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A Consultative Document

(1) REVIEWING THE CORPORATE INSOLVENCY REGIME – THE PROPOSAL FOR A CORPORATE REHABILITATION FRAMEWORK; (2) REVIEWING THE COMPANY RECEIVERSHIP PROCESS; AND (3) COMPANY CHARGES AND REGISTRATION PROCESS – IMPROVEMENTS TO THE PRESENT REGISTRATION SYSTEM.

by the Corporate Law Reform Committee
for the Companies Commission of Malaysia

SURUHANJAYA SYARIKAT MALAYSIA
COMPANIES COMMISSION OF MALAYSIA

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COMPANY LAW

CORPORATE LAW REFORM COMMITTEE

A CONSULTATIVE DOCUMENT ON

(1) REVIEWING THE CORPORATE INSOLVENCY REGIME - THE PROPOSAL FOR A CORPORATE REHABILITATION FRAMEWORK;
(2) REVIEWING THE COMPANY RECEIVERSHIP PROCESS; AND
(3) COMPANY CHARGES AND REGISTRATION PROCESS - IMPROVEMENTS TO THE PRESENT REGISTRATION SYSTEM.

AUGUST 2007

The Corporate Law Reform Committee invites comments, by **27 September 2007** on the issues set out in this consultative document.

You are invited to send comments, together with any supporting evidence on any part of this consultation. We would be grateful if you could refer to the recommendation number(s) and/or paragraph number(s) in your feedback, preferably by email, to:

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Foreword

FOREWORD

The remit of Working Group D of the CLRC is to consider the current law and practice relevant to corporate securities and insolvency practices. Chapter 1 of the Consultative Document (the Document) deals with the review of the corporate insolvency framework. Chapter 2 discusses issues concerning the review of the corporate receivership whilst Chapter 3 concentrates on matters relating to company charges and its registration processes.

One of the objectives of this review is to create a comprehensive corporate insolvency framework:

(i) that will facilitate the winding up of companies where there is no prospect of the business becoming profitable and viable;

(ii) that will be able to provide an efficient system to rehabilitate companies where appropriate;

(iii) that is able to ensure the protection of rights of creditors and members by providing an enforcement mechanism without undue delay or difficulty; and

(iv) that ensures accountability of the persons involved in the process and transparency of the process.

Chapter 1 comprises of Part I, Part II and Part III. Part I of Chapter 1 discusses whether the Companies Act 1965 should be revised to include corporate rescue procedures to help revitalise ailing companies in Malaysia with a view towards ensuring and promoting efficient and sustainable use of economic resources and encouraging private sector development and growth. The key recommendations of the CLRC on the corporate insolvency framework are stated in Part II of Chapter 1 which contains the views of the CLRC in relation to the introduction of a judicial management framework. Part III of Chapter 1 contains the views of the CLRC in relation to the introduction of a company's voluntary arrangement framework.

Chapter 2 focuses on the review of issues pertaining to the company receivership process under sections 182 to 192 of the Companies Act 1965. One of the main recommendations is the proposal to codify the agency status of a receiver under the Companies Act 1965. This is to ensure clarity on the status of the receiver that he becomes the agent of the company upon his appointment by the debenture holder. Another important recommendation by the CLRC is the proposal to extend the agency status of a receiver following a winding up order. This recommendation, however, is subject to the consent of the liquidator being first obtained before a receiver should continue to be the agent of a company under liquidation.

Chapter 3 considers several aspects of company charges and the registration process with a view of improving the relevant law and procedures. The main purposes of the registration of a charge under the company law is to recognise a claim which otherwise would be voidable against a liquidator in the case of where a company goes into liquidation and to serve as a centralised registration unit to enable third parties to make searches in respect of charges registered in relation to a particular company's asset. The main thrust is the retention of the present registration system of company charges but with changes or improvements to the existing system that will be able to facilitate business, protect interest of stakeholders and reduce unnecessary business and compliance costs.

We hope to receive views and comments on the recommendations stated in this Consultation Document. Please reply to Puan Nor Azimah Abdul Aziz at the Companies Commission of Malaysia (CCM) by **27 September 2007.**

Thank you

Yours truly,

Dato K.C. Vohrah
Chairman
Corporate Law Reform Committee

Lim Tian Huat
Chairman
Working Group D

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Chapter 1

Reviewing The Corporate Insolvency Regime - The Proposal For A Corporate Rehabilitation Framework

CHAPTER 1 - REVIEWING THE CORPORATE INSOLVENCY REGIME - THE PROPOSAL FOR A CORPORATE REHABILITATION FRAMEWORK

EXECUTIVE SUMMARY

1. The Proposed Corporate Insolvency Framework

1.1 Due to the inadequacy of the present legal framework to enable for the rehabilitation of companies, the CLRC recommends the introduction of a Judicial Management System and Corporate Voluntary Arrangement (CVA) to complement the existing scheme of arrangement provided for under section 176. The proposed new rescue schemes are intended to enable a financially distress company to restructure where there is a business case for it to continue its business.

1.2 The CLRC recommends that the proposed alternative corporate rehabilitation procedures should have the following key features:

(i) A clear rehabilitation plans that is easily understood and implemented;

(ii) A realistic time frame within which the proposal is to be prepared, approved and implemented;

(iii) A moratorium period to enable the proposal to be formulated and implemented without the threat of liquidation or creditors' action that may frustrate the rehabilitation process;

(iv) Provisions to safeguard creditors interest by providing moratorium against the dissipation of the company's assets or funds, by adequately providing for creditors' voting rights and the right to receive reliable information concerning the company and the rehabilitation plan;

(v) The involvement of qualified and competent insolvency practitioners will ensure that there is no unnecessary delay in the process; and

(vi) The system needs to ascertain the level and extent of the court's involvement in the initiation, implementation and supervision of the rehabilitation plan.

2. Judicial Management

2.1 The CLRC recommends introducing a statutory scheme to be known as Judicial Management to facilitate the rehabilitation process of a financially distressed company. In general, judicial management allows the aggrieved party to apply to the court to place the management of the company in the hands of a qualified independent person with the necessary skill and experience known as a Judicial Manager. The Judicial Manager, once appointed by the court, will prepare a workable restructuring plan which must be acceptable to the majority of the creditors. Once approved by the creditors and sanctioned by the court, the plan will be implemented.

2.2 Initiating the Process

The CLRC recommends the following:

(i) the application for judicial management may be made if the company is or will be unable to pay its debts;

(ii) the court should only make the order if this would be likely to achieve the survival of the company as a going concern, the approval of the scheme or a more advantageous realisation of assets than a winding up; and

(iii) the application for the company to be put under judicial management shall be made by the company or its directors pursuant to a resolution by members of the board of directors or the creditors of the company (including prospective and contingent creditors).

2.3. Moratorium

The CLRC recommends that:

(i) an interim judicial manager may be appointed by the court upon the filing of the petition.

(ii) a moratorium shall commence from the filing of the petition for judicial management and shall end upon the appointment of the judicial manager;

(iii) once a judicial management order is in force:-

(a) no winding up order can be made or any petition for winding up will be dismissed;

(b) Receiver & Manager (R&M) shall vacate their office and no new appointment of a R&M is permitted;

(c) no enforcement of any charge or security or repossession of hire purchase goods;

(d) no other legal proceedings except with leave of the court,

(e) any transfer of shares or any alteration in the status of members are also void unless the court so orders.

(iv) the judicial management order and the moratorium period should terminate after the expiration of the 180-days unless it has been earlier discharged. However, it should be possible to extend this period with a court order on application by the judicial manager.

2.4. Creditors' Rights and Voting by Creditors

The CLRC recommends that:

(i) the judicial manager should be given 180 days to prepare the proposal and have it approved by creditors at the creditors' meetings.

(ii) the proposal must be approved by a majority in value of the creditors who are present and voting at the meeting. At the creditors meeting, only creditors who have had their proof of debts accepted by the judicial manager, may vote.

2.5 Effect of Creditors' Approval or Rejection of the Proposal

The CLRC recommends that:

(i) any secured creditors may oppose the petition for the judicial management order. However, once the judicial management order has been made, the secured creditors cannot realise their security and the judicial manager has the power to deal with the charged property of the company as if the property was not subjected to the security.

(ii) the proposal once approved by creditors shall be binding on all creditors of the company whether or not they have voted in favour of the proposal.

2.6 Control of the Process

The CLRC recommends that there should be a clear provision stating:

(i) The judicial manager is an agent of the company.

(ii) The judicial manager has control over the affairs, business and property of the company during the judicial management period.

(iii) The powers of the other officers of the company are suspended unless written approval is obtained from the judicial manager.

2.7. Ending the Judicial Management

(i) The CLRC recommends that the judicial management order should be capable of being discharged prior to the expiry of the time frame or any longer period that the court may order.

(ii) The CLRC further recommends that the judicial management order shall end:

(a) if the proposal has not been accepted by the creditors' meeting and where the court orders the discharge of the judicial manager; or

(b) if the purpose of the judicial management has been successfully achieved; or

(c) if the judicial manager is of the view that the purpose is unachievable; or

(d) if the judicial manager applies for a discharge, is no longer qualified to be a judicial manager or is removed from office.

2.8. The Roles and Functions of a Judicial Manager

The CLRC recommends that:

(i) the judicial manager should be given 180 days to table the proposal for creditors' approval.

(ii) the company secretary should not be imposed with the obligation of submitting the statement of affairs to the judicial manager although the judicial manger should be given the power to request for the statement of affairs from any relevant person.

(iii) the judicial manager should be allowed to exclude personal liability in contracts so that he is personally liable unless he disclaims it;

(iv) the judicial manager should be indemnified out of the assets of the company and the indemnity to which he is entitled to is to be paid out of the asset of the company in priority to other unsecured creditors if the company is subsequently wound up.

(v) the judicial manager should be given a grace period of 28 days to decide whether or not to adopt any contract of employment and if the judicial manager caused the contract to continue after the 28 day grace period, the contract is assumed to have been adopted by him.

3 Company Voluntary Arrangement (CVA)

3.1. The CLRC recommends the introduction of the Company Voluntary Arrangement (CVA) into the Companies Act which is modelled after the UK CVA with modifications where necessary. The CVA is a procedure where a debtor company is allowed to put up a proposal to creditors, the implementation is to be supervised by an independent insolvency practitioner who would report to the court on the viability of the proposal. There will be minimal court intervention and this procedure is suitable where there is confidence in the management of the company.

3.2. Moratorium

The CLRC recommends that:

(i) that a moratorium period shall be in force once the relevant documents are filed in court without the need to apply for a court order. This is to restrain the company's creditors from initiating legal suits against the company whilst the CVA proposal is being formulated and implemented.

(ii) that the application for a moratorium period should not be limited to small companies as practised under the UK CVA. Under the Malaysian perspective, the moratorium period shall apply to all companies seeking to propose for a CVA.

3.3. Court's Involvement

The CLRC recommends that the court's involvement should be limited to hearing challenges on the workout proposal on the grounds that there has been a material irregularity or the CVA unfairly prejudices the interest of a creditor or the CVA is anticipated to be ineffective in practice.

3. 4 Management Powers

The CLRC recommends that the directors and the management of a financially distressed company should remain in control of the management powers.

4. Scheme of Arrangement

4.1. The CLRC recommends that:

(i) The scheme of arrangement should still remain but should only be used in relation to solvent companies;

(ii) the provision under section 176 should be reverted to its pre-amendment form i.e. before the 1998 amendment with an emphasis that there must be a finality on the moratorium period. The moratorium period should be limited and the current practice of allowing for an extension of the moratorium period should be ended; and

(iii) the moratorium period should only be applicable to creditors and not as against regulators.

PART I - THE APPROACH IN FORMULATING A CORPORATE REHABILITATION FRAMEWORK

1 Introduction

1.1. Some of the general objectives of corporate insolvency law are:[1]

- The facilitation of the recovery of companies which are in financial difficulties;
- The suspension of legal actions by individual creditors through the creation of a moratorium;

[1] See RM Goode, *Principles of Corporate Insolvency Law* (1990) Sweet & Maxwell, London pp 5-10; RW Harmer, *General Insolvency Inquiry, Report No 45,* AGPS (1988) Canberra; IF Fletcher, *The Law of Insolvency* (2nd Edition, 1996) Sweet & Maxwell, London.

- The removal of the powers of management of the company by its directors, even if directors retain their position as directors;
- The avoidance of transfer and transactions which unfairly prejudice the general body of creditors;
- Ensuring that there is an orderly distribution of the company's assets;
- The provision of a fair system for the ranking of claims against the company;
- Making provisions for the investigation of the company' failures and the imposition of liability of those responsible for the failure;
- The protection of the public from directors who might in future engage in improper trading;
- Maintaining the ethical standards and competence of insolvency practitioners; and
- The dissolution of a company at the end of the liquidation process.

1.2. A corporate rehabilitation framework facilitates the continuation of a business and enables the preservation of the economic value of the company as a going concern for all stakeholders in that business, enables minimisation of losses for creditors, including employees, and others who deal with the insolvent company and may also provide a more measured distribution of assets of a company if it does eventually fail, thus increasing returns to all creditors. There is also a public interest element that justifies rehabilitation in some cases for example the rehabilitation of abandoned housing projects.

A. THE CORPORATE INSOLVENCY FRAMEWORK IN MALAYSIA

1.3. Under the current corporate insolvency law in Malaysia, there are several methods of dealing with company insolvency:

i ***Receivership process***

The receivership procedures are widely practiced in all jurisdictions. However, the primary purpose of a receivership is the realisation of the company's assets under a debenture for the interest of the debenture holder and not primarily to rescue or rehabilitate the company. Most often the company will be wound up and company's assets are hived off and sold separately.

ii ***Winding up process***

This is intended to enable for the proper closure of a company that may not want to or be able to continue its business. The winding up may be made voluntarily (through a members' voluntary or creditors' voluntary resolution) or by an application to court for a winding up order.

iii ***Pengurusan Danaharta Nasional Berhad***

In response to the problems faced by the banking sector in Malaysia in the wake of the 1997 Asian financial crisis, the government introduced measures to restore stability in the banking system industry. This led to the establishment of Pengurusan Danaharta Nasional Berhad (Danaharta) in June 1998. The Pengurusan Danaharta Nasional Berhad Act 1998 (the Danaharta Act) provided Danaharta the legislative framework for Danaharta's operations and empowered Danaharta to do the following:

(a) to buy assets through statutory vesting. This was essential to enable Danaharta to acquire assets with certainty of title and maximise value.

(b) to appoint 'Special Administrators' to manage the affairs of distressed companies. This is viewed as to complement the older insolvency laws and the restructuring process.[2]

(c) to sell foreclosed assets quickly.[3]

One feature of the special administration under the Danaharta Act is that it is a non-court based procedure where the special administrator devises a workable restructuring plan and ensures that the plan is implemented within a period of three (3) to six (6) months after the appointment. The 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 approved, the workout proposal binds the company, its shareholders and all creditors.

iv ***The Corporate Debt Restructuring Committee (CDRC)***

Another informal corporate rescue workout that was introduced following the 1997 financial crisis is the Corporate Debt Restructuring Committee (CDRC), a debt mediation agency under the auspices of the Central Bank of Malaysia. To facilitate the restructuring of large corporate debts, the CDRC was formed to provide a platform for both financial institutions and borrowers to implement a workable feasible debt restructuring scheme by way of compromise and consensus without having to resort to legal proceedings. The arrangement is informal, has no binding legal status and can be called off by either party at any time. The implementation of the CDRC framework was based on 4 basic principles as follows:

2 Prior to the financial crisis that hit the Asian countries in 1997, the only formal corporate rescue process in Malaysia was the scheme of arrangement under section 176 of the Companies Act 1965.

