International Journal of Humanities and Social Science Invention
ISSN (Online): 2319 – 7722, ISSN (Print): 2319 – 7714
www.ijhssi.org ||Volume 5 Issue 12||December. 2016 || PP.33-37

Recent Developments of Corporate Insolvency Law in Malaysia

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ABSTRACT: *This article aims to analyse the current corporate insolvency framework in Malaysia and the problem faced in the corporate insolvency law. Under the current corporate insolvency law in Malaysia, there are numerous approaches in dealing with corporate insolvency, but it appears that the current framework is found to be inadequate due to lack of focus accorded on the rescue mechanisms or attempts to rehabilitate companies. Conversely, the current corporate insolvency framework is very much focused on liquidation or winding up of a company. This article also highlights some of the proactive reform efforts undertaken by the Malaysian government to keep in tandem with the latest development that had taken place in the corporate sector. Accordingly, this article will propose some future reforms to the relevant department in order to reinvigorate the existing insolvency regulatory framework to be more dynamic and in line with international standards adopted by other countries within the region.*

Keywords: *corporate insolvency, corporate rescue mechanisms, corporate voluntary arrangement, cross-border insolvency, judicial management*

I. INTRODUCTION

The law relating to corporate insolvency in Malaysia is governed by the Companies Act 1965 and the Companies Winding-up Rules 1972. While the laws relating to personal insolvency in Malaysia are contained in the Bankruptcy Act 1967 and the Bankruptcy Rules 1969. Malaysia maintains a separate insolvency regulatory frameworks for personal and corporate insolvency. There is no single insolvency regulatory framework which consolidates both the corporate and personal insolvency unlike the Insolvency Act 1986 in the United Kingdom.

II. THE CURRENT CORPORATE INSOLVENCY FRAMEWORK IN MALAYSIA

Under the current corporate insolvency law in Malaysia, there are numerous approaches adopted in dealing with corporate insolvency. Firstly, regarding the receivership process where creditors may appoint a receiver and manager. More often than not, the company intended to be wound up and its assets are hived off and sold separately. The receivership procedures are widely practised in all jurisdictions. However, the primary purpose of a receivership is not to act in the collective interest of all creditors of the company but to liquidate the company's assets under a debenture for the interest of the debenture holders and not primarily to rescue or rehabilitate the company. Second, a winding up process which is intended to enable proper closure of a company that intends to cease operation or unable to continue with its business. The winding up process may be made voluntarily (through a member's or creditor's resolution) or by way of an application filed to the court for winding up order. Third, a scheme of arrangement under Section 176 of the Companies Act 1965. Whilst the section is not intended to serve specifically as a corporate rescue mechanism, it has somehow proven to be useful for companies facing financial difficulty. Where Section 176 of the Companies Act 1965 is concerned, although the procedures under Section 176 of the Companies Act 1965 have been amended in 1988 following constant criticisms from the market players, the scheme offered by Section 176 is still seen as costly, cumbersome and slow in its procedures and implementation particularly if it is to be used for corporate rehabilitation or rescue.

In responding to the problems faced by the banking sector in Malaysia in the wake of the 1997 financial crisis, a new formal insolvency process that is the "special administration" under the Pengurusan Danaharta Nasional Berhad Act 1998 (the Danaharta Act) was introduced to complement the older insolvency law and the restructuring process. The Danaharta Act proffers a non-court based procedure that operates along the commercial principles by adopting the market driven approach despite the fact that it is a government entity. This is one of the remarkable features of the special administration under the Danaharta Act as compared to the process under the scheme of arrangement. Time is very crucial in the formulation of a workable restructuring plan. The appointed special administrator must devise a workable restructuring plan in ensuring that the implementation of the plan be carried out within the period of three to six months after the appointment. This process proves to be faster than the procedures made available under Section 176 of the Companies Act 1965 because the normal court process would usually involve longer time to complete. The workable restructuring plan initiated by the special administrator requires only the approval of the secured creditors and not the shareholders of the company or its unsecured creditors. Once it is approved, the workout proposal binds the company, its shareholders and all creditors. This process is very distinct from the procedure under the scheme of arrangement which requires approval of 75 percent in value and a simple majority in number of each class of creditors and members present and voting. The creditors under the scheme of arrangement are divided into classes according to their communality of interests.

