponder

A secured creditor of the company can make an application to the court to set aside the judicial management order (JMO) because the company has failed to make full disclosure and withhold information; and has acted in bad faith (mala fide). The court may still retain the power to issue a JMO if it considers the public interest. The debenture holder is the only secured creditor who is given exclusive rights to reject the application for judicial management and appoint a receiver for partial or all of the company's property. The other creditors are only allowed to appear at the hearing of the judicial management application to reject the nomination of the judicial managers. They cannot oppose the issue of the JMO itself.

There are four situations where such an order may be discharged:

1. The creditors do not approve the judicial manager's proposal with or without amendment
2. The purpose of the JMO may not be achieved or has been achieved
3. The court, during the hearing has ordered the discharge of the JMO
4. The judicial manager has acted unfair and prejudice against the creditor.

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The court had the inherent power for setting aside the JMO. The power of the court is really wide, and it may allow for rejection of the order if the order was obtained without full and honest disclosure, and or acting in bad faith, or the application is defective.
There are two key points that the applicants of JM need to be aware of. First, it is important for the applicants to make a full and honest disclosure of material facts. Secondly, it is also critical that the majority creditors of the company support the application of JM. If the majority creditors oppose the JM, then the application and the proposal of the restructuring have a high chance of failure.

CONCLUSION

The main agenda of the new Corporate Rescue Mechanism (CRM) is to help ailing companies to rescue their business as a going concern and sustain for a long period to avoid winding-up. Even though the new CRM has advantages in terms of cheap and faster processes and requires minimal monitoring from the court; nonetheless, there are also some setbacks of the new CRM. One major limitation is that the limited application of the CRM to specific companies which would substantially make the CRM less effective in helping ailing companies. Next, the secured creditor's power to reject the application for JMO may further lessen the effectiveness of the new CRM to rehabilitate ailing companies. Finally, there is the possibility of the applicant (owner of the company) to abuse the CRM to delay payment of debts to the creditors.

As the new CRM is still at an infant stage in the corporate framework and only a few cases have been evidenced over the past two years, it is still early to gauge, test and assess the effectiveness of the new CRM and its capability to assist small companies in Malaysia to revive failing companies and sustain them for an extended period. We hope to see many more companies opting for CRM to rescue their businesses.

Malaysia, like any other countries around the world, is also affected by the recent COVID-19 pandemic. Many small companies may seek to restructure their financial positions and operations to avoid going out of business as the COVID-19 pandemic takes Malaysia into its first recession since the global financial crisis in 2008/2009. Recently, Esquel Group, a Hong Kong-based textile and garment manufacturer, has shut down its operations in Malaysia (Supriya, 20 April 2020). Many more companies would have found themselves unprepared to deal with this 'business unusual'. Therefore, it is necessary for companies to structure their businesses to stay relevant, to remain

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competitive and to avert the going-concern threat. The new corporate rescue mechanism under the Companies Act 2016 is available to them as their restructuring and rescue options.

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