3 The Pengurusan Danaharta Nasional Berhad Act 1998 and the Schedule 15 of the National Land Code 1965 allowed Danaharta to carry out foreclosures on a loan's underlying property collateral *via* private treaty, which was either by auction, tender or private contract without going through the court process.

(a) financial institutions must be supportive and not precipitate insolvency;

(b) decision-making is on the basis of sharing of reliable information amongst all parties involved in the workout;

(c) financial institutions must co-operate to reach a collective view on whether a company should be given financial support based on specified terms; and

(d) losses should be jointly borne in a fair manner to specified categories.[4]

The CDRC sets specific criteria to be met by the applicant, such as, the company must have a potentially viable business and have more than RM50 million worth of debts with more than one financial institution. The CDRC acts as a secretariat which supervises and facilitates negotiations between the creditors, banks and debtor. It also acts as an advisor and mediator between the financial institutions and the borrower on the restructuring exercise.[5]

B. THE PROPOSED CORPORATE INSOLVENCY FRAMEWORK

1.4. The CLRC is of the view that there is a need for the introduction of a corporate rescue or rehabilitation framework for companies in Malaysia and that the Companies Act should have a legal framework to enable a financially distressed company to restructure, rather than being liquidated or placed in receivership (if there is a debenture), if there is a business case for its continuing survival.

4 Introduction to the Corporate Debt Restructuring Committee (CDRC) at http://www.bnm.gov.my.

5 After four years of its establishment, the CDRC closed its operations on 31 July 2002. Since its inception in July 1998 to 15 August 2002, the CDRC resolved 47 cases with the total debts amounting to RM43,971 billion. In total, the resolved cases represented approximately 65 per centum of the total cases under the CDRC. As of 15 August 2002, of the 47 cases resolved, 28 have been fully implemented and the remaining 19 are pending implementation. Amongst the companies which have fully implemented their restructuring plans under the CDRC's purview were the Johor Corporation, Renong Bhd., TIME Engineering Bhd., Faber Group Berhad, Titan Group and many others - Source: Press release dated 21 August 2002 on 'Closure of the CDRC: status as at 15 August 2002'.

1.5. The CLRC is of the view that the present framework is inadequate as there has been a lack of focus on rescue mechanisms or attempts to rehabilitate companies. The option available is usually liquidation. Receivership is not available where there is no debenture. Even when receiverships are granted by the court, the purpose is not the restructuring of companies.

1.6. Under the Companies Act 1965, a company in financial difficulties can only restructure itself under section 176. Section 176 allows the management of the company to continue to remain in the hands of the board of directors and can be considered to be effective when there is confidence in the existing management. However, there is a need to introduce a scheme where the rescue effort is to be administered by an independent insolvency practitioner. Whilst the Pengurusan Danaharta scheme and the Corporate Debt Restructuring Committee efforts have been effective, these schemes were established to deal with a specific set of circumstances arising out of the financial crisis and as such, there is a pressing need to establish corporate rescue mechanisms for company law in general.

1.7. In addition, the CLRC believes that in line with the international standards,[6] a corporate rehabilitation system for Malaysia generally should include the following key features:

i ***Clear rehabilitation plans -***

The system should be able to provide for a rehabilitation plan that is easily understood and implemented;

[6] World Bank, *Principles and Guidelines for Effective Insolvency and Creditors. Rights Systems* (April 2001) Executive Summary and Introduction. Principle 17 states that:
"To be commercially and economically effective, the law should establish rehabilitation procedures that permit quick and easy access to the process, assure timely and efficient administration of the proceeding; afford sufficient protection for all those involved in the process, provide a structure that encourages fair negotiation of a commercial plan, enable a suitable majority of creditors in favour of a plan or other course of action to bind all other creditors by the exercise of voting rights (subject to appropriate minority protections and the protection of class rights) and provide for judicial or other supervision to ensure that the process is not subject to manipulation or abuse."

ii ***Time frame -***

The system should encourage the rehabilitation of the company by providing a realistic timeframe within which the proposal is to be prepared, approved and implemented;

iii ***Moratorium -***

The system should facilitate rehabilitation by providing a moratorium period to enable the proposal to be formulated and implemented without having the threat of liquidation or a creditors' action that may frustrate the rehabilitation process;

iv ***Safeguarding of creditors' interest -***

The system should have provisions to safeguard creditors' interest by providing a moratorium against the dissipation of the company's assets or funds, by adequately providing for creditors' voting and by providing creditors the right to receive reliable information concerning the company and the rehabilitation plan;

v ***Involvement of insolvency practitioners -***

The involvement of qualified and competent insolvency practitioners will ensure that there is no unnecessary delay in the process;

vi ***Involvement and supervision of the court -***

The system needs to ascertain the level and extent of the court's involvement in the initiation, implementation and supervision of the rehabilitation plan.[7]

1.8. Thus the CLRC recommends the introduction of:

i. ***A Judicial Management scheme -***

Where the aggrieved creditor (secured and unsecured, provided certain criteria are met) could make an application to court to place the management of the company in the hands of a qualified independent person and at the same time (while managing the company), the independent person seeks a suitable restructuring option acceptable to creditors. The system should facilitate the rehabilitation process by ensuring the process is managed by a person with the necessary skill and experience and by providing that person with the necessary powers to enable the implementation of the process.

ii. ***A Company Voluntary Arrangement scheme (CVA) -***

Where a company in financial distress, it should be able to obtain protection against creditors whilst the directors manage the company. In the meantime, a qualified insolvency practitioner (IP) supervises the restructuring plan.[7]

PART II - THE JUDICIAL MANAGEMENT PROCESS

2 Introduction

2.1. The objectives of the judicial management should be to consider rescuing or rehabilitating the company's business as a going concern. However, if this is not possible, the objective should then be to ensure that there is a better realisation of the company's assets to enable creditors to be paid.

[7] It may be argued that a CVA is somewhat similar to section 176 in that the directors of the company continue to manage the company while a restructuring plan is being worked out. The strength and weaknesses of a CVA against section 176 could best be understood by referring to detailed discussions and provisions in this paper.

A INITIATING THE PROCESS

2.2. The judicial management process may be initiated by an application to the court, to be made by a permitted party. In addition, a rehabilitation process can only be initiated if the company is insolvent or will become insolvent.

2.3. The person(s) who may apply for the order are the company or its directors pursuant to a resolution by members of the board of directors or the creditors of the company (including prospective and contingent creditors). However, the court shall not make the order if:

(i) a receiver and manager has been or will be appointed or the making of the order is opposed by a person who is entitled to appoint a receiver and manager e.g. a debenture holder; and

(ii) the company is in liquidation or the company is a bank or a finance company or an insurance company licensed under the relevant Act.

RECOMMENDATIONS

2.4. The CLRC recommends that:

(i) the application for judicial management may be made if the company is or will be unable to pay its debts;

(ii) the court should only make the order if this would be likely to achieve the survival of the company as a going concern, the approval of the scheme or a more advantageous realisation of assets than a winding up; and

(iii) the application for the company to be put under judicial management shall be made by the company or its directors pursuant to a resolution by members of the board of directors or the creditors of the company (including prospective and contingent creditors.

Questions for Consultation

Question 1:

Do you agree with the introduction of the judicial management scheme?

Question 2:

Do you agree that the application for a judicial management scheme may be made if the company is or will be unable to pay its debts?

Question 3:

Do you agree that the court should only make the order if this would be likely to achieve the survival of the company as a going concern, the approval of the scheme or a more advantageous realisation of assets than a winding up?

Question 4:

Do you agree that the application for the company to be put under judicial management shall be made by the company or its directors pursuant to a resolution by members of the board of directors or the creditors of the company (including prospective and contingent creditors)?

B THE MORATORIUM

2.5. Since judicial management is intended to provide a breathing space for the company, one important feature is the moratorium period which will enable the company to prepare a proposal and to implement it without the threat of a winding up petition or any action by the creditors of the company that will frustrate the purpose of the judicial management process.

2.6. Nonetheless, it is not disputed that there is a potential for the abuse of the moratorium since the moratorium may be used to prevent creditors from enforcing their contractual rights and thus, enabling the company to delay in complying with its contractual obligations to creditors. Therefore, the main concern is drawing a balance between protecting the interest of the relevant parties and providing sufficient time for the person entrusted with the task of rehabilitating the company to do so.

2.7. The CLRC is of the view that the time of commencement of the moratorium and the length of the moratorium period are crucial to enable a viable proposal to be drawn up and implemented. An appropriate time frame can be an incentive for the efficient administration and implementation of the proposal.

2.8. The CLRC noted that in some jurisdictions, once an application for the appointment of a judicial manager is presented in court, it has the following effect:

(i) no resolution shall be passed or order made for the winding up of the company;

(ii) no steps should be taken to enforce any charge or security over the company's asset without leave of the court;

(iii) no proceedings against the company shall be commenced or continued without leave of the court.

For example, under the Singapore and UK legislations,[8] once a petition is presented, there is an automatic stay, from the time of the presentation of the petition for a judicial management order and ends with the appointment of a judicial manager, in which case another moratorium will be in place. However, if the petition is

[8] Section 227C of the Singapore Companies Act (Chapter 50) and section 10(1) of the UK Insolvency Act 1986.

dismissed, the moratorium will also cease. The CLRC is of the view that the judicial management provision in Malaysia should include the above-mentioned provisions.

2.9 If an order for the appointment of a judicial manager is subsequently made, another moratorium would come into force. In Singapore, the judicial management order will be in force for 180 days unless it has been discharged. The UK Enterprise Act 2002 specifies an overall time limit of one year, although this can be extended by the consent of the creditors. The moratorium is in force during this period. The CLRC is of the view that once the judicial management order is made, the moratorium comes into effect and is in place for 180 days.

2.10. During the period of the judicial management order and while the moratorium is in force:

(i) No winding up order can be made or any petition for winding up will be dismissed;

(ii) Receiver & Manager (R&M) shall vacate their office and no new appointment of R&M will be made;

(iii) No enforcement of any charge or security or repossession of hire purchase goods; and

(iv) No other legal proceedings except with leave of the court.

2.11. The CLRC noted that the Australian Corporations Act 2001 has a specific statutory provision stating that a transfer of shares or any alteration in the status of members are also void unless the court so orders.[9] The CLRC is of the view that in addition to

[9] See section 437F of the Australian Corporations Act 2001.

the above, there should be an express provision stating that a transfer of shares or any alteration in the status of members is also void unless the court orders otherwise.

RECOMMENDATIONS

2.12 The CLRC recommends that:

(i) an interim judicial manager may be appointed by the court upon the filing of the petition.

(ii) a moratorium shall commence from the filing of the petition for judicial management and shall end upon the appointment of the judicial manager or if the petition is dismissed. Once a petition is presented, there is an automatic stay of the following:

(a) no resolution shall be passed or order made for the winding up of the company;

(b) no steps should be taken to enforce any charge or security over the company's asset without leave of the court;

(c) no proceedings against the company shall be commenced or continued without leave of the court;

(iii) Once a judicial management order is made, a moratorium of the following will be in place:-

(a) no winding up order can be made or any petition for winding up will be dismissed;

(b) Receiver & Manager (R&M) shall vacate their office and no new appointment of R&M is permitted;

(c) no enforcement of any charge or security or repossession of hire purchase goods;

(d) no other legal proceedings except with leave of the court;

(e) any transfer of shares or any alteration in the status of members are also void unless the court so orders,

(iv) The judicial management order and the moratorium period in relation to the judicial management order should terminate after the expiration of the 180-days unless it has been earlier discharged. However, it should be possible to extend this period with a court order by an application from the judicial manager.

Questions for Consultation

Question 5:

Do you agree that once a petition is presented, there is an automatic stay of the following:

(i) no resolution shall be passed or order made for the winding up of the company;

(ii) no steps should be taken to enforce any charge or security over the company's asset without leave of the court;

(iii) no proceedings against the company shall be commenced or continued without leave of the court?

Question 6:

Do you agree that the moratorium takes effect from the time of the presentation of the petition for a judicial management order and ends with an appointment of a judicial manager or dismissal of such petition?

Question 7:

Do you agree that the length of the judicial management order and the moratorium should be 180 days from the date the order is made?

Question 8:

Do you agree that the time frame should be capable of being extended by an order of the court?

Question 9:

Do you agree that once a moratorium is in force, the following transactions should be prohibited from being taken against the company:

- **(i) no winding up order can be made or any petition for winding up will be dismissed;**
- **(ii) the Receiver & Manager (R&M) shall vacate their office and no new appointment of R&M is permitted;**
- **(iii) no enforcement of any charge or security or repossession of hire purchase goods;**
- **(iv) no other legal proceedings except with leave of the court; and**
- **(v) any transfer of shares or any alteration in the status of members are also void unless the court so orders?**

C CREDITORS' RIGHT AND VOTING BY CREDITORS

2.13. One of the key features of a corporate rehabilitation framework is the need to ensure that creditors have the right to vote on the rehabilitation plan and the right to obtain sufficient and reliable information about the company and the rehabilitation plan.

2.14. One difficulty of the existing procedure under the Companies Act 1965 that is used to rehabilitate a company is the fact that, under section 176 the different classes of creditors must be identified and these classes who must vote separately as a class in favour of the proposal. If the person in control of the process is required to identify the separate classes of creditors and obtain the respective classes' approval, it is possible that the proposal could not be prepared and implemented within the specified time frame. Thus, the CLRC recommends that there should not be any need to identify separate classes of creditors in relation to the judicial management process.

2.15. There are different approaches in relation to the voting percentage at the creditors' meeting required to approve the proposal. The CLRC noted that Singapore specifies the voting percentage as "creditors *with majority in number and value.*" Australia on the other hand, specifies that there must be a majority in number and value and in cases where a majority in value of the creditors supports the proposal but not a majority in number, the judicial manager has the casting vote.[10] The UK Insolvency Act 1986, on the other hand, provides that the approval of a simple majority of creditors by value is required. In Hong Kong,[11] the Law Reform Commission proposed that for any resolution to pass at a meeting of creditors, approving a proposal or modified proposal, there *should be a majority in number and in excess of two thirds in value of the creditors present in person or by proxy and voting on the resolution*. Initially, the Law Commission of Hong Kong considered recommending that the majority in value should be three-quarters but in its Report recommended following the Canadian provisions by adopting a two-thirds majority. The Law Commission of Hong Kong did not favour a bare

[10] Regulations 5.6.19-5.6.21 Australian Corporations Regulations.
[11] The Law Reform Commission of Hong Kong, Report on Corporate Rescue and Insolvent Trading (October 1996).

majority as the procedure contemplates altering the rights of creditors and there must be a convincing level of acceptance by creditors. The Law Commission was also of the view that a requirement for acceptance by three-quarters in value could discourage a provisional supervisor and could also encourage creditors to hold out in some situations. The New Zealand Law Commission[12] recommended that the voting percentage for creditors' meeting should be 75 per centum of creditors present and voting at the creditors meeting.

2.16. In ascertaining what is the voting percentage, the CLRC noted the concern that there could be one secured creditor holding a charge over all of the company's asset (by way of a floating charge) who can decide the outcome of the voting process merely by having a majority in value although not in number. On the other hand, there could be a case where creditors of the company who are in the majority due to their number but not the value of the debts owed by the company to them will be able to defeat the corporate rescue exercise. The CLRC's recommendation is that the proposal must be approved by a majority in value of the creditors who are present and voting at the meeting. At the creditors meeting, only creditors who have had their proof of debts accepted by the judicial manager, may vote.