Another informal corporate rescue work out that had been introduced following the 1997 financial crisis was the Corporate Debt Restructuring Committee (CDRC) under the auspices of the Central Bank of Malaysia. The CDRC sets specific criteria to be met by applicant such as, the company must have a potentially viable business and have more than RM50 million worth of debts attached to more than one financial institution. The CDRC acts as a secretariat which supervises and facilitates negotiations between the creditors, banks and debtors (Aishah Bidin, 2012). The above mentioned frameworks outline the current insolvency measures available in dealing with corporate insolvency in Malaysia. However, it would not be too farfetched to suggest that the current framework is found to be inadequate because lack of focus on the rescue mechanisms or attempts to rehabilitate companies.

III. THE PROBLEM FACED

Careful perusal of the earlier mentioned framework positively indicates that the current corporate insolvency framework emphasized more on the liquidation process or winding up of a company. That could be the probable reason as to why liquidation often been seen as the only viable option for insolvent companies. However, the present framework is insufficient because the framework lacks of focus on the rescue mechanisms or efforts to rehabilitate companies. It is observed that the corporate insolvency framework in other jurisdictions govern matters pertaining to pre-insolvency procedures, liquidation process, consolidation of corporate and personal laws and corporate rescue mechanisms. In most jurisdictions, effective corporate insolvency regime means a process that is able to provide a system that enables the winding up of companies that has no future prospect of the business in becoming profitable and viable with the least possible cost and delay. At the same time, an effective corporate insolvency regime should be able to provide mechanisms to rehabilitate companies and rescue companies from being wound up. For instance, the Harmer Report of Australia, whilst acknowledging the general principles of corporate insolvency law, stated that there should be an effective release of the insolvent company from financial obligations and liabilities (The Secretariat to the Corporate Law Reform Committee (CLRC) Companies Commission of Malaysia, 2014). The so called ‘corporate rescue mechanisms’ is also present in the United Kingdom, where two further measures exist, to wit, administration, which aims to afford a company in a potentially insolvent position an alternative to automatic liquidation, including the possible outcome of assuring that company's survival; and company voluntary arrangements, conceived as a pre-insolvency measure leading to creditors being consulted in order to facilitate the reconstruction of a company (Paul J. Omar, 1998).

By improving the capability of the corporate insolvency law to be able in dealing with liquidation as well as corporate rescue mechanism, more commercially realistic measures could be devised in addressing the needs of companies and investors. It is pertinent to note that companies are mostly used as mode of conducting business. Indeed, some businesses flourish but some bound to fail. Therefore, a company that is used as a vehicle to conduct business should be permitted to wind up its business whenever it feels that there is no viable prospect of the business becoming profitable. As such, the corporate insolvency law should provide or facilitate the winding up process of that company efficiently. However, if a company’s failure is due to temporary financial problems or external economic factors, then a rescue mechanism may enable the company to be rehabilitated and to preserve its business as a going concern. A corporate rescue mechanism may also enable better returns for creditors and shareholders as fragmented sale of a company’s business in most cases may not be in the best interest of the company’s creditors and shareholders. At this point, the lack of focus on the rescue mechanisms or attempts to rehabilitate companies in the current corporate insolvency law is the main problem that requires attention.

IV. LAW REFORM EFFORT

In overcoming the experiencing problem, the government had taken up proactive steps to keep in tandem with the latest development in the corporate sector. Earlier this year, the Companies Bill 2015 was passed on 4 April 2016 by the ‘Dewan Rakyat’ (House of Representatives). The Bill would replace the existing Companies Act 1965 and expected to bring major reforms largely in the corporate landscape and harmonise the Malaysia's insolvency laws and bridging it closer to the modern international standards. One of the key features of the Bill is the introduction of two new corporate rescue mechanisms in attempting to assist financially distressed companies from being wound-up. The Bill obtained its royal assent on 31 August 2016, but yet to be in force.

In short, the two new corporate rescue mechanisms introduced by the Bill are the Judicial Management and the Corporate Voluntary Arrangement (Shereen Khan, Olivia Tan, Aishah Bidin, 2014). These two new corporate rescue mechanisms have been succinctly explained by Jason Opperman and Nick Williams in their article "Malaysia's New Insolvency Regime" which can be briefly described below:

4.1 The Judicial Management (section 403-430 Companies Bill 2015)

The Judicial Management process allows the directors, shareholders or creditors of a company, where there is a reasonable probability of rehabilitating the company, to apply to the Court to appoint an independent and qualified Judicial Manager to take charge of the management of the company. The Judicial Management process under the Bill is modelled based on the existing Singaporean Judicial Management regime. Pursuant to the new law, the Court may grant a Judicial Management order if: (1) it is satisfied that the company is or will be unable to pay its debts; (2) it considers that the making of the order would be likely to achieve one or more of the following purposes: (i) the survival of the company, or the whole or part of its undertaking as a going concern; (ii) the approval of a compromise or arrangement between the company and its creditors; (iii) a more advantageous realisation of the company's assets would be effected than on a winding up.

