

## **CORPORATE RESCUE MECHANISM FOR COMPANIES IN DISTRESS: A COMPROMISE BETWEEN DEBTORS AND CREDITORS**

As an attempt to curb and contain the spread of the COVID-19 pandemic in the country, the Government of Malaysia implemented the Movement Control Order (“MCO”) which took effect from 18.03.2020. As at the date of this article, the Conditional MCO (“CMCO”) which was announced on 01.05.2020 is scheduled to end on 09.06.2020. The Recovery Movement Control Order (“RMCO”) was announced by the Government of Malaysia on 05.06.2020 and will be effective from 10.06.2020 until 31.08.2020.

A myriad of businesses have not been generating income but are still burdened with overhead costs and expenses. With the uncertainty as to whether the CMCO will be extended beyond 09.06.2020, business owners ranging from small businesses to large corporations in particular those with no cash cushion are now facing difficulties and hardship to weather the economic catastrophe that has resulted from the COVID-19 pandemic.

## **SHORT TERM RELIEF MEASURES – ADEQUATE?**

Various measures have been announced by the Government of Malaysia to aid business owners to weather the pandemic such as:-

- (i) enhancement to the existing financing facilities under the Bank Negara Malaysia’s Funds for Small and Medium Enterprises (“SMEs”)<sup>1</sup>;

- (ii) deferment of monthly income tax instalment payments to all SMEs for a 3 month period<sup>2</sup>;
- (iii) introduction of a wage subsidy programme<sup>3</sup>;
- (iv) a 6 month rental exemption for tenants of Federal Government-owned premises which includes premises owned by agencies and statutory bodies of the Federal Government etc<sup>4</sup>;
- (v) increase in the winding up threshold from RM10,000.00 to RM50,000.00<sup>5</sup>; and
- (vi) extension of time to respond to a statutory notice of demand from 21 days to 6 months<sup>6</sup>.

The objective underlying the introduction of the measures above is to ensure that companies are afforded time to resolve their cashflow problems without being faced with the threat of liquidation by its creditors in the interim. Whilst the measures announced are a welcomed relief, it remains to be seen whether it would be sufficient to ensure continuity of businesses during this difficult time.

## **CORPORATE RESCUE MECHANISMS – AVAILABLE OPTIONS**

In addition to the measures introduced by the Government of Malaysia, the two Corporate Rescue Mechanism namely Judicial Management and Corporate Voluntary Arrangement introduced by the Companies Act 2016 may be of assistance to financially distressed companies to avoid liquidation.

What exactly are ‘*Corporate Rescue Mechanisms*’? In simple terms, it means restructuring and rescue options for companies to overcome its financial problems and to avoid liquidation. We set out below the basic pre-requisites of each of these mechanisms, its key features and benefits.

<sup>1</sup> [https://www.bnm.gov.my/index.php?ch=en\\_press&pg=en\\_press&ac=5022&lang=en](https://www.bnm.gov.my/index.php?ch=en_press&pg=en_press&ac=5022&lang=en)

<sup>2</sup> [http://lampiran1.hasil.gov.my/pdf/pdfam/faq\\_2.pdf](http://lampiran1.hasil.gov.my/pdf/pdfam/faq_2.pdf)

<sup>3</sup> <https://www.perkeso.gov.my/index.php/en/wage-subsidy-programme>

<sup>4</sup> <https://www.treasury.gov.my/pdf/Infografik-Prihatin.pdf>

<sup>5</sup> [https://www.ssm.com.my/Documents/FAQ%20SECTION%20466%20INCREASE%20TO%20THE%20VALUE%20OF%20INDEBTEDNESS%20FROM%20RM10,000%20TO%20RM50,000%20\(6.4.20\).pdf](https://www.ssm.com.my/Documents/FAQ%20SECTION%20466%20INCREASE%20TO%20THE%20VALUE%20OF%20INDEBTEDNESS%20FROM%20RM10,000%20TO%20RM50,000%20(6.4.20).pdf)

[https://www.ssm.com.my/Documents/FAQ%20SECTION%20466%20INCREASE%20TO%20THE%20VALUE%20OF%20INDEBTEDNESS%20FROM%20RM10,000%20TO%20RM50,000%20\(6.4.20\).pdf](https://www.ssm.com.my/Documents/FAQ%20SECTION%20466%20INCREASE%20TO%20THE%20VALUE%20OF%20INDEBTEDNESS%20FROM%20RM10,000%20TO%20RM50,000%20(6.4.20).pdf)

<sup>6</sup>

[https://www.ssm.com.my/Documents/FAQ%20SECTION%20466%20INCREASE%20TO%20THE%20VALUE%20OF%20INDEBTEDNESS%20FROM%20RM10,000%20TO%20RM50,000%20\(6.4.20\).pdf](https://www.ssm.com.my/Documents/FAQ%20SECTION%20466%20INCREASE%20TO%20THE%20VALUE%20OF%20INDEBTEDNESS%20FROM%20RM10,000%20TO%20RM50,000%20(6.4.20).pdf)

## CORPORATE VOLUNTARY

**ARRANGEMENT (“CVA”)** CVA is not available to all companies. Companies which are eligible to opt for CVA as a rescue option are private limited companies incorporated under the Companies Act 2016 which are not regulated under the laws enforced by Bank Negara Malaysia and that of the Capital Markets and Services Act 2007<sup>7</sup>.