[12] New Zealand Law Commission - Study Paper 11- 'Insolvency Law Reform: Promoting Trust and Confidence" at page 80 states that 'we are satisfied from the research which we have carried out that there is no need to make alterations to Part XIV of the NZ Companies Act 1993'.
At page 70 of the Report states that 'a compromise is binding on all creditors that received notice of the proposal if 75 per centum at each meeting vote in favour (unless there is provision in the compromise for classes of creditors to be separately bound). The voting percentage can be found in Schedule 5 of the New Zealand Companies Act 1993. This is to be read together with section 230 of Part XIV of the New Zealand Companies Act 1993.

2.17. The judicial manager should be required to give notice to the creditors of the meeting as well as sending to all the creditors a copy of the proposal. Apart from sending the proposal to all creditors, a copy must also be sent to:

(i) the Registrar, and

(ii) all members or publish a notice in the newspaper the address for members to write in to request for a copy of the statement of proposal.

2.18. It is to be noted that whilst the voting is to be carried out only by the creditors whose proof of debts has been accepted, the statement of proposal must be sent to all creditors. Where the creditors' meeting is concerned, there should be clear procedures in relation to the convening and holding of the creditors' meetings as well as provisions to deal with the proof of debts.

2.19. In addition, the creditors should also be allowed to approve the proposal with modifications, if any. However in most cases, the judicial manager's consent to the modifications is required. This is to ensure that the judicial manager will be able to achieve the objectives of the judicial management.

2.20. The creditors are also allowed to bring an action to court against oppressive conduct of the company.

RECOMMENDATIONS

2.21. The CLRC recommends that:

(i) the judicial manager should be given 180 days to prepare the proposal and have it approved by creditors at the creditors' meetings.

(ii) the proposal must be approved by a majority in value of the creditors who are present and voting at the meeting. At the creditors meeting, only creditors who have had their proof of debts accepted by the judicial manager, may vote.

Questions for Consultation

Question 10:

Do you agree that the judicial manager should be given 180 days to prepare the proposal and have it approved by creditors at the creditors' meeting?

Question 11:

Do you agree that the statement of proposal should be approved:

(i) by a majority in value and number of the creditors present and voting and whose proof of debts have been accepted? or

(ii) by a majority in value of the creditors present and voting and whose proof of debts have been accepted? or

(iii) by a 75 per centum majority in value and number of the creditors present and voting and whose proof of debts have been accepted? or

(iv) by a 75 per centum majority in value of the creditors present and voting and whose proof of debts have been accepted?

Question 12:

Do you agree that the creditors should be allowed to modify the proposal?

D EFFECT OF THE CREDITORS' APPROVAL/REJECTION OF THE PROPOSAL

2.22. A concern in relation to rescue procedures is the fact that the proposal that has been agreed to may be defeated by any creditors. There are views that once the creditors' meeting approves the proposal, it is implied that the proposal is binding on all creditors whether or not they have voted in favour of the proposal, otherwise there would be no necessity to expressly provide for the voting requirement.

2.23. The CLRC noted that under the Singapore Companies Act (Chapter 50), it is unclear whether the proposal that has been approved by the necessary votes of the creditors at the creditors' meeting is binding on all creditors irrespective of whether they have voted in favour of the proposal.

2.24. The CLRC is of the view that the absence of an express statutory provision to this effect will create ambiguity. Thus, the CLRC recommends that it should be expressly provided that once the creditors approve the proposal, the proposal shall be binding on all creditors of the company whether or not they voted in favour of the proposal. It is possible that the creditors may reject the proposal and ask for it to be re-worked, and the amended proposal is then tabled for approval. The Judicial Manager therefore would re-work or amend the proposal. The judicial management order will remain until he reports to the court on the outcome of the meeting and also expressed his views to the court what the next course of action should be.

2.25. The judicial manager should also be obliged to report the result of the creditors' meeting to the court and the Registrar. If the creditors' meeting rejects the proposal, the judicial manager should be obliged to report the result of the meeting to the court. In the event that the creditors' meeting rejects the proposal, the court may order a discharge of the judicial management order and make such consequential provisions as it thinks fit. The court may also adjourn the hearing conditionally or unconditionally or make an interim order or any other orders as it thinks fit.

2.26. The CLRC noted that there are jurisdictions that allow secured creditors to thwart the judicial management or administration process by electing not to be bound by the judicial management or administration. The ability of the secured creditor to veto the administration process in the UK has been identified as one of the deficiencies of the administration regime. The CLRC noted that, under the Australian Corporations Act 2001, a secured creditor holding a charge over the whole or substantially the whole of the company's assets may effectively veto the administration after the order is made. In Australia, the appointment of administrator does not affect the power of a secured creditor when the enforcement of the charge has commenced before the appointment of the administrator which means that the receiver and manager's powers to realise the asset exists.[13] However, the court may restrict these rights.[14] In Australia, such a creditor has 10 business days after the appointment of an administrator to enforce the security, after which he cannot enforce the security unless the administrator or the court agrees. Hence, the practice in Australia is to obtain the cooperation of a chargee who holds an all embracing charge and often there will be a discussion before the voluntary administration begins and there is evidence that the secured creditors often do not utilise this remedy.

[13] Section 441B of the Australian Corporations Act 2001.
[14] Section 441D of the Australian Corporations Act 2001.

2.27. A similar approach has been forwarded by the Report of the Law Commission of Hong Kong where the issue of secured creditors' rights was raised for discussion. The consultation paper proposed that only the holder of a floating charge over the whole or substantially the whole of the company's assets should be given the right to elect whether or not to participate in the provisional supervision. However, after consultation, the proposal was amended so that the Law Commission recommended that the holder of any charge, whether a fixed or a floating charge or a combination of both, over the whole or substantially the whole of a company's assets, whose level of exposure or lending would warrant such an extensive charge, should not have provisional supervision imposed on it by a company seeking provisional supervision. Such major secured creditors should have the right to elect whether or not to participate in the provisional supervision. However, if the secured creditors elect to participate or make no election within 3 business days of receipt of the notice of election, the secured creditor is bound by the provisional supervision.

2.28. Under the Singapore Companies Act (Chapter 50), the secured creditors have a right to oppose the petition for a judicial management order and the court shall dismiss the petition to appoint the judicial manager if a receiver and a manager has been or will be appointed or the making of the order is opposed by a person who is entitled to appoint a receiver and manager e.g. the debenture holder.[15] Whilst this provision enables any secured creditors to oppose the petition for the judicial management order, once the judicial management order has been made the secured creditor cannot realise their security. The judicial manager is conferred the power to deal with the charged property of the company as if the property was not subject to any security but the holder of the security does not lose its priority over the proceeds of the sale.[16]

[15] Section 227B of the Singapore Companies Act (Chapter 50).
[16] Section 227H of the Singapore Companies Act (Chapter 50).

2.29. The CLRC is of the view that the Singapore approach is better suited for the Malaysian environment and recommends to adopt section 227B(5) of the Singapore Companies Act. Although the secured creditor has a right to object to the appointment of the judicial manager, once the judicial management order has been made and has been approved by the creditors' meeting, all creditors should be bound by the proposal. A secured creditor who wishes not to be bound by the judicial management order must then take the initiative to oppose the petition. However, once the judicial management order has been made all creditors shall be bound. This will ensure that the rehabilitation plan can be implemented especially if it involves the disposal of any of the company's assets. On this point, the judicial manager should also be given the power to deal with the charged property of the company as if the property was not subjected to the security.[17] Nonetheless, if such property was disposed, the holder of the security shall have the same priority over the proceeds of the sale.

RECOMMENDATIONS

2.30 The CLRC recommends that:

(i) any secured creditor may oppose the petition for the judicial management order. However, once the judicial management order has been made, the secured creditors cannot realise their security and the judicial manager has the power to deal with the charged property of the company as if the property was not subjected to the security.

(ii) the proposal once approved by creditors shall be binding on all creditors of the company whether or not they have voted in favour of the proposal.

[17] Section 227H of the Singapore Companies Act (Chapter 50).

Questions for Consultation

Question 13:

Do you agree that the court shall dismiss the petition if:

(i) a receiver and manager has been or will be appointed; or

(ii) the making of the order is opposed by a person who has appointed or is entitled to appoint such a receiver and manager?

Question 14:

Do you agree that there should be an express statutory provision that once the proposal is approved, it shall be binding on all the creditors of the company?

Question 15:

Do you agree that there should be a reporting obligation by the judicial manager of the decision of the creditors' meeting to the court and the Registrar?

E CONTROL OF THE PROCESS

2.31. To enable the judicial manager or the administrator to act on behalf of the company, most jurisdictions specify that the judicial manager or administrator is an agent of the company.[18] Under the Singapore Companies Act (Chapter 50), the judicial manager has control over the process whilst the order is in force. The judicial manager shall manage the affairs, business and property of the company during this period.[19] Under the Australian Corporations Act 2001, the administrator is given a control of the company's affairs, business and property.[20] It is also expressly

[18] Section 227I of the Singapore Companies Act (Chapter 50), Section 14 (5) of the UK Insolvency Act 1986 and section 437B of the Australian Corporations Act 2001.
[19] Section 227B(2) of the Singapore Companies Act (Chapter 50).
[20] Section 437A of the Australian Corporations Act 2001.

provided that any other officers' powers are suspended unless the administrator has given his written approval.[21] The New Zealand proposal on business rehabilitation forwarded an alternative approach where the current management could be completely replaced by a team of professional managers who are either representatives of the creditors or fully independent.[22]

2.32. Whilst there is merit in replacing the existing management in cases where there is proof or allegation of fraud or mismanagement, there is a possibility of the process being delayed because the new management may require additional time to familiarise itself with the business. The CLRC is of the view that a balance may be achieved by ensuring that there is the involvement of a qualified insolvency practitioner in the process who is subject to the court's supervision and that the powers of the company's officers should be suspended unless the insolvency practitioner appointed as the judicial manager approves any exercise of the powers.

RECOMMENDATIONS

2.33. The CLRC recommends that there should be a clear provision stating:

(i) The judicial manager is an agent of the company;

(ii) The judicial manager has control over the affairs, business and property of the company during the judicial management period; and

(iii) The powers of the other officers of the company are suspended unless written approval is obtained from the judicial manager.

[21] Section 437C of the Australian Corporations Act 2001.
[22] Ministry of Economic Development of New Zealand "Business Rehabilitation", Discussion Document, (May 2002) paragraph 105.

Questions for Consultation

Question 16:

Do you agree with the proposal that the judicial manager should be deemed the agent of the company?

Question 17:

Do you agree with the proposal that the judicial manager should be given control over the affairs, business and property of the company during the judicial management period?

Question 18:

Do you agree with the proposal that the powers of the other officers of the company should be suspended during the judicial management period unless a written approval is obtained from the judicial manager?

F ENDING THE JUDICIAL MANAGEMENT

2.34. As a result of the moratorium, there is a possibility that some companies will rely on the judicial management procedure to delay honouring its obligations to its creditors. To ensure that the judicial management order and the consequential moratorium would not be abused and to ensure that the company is able to resume its business as a going concern as soon as possible, a time frame should be specified for the judicial manager to implement the rehabilitation of the company. The CLRC is of the view that a judicial management order shall remain in force for 180- days from the date the order is made. The court, however, may extend the time frame upon an application by the judicial manager. It should also be possible to end the judicial management by a discharge of the order, even before the expiry of the time-frame or any longer period that the court has approved.

2.35. Cross-jurisdictional[23] studies show that the judicial management order or the administration order is capable of being discharged in the following situations:

(i) if the proposal has not been accepted by the creditors' meeting and where the court orders the discharge of the judicial manager; or

(ii) if the purpose of the judicial management has been successfully achieved; or

(iii) if the judicial manager is of the view that the purpose is unachievable; or

(iv) if the judicial manager applies for a discharge, is no longer qualified to be a judicial manager or is removed from office.

RECOMMENDATIONS

2.36. The CLRC recommends that the judicial management order should be capable of being discharged prior to the expiry of the time frame or any longer period that the court may order.

2.37. The CLRC further recommends that the judicial management order shall end:

(i) if the proposal has not been accepted by the creditors' meeting and where the court orders the discharge of the judicial manager; or

(ii) if the purpose of the judicial management has been successfully achieved; or

(iii) if the judicial manager is of the view that the purpose is unachievable; or

(iv) if the judicial manager applies for a discharge, is no longer qualified to be a judicial manager or is removed from office.

[23] Sections 227J and 227Q of the Singapore Companies Act (Chapter 50) and sections 18 and 19 of the UK Insolvency Act 1986.

Questions for Consultation

Question 19:

Do you agree that the judicial management order should be capable of being discharged prior to the expiry of the time frame or any longer period that the court may order?

Question 20:

If yes, do you agree with the following situations as events that should enable a judicial management order to be discharged:

- **(i) if the proposal has not been accepted by the creditors' meeting and where the court orders the discharge of the judicial manager?**
- **(ii) if the purpose of the judicial management has been successfully achieved?**
- **(iii) if the judicial manager is of the view that the purpose is unachievable?**
- **(iv) if the judicial manager applies for a discharge, is no longer qualified to be a judicial manager or is removed from office?**

Question 21:

Do you have any other views on any other events that should enable a judicial management order to be discharged?

G THE ROLE AND FUNCTIONS OF A JUDICIAL MANAGER

2.38. The CLRC is of the view that the creditors should be able to decide whether or not a person should be appointed as a judicial manager and the person so nominated should be a qualified person.

2.39. Once a judicial manager has been appointed, the judicial manager must prepare a proposal to be approved by the company's creditors. A time-frame needs to be specified to encourage the judicial management process to be implemented expeditiously but must also enable the judicial manager to be able to come up with a realistic and workable proposal.

2.40. The CLRC noted that under section 227M(1) of the Singapore Companies Act (Chapter 50), the judicial manager is given 60 days to have the proposal prepared and submitted to the company's creditors for approval. This 60 days period has been viewed as too short since the actual time for the judicial manager to come up with the concrete proposal to salvage the company is actually 46 days bearing in mind that the proposal must be sent to the creditors with at least 14 days notice prior to the meeting. Because of this, it is proposed that the time frame given to the judicial manager to prepare the proposal is 120 days within which he must also lay the proposal before the creditors' meeting which shall be called with not less than 14 days notice.

2.41. The Australian Corporations Act 2001, on the other hand, provides that the meeting must be convened within 4 to 5 weeks of the commencement of the administration although there is a provision for the convening period to be extended by the court. In addition, the meeting of creditors may be adjourned for a further 60 days after the meeting of creditors is held.

2.42. A judicial manager, once appointed should become an agent of the company. His status will enable the judicial manager to act on behalf of the company.[24] The directors' powers should be suspended and should not be exercisable unless the consent of the judicial manager has been obtained.

2.43. The powers of the judicial manager should also be clearly stated in the legislation. On this point the CLRC referred to the Singapore Companies Act (Chapter 50)[25] and identified that the powers provided to the judicial manager/ administrator are as follows:

(i) manage the affairs, business and property of the company;

(ii) take into custody all properties which the company is or appears to be entitled to;

(iii) shall do all other things as the court may sanction;

(iv) shall have all the powers specified in the 11th Schedule;

(v) may apply to court for direction;

(vi) may issue payment for a discharge of debts if it is sanctioned by the court or it is pursuant to a compromise sanctioned or the payment is to discharge a sum secured by a security that is payable under hire purchase;

(vii) may call for a creditors' meeting at any time and shall do so if directed by the court;

(viii) may alter the M&A of the company in which case the alteration shall have the same effect as if it was duly made by a resolution of the company;

(xi) to lodge a copy of the order sanctioning the alteration with the Registrar within 14 days from the making of the order.