Once Judicial Management order is issued by the Court, a statutory moratorium of 180 days would commence during which the company cannot be wound-up. Further, during the moratorium period, no receiver can be appointed, no security can be enforced, no shares can be transferred and no proceedings can be commenced against the company without leave from the Court. The effect on counterparties of a company under the Judicial Management will vary. For example, other than with leave from the Court, no landlord or other person to whom rent is payable may exercise any right of forfeiture in relation to premises let to the company. On the other hand, if (as expected) the Malaysian Courts follow the application of the Singaporean Judicial Management laws, then *ipso facto* clauses which entitle an innocent contracting party to terminate the agreement and/or exercise certain remedies upon the commencement of Judicial Management will be effective. During the 180 days moratorium, the Judicial Manager is charged with preparing a restructuring plan for the company for approval by the creditors of the company. The moratorium may be extended on the application of the Judicial Manager for another 180 days. In order for the Judicial Manager's restructuring plan to be approved by the creditors, at least 75% in value of the creditors must approve the plan. If the restructuring plan is approved by the creditors, the Judicial Manager then applies to Court to sanction the plan following which the plan will be implemented.

4.2 Corporate Voluntary Arrangement (section 395-402 Companies Bill 2015)

The new second mechanism is the Corporate Voluntary Arrangement process, which is based on similar legislation available in the UK. Under the Corporate Voluntary Arrangement, the directors of a private company could propose a debt restructuring proposal to revive the fortunes of the company. Unlike the existing Scheme of Arrangement process, the Bill requires a qualified insolvency practitioner, known as the "nominee" to conduct an initial assessment of the viability of the proposed Corporate Voluntary Arrangement. Once the nominee has considered the proposed Corporate Voluntary Arrangement, he would then submit to the directors a statement indicating whether or not in his opinion: (1) the proposed Corporate Voluntary Arrangement has a reasonable prospect of being approved and implemented; (2) the company is likely to have sufficient funds available for it during the proposed moratorium to enable the company to carry on its business; (3) that meetings of the company and creditors should be summoned to consider the proposed Corporate Voluntary Arrangement.

If the nominee provides a positive statement regarding the proposed Corporate Voluntary Arrangement, the directors could file with the Court a document setting out the terms of the proposed Corporate Voluntary Arrangement and other necessary documents. In order for the proposed Corporate Voluntary Agreement to be approved at a specially convened meeting of creditors: (1) a simple majority of creditors present and voting must approve the scheme; (2) at least 75% in value of the creditors present and voting must approve the scheme.

If a Corporate Voluntary Arrangement is approved, the company may apply for a moratorium of between 28 and 60 days during which the company cannot be wound-up, no Judicial Manager can be appointed and no shares can be transferred etc. It is important to note that under the Corporate Voluntary Arrangement, a secured creditor is not prevented from appointing a receiver over its secured property during the moratorium. Although the Corporate Voluntary Arrangement proposal is initially proposed by the directors of a company, it is the nominee insolvency practitioner who is responsible for supervising and implementing the proposal. The nominee can apply to Court for directions in relation to any particular matter arising under the Corporate Voluntary Arrangement.

The aforementioned are the ongoing efforts undertaken to recalibrate the corporate insolvency law in Malaysia to be in line with the international standards adopted by other countries in the region. Most importantly, the current reform has introduced new corporate rescue mechanisms into the corporate insolvency law in availing directors more flexibility to deal with a company facing distress so that the company may remain in business and to avoid being trapped in a winding-up scenario. Although the current reform has substantially resolved the problem concerned, but there is still room for improvement (Jason Opperman and Nick Williams, 2016).