Further, CVA is only available for private limited companies that have not have created any form of charge or undertaking of the companies’ properties<sup>8</sup>. In short, the companies have no secured debt. This stringent condition has attracted a number of criticisms as any company engaging in business would normally have obtained some form of financing requiring the creation of a charge or undertaking of the companies’ properties.

For companies which are eligible, CVA allows financially distressed companies to enter into an arrangement with their creditors without the need for court approval. CVA may be proposed and prepared<sup>9</sup> by the director(s) of the company<sup>10</sup>. A nominee is to be appointed to oversee and supervise the CVA but directors would still retain their powers of the day-to-day management of the company throughout the CVA process.

One of the main advantages provided by CVA is that a company would be clothed with an automatic ‘*moratorium*’ upon filing of the relevant documents to the court. The court’s involvement under CVA is only to the extent of serving as a filing platform of the required documents.

The term *moratorium* in this context is entirely different from the meaning understood by many i.e. loan repayment deferment. The automatic moratorium<sup>11</sup> in this context is protection to a company opting for CVA from a range of actions which includes *inter alia*:-

- (a) no winding up petition may be presented against the company;

- (b) no other proceedings and no execution or other legal process may be commenced or continued against the company;
- (c) no landlord or other person to whom rent is payable may exercise any right of forfeiture and re-entering the premises let to the company etc<sup>12</sup>.

The moratorium is for an initial period of 28 days and the extension may only be made up to a maximum of 60 days calculated from the commencement of the moratorium<sup>13</sup>. Within the said 28 days, a meeting will be held with the company’s members and creditors to either approve or disapprove the CVA proposal or to extend the moratorium or otherwise. Such proposal must be passed by a majority of 75% of the total value of creditors present and voting<sup>14</sup> and in a meeting of members, must be passed by a majority of members present and voting. All creditors and members of the company would be notified of the meetings to be held.

Once the CVA proposal is approved, all creditors will be bound by the terms of the same. A CVA proposal would usually include the company’s assets and funds, distribution of such funds to each and every creditor and the time frame for such distribution, future plans or performance to be undertaken by the company etc.

## JUDICIAL MANAGEMENT (“JM”)

Similar to CVA, JM is not available to all companies. This rescue option is readily available to all private limited companies save for financial institutions or companies which is subject to the Capital Markets and Services Act 2007<sup>15</sup>. Companies which are not able to fulfill the stringent condition applicable for CVA as stated above, may opt to explore this rescue option.

Unlike a CVA, JM is a court supervised rescue plan that places the management of a company under a judicial manager appointed by the court. The director(s) of the company will no longer be in

<sup>7</sup> Section 395 of the Companies Act 2016

<sup>8</sup> Section 395(d) of the Companies Act 2016

<sup>9</sup> Section 397 of the Companies Act 2016

<sup>10</sup> Section 396 of the Companies Act 2016

<sup>11</sup> Section 398 read with Eighth Schedule of the Companies Act 2016

<sup>12</sup> Paragraph 17 of Eighth Schedule of the Companies Act 2016

<sup>13</sup> Paragraph 3 of Eighth Schedule of the Companies Act 2016

<sup>14</sup> Section 400 of the Companies Act 2016

<sup>15</sup> Section 403 of Companies Act 2016

control of the management of the company. An application for JM may be made by the company itself, the director(s) or even the creditors of the company. The application would need to be made to the court where upon such application, the company will be granted with a similar automatic moratorium as the moratorium in the CVA context which shall last until the JM application is dismissed or conversely, when a JM order is granted.

In JM, the court plays an important role in determining whether to grant a JM order as opposed to CVA, where the court merely serves as the filing platform of the required documents. In determining whether to grant a JM order, a court will need to be satisfied that the company **is or will be unable to pay its debts** and considers that the making of the order would be likely to achieve one or more of the purposes set out in Section 405(1)(b) of the Companies Act 2017 which includes *inter alia* **the survival of the company.**

Apart from the possibility of a court not allowing the JM application, a company intending to opt for such rescue option will also need to consider the possibility of the JM application being opposed by a secured creditor or a debenture holder. If a secured creditor opposes or a debenture holder proceeds to appoint a receiver or receiver and manager, a court will dismiss such judicial management application<sup>16</sup>. It will be in the company's best interest and time to first liaise and seek the consent of the secured creditor(s) and debenture holder(s) prior to making such application.

If a company is successful in its JM application, a JM order remains in force for 6 months and may be extended for another period of not more than 6 months. The moratorium shall continue during this period. Within 60 days of the JM order, the judicial manager appointed shall table a statement of his JM proposal before a meeting of the company's creditors and is required to achieve 75% in value of the creditors' approval for the proposal. Once approved, all creditors will be bound by the terms set forth in the JM proposal.

## CORPORATE RESCUE MECHANISMS – A COMPROMISE BETWEEN DEBTORS AND CREDITORS WORTH EXPLORING

Creditors must be prepared to face the increasing possibility that recovery of debts *via* the traditional debt collection practices may not achieve or yield the desired results in light of the current economic climate. Creditors may instead recover a higher portion of debts due and owing in a CVA or JM scenario in comparison to the traditional winding up scenario.

The Corporate Rescue Mechanisms above is an avenue that can be explored by both debtors and creditors to achieve the goal of creditors still being able to recover a portion of their debts, whilst at the same time allowing the debtor to continue as an ongoing concern.

For more information, kindly contact the undersigned.

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<sup>16</sup> Section 409 of Companies Act 2016 and the High Court case of Per: Wellcom Communications (NS) Sdn Bhd and one more [2019] 9 MLJ 510