[24] Section 14(5) of the UK Insolvency Act 1986; Section 227I of the Singapore Companies Act (Chapter 50).
[25] Section 227G of the Singapore Companies Act (Chapter 50).

Under the Singapore Companies Act (Chapter 50), a person dealing with the judicial manager in good faith shall be entitled to assume that the judicial manager is acting within his powers.

2.44. One specific power of the judicial manager is the right to dispose off the company's assets. This particular power is especially helpful where the judicial manager believes that any of the company's assets should be sold-off but is opposed by any of the company's creditors. However, there should be provisions in place to ensure that creditors' rights are protected in such instances.

2.45. The judicial manager should also be provided with access to information especially financial information relating to the company. On this point, the Singapore Companies Act (Chapter 50) provides that the statement of affairs shall be provided to the judicial manager by one of more persons who are the company directors or company secretary or any other person that the law specifies as being capable of being requested by the judicial manager to submit the statement of affairs. These other persons are those who are or have been officers of the company, who have taken part in the formation of the company at any time within one year before the date of the judicial management order or employees or former employees of the company or any person the judicial manager believes is capable of providing him with the necessary information.[26] The CLRC is of the view that the responsibility to provide the statement of affairs should not be imposed on a person merely because the person is the company secretary.

[26] Section 227L(2) and (3) of the Singapore Companies Act (Chapter 50).

2.46. An important issue is whether the judicial manager should be made personally liable for contracts entered by him. Section 227 of the Singapore Companies Act (Chapter 50) provides that the judicial manager would be personally liable on any contract entered by him or adopted by him. However, he may exclude personal liability for contracts entered by the company which are then adopted by the judicial manager.[27] The extent of the judicial manager's personal liability may arguably affect the willingness of third parties to continue to transact with the company during the period the judicial management is in force with the possibility that this may affect the viability of the judicial management. Nonetheless, the threat of personal liability may also discourage persons from being appointed as judicial manager and impede the judicial management process. Nonetheless, although there is a risk that third parties may be discouraged from dealing with the company, it may be too onerous for the judicial manager to assume personal liability for contractual obligations and this may affect the viability of the scheme.[28] The CLRC is of the view that the judicial manager should be allowed to exclude personal liability in contracts entered into by him or adopted by him during the judicial management process. In addition, although the judicial manager should be permitted to exclude personal liability for contracts, he shall be indemnified in respect of his liabilities, remuneration and expenses out of the assets of the company in priority, to all other debts except those subject to security of a non-floating nature.

2.47. Another issue is whether the judicial manager is deemed to have adopted any employment contract upon taking office. UK case law[29] states that judicial management does not automatically terminate any contract of employment, but

[27] See section 227I(1)(b) of the Singapore Companies Act (Chapter 50): "… shall be personally liable on any contract including any contract of employment entered by him or adopted into [except in so far as the contract or a notice under subsection (2) other wise provides]". See section 227I(2) where it is stated "Where a contract entered into by the company is adopted by the judicial manager, he may, by notice given to the other party, disclaim any personal liability under the contract".
[28] Notwithstanding, where negligence or wilful conduct is involved, he would be personally liable for it.
[29] *Powdrill v Watson* [1995] 1 BCLC 386.

the contract continues until notice of termination is given by the judicial manager or if the judicial manager does not pay the wages of the employees. Nonetheless, the judicial manager cannot pick and choose which part he wants to adopt or reject but must choose to adopt or reject the employment contract in its entirety. The judicial manager is given a grace period of 28 days to decide whether or not to adopt the contract of employment. If the judicial manager causes the contract to continue after the 28 day grace period, the contract is assumed to have been adopted. The Singapore Companies Act (Chapter 50) has a similar provision on this point. The CLRC is of the view that such a provision is needed to ensure that the judicial manager is given discretion in formulating and implementing the rehabilitation plan efficiently.

RECOMMENDATIONS

2.48. The CLRC recommends that:

(i) the judicial manager should be given 120 days to table the proposal for the creditors' approval;

(ii) the company secretary should not be imposed with the obligation of submitting the statement of affairs to the judicial manager although the judicial manger should be given the power to request the statement of affairs from any relevant person;

(iii) the judicial manager should be allowed to exclude personal liability in contracts so that he is personally liable unless he disclaims it;

(iv) the judicial manager should be indemnified in respect of his liabilities, remuneration and expenses out of the assets of the company in priority, to all other debts except those subject to security of a non-floating nature;

(v) the judicial manager should be given a grace period of 28 days to decide whether or not to adopt any contract of employment and if the judicial manager cause the contract to continue after the 28 day grace period, the contract is assumed to have been adopted by him.

QUESTIONS FOR CONSULTATION

Question 22:

Do you agree that the judicial manager should be given 120 days to table the proposal for the creditors' approval?

Question 23:

Do you agree that the judicial manager under the proposed scheme should be given powers equivalent to those found under the Singapore Companies Act (Chapter 50)?

Question 24:

Do you agree that the company secretary should not be imposed with a duty to submit the statement of affairs?

Question 25:

Do you agree that the judicial manager should be allowed to exclude personal liability in contracts so that he is personally liable unless he disclaims it?

Question 26:

Do you agree that the judicial manager should be given indemnity for his expenses remuneration out of the assets of the company in priority to all other debts subject to a floating charge?

PART III - THE COMPANY VOLUNTARY ARRANGEMENT (CVA)

3 Introduction

3.1. The UK CVA in the UK Insolvency Act 1986 was based on the recommendation of the Cork Committee which was of the view that the law was deficient in failing to provide that a company, like an individual, could enter into a binding agreement with its creditors by a simple procedure that would allow it to organise its debts. When it was introduced, the UK CVA was conceived as a simple form of compromise procedure whereby a debtor company could put up a proposal to creditors, supervised by an independent practitioner who would report to court on the viability of the proposal. However, the original CVA was criticised due to the lack of a moratorium procedure. Companies applying for CVA would still be exposed to court actions by its creditors making it difficult to achieve the objectives of compromise under the CVA.[30] The current UK CVA has addressed these shortcomings[31] and the CLRC recommends the adoption of the UK CVA.

A INITIATING THE PROCESS

3.2. A CVA is a rescue or rehabilitation scheme initiated by the company which is in financial difficulties by proposing, through a nominee, a scheme to its creditors. The CVA scheme relies on the involvement of a nominee, who must be a qualified insolvency practitioner (IP) nominated and appointed by the company for the purpose of supervising the implementation of the scheme. Although the directors of the company may make the proposal, they should only be allowed to do so where there is no pending petition to place the company in liquidation, judicial management or that a receiver is likely or will be appointed.

[30] See Report for the Ministry of Economic Development, New Zealand on Corporate Rescue (Nov 2000) at pp 33 and 34.
[31] See the amendment of the UK Insolvency Act 1986 via the UK Insolvency Act 2000 which came into force on 1st January 2003.

3.3. If the company is already in judicial management or liquidation, the proposal should come from the IP responsible for conducting the judicial management or winding up in which case the judicial manager or the liquidator may act as the nominee.

3.4. The CVA is intended to be used by a company which is insolvent or unable to pay its debts. The director must nominate an IP to act in relation to the CVA and may make a proposal. It is common for the directors to produce the proposal with assistance of a licensed IP. The directors must submit the written statement of the terms of the proposal to the nominee supported by sufficient information to enable the nominee to form a professional judgment on the viability of the proposal. For example, the proposal should be supported by trading and cash flow forecasts which have been carefully thought through. In addition to the proposal, the directors must prepare a statement of affairs for the information of creditors. This should show the likely return to creditors after the deduction of costs. It should also show comparative figures for an alternative for insolvency procedures typically the creditors' voluntary liquidation.[32] If the company is already in liquidation or administration, the proposal should be the responsibility of the administrator or liquidator.

[32] In UK, rule 1.35 in the Insolvency (Amendment) (No. 2) Rules 2002 provides that where a moratorium is being sought the proposal must state the address to which the notice of the consent of the nominee to act is to be sent. The new rule enables the directors to amend the proposal before submission to them by the nominee of the statement required by paragraph 6(2) of Schedule A1. This is the statement confirming the nominees view that:

i. the proposal has reasonable prospect of being approved and implemented;
ii. the company is likely to have sufficient funding; and
iii. meeting of the company and its creditors should be convened.

When the directors of a company wish to apply for the moratorium they must supply the nominee with a copy of the following:

i. the proposed arrangement;
ii. statement of affairs;
iii. other information as described in the rules; and
iv. such other information as the nominee require and to enable him to form an opinion as to whether the proposal is viable. This further information will include an explanation as to how the arrangement is to be financed.

3.5. The nominee's role is to propose or vet the scheme and to call for members' and creditors' meeting to approve the proposal. The nominee will need to consent to act as well as agree to the scheme before it is laid before the creditors for creditors' approval. The nominee is required to submit to the court a report within 28 days after the nominee's appointment stating the opinion as to the scheme or proposal and whether the members and creditors' meetings must be called to consider the proposal. Thus in practice, the company directors may lodge the necessary documents, together with the nominee's consent to act and to report to the court only when there has been validation of the proposal by the nomineee.[33]

3.6. Assuming that the company is not already under judicial management or liquidation, it is essential for CVA proposals to be approved by the directors before they are lodged in court or submitted to members and creditors. A common sample of the proposal would normally require the proposal to be signed by the directors. In any event it is important that a formal meeting of the whole board should be convened in order to approve the proposal. On a practical level it is important that there should be a binding decision because it is the board of directors who will have to manage the affairs of the company during the period of the CVA. In convening and conducting the meeting of directors, the nominee and other advisers should pay close attention to the provisions of the company's article of association and any relevant standing orders. If the constitution of the company is not properly complied then it may be open to a director or any other interested party to challenge the validity of the proposal even after they have been approved by the creditors and members.

[33] Section 2(2) of the Insolvency Act 1986. In UK where the nominee is not the liquidator or administrator he must also state in his report whether in his opinion the proposed CVA has a reasonable prospect of being approved and implemented.

B CREDITORS' PROTECTION MECHANISM/MORATORIUM

3.7. The CLRC is of the view that to enable the CVA proposal to be formulated and implemented, there should be a moratorium period within which the company is given protection from creditors. The moratorium is to be in force once the relevant documents are filed in court without the need to apply for a court order.

3.8. An application for a moratorium may be made by the directors of a company who shall forward the same to the proposed nominee. The nominee needs to consent to act and to agree to the moratorium application. The application must include a statement of affairs, a creditors' list and an estimated outcome of the voluntary arrangement. The nominee then is required to make a statement stating that, in his opinion, the company has sufficient funds for the business available during the proposed moratorium to enable it to carry on its business and that there is a reasonable prospect of the CVA being approved.[34] The nominee is also required to advertise the end of a moratorium and to notify the court, the Registrar, the company and any creditors of the company of whose claim he is aware of the fact that the moratorium has ended.[35]

3.9. The period of a moratorium begins when all the relevant documents have been filed in court in which case the company is able to obtain a 28 day moratorium.[36] There is no requirement for an order from the court. The moratorium ends:[37]

[34] Paragraphs 6 and 7 of Part II of Schedule A1 of the Insolvency Act 1986 (Amendment) 2000.
[35] Paragraph 11 of Part II of Schedule A1 of the Insolvency Act 1986 (Amendment) 2000.
[36] See Insolvency Act 1986, Schedule A1 para. 7 inserted by the Insolvency Act 1986 (Amendment) 2000. Once the nominee has prepared his statement, the directors should file the following documents in court:
i. the proposed arrangement;
ii. the statement of affairs;
iii. statement that the company is eligible for a moratorium;
iv. a statement that the nominee has consented to act; and
v. the nominee's statement as to the validity and funding.
[37] Paragraph 8(1) of Part II of Schedule A1 of the Insolvency Act 1986 (Amendment) 2000.

(i) at the end of the business day of the creditors' meeting unless the creditors' meeting requests an extension to the moratorium.[38] The moratorium period can be extended for a period of up to 60 days thereafter, provided the nominees, members and creditors of the company agree.[39] The resolution in relation to the extension or further extension of the period of moratorium must be approved by a majority in excess of three-quarters in value of the creditors present in person or by proxy voting on the resolution at the creditors' meeting.[40] If it is extended then the moratorium ends at the end of the day to which it is extended, or further extended. At any meeting where there is a proposed extension of moratorium, the nominee is duty bound to inform the creditors of the steps he has taken in dealing with the company's funding during the moratorium and of the reasonable prospect of approval of the CVA. The nominee will also be expected to update the creditors of the anticipated costs to be incurred during the extended moratorium process.

(ii) if the nominee fails to summon creditors' meetings within 28 days beginning with the day the moratorium first came into force, the moratorium ends at the end of the last day of that period.

Nevertheless, to address the concerns that the CVA could be abused, the CLRC recommends that the moratorium period shall not be applicable to debenture holders.

3.10. The CLRC noted that the absence of a moratorium under a CVA regime under the UK Insolvency Act 1986 has been advanced as one of the reasons why the CVA procedure has not been adopted in greater numbers since its introduction.[41] The absence of the moratorium provision in the CVA procedure has been improved

38 Paragraph 8(2) of Part II of Schedule A1 of the Insolvency Act 1986 (Amendment) 2000.
39 Paragraph 32 of Part II of Schedule A1 of the Insolvency Act 1986 (Amendment) 2000.
40 Rule 152(3) of the Insolvency Rules 1986 (Amendment) 2000.
41 D. Flynn , Department of Trade & Industry London, UK, "Administrative Support to the Judiciary in the UK Insolvency System" (unpublished paper) Forum for Asia Insolvency Reform: "Insolvency Reform in Asia: An Assessment of the Recent Developments and the Role of Judiciary" - Bali, Indonesia, 7-8 February 2001.

when the UK Insolvency Act 2000 came into force on 1st January 2003. The Insolvency Act allows directors of a company to apply for a moratorium to protect the company from any prospective legal suits or liquidation proceedings brought by its creditors. However, this is limited to eligible small companies only.[42] Unlike the UK CVA that only allows a moratorium for small companies, the CLRC is of the view that there should not be any distinction between small or large companies on this point.

3.11. Under the UK Insolvency Act 1986, the effect of the moratorium is that:

(i) no petition may be presented for the winding up of the company;

(ii) no meeting of the company may be called or requisitioned except with the consent of the nominee or with leave of the court and subject (if the court gives leave) to such terms as the court may impose;

(iii) no resolution may be passed or order made for the winding up of the company;

(iv) no administration application may be made in respect of that company;

(v) no administrative receiver of the company may be appointed;

(vi) no landlord or other person to whom rent is payable may exercise any right of forfeiture by peaceable re-entry in relation to premises let to the company in respect of a failure by the company to comply with any term or condition of its tenancy of such premises, except with leave of the court and subject to such terms as the court may impose;

(vii) no other steps may be taken to enforce any security over the company's property, or to repossess goods in the company's possession under any hire-purchase agreement, except with leave of the court and subject to such terms as the court may impose;

[42] Section 1A of the Insolvency Act 1986 (Amendment) 2000.
The requirements for constituting a small company under section 381 of the Companies Act 2006 are as follows:
- Turnover - not more than £5.6 million in a year
- Balance sheet total not more than £2.8 million in a year
- Number of employees not more than 50

(viii) no other proceedings and no execution or other legal processes may be commenced or continued, and no distress may be levied, against the company or its property except with leave of the court and subject to such terms as the court may impose.