V. REFORMS FOR THE FUTURE

According to the World Bank based on data provided in the Doing Business Report 2016, Malaysia ranked 45th out of 189 economies globally in 2015 relating to efficient insolvency. Meanwhile, Malaysia is ranked second after Singapore among the ASEAN countries. Singapore ranked as the most efficient in resolving insolvency issue amongst the ASEAN countries. Singapore took the 27th position in 2015 (The World Bank, 2015). The ranking of resolving insolvency among ASEAN countries are listed in the following schedule:

Table 1. Ranking of Efficient Insolvency 2016 Among ASEAN Countries

Countries	Ranking of Efficient Insolvency 2016 (ASEAN)
Singapore	27
Malaysia	45
Thailand	49
Philippines	53
Indonesia	77
Cambodia	82
Brunei	98
Vietnam	123

(Source: Doing Business Report 2016)

This indicates that that more efforts must be given to improve Malaysia's ranking at the global arena and between the ASEAN countries. Therefore, to provide an efficient process in insolvency proceeding, the need is pressing to streamline the insolvency laws in Malaysia.

As earlier mentioned, Malaysia is currently maintaining a separate insolvency regulatory frameworks for personal and corporate insolvency. There is no single insolvency regulatory framework which consolidates both the corporate and personal insolvency. Henceforth, it would be cogent to propose for a single Insolvency Act for Malaysia to consolidate both existing legislations into a single legislation. Reason being, the current corporate insolvency law framework is confusing due to the fact that extensive cross-references to various bankruptcy principles and rules provided in the Bankruptcy Act 1967 have to be made. For instance, the application of Section 53 of the Bankruptcy Act 1967 under Section 293 of the Companies Act 1965 for undue preference transactions. This situation had caused confusion and in some occasions, failed to facilitate easy understanding of the corporate insolvency regulatory framework. That is the reason why there is a need to streamline the insolvency laws to a single piece of insolvency regulatory framework similar to the Insolvency Act 1986 in the United Kingdom. This could be the reform that could be undertaken.

On the other hand, a model law on cross-border insolvency as propounded by the United Nation Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency 1997 could also be adopted. The purpose of the model law is to assist countries to equip their insolvency laws with a modern legal framework to effectively address cross-border insolvency proceedings concerning debtors experiencing severe financial distress or insolvency. The Model Law contains four key areas outlining the scope of the Model Law itself and rules for access by representatives of foreign insolvency proceedings, including those governing the treatment of foreign creditors. It also covers the effects of domestic recognition of foreign procedures and, most importantly, rules for cooperation and for co-ordination of simultaneous proceedings in several jurisdictions over the same debtor (Paul J. Omar, 2008).

In the Asia context, many countries currently do not have sufficient laws to deal with the issue of co-operation in insolvency cases that have cross-border or international elements. The principle of "territoriality" often dominates and the insolvency of a group company which covers several countries in Asia, will be resolved by reference to the specific law of the country that a particular entity is incorporated or where its assets are located. On the cross-border insolvency front, the issues that face institutions is the differing levels of legal, social and economic development amongst the various countries in Asia, coupled with the differences in legal systems, language and culture. This adds a further dimension or obstacle to issues such as Court to Court communication and judicial co-operation. As a result of that, it leads to differences in treatment of creditors and differences in approaches towards debt restructuring, appointment of insolvency practitioners in multiple jurisdictions, and no clear direction for the entire group company, unless all stakeholders co-operate and work together for a common commercial benefit (Patrick Ang, 2015).

Based on the above reasons, it would be convincing to adopt the Model Law in our domestic insolvency regulatory framework in order to address commercial and business concerns in international level. The insolvency law in Malaysia, does not possess the necessary provisions to properly exercise control over cross-border insolvency, notwithstanding the incremental growth of cross-border trade and transactions. In light of the work that is being carried out in the region by international bodies operating in the financial sector, it is necessary to take the issue of cross-border insolvency as a priority in Malaysia. This would seem persuasive and essential given that the framework for international insolvency has been considerable advanced by the adoption of the UNCITRAL Model Law on Cross-Border Insolvency 1997.

VI. CONCLUSION

It is clear that current framework of insolvency measures dealing with corporate insolvency is inadequate due to lack of focus on rescue mechanisms or attempts to rehabilitate companies. Nonetheless, the Government had acted in tandem with the latest development in the corporate sector by introducing the Companies Bill 2015 that will replace the existing Companies Act 1965, and bring major reforms to the insolvency regulatory framework. Two new corporate rescue mechanisms have been introduced in the Companies Bill 2015. However, there is still room for improvement particularly to provide an efficient process in insolvency proceeding. Therefore, the government is urged to carry out a study on the proposed future reform in order to take all necessary steps in making the existing insolvency regulatory framework relevant and in line with the same international standards as many other countries in the region.

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