3.12. The CLRC recommends the same for the CVA in Malaysia except that it shall not prevent the debenture holders from appointing a receiver.

3.13. Another significant feature following an extension of moratorium is the introduction of a moratorium committee. This is subject to the nominee's approval. This committee is intended to be a control mechanism *vis-a-vis* the directors during the moratorium process. If the consent of the nominee for the moratorium committee's actions is withheld, the creditors may apply to court for directions.[43]

3.14. Any creditor, director or member of the company or other person affected by a moratorium may apply to court if there is dissatisfaction with an act or omission or decision of the nominee during the moratorium. The court is then empowered to confirm, reverse or modify any nominee decision, give him directions or make such other order as it thinks fits. The acts of directors can also be challenged similarly. The person can challenge the CVA on grounds that it unfairly prejudices the interest of the creditor, member or contributory of the company or there has been an irregularity at or in relation to the meetings of the company and/or creditors. Once the approved CVA has taken effect, the person formerly known as the nominee becomes the supervisor of the CVA and any of the company's creditors or other persons dissatisfied by any act, omission or decision of the supervisor may challenge this in court.

[43] Paragraph 26 of Part II of Schedule A1 of the Insolvency Act 1986 (Amendment) 2000.

3.15. It is proposed that the court's involvement be limited to hearing challenges to the workout proposal after the proposal has been approved by the required majority of creditors on the grounds that there has been a material irregularity or the CVA unfairly prejudices the interests of a creditor or a member or the CVA is anticipated to be ineffective in practice.[44]

C VOTING

3.16 If the proposal is approved by the required majority of the company's shareholders and the creditors at their respective meetings, then the scheme or proposal becomes a voluntary arrangement that is binding on every person who was entitled to vote at the respective meetings or who would have been so entitled if he had had notice of the meetings.

3.17 A simple resolution is required at the members' meeting. Notice of the creditors' meeting to approve the scheme or proposal must be sent to all of the company's creditors whose claim and addresses the IP is aware of. The proposal must be approved by a majority vote of 75 per centum of the total value of the creditors, who may vote in person or by proxy. Once the voting is done, the creditors who were notified and included in the meeting are legally bound by the proposal whether or not they attended and voted at the meeting. This includes creditors who would have been entitled or eligible to vote even though they did not have notice of the meeting, nor the opportunity to be heard or vote. However, the creditors' meeting should not be allowed to modify the proposal, unlike the UK position,[45] as the view is that this may be unfair to the creditors who are not present since any modification might change the substance of the proposal. The results of the meeting must then be reported to the court.

[44] Similar to the UK CVA, see section 6 of the Insolvency Act 1986.
[45] The UK provision limits the matters that may be modified.

3.18 There is nonetheless, the power to challenge the CVA itself or the procedure involved in its approval. The application must be made within 28 days beginning with the first day the report is made to the court. If a creditor alleges that he has not been given notice, he may challenge the decision of the meeting within 28 days of the day on which he became aware that the meeting had taken place.[46]

D MANAGEMENT POWERS

3.19. Under the CVA, the directors and the management of a financially distressed company still retain the management powers. Although there are reservations on this issue, the CLRC is of the view that this position is suitable for a CVA especially since the CLRC foresees that the CVA would be utilised where the creditors have confidence in the existing management and in situations where the company's financial difficulties are not attributable to mismanagement or incompetence of the existing management. In such a case, there is less cost involved in the scheme if management is still vested in the existing board. This is because it would be more costly and time consuming for an external party i.e. an IP to get acquainted with the company's operations so as to enable the IP to manage the company.

RECOMMENDATIONS

3.20 The CLRC recommends:

(i) the introduction of the CVA regime into the Companies Act and the UK CVA shall be adopted as a model with modifications where necessary.

[46] Section 6(1), (2) and (3) of the UK Insolvency Act 2000.

(ii) that a moratorium period shall be in force once the relevant documents are filed in court without the need to apply for a court order. This is to restraint the company's creditors from initiating legal suits against the company whilst the CVA proposal is being formulated and implemented.

(iii) that the application of a moratorium period should not be limited to small companies as practised under the UK CVA. Moratorium period shall apply to all companies seeking to propose for a CVA.

(iv) that the court's involvement should be limited to hearing challenges on the workout proposal on the grounds that there has been a material irregularity or the CVA unfairly prejudices the interest of a creditors or the CVA is anticipated to be ineffective in practice.

(v) that the management of a financially distressed company should remain with the directors.

Questions for Consultation

Question 27:

Do you agree with the proposed introduction of the company voluntary arrangement regime into the Companies Act?

Question 28:

If yes, do you agree that the proposed company voluntary arrangement for Malaysia should be modelled after the UK CVA regime?

Question 29:

Do you agree that the proposed CVA for Malaysia should allow a moratorium period to be applied to all companies regardless whether it is a small or a larger company seeking to propose for a CVA?

Question 30:

Do you agree that the moratorium period should be automatically in force once the relevant documents are filed in court without the necessity to apply for a court order?

Question 31:

Do you agree that the court's involvement in the CVA process should be limited to hearing challenges on the workout proposal on the grounds that there has been a material irregularity or the CVA unfairly prejudices the interest of a creditor or the CVA is anticipated to be ineffective in practice?

PART IV - SECTION 176 OF THE COMPANIES ACT 1965 - SCHEME OF ARRANGEMENT

4.1. Prior to the financial crisis in South-East Asia in 1997, the only formal corporate rescue process in Malaysia is the scheme of arrangement under section 176 of the Companies Act 1965. Whilst the section is not intended specifically as a corporate rescue mechanism,[47] it has been used frequently by companies in financial difficulties during the Asian Financial Crisis.

4.2. The application for a scheme of arrangement is not limited to an unhealthy company only.[48] It may also be proposed in the following situations:

(i) where there is a need to adjust members' or creditors' rights;

(ii) to reorganise the share capital of the company; and

(iii) a reconstruction or merger in the case of a group of companies.

[47] Section 176 (11) defines "arrangement" as a reorganisation of the share capital of a company by the consolidation of shares of different classes or by the division of shares into shares of different classes or by both these methods.

[48] Malaysian Rating Agency (RAM) Report Issue No. 9, September 1998 states that over the short period from February 1998 to August 1998, there were 33 companies that had succeeded in obtaining section 176 orders.

4.3. Section 176 of the Companies Act 1965 provides a statutory remedy to sort the problems of financially troubled companies with their creditors without resorting to the drastic process of liquidation. Such a scheme is proposed when the members and creditors of the company consider that there are some advantages in continuing its business. In this respect, an ailing company may, with the approval of its creditors, prepare a scheme of arrangement in either of the following manners:

(i) a moratorium scheme of arrangement in which the company will be allowed to defer the payment of its debts for a specified period of time. The aim of a moratorium scheme is to enable the company in financial difficulty to continue carrying on its business as a going concern without having to worry about a legal battle by its creditors.

(ii) a compromise scheme where creditors of the company agree to accept payment of less than the amounts owed to them in full and final satisfaction of their debts. Once the compromised debts are paid, the company is released from any further obligation to the concerned creditors and is permitted to continue its business.

4.4. The court's involvement in the scheme of arrangement procedures is crucial. The scheme will not be binding on the members and creditors of the company unless it has the approval of the court. The role of the court is two-fold: firstly, it must ensure that the statutory procedure has been complied with and that the resolutions are passed by the requisite majority in value and in number[49] at the meetings duly convened and held; secondly, the court must determine that the scheme is fair and reasonable.[50]

[49] Section 173(3) of the Companies Act 1965 provides for the majority in number representing three-fourths in value of the creditors or members present and voting either in person or by proxy at the meeting as a requisite to approve the scheme.
[50] Walter Woon on Company Law: "Scheme of Arrangement" page 629.

4.5. Since the beginning of the financial crisis in 1997, a huge number of companies have benefited themselves with the protection of section 176. Whilst some of these companies are complying with both the spirit and intent of this section, there are concerns that there is abuse of process where some companies may have sought judicial protection under section 176 for the sole purpose of delaying the repayment of debts by the company. The pre-amended section 176 has been constantly criticised for its following deficiencies:

(i) The application for a restraining order under section 176(10) is open to companies that are without a proposed scheme of arrangement in place for protection from creditors and to apply for a meeting of the creditors to be held at a later stage i.e. when the terms of the proposed scheme have been worked out. Since section 176 does not specify the time frame for the proposed scheme to be presented, the use of a restraining order as a means for "buying time" is prevalent among debtor companies.

(ii) The provision allows the existing management to continue to take charge of the affairs of the company and also to actively involve in structuring the proposal to salvage the company out of trouble. This does not seem to be appropriate as in most instances it is the existing management that was responsible of putting the company in a dire financial state and had to seek protection under section 176. As existing management continue, the interests of creditors are not adequately protected to prevent the dissipation of assets or to ensure cash flow is used solely for the benefit of the business of the company.

(iii) The pre-amended section 176 does not specify the period of protection allowed and the court has generally granted a period of six months and upon further application, an extension of three or six months.[51] The creditors are greatly affected by the prolonged period of protection to the debtor company as they could not exercise their rights to recover debts against the company. For instance, in the banking industry, the mere issuance of a restraining order will cause a beneficiary to cease paying interest to creditor banks.

4.6. In view of the shortcomings, section 176 was amended.[52] The amendments of section 176 was aimed at ensuring the process for obtaining a restraining order is more transparent and that creditors are well protected by providing for more stricter time periods for application for extension of the restraining order and preventing the company from disposing its assets during the period of a restraining order. The amendments mainly focus on the requirement for full disclosure by a debtor company to enable the creditors to be well informed on the scheme of arrangement and to determine at a very early stage if it is a viable scheme.

4.7. The amended section 176 introduces the following conditions to be satisfied by the debtor company:

(i) The maximum duration for a restraining order to be effective on a creditor is now limited to 90 days. Any extension to the order will be granted by the court provided that:

[51] Section 176(10) of the Companies Act 1965.
[52] The amendment of section 176 was incorporated in the Companies (Amendment) Act (No. 2) Act (A1043) 1998 with effect from 1 November 1998. The amendments retain all the existing provisions of section 176 but have added new provisions in the form of sections 176(10A) to 176(10E).

(a) the debtor company has in the first place drawn up a proposal for a scheme of arrangement between the company and its creditors or any class of creditors representing at least one half in value of all the creditors at the time when it is called upon to consider whether a restraining order should or should not be made.[53]

(b) the debtor company must satisfy the court that the restraining order sought is necessary for the debtor company to formalise a scheme of arrangement before placing it at the creditors meeting pursuant to section 176(1).[54]

(c) the debtor company seeking a restraining order is required to lodge, together with section 176 application, a statement of affairs of the debtor company made up to a date not more than three days before the date of the filing of the application.[55]

(ii) The debtor company must fully disclose to the creditors the proposed scheme of arrangement and to determine in the very early stage if it is a viable scheme. Since section 176(10A), in particular sub-paragraph (d) requires the company to give creditors the opportunity to nominate a representative to be appointed as director and to satisfy that, the company usually informs the creditors generally of the proposed scheme and would ask them if they wished to appoint someone as director. This is to enable the creditors to have notice of the application for a Restraining Order so as not to cause injustice to creditors who are legally entitled to enforce execution proceedings. Under the amended section 176, the creditors are now allowed to nominate a representative to act as a director of the debtor company.[56] The

[53] Section 176(10A)(a) of the Companies Act 1965.
[54] Section 176(10A)(b) of the Companies Act 1965.
[55] Section 176(10A)(c) of the Companies Act 1965.
[56] Section 176(10A)(d) of the Companies Act 1965.

representative shall have the right of access at all reasonable time to the company's accounts and records and may require information from the company to be furnished to him in the discharge of his duties.[57] This shows that the creditors' representative can take active part in the management of the company. An office copy of the order must be lodged with the registrar and must be published in a daily newspaper circulating throughout Malaysia within seven days of the order being granted.

(iii) Section 176(10C) also shows that a debtor company is now restrained from disposing of its properties or acquiring any property other than in the ordinary course of business upon a restraining order is being obtained. Any disposition or acquisition of property by a debtor company other than in the ordinary course of business is void unless court permission has been sought.[58]

4.8. The amendments addressed some of the shortcomings in the sense that they promote full disclosure in the early possible stage which was non-existent in the .pre-amended section 176. The changes also reduce the prospect of an abuse of the provisions and prevent an ailing company from merely obtaining a moratorium to ward off claims by its legitimate claimants.

4.9. However, the amendments did not resolve the issue that there is an absence of an independent third party professional that would be able to determine whether the scheme is in the creditors interest. Although there is a requirement of an independent director, his roles are not stated. More importantly, he is not a qualified professional to be able to form an opinion on whether the restructuring scheme is beneficial. In addition, there are views that it is impractical for the statements/ proposal to be made up to 3 days prior.

[57] Section 176(10B) of the Companies Act 1965.
[58] Section 176(10D) is the penal provision for section 176(10C) in which every officer of a debtor company will be guilty of an offence punishable with imprisonment of five years or a fine of one million ringgit or both if the debtor company either disposes or acquirers any of its property without first obtaining leave of the court.

4.10 Whilst these shortcomings need to be addressed and in the absence of any other form of rescue mechanisms in the Companies Act 1965, the scheme of arrangement process is still useful.[59] It is therefore recommended that section 176 revert to its pre-amendment form with particular emphasis that there must be finality on the moratorium period. It is also proposed that the moratorium period should be limited and the current practice of allowing extension to moratorium period should be ended. The CLRC further recommends that the moratorium period should only be applicable to creditors and not be enforceable against the regulators.

RECOMMENDATIONS

4.11 The CLRC recommends that:

(i) the provision on the scheme of arrangement under section 176 of the Companies Act 1965 be retained with some modifications.

(ii) the provision under section 176 should be reverted to its pre-amendment form i.e. before the 1998 amendment with an emphasis that there must be a finality on the moratorium period. The moratorium period should be limited and the current practice of allowing for an extension for the moratorium period should be ended.

(iii) the moratorium period should only be applicable to creditors and not as against regulators.

[59] In its effort to strengthen its insolvency legislation, Singapore, has introduced a Judicial Management procedure, a replica of the UK administration procedure which proves to be useful in the Barings case. Singapore has also retained the scheme of arrangement procedure and is recommending the adoption of the UK CVA: Singapore Company Legislation and Regulatory Framework Committee (CLRFC) Final Report (October 2002).

Questions for consultation

Question 32:

Do you agree that the provision on the scheme of arrangement under section 176 of the Companies Act 1965 be retained with some modifications?

Question 33:

Do you agree that the present provision under section 176 should revert to its pre-amendment form that is before the 1998 amendment with particular emphasis that there must be finality on the moratorium period?

Question 34:

Do you agree that the moratorium period should be limited?

Question 35:

Do you agree that the current practice of allowing an extension for the moratorium period should be ended?

Question 36:

Do you agree that moratorium should only be applicable to creditors of the companies and not regulators?

Chapter 2

Reviewing The Company Receivership Process

CHAPTER II -REVIEWING THE COMPANY RECEIVERSHIP PROCESS

EXECUTIVE SUMMARY

1. Introduction

The appointment of a receiver usually derives from a debenture which generally provides a debenture holder (normally a bank or a financial institution) to appoint a receiver to take charge and control over the secured property of a debtor company, at any time after the principal monies secured by the debenture becomes payable or upon the occurrence of events of default as specified in the debenture. This Chapter focuses on the review conducted by Working Group D of the Corporate Law Reform Committee ('CLRC') on issues pertaining to the company receivership process under sections 182 to 192 of the Companies Act 1965. The proposed recommendations of the CLRC are as follows:

1.1 Appointment of a receiver and its agency status

The CLRC recommends that the agency status of a receiver or a receiver and manager be codified in the Companies Act. The codification of a receiver's agency status is necessary to ensure that there will be no ambiguity on issues arising out of the status of the appointed receiver even if such provision on the agency status is not provided or has been advertently left out in the debenture. The codification will also clarify the position of a receiver whereby he becomes the agent of the company upon his appointment and therefore, is able to contract on behalf of the company or do any act as an agent of the company in performing his functions as a receiver.

1.2 The effect of liquidation on the appointment and agency status of a receiver who has been appointed prior to the commencement of winding up

The CLRC recommends to expressly codifying in the Companies Act:

(i) that a receiver may with the consent of the court or the liquidator continue to act as a receiver or a receiver and manager of the debtor company for the purpose of carrying on the business of the company even though the company is already in liquidation;

(ii) that a receiver who has obtained consent from the court or the liquidator is deemed as an agent of the company; and

(iii) the agency status of a receiver or a receiver and manager over the property or asset secured under the debenture upon which his appointment was made shall survive and continue after the appointment of the liquidator.

1.3 Powers of a receiver

The CLRC recommends:

(i) to codify the powers of a receiver which is to be modelled after section 42(1) and Schedule 1 of the UK Insolvency Act 1965; and

(ii) to expressly state in the Companies Act that these statutory powers of a receiver apply only in so far as they are not inconsistent with any of the powers conferred by the debenture by virtue of which a receiver was appointed.

1.4 Liabilities of a receiver for debts of the company

The CLRC recommends:

(i) that a receiver be personally liable for debts incurred by him or his authorised agent during his tenure of office unless there is a specific agreement to the contrary between the contracting parties; and

(ii) that notwithstanding the above, the right of a receiver to be indemnified out of the assets of the debtor company should be retained. This right is to be paid in priority to any charge or other security held by the person or on whose behalf the receiver was appointed.

1.5 Priority of payments

The CLRC recommends:

(i) that the priority of claims by creditors of a debtor company should be restricted to those provided for under the Companies Act 1965. The provisions should take precedence over any other legislation or any conflicting provisions in other written law; and

(ii) that the costs and expenses incurred by a receiver in a receivership process should be given priority over all creditors.

REVIEWING THE COMPANY RECEIVERSHIP PROCESS

1. INTRODUCTION

1.1 The objective of this chapter is to highlight and discuss the issues and problems which are related to the current law of receivership with the aim of improving the efficiency of the receivership process in Malaysia. This chapter will also highlight the statutory reforms that have been introduced in other comparable jurisdictions such as the United Kingdom, Australia and New Zealand in the area of receivership law and evaluate whether the Companies Act 1965 should adopt these reforms in order to facilitate and increase the efficiency of the receivership process.

1.2 Sections 182 to 192 in Part VIII of the Companies Act 1965 are the provisions relating to the application of the law of receivership in Malaysia.

2. RECEIVER'S APPOINTMENT AND AGENCY STATUS

2.1 The rights to appoint a receiver is usually derived from a debenture, save in the case where the court makes an order for such an appointment. A debenture normally provides that a debenture holder may appoint a receiver to take charge over the secured property of the debtor company, at any time after the principal monies secured by the debenture becomes payable or upon occurrence of an event of default as specified in the debenture.

2.2 In the absence of any express specific circumstances in a debenture, a debenture holder or an unsecured creditor is not entitled to appoint a receiver except after an application to court is made. The court may make an order under Order 30 of the Rules of the High Court 1980, if the court is satisfied over the rationale in support of the need for such an appointment, which includes when the property of the debtor company is in jeopardy i.e. when there is a danger that the asset secured by a charge is being dissipated resulting in the detriment of the debenture holders.

2.3 The current legislative framework is silent on the agency status of a receiver. At present, a receiver or a receiver and manager (R&M) becomes the agent of the debtor company upon his appointment, by virtue of the inclusion of provisions to that effect in the debenture under which he is appointed. This means that the presence or absence of such provisions in the debenture will determine whether or not a receiver or a R&M is the agent of the debtor company.

2.4 In addition, the Companies Act 1965 has no express provision in relation to the effect of liquidation on a receiver or a R&M as an agent of the debtor company i.e. whether or not the agency status of a receiver continues even after liquidation sets in.

2.5 Upon the appointment of a receiver or a R&M, *by common law,* the powers of the directors of the debtor company to deal with the charged assets including the business of the debtor company are suspended, although they are still obliged to comply with all statutory duties required under the Companies Act 1965. *Should the debenture so provide,* the receiver or the R&M shall act as an agent of the debtor company upon his appointment. He shall take control over and deal with the charged assets and he has the power to affect the company's position by acts which, though done principally for the benefit of the debenture holder, are treated as if they were the acts of the debtor company. However, as noted earlier, the suspension of the management powers of the directors and the agency status of the receiver or the R&M is not codified in the Companies Act 1965.

2.6 The CLRC is of the view that the codification of the receiver's agency status is necessary for the following reasons:

- it will remove ambiguities as to the status of a receiver particularly when such provisions are inadvertently omitted or left out in the debenture; and
- it will clarify the position of a receiver that, upon his appointment by the debenture holder, he becomes the agent of the company and is able to contract on behalf of the company or do any act as an agent of the company to enable him to perform his functions.

2.7 It is also noted that the effect of liquidation on the appointment of a receiver appointed before the liquidation commences is not stated in the Companies Act 1965. This has created difficulty and uncertainty in relation to the exercise of the receiver's powers after liquidation. Under the common law, a liquidator can be appointed for a company even though it is already under receivership. A receiver can also be appointed to take control of a property subject to a charge even though the company has gone into liquidation. However, under common law the agency status of a receiver who is appointed prior to a winding up is automatically terminated on the commencement of the winding up of the debtor company as the company is expected to cease carrying on business. Consequently, the receiver loses the authority to carry on the business as the agent of the company and therefore has no power to continue the business of the company as its agent and is unable to bind the company to any contract made by him.

2.8 The effect of liquidation on the appointment and agency status of receivers has been highlighted in the case of *Kimlin Development Sdn Bhd v Bank Bumiputra (M) Bhd*.[60] In *Kimlin,* the Supreme Court held as follows:

[60] (1997) 2 MLJ 805 (Supreme Court).

- that under the National Land Code, a chargee has no right to sell charged land by way of a private treaty but has to resort to a judicial sale;
- that the provisions of the National land Code cannot be contracted out of;[61]
- that, with the event of a liquidation, any sale of land by a receiver pursuant to a debenture would require the approval or validation of the court under section 223 of the Companies Act 1965; and
- a receiver appointed under a debenture, being an officer of the court, is obliged to deliver up to the liquidator all assets under his custody and the clear implication is that the liquidation does not merely terminate the agency of a receiver but also his powers on winding up, since there is no estate for the receiver and manager to administer.

2.9 The effect of the *Kimlin* case is far-reaching. There are views that the decision has impaired the ability of the receiver and manager appointed under the debenture to deal with and/or dispose off landed property secured under the debenture (where the property is also the subject of a National Land Code charge), thus curtailing the effectiveness of the receivership process upon the filing of a winding up petition or the making of the winding up order. The decision has also led to the view that upon liquidation, all powers of a receiver cease and he has to deliver up to the liquidator the charged assets under his control. This is inconsistent with the common law position that a secured creditor always stands outside the liquidation process and can realise his security without reference to the liquidator.[62]

[61] The Supreme Court took the view that:
"The provisions of sections 254 to 265 of the Code (NLC) are designed to protect the chargor and they cannot be waived or contracted out of him. These provisions... setting out the rights and remedies of the parties under a statutory charge over land are exhaustive and conclusive and any attempt at contracting out of those rights unless expressly provided for in the Code (NLC) would be void as being contrary to public policy".

[62] *Re High Crest Motors Pty Ltd (in liq)* [1979] 3 ACLR 564 - held that the only way that an insolvent company or its liquidators could recover its property was by way of a redemption action against the debenture holder but even that too would be dependent upon the company satisfying all the obligations under the debenture.
The case of *Director of Customs, Federal Territory v Ler Cheng Chye (Liquidator of Castwell Sdn Bhd, in liquidation)* [1995] 2 MLJ 600 confirmed that the secured creditors' status that he stands outside the liquidation and that he must be paid first in preference over other unsecured creditors.

2.10 The CLRC is of the view that by expressly stating that the receiver is an agent of the company even after liquidation commences, the agency of a receiver may continue and therefore he is able to carry on the business of the company and to dispose of the charged assets (including land charged under the debenture) for the benefit of the debenture holder and other stakeholders. The agency status is to continue where the receiver obtains consent in writing of the liquidator or where, if the liquidator refused or failed to give consent, the court so ordered. Without this agency status, the receiver would be exposed to full personal liability and if the secured creditors do not support the receiver by agreeing to indemnify the receiver, the receiver would be forced to bring the business to an end. By allowing for the continuation in office of the receiver under the supervision of the liquidator or the court there would be a more orderly and unified administration of the company's affairs.

2.11 The advantages of allowing a receiver to continue carrying on the business and dispose off charged assets of a company in liquidation are:

- this will enable the receiver to make a choice to carry on with the business of the company with the hope that the company trades out of insolvency, thus adding/enhancing value to the debenture holder and other stakeholders.
- the receiver is in a better position to negotiate a better deal for the price of the company's assets if sold on a going concern, hence maximising the returns to the debenture holders and other stakeholders.
- the termination of the power of the receiver to continue business of the company as its agent would expose the receiver to full personal liability. If the debenture holder is unwilling to indemnify the receiver, the receiver may be constrained to bring the business to a sudden stop. Thus, the opportunity to dispose of the business as a going concern may be lost and the property may have to be disposed off in a fragmented manner. The effect of this would be detrimental not only to the company but to the debenture holder and the creditors as well.

- should the receiver's agency survive the appointment of the liquidator, the receiver will be able to dispose off the assets of the company on a "lock stock and barrel" basis, which in most circumstances will bring about better value for the company.

2.12 The Harmer Report of Australia[63] proposed that a receivership should be able to be continued, notwithstanding the commencement of winding up, with the receiver as the agent of the company but on the condition that the receiver has obtained a written consent from the liquidator or from the court where such consent is being withheld by the liquidator. The Report further stated that the continuation in office for the receiver under the supervision of the liquidator or the court is necessary to promote a more orderly and unified administration of the company's affairs. The written consent is to ensure that the liquidator or the court would have some measures of control over the conduct of the receiver in the interest of the company and its creditors generally.

2.13 The Australian Corporations Act 2001 adopted the recommendations of the Harmer Report and allowed a receiver, in certain circumstances to carry on a company's business following the appointment of a liquidator.[64] A receiver who carries on business with the requisite approval from either the court or the liquidator does so as an agent for the company and, therefore, has a right of indemnity from the company's assets for expenses and liabilities incurred in carrying on the business.[65]

[63] The Law Reform Commission (Australia), General Insolvency Inquiry (Discussion Paper No 32, August 1987).
[64] Section 420C of the Corporations Act 2001.
[65] Section 420(3) and (4) of the Corporations Act 2001.
The implementation of section 420C can be seen in the recent case of *Perpetual Trustees Australia Limited v Bank of Western Australia Limited,* [2004] 22 ACLC 1, 263 *(The Perpetual Trustees)* the Supreme Court of Queensland held that the winding up of a company to which receivers appointed affected the receiver's powers to the extent that it prevented the receiver from incurring liabilities enforceable against the company. Subject to that limitation, the rights and obligations of a secured creditor such as a chargee and receivers appointed by it survived the winding up except to the extent that the Corporations Act provided otherwise. The voluntary winding up of Mainsable (the company) did not affect the receiver's right to surrender the gaming licence. Section 420C did not affect this conclusion. The surrender of the licence may have been the relinquishment of a right of Mainsable but it was part of a process of creating an asset (cash) which, when it came into existence, would have been the property of Mainsable and subject to the charge.
The Perpetual Trustees case made reference to the earlier case of section 420C in *Re Rico Pty Ltd Matter No. 4673/98 [1998] NSWSC 618 (Re Rico)* in which the company went into liquidation and the appointed liquidator declined to give his consent for the receiver to continue to negotiate the second stage of a contract involving a design and construction of engineering plant with Mt Isa Mines Limited of which the first stage of the contract proved to be a success and produced a considerable profit to the corporation. The second stage of the contract will enable the corporation to continue trading, substantially reduced the shortfall to the secured creditors and allow for the continued employment of thirty employees of the corporation. The receiver applied to the court for the consent to continue carrying to negotiate the second phase of the contract of which the court agreed that the receiver should be allowed to continue negotiating the second phase of the contract as the unsecured creditors of the corporation will not in any practical sense be advantaged or disadvantaged at all by the receiver's application.

2.14 New Zealand has a similar provision in permitting a receiver to carry on the business of the company as the agent of the company after liquidation provided that an approval to continue to act as a receiver has been obtained either from the court or the liquidator or the official assignee as the case may be.[66]

2.15 The position in United Kingdom differs from that of Australia and New Zealand by virtue of section 44(1)(a) of the UK Insolvency Act 1986 in which the receiver or administrative receiver ceases to be the company's agent and can no longer bind the company after it has gone into liquidation. For this reason, the receiver cannot continue to carry on the company's business.

2.16 The CLRC is of the view that the Australian and New Zealand statutory provisions encourage efficiency of the receivership process when the company is in liquidation because these provisions allow the receiver the opportunity to carry on the business as an agent of the company, with the hope that the company trades out of insolvency or an investor can be found to take over the company's assets and business as a going concern. This will enhance the value of the company and the returns to all stakeholders. In that respect, consent from the liquidator or the court in allowing a receiver to carry on business in relation to the specific assets of the company seems to be the answer to control the conduct of a receiver in such deals.

RECOMMENDATIONS

2.17 The CLRC recommends:

(i) to codify in the Companies Act the agency status of a receiver or a R&M;

(ii) to codify in the Companies Act that after the appointment of the liquidator, the receiver or a R&M may with the consent of the court or the liquidator continue to act as a receiver and a R&M of the debtor company *for the purpose of carrying on the company's business;*

[66] Section 31(1) and (2) of the New Zealand Receiverships Act 1993.

(iii) to codify in the Companies Act that the receiver who has obtained consent from the court or the liquidator is the agent of the company; and

(iv) to codify in the Companies Act that the agency status of a receive or a R&M over the property/assets secured under the debenture appointing the receiver or the R&M shall continue after the appointment of the liquidator.

Questions for Consultation

Question 37:

Do you agree with the codification of the agency status of a receiver?

Question 38:

Do you agree with the proposal that after liquidation the receiver may with the consent of the court or the liquidator continue to act as a receiver of the company for the purpose of carrying on the company's business and disposal of assets specifically charged?

3. POWERS OF A RECEIVER

3.1 The powers of a receiver are not statutorily provided in the Companies Act 1965. At present, a receiver derives his powers to act from the terms as spelt out in the debenture under which he is appointed.

3.2 Usually the debenture confers very wide powers on the receiver to enable him to, *inter alia,* take possession of, get in, and realise the property of the company, carry on the business and to borrow money on security of asset in order to carry on the business. However, it is not uncommon that the powers of a receiver as stated in the debenture are inadequate and or ambiguous causing the powers to be constantly challenged in the court of law thus, resulting in a receiver to be unable to carry out his duties efficiently and effectively.

3.3 The CLRC is of the view that there should be a codification of a minimum list of powers exercisable by the receiver applicable as default provisions i.e. to be applicable if the debenture is silent as to the powers of a receiver. However, the statutory provisions should also clearly state that the powers set out may be limited or widened by the debenture instrument.

3.4 United Kingdom has codified the powers of administrative receiver by virtue of section 42(1) and Schedule 1 of the UK Insolvency Act 1986. However, these statutory powers only apply except in so far they are not inconsistent with any of the powers conferred by the debenture by virtue of which the receiver was appointed.[67]

[67] The administrative receiver is empowered under Schedule 1 of the UK Insolvency Act 1986 to do the following act:
(1) to take possession of, collect and get in the property of the company;
(2) to sell or otherwise dispose of the property of the company by public auction or private contract;
(3) to raise or borrow money and grant security over the property of the company;
(4) to appoint a solicitor or accountant or other professionally qualified persons to assist him in the performance of his functions;
(5) to bring or defend any action in the name or on behalf of the company;
(6) to refer to arbitration any question affecting the company;
(7) to effect and maintain insurances in respect of the business and property of the company;
(8) to use the company's seal;
(9) to do all acts and to execute any deed, receipt or other document in the name and on behalf of the company;
(10) to draw, accept, make and endorse any bill of exchange or promissory note in the name and on behalf of the company;
(11) to appoint any agent to do any business which he is unable to do himself and power to employ and dismiss employees;
(12) to do all such things as may be necessary for the realisation of the property of the company;
(13) to make any payment which is necessary or incidental to the performance of his functions;
(14) to carry on the business of the company;
(15) to establish subsidiaries of the company;
(16) to transfer to subsidiaries of the company the whole or any part of the business and property of the company;
(17) to grant or accept a surrender of a lease or tenancy of any of the property of the company, and to take a lease or tenancy of any property required for the business of the company;
(18) to make arrangement or compromise on behalf of the company;
(19) to call up any uncalled capital of the company;
(20) to rank and claim in the bankruptcy, insolvency, sequestration or liquidation of any person indebted to the company and to receive dividends, and to accede to trust deeds for the creditors of any such person;
(21) to present or defend a petition for the winding up of the company;
(22) to change the situation of the company's registered office; and
(23) to do all other things incidental to the exercise of the foregoing powers.

3.5 Australia by virtue of section 420 of the Corporations Act 2001 expressly sets out the powers of a receiver in addition to those conferred in the debenture. However, section 420 is not applicable to equitable charges and does not deal with powers of a receiver upon winding up as this has been dealt with by the provision of section 420C which allows a receiver to continue to carry on business as agent of the company with consent with either the liquidator or the court.

3.6 New Zealand has also codified the general powers of a receiver in sections 14 and 15 of the Receiverships Act 1993 which amongst other things includes the power to manage, insure, repair, maintain, demand and recover the property in receivership and make call on uncalled capital of a charged property under the debenture.

3.7 As in other jurisdictions, codification of the powers of receivers in Malaysia will provide the receiver with minimum statutory powers to conduct the receivership and avoid the need to seek the court's direction in the absence of such provisions or ambiguous wordings in the debenture.

RECOMMENDATION

3.8 The CLRC recommends to codify the powers of a receiver to be modelled after section 42(1) and Schedule 1 of the UK Insolvency Act 1986 and to *expressly state* that these statutorily powers apply in so far as they are not inconsistent with any of the powers conferred by the debenture by virtue of which the receiver was appointed.

Questions for Consultation

Question 39:

Do you agree with the codification of the powers of a receiver?

Question 40:

Do you agree that these powers should apply as a default provision so that if the debenture is silent, these powers are applicable unless stated otherwise?

4. LIABILITIES OF A RECEIVER FOR DEBTS OF THE COMPANY

4.1 Section 183 of the Companies Act 1965 states that the receiver shall be liable for the debts incurred by him or his authorised agent during his tenure in office. There is personal liability notwithstanding that there is any agreement to the contrary between the contracting parties. However, the receiver has the right against the debtor company to be indemnified out of the assets of the said company.

4.2 Although there is merit in ensuring that receivers are to be personally liable for contracts entered by them, there are concerns that such a provision does not contribute towards the efficiency of the receivership process as it will deter a person from accepting any appointment as a receiver and/or to continue business of the debtor company.

4.3 It is generally felt that an insolvency practitioner should not be personally liable for contracts entered into. As a matter of practice, an insolvency practitioner does not enter into contract with personal liability in these countries. From a commercial standpoint, it makes sense that an insolvency practitioner is a professional carrying out the management of an insolvent company for a fee. He does not take a commercial gain from the contract. Neither should he suffer a commercial loss (although he continues to be liable for tort of negligence). Because of these factors,

an insolvency practitioner should not be personally liable for contracts and that the statute should afford him such protection automatically. He therefore does not need to state it in each contract that he enters.

4.4 However, there are also views that if the receiver is not held to be personally liable this could deter third parties from dealing with the receiver. Retaining personal liability of a receiver and allowing the receiver to contract out of the personal liability ensure there is confidence in the market.

4.5 The United Kingdom legislation provides that although the receiver is personally liable, it is possible to contract out of this liability. The receiver is also entitled to be indemnified out of the assets of the company.[68]

4.6 Section 419 of the Australian Corporations Act 2001 is similar to section 183 of the Companies Act 1965. However, there are additional provisions to enable the court to grant relief for certain liabilities in circumstances where he has not been properly appointed.

RECOMMENDATION

4.7 The CLRC recommends:

(i) the receiver is to be personally liable for debts incurred by him or his authorised agent during his tenure of office, unless there is an specific agreement to the contrary between the contracting parties.

[68] See section 44(1) of the UK Insolvency Act 1986 in relation to administrative receiver and section 37(1) in relation to a receiver or manager appointed under powers contained in an instrument (other than an administrative receiver).

(ii) notwithstanding the above, the right of the receiver to be indemnified out of the assets of the debtor company should be retained. This is to be paid in priority to any charge or other security held by the person by or on whose behalf the receiver was appointed.

Questions for Consultation

Question 41:

In relation to a receiver's liability, which one of the following options do you agree to:

(a) that a receiver should be personally liable and any agreement stating otherwise should not be allowed?

(b) that a receiver should be personally liable unless otherwise stated by the debenture?

(c) that the receiver should not be personally liable unless otherwise provided in the debenture?

Question 42:

Do you agree that the receiver should be allowed to be indemnified out of the asset of the debtor company?

5. PRIORITY OF PAYMENTS

5.1 In the conduct of a receivership, the receiver or the R&M will incur costs and charge remuneration for his appointment. The debenture instrument pursuant to which the receiver or the R&M is appointed, usually specify that such costs and remuneration shall be paid out of the proceeds realised from assets charged under the debenture, including proceed from the continuing the business of the debtor company. These payments are made in priority to claims from all other creditors.

5.2 The net proceeds from the carrying of the debtor company's business and/or realisation of assets, after settlement of all receivership costs and remuneration, shall be applied for payments to preferential creditors in accordance to section 191 read with section 292 of the Companies Act 1965. Besides these creditors, the following Acts of Parliament contain provisions setting out competing priority of claims by creditors of the debtor company:

(a) Sections 52 and 70 of the Service Tax Act 1975;
(b) Section 10 of the Government Proceedings Act 1956;
(c) Section 2 of the Real Property Gain Tax Act 1976;
(d) Section 51 of the Employees Provident Funds Act; and
(e) Section 69 of the Sales Tax Act 1972.

5.3 Under the Companies Act 1965, priority of claims by creditors of a debtor company in receivership is set out in section 191, which is to be read with section 292. These debts owed to the preferential creditors specified under section 292 are to be paid out of floating assets of the debtor company. Over the years, provisions entitling priority of claims over the assets of the debtor company have been enacted subsequently in several Acts of Parliament. These competing claims have created confusion and led to numerous suits against and taken by the receiver or the R&M.

5.4 In the UK, Australia and New Zealand, priority claims of preferential creditors are contained in the Insolvency Act and sections of the Australian and New Zealand Corporations and Companies Acts dealing with insolvency provisions. No other Acts of Parliament take precedent over these provisions.

5.5 As mentioned earlier, the priority payments of receivership costs and remuneration of the receiver or the R&M are usually provided for in the debenture. Under section 292(1)(a) of the Companies Act 1965, priority is given to remuneration payable to the liquidator. Section 292(4) states that there are preferential debts that will be paid first out of the assets subject to a floating charge but it does not include cost and expenses of the liquidation.

5.6 The CLRC is of the view that priority of claims over assets of a debtor company in insolvency should be consolidated under the sections of the Companies Act 1985 dealing with insolvency matters. These provisions should take precedent over any other Acts of Parliament. This will avoid unnecessary confusion and resources to be deployed for legal direction/clarifications in the event of disputes and conflict. The CLRC is also of the view that the cost incurred by the receivership process should also be given priority.

RECOMMENDATION

5.7 The CLRC recommends:

(i) Priority of claims by creditors of a debtor company should be restricted to those provided for in the Companies Act 1985. Such provisions should take precedent over any other legislation or any conflicting provisions in other written law.

(ii) In line with (i) above, inclusion of the receivership costs and remuneration together with priority claims currently in the other acts of Parliament are to be considered in the Companies Act 1985.

Question for Consultation

Question 43:

Do you agree that the receiver's cost and remuneration should be given priority over all creditors?

Chapter 3

Company Charges And Registration Process - Improvements To The Present Registration System

CHAPTER 111 - COMPANY CHARGES AND REGISTRATION PROCESS - IMPROVEMENTS TO THE PRESENT REGISTRATION SYSTEM

EXECUTIVE SUMMARY

1. Introduction

The main purposes of the registration of a charge under the company law are to recognise a claim which otherwise would be voidable against a liquidator in the case where a company goes into liquidation and to serve as a centralised registration unit to enable third parties to make searches in respect of charges registered in relation to a particular company's asset.

This paper considers several aspects of company charges and the registration process with a view of reforming and/or restating the law.

2. Registration Process

2.1. Retention of the existing registration system

The CLRC recommends that the present registration system of charges should be retained as opposed to the introduction of a 'notice filing system' as it would be difficult recommending changes to the present system if the following issues have yet to be resolved:

(a) automating (e.g. e-filing) and reconciling the document flows in the registration system; and

(b) the coordination in the registration process involving company charged asset with other authorities (e.g. land office, patent office and shipping department).

2.2. Retention of the 30-day period of registration

Under the present system, a charge would have to be registered with the Registrar within 30 days of its creation; otherwise, an application to court for an extension of time under section 114 will have to be made. The CLRC noted that the 30-day period is adequate and should be retained. The CLRC further noted that any extension of the period of registration would only be required if the present system is inefficient or if there are a lot of applications to the courts for extension of time to register the charge under section 114.

2.4 Dual registration

There are several specialist registers in Malaysia such as, specialist registers under the Merchant Shipping Ordinance and Patent and Trademark Act, etc. It is noted that these specialised registers deal with the notification and registration of ownership of the assets and therefore serve a different purpose from the registration under the Companies Act 1965. Thus, registration under the Companies Act will not confer the same protection as provided for under the specialised registers. The CLRC, therefore, recommends retaining the existing system of dual registration of charges.

The CLRC noted that section 108(9) seems to create confusion as it implies that no other filing or registration under any other law, except in relation to land, will be required. The CLRC, therefore, suggests that section 108(9) be deleted.

2.5. Late registration

The CLRC recommends the retention of the requirement for a time limit of 30 days to register the charge.

3. Duty to Register Charges

Section 109 provides that the charge may be registered by 'the company concerned (chargor) or by any other person interested in the document'. One major concern is the possibility of the charge being registered by fraud or without the knowledge of the company. The CLRC noted that Form 34 which contains the particulars of a charge makes it a mandatory requirement that the form be signed by either the director or secretary of the company. This requirement will in a way eliminate the possibility of fraud. However, the CLRC also believed that the Registrar should not be burdened with the obligation of ascertaining the validity of the charge as this has never been the function and purpose of the registration of charge. Thus, the CLRC recommends that section 109 be retained.

4. Certificate of Registration

The certificate of registration of a charge issued by the Registrar is conclusive evidence for compliance of the requirement for registration. This is provided for in section 111(2) and conclusive evidence does not confer any validity as to the creation of such charge.

5. Types of Registrable Charges

The existing section 108(3)(a)-(k) provides a list of charges that must be registered under the Companies Act 1965 to ensure the charge is valid against the liquidator and to enable the chargee to rank as a secured creditor if the company goes into liquidation.

5.1. The CLRC agreed that a revision of the types of registrable charges must bear in mind the following:

(a) that the charge must be over a company's asset and that this statement should be included in the list of registrable charges; and

(b) the list of registrable charges must be general enough to cover new type of assets.

5.2. The CLRC noted that there are several practices in relation to charges that require clarification as to whether or not there is a charge created. These are -

(i) retention of title clause;

(ii) negative pledge;

(iii) automatic crystallisation clause; and

(iv) memorandum of security deposit.

5.3. The retention of title clause or the 'Romalpa clause' must comply with section 25 of the Sales of Goods Act in order for it to be validly created. Once created, it may be considered as a security in favour of the owner of the goods who has retained title to the goods. If the Romalpa clause creates a floating charge this is adequately provided for under section 108(3)(g).

5.4. A negative pledge is also known as a restrictive covenant and is commonly found in a document creating floating charges. The CLRC felt that a negative pledge should not be required to be registered as a registrable charge as it is not a charge over the asset of the company. It is merely a pledge that restricts or prohibits the creation of subsequent charges.

5.5. An automatic crystallisation clause merely serves as a notification that the charge may be crystallised automatically at the occurrence of a specific event (e.g. default payment) without the chargee having to serve notice to the company. Therefore, an automatic crystallisation clause is not a charge by itself.

5.6. A memorandum of security/fixed deposits is only evidence of acceptance of deposits and when they are used as securities, they fall within section 108(3)(k) of the Companies Act 1965. The creation of a fixed deposit is not a charge but the pledge is, therefore, any collateral involved must be registered.

5.7. The CLRC proposes to solicit views on whether section 108(3)(d) in relation to references to the Bill of Sales Act 1950 should be restated if not deleted.

6. Changes to the Registered Charge: Assignment or Variation of Charge

6.1. The CLRC proposes the retention of section 112A as it is an exhaustive procedure for an assignment of a charge in which the obligation is on the new holder of the charge to register the assignment to the Registrar and to notify the company within 30 days after he becomes the assignee of the charge.

6.2. The CLRC recommends no changes to the variation of charges provisions under section 112A(2) and (3) as they are adequate.

COMPANY CHARGES AND REGISTRATION PROCESS - IMPROVEMENTS TO THE PRESENT REGISTRATION SYSTEM

1 BACKGROUND

1.1. This chapter considers several aspects of company charges and the registration process with a view of improving the relevant law and procedures. The basis for the consultation paper is that there is still a need for the present registration system of company charges. However, the contents of this chapter focuses on the changes or improvements to the existing system that will be able to facilitate business, protect interest of stakeholders and reduce unnecessary business and compliance costs.

2 THE REGISTRATION PROCESS

2.1. The statutory provisions relating to registrable charges are provided under sections 108 to 119 of the Companies Act 1965. The purposes for the registration of a charge, amongst others, are to serve as a centralised registration unit to third parties needing to search for what charges have been registered in relation to a particular company's assets. This information is relevant to third parties to assess any encumbrances over the company's assets and may be useful in assisting third parties to decide whether or not to provide credit to a company. By requiring registration and penalising the concealment of secured credit, there will be less possibility of creditors and markets being misled by companies claiming ownership over assets which are in fact already encumbered in favour of prior creditors. It is also an incentive for creditors to provide debt capital to companies since registration ensures that the debt is secured and valid against the official liquidator.

2.2. Nonetheless, there are views that the present registration system is inadequate because it does not provide information to creditors to enable creditors to ascertain whether there are any existing encumbrances on the assets of the company until and unless the encumbrance has been registered. The present system for registration of charges requires that any of the registrable charges must be registered with the Registrar of Companies within 30 days of its creation.[69] Failure to do so means that the charge will be void as against the official liquidator and the creditor will rank as an unsecured creditor upon the liquidation of the company. However, when a charge is registered within 30 days of its creation, its priority as against other charges is determined by the date of its creation. Under the existing registration system, there is an information gap between the date of creation and the date of registration. However, it is the date of creation that is more relevant for creditors since it is this date that determines the priority as between the registered charges, provided the charge is registered.

2.3. The CLRC noted that the Steering Committee of the United Kingdom Company Law Review (UK CLR) recommended the introduction of a "notice-filing system" to resolve this shortcoming in the present system.[70] The Steering Committee of the UK CLR also recommended the creation of a single system for registering company charges and other "quasi-security" over property other than land to cover both company law and security over property other than land.

2.4. Nevertheless, the CLRC noted that any introduction to a new system such as a "notice-filing system" or the registration of other "quasi-security" cannot be resolved by reviewing the system relating to company charges only. The introduction of a

[69] Section 108 (1) states that "... there shall be lodged with the Registrar for registration within thirty days after the creation of the charge a statement of the prescribed particulars."
[70] The UK DTI consultation paper on Registration of Company Charges and the Final Report of the UK Company Law Review Steering Group Chapter 12 Registration of Company Charges.

notice-filing system would be difficult to implement if issues pertaining to automated (e.g. e-filing) and reconciliation of document flow and the coordination in the registration process of a company's charged asset with the various authorities (e.g. land office, patent office) is not resolved.

2.5. In addition, in a notice-filing system, there is a possibility that the charge may not be created subsequent to the advance filing of the notice. The present registration system is based on the fact that a charge has been created and is registered after its creation. A notice-filing system means that the charge need not be created before it is registered. The Steering Committee of the UK CLR suggested that a confirmation of a notice filed in advance should be lodged or if the charge is not subsequently created after the filing of the notice, a notice of cancellation. However, the CLRC is of the view that this will add on to the costs of business and may cause confusion especially if there is accidental omission in either confirming the notice filing or cancelling the notice filing.

2.6 The CLRC also compared this "30-day registration period" with other jurisdictions for example Australia, which provides for a 45-day period and UK which provides for a 21-day period. The CLRC is of the view that the present 30 day period is adequate judging from the rare application to court for an extension of time to register a charge. There is also no pressing need for shortening the registration period as in most cases the company or the creditor would register as soon as possible as it is in their best interest to expedite the registration.

2.7 The above discussion also has an impact on late registration of a charge. Where late registration is concerned, section 114 of the Companies Act 1965 allows an application to be made for extension of time to register. If the application for extension of time is granted, the charge would be validly registered as from the date

of creation. The Steering Committee of the UK CLR recommended that late registration be possible without an application to the court provided that at the time of registration no winding-up petition has been presented and no meeting has been convened to pass a resolution for a creditors' voluntary winding-up petition. In addition, in the event of late registration, the charge should be treated from then on as if it were registered within time, save that it should rank behind any prior registered charges. The CLRC recommends this approach.

Dual Registration

2.8 The CLRC also considered whether a dual registration system should be abolished. There are also views that charges over assets which are subject to an asset registry (such as land, ships, aircraft and certain types of intellectual property) should be excluded from the registration requirement under the Companies Act 1965. There are several specialist registers in Malaysia for instance, specialist registers under the Merchant Shipping Ordinance and Patent and Trademark Act, etc. It is noted that these specialist registers deal with the notification and registration of ownership of the assets and therefore serve different purposes from the registration under the Companies Act 1965. Therefore, the CLRC is of the view that dual-registration should be retained. This is because there is a difference in the nature of the registry. Under the Companies Act 1965 a charge is registered under the name of a company whilst other asset registries can only be searched by reference to the particular asset.

2.9 In view of the recommendation that dual registration should be retained, the CLRC is of the view that section 108(9) needs to be reviewed. Section 108(9) states that no charge or assignment to which this section applies (except a charge or assignment

[71] Company Law Review Steering Committee, Modern Company Law for a Competitive economy, Final Report, June 2001, Chapter 12 Registration of Company Charges at page 252.

over land) need be filed or registered under any other written law. Since the purpose of registration of a charge under the Companies Act and the registration of asset under other specialised registry is different, the CLRC is of the view that section 108(9) is confusing as it gives the impression that registration under the Companies Act is sufficient for the purpose of other specialised registry. The CLRC recommends that section 108(9) be deleted and that a statutory provision should be enacted stating that a failure to register a charge under any other law does not affect the validity, or limit the effect of the charge for the purpose of the Companies Act.

RECOMMENDATIONS

2.10. The CLRC recommends:

(i) that the present registration system of company charges be retained as opposed to the introduction of a 'notice-filing system'.

(ii) that the requirement for a charge to be registered within 30 days of the date of its creation be retained.

(iii) that the dual registration of charges be retained.

(iv) that the provision under section 108(9) of the Companies Act 1965 be deleted and that a new statutory provision should be enacted to state that a failure to register a charge under any other law does not affect the validity or limit the effect of the charge for the purpose of the Companies Act.

Questions for Consultation

Question 44:

Do you agree to retain the existing position that a charge which is registrable, once created and registered, gets priority from the date of its creation?

Question 45:

Do you agree to retain the requirement for a time limit of 30 days to register the charge?

Question 46:

Do you agree that section 108(9) of the Companies Act 1965 should be deleted?

Question 47

Do you agree that the requirement to register a charge in different registries i.e. under the Companies Act and other specialist registers be maintained?

3. DUTY TO REGISTER CHARGES

3.1. The existing provision in section 109 of the Companies Act 1965 states that the charge may be registered by "*the company concerned or by any person interested in the documents*..." However, the CLRC noted that the concern of a possibility that the charge being registered without the knowledge of the company.

3.2. The CLRC noted that the UK Company Law Review Steering Group Final Report[71] recommended that if the charge is being registered by other than the chargor then it must be verified that the chargor has consented to the charge. However, in practice in Malaysia this is resolved by providing in Form 34, a requirement that the company director's or secretary's signature is required. It is usually in the interest of the chargee to register the charge as failure to do so means the lost of priority *vis-à-vis* the official liquidator of the company. It is also in the interest of the chargor to give its consent to the charge since monies will normally not be disbursed until the chargee is certain that the debt is registered. The CLRC is of the view that there

will be no beneficial purpose in imposing a duty on the company to register a charge and that the current position balances the protection of creditors with that of the company. However, there are views that modification to Form 34 should be made by adding the words" the interested party" i.e. the chargee to enable the chargee to sign Form 34.

RECOMMENDATION

3.3 The CLRC recommends retaining the provision relating to duty to register charges under section 109 of the Companies Act 1965.

Question for Consultation

Question 48:

Do you agree that Form 34 should be modified to include the words 'the interested party' i.e. the chargee to enable the chargee to sign Form 34?

4 CERTIFICATE OF REGISTRATION

4.1. Section 111(2) of the Companies Act 1965 provides for a certificate of registration of charges to be issued by the Registrar and that the certificate is the conclusive evidence as to compliance of "the requirements as to registration". Section 111 is clear in terms of the certificate being evidence of compliance with the registration requirement only. The section does not mean that the charge is validly created. Case law provides that the section does not prevent any person from challenging the validity of the charge.[72]

[72] *Re Lin Securities (Pte)* [1988] 2 MLJ 137.
The Asiatic Enterprises (Pte) Ltd v United Overseas Union Bank Ltd [2000] 1 SLR 300 It was decided in both cases that the certificate of charge confers conclusiveness as to the fact that the charge has been duly registered but not to the validity of the charge, its extent or the property that its covers.

4.2. In practice, if there are any changes that should be made to the certificate, the Registrar will issue a new certificate in place of the former upon being satisfied that there were actually discrepancies in the certificate. Where the changes in the particulars are due to accidental omission or misstatement, the Court may order that the omission or misstatement be rectified under section 114 of the Companies Act 1965. Section 114 may be relied on to rectify Form 34 and does not affect the certificate issued by the Registrar.

4.3. The CLRC is also of the view that the Registrar should not be burdened with the obligation to ascertain the validity of the charge as this has never been the function and purpose of registration of charges. Since registration is effected by the company or any other person interested in the charge, registration by the Registrar should not be construed as the Registrar making any representation as to the validity of the charge or accuracy of the document. Registration gives security and priority *vis-à-vis* the official liquidator of the company and any person interested is always free to challenge the validity of the charge. However, because of the fact that the certificate is a conclusive evidence as to compliance of registration requirements, the CLRC is of the view that there should be a mechanism in place to reduce accidental omission or misstatement when the Registrar issues the certificate for example by the Registrar requiring that the instrument creating the charge be produced.

5. TYPES OF REGISTRABLE CHARGES

5.1 The existing section 108(3)(a)-(k) provides a list of the charges that must be registered under the Companies Act 1965. The registration will ensure that the charge is valid as against the official liquidator and that the chargee will rank as a secured creditor in the event the company goes into liquidation.

5.2. There are views that the list of registrable charges should be extended to include all security interests of a company. This will be in line with the rapid commercial development that shows the creation of new security interests and their usage in financing transactions. On this point, the UK CLR recommended specifying the types of obligations which are not registrable, making registrable charges over all other forms of obligations (i.e. whether or not financial and whether present or future), exempting only those specified.[73] The UK CLR proposal will mean that all other obligations except those stated in the list as non-registrable, will have to be registered. On the other hand, Australia has specified, in addition to a list of registrable charges, a list of obligations that is not required to be registered.

5.3. However, the CLRC is of the view that a revision of the registrable charges must bear in mind the following:

(a) that the charge must be over a company's asset; and

(b) the list of registrable charges must be general enough to cover new types of asset.

[73] Company Law Review Steering Committee, *Modern Company Law for a Competitive Economy, Final Report,* June 2001, Chapter 12 Registration of Company Charges at 265, para 12.60.

5.4. By retaining the present position, there is less compliance cost for companies and there will be significant reduction of impracticalities that would be faced if a company is required to register all obligations in view of the possibility of the registration covering a day-to-day business transaction of a company. The risk of listing the types of registrable charges is that it may cause problems when new types of asset are created and the list is construed as exhaustive. The CLRC is of the view that the important consideration is whether the list of registrable charges is sufficiently clear and is couched in sufficiently wide terms so as to cover any new types of securities over a company's assets.

5.5. The CLRC also noted that there are several practices that require clarification as to whether or not there is a charge created. These include the following:

(a) retention of title clause
(b) negative pledge
(c) automatic crystallisation clause

5.6. The retention of title clause (commonly known as the "Romalpa clause") reserves title of the goods supplied by the supplier to the buyer as a security until the price has been fully settled. The retention of title clause may create a charge, depending on the way the retention of title clause is drafted. If there is a charge created, it is usually either a charge over book debts of the company or a floating charge and sections 108(3) already provides for registration of a floating charge or book debts of the company. Thus, the CLRC is of the view that a mere retention of title clause should not be registrable because a charge may or may not be created.

5.7. A restrictive covenant is a contractual undertaking given by a company to its creditor that it will not create a charge over its assets without the consent of the creditor. A restrictive covenant may be found in a loan document or in a document creating a charge. If there is a charge created and the charge is registered as a floating charge under section 108(3), the restrictive covenant is useful to protect the interest of the creditor in whose favour it is given if a fixed charge is created subsequent to the floating charge. Under the common law, a charge over fixed assets which is created after a floating charge will be given priority if the fixed chargee has no notice of the restrictive covenant in the existing floating charge. The concern here is to ensure that there is notice of the restrictive covenant. The CLRC noted that notice is sufficiently provided in Form 34. The effect of Form 34 is that if the negative pledge is mentioned in Form 34 (particularly in item 7), this is a constructive notice for subsequent chargees. The CLRC did not find it necessary to amend the wordings in Item 7 of Form 34 in relation to notification as to whether or not the creation of subsequent charges "…is/is not restricted or prohibited". If the chargee has not included the fact that there is a negative pledge in relation to the charge in Form 34, there will be no constructive notice of the negative pledge.[74]

5.8. However the CLRC is made aware of a practice where the creditor does not require security other than a promise by the debtor that it will not create a charge over its assets without the consent of the creditor. The CLRC believes that this restrictive covenant on its own should not be registrable based on the underlying premise for registration of charges i.e. that the charge must be over an asset of the company. On its own, a negative pledge is not a charge over an asset or property of a company. It merely restricts or prohibits creation of subsequent charges.

[74] *UMBC v Aluminex (M) Sdn Bhd.* [1993] 3 MLJ 387.

5.9. The CLRC noted that there have been attempts at registering negative pledges as security. However, even if there have been successful registration of negative pledges, it does not mean that a charge is created and consequently as there is no charge, the Courts will not enforce this as a valid charge. Whether or not the charge is valid is not determined solely by registration under section 108 of the Companies Act 1965.

5.10. Similarly an automatic crystallisation clause does not by itself create a charge. It merely serves as a notification that the charge may be crystallised at the occurrence of specified events without the chargee having to serve a notice to the company. However, there are views that once a charge with an automatic crystallisation clause crystallises, notice of the crystallisation should be lodged with the Registrar. The rationale is to enable a prospective chargee to find out whether or not the charge has been crystallised when searching the registry.

5.11. The CLRC also considered whether it was possible to delete any reference to the Bills of Sales Act 1950 from section 108(3)(d) of the Companies Act 1965, the CLRC believes that the section is still relevant but would like to propose that the subsection be restated.

Question for Consultation

Question 49:

Which of the following options do you agree to:

(a) retaining the present position of stating that only those obligations specified as registrable charges should be registered?

(b) the company legislation should include, in addition to the present list of registrable charges, a list of obligations which are not required to be registered?

(c) the company legislation should specify a list of obligations stated as non-registrable and that all other obligations except those stated in the list as non-registrable, will have to be registered?

6. CHANGES TO THE REGISTERED CHARGE: ASSIGNMENT OR VARIATION OF THE CHARGE

6.1. A change to the registered charge may occur because of the assignment of the indebtedness by the chargee. The CLRC noted that section 112A of the Companies Act 1965 already provides for an exhaustive procedure when there is an assignment of the charge. In such cases, the obligation is on the new holder of the charge, within 30 days after he becomes the new holder of the charge, to lodge with the Registrar the fact that he has become the new holder and to notify the company. The CLRC believes that such a provision is adequate and thus, does not recommend any amendment.

6.2. Any variation of the charge in terms of increase in the amount of debt or if the charge prohibits or restricts creation of subsequent charges must be lodged with the Registrar within 30 days of variation. However, under section 112A(3) of the Companies Act 1965, if the increase is due to the debt being unspecified or specified with further advances, this is not a variation. The CLRC believes that this means that a variation by increase of the debt except if the increase is in line with section 112A(3) of the Companies Act 1965, would result in a new charge.

(1) Reviewing The Corporate Insolvency Regime - The Proposal For A Corporate Rehabilitation Framework;
(2) Reviewing The Company Receivership Process; And
(3) Company Charges And Registration Process - Improvements To The Present Registration System.

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