Corporate Rescue Procedures in Malaysia

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Abstract

The Malaysian legal system is characterized as a pluralistic system. Its laws and legal institutions reflect various stages of Malaysian history and include the laws of pre-colonial Malaysia, the laws and institutions imposed by Britain during its period of colonization, and the laws of independent Malaysia. The underlying philosophy of Malaysian insolvency law has been described as combining the elements of distributive, rehabilitative and penal philosophies. Insolvency law in Malaysia is governed by two main statutes: the Companies Act of 1965 ("the Act") and the Companies Winding-up Rules. Though the former functions as both a simplified restructuring scheme in the name of Scheme of Arrangement under Section 176 as well as the winding up of the companies, the latter relates purely to the rules related to winding up proceedings. Although they have gone through a number of amendments, both are antiquated statutes, which have sometimes proven to be inadequate in handling issues arising within the modern restructuring climate. The administration of restructuring cases became more pragmatically focused on achieving a plan or deal, often to the detriment of the legal rights of particular stakeholder groups. There is no other alternative other than the scheme of arrangement under Section 176 of the Act, and if the plan does not work out as anticipated, the winding up will begin. As a result, when companies are in financial distress in Malaysia, they most often end up in a winding up process which presages their dissolution rather than the initiation of a successful restructuring process. This article examines the existing restructuring procedures in Malaysia, both the formal and informal processes. Further the scope of the paper also includes analysis of the current legislation in Malaysia on the restructuring process. This is essential since the fundamental reason for carrying out corporate restructuring is to enhance the long term survival of corporation through greater efficiency and cost effectiveness. It also analyses the strength and weaknesses of the current system by further investigating the latest trends and the efficiency of insolvency procedures in Malaysia. A comparative study is also carried out by looking to the practice in other jurisdictions such as the United Kingdom and Australia. This research will be a significant endeavour in highlighting the need to reform the laws relating to restructuring of companies and corporate rescues procedures in Malaysia. By understanding the loopholes in the systems, this research can assist the regulatory authorities in implementing the best practice of restructuring process in Malaysia. In addition, this article would also benefit practitioners, academicians and other stakeholders affected by the restructuring process of the company and help them understand the need for insolvency reform in the corporate rescue process in Malaysia.

Keywords: corporate rescue, insolvency, restructuring, winding–up, creditors, scheme of arrangement

Ⅰ. An Overview of the Corporate Restructuring in Malaysia

The underlying philosophy of corporate insolvency law in Malaysia has been described as combining the elements of distributive, rehabilitative and penal philosophies.[1] The main objectives of such law are: (1) to provide rehabilitation where possible; (2) to ensure the preservation and ranking of secured creditors' rights and equal treatment of all other creditors where a company cannot be saved; and (3) to punish delinquent officers who have contributed to the insolvency. In the case of personal bankruptcy, upon their discharge the bankrupt is freed from all debts provable in bankruptcy and is also released from many civil liabilities attached to the bankrupt.

The predominant theoretical foundation for corporate insolvency is known as the *Creditors' Bargain Theory*.[2] One of the earliest and predominant attempts to rationalise this regime was made by Thomas Jackson in the early 1980's, he attempted to develop a model for shaping rules for creditor distributions, which he called 'the creditors' bargain'.[3] The Bargain model is supposedly based on the hypothetical agreement of those who would turn out to be creditors of an insolvent company. If these people could come together *ex ante*, before any lending has taken place, it is claimed they would agree to give up their freedom of action, should their debtor become insolvent. They would realise that in such a situation, independent action to enforce individual claims would be wasteful for

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1. Rabindra S. Nathan, *Insolvency Law Reforms: Report on Malaysia*, ASIAN DEV. BANK TECHNICAL ASSISTANCE, No. 5795 (1999).
2. Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L. J. 857 (1982).
3. Jackson asserted, "Bankruptcy law has, for too long, been moulded and interpreted without any systematic questioning or understanding of its normative role in a larger legal, economic, and social world. This Article asserts that not only is there a coherent normative theory justifying a bankruptcy system that deals with inter-creditor questions, but also that we would be better able to formulate and apply principled bankruptcy rules if we would give systematic and critical attention to the impact of those rules on non-bankruptcy entitlements." *Id*. at 907. However, Jackson and Scott later noted "the inherent incapacity of the legal system to specify ex ante rules for implementing ex post distributional principles." Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75(2) VA. L. REV. 155, 158 (1989).

all of them as a group. It might be, for example, that the debtor's assets are more valuable if sold together as a going concern, than if they were disposed of piecemeal.[4] Its basic premise was that there is a notional agreement amongst creditors, comprising terms that they themselves would consent to before any of them entered into contracts with the company. The terms of the agreement deal with how their claims should be treated in the event of the company's insolvency and creditors are then forced to share the company's remaining assets by the imposition of a collective and compulsory regime. The advantage of a collectivised debt collection regime is that it takes away the benefits of being the first creditor to claim and therefore avoids costly and duplicative monitoring of the company's solvency.[5] It also removes the wasteful and potentially inefficient liquidation of the company's assets by individual creditors. A key feature of the collective system is that it leads to administrative efficiencies at the time of liquidation. Many creditors are assumed to be risk averse, and to prefer to receive a more certain, lesser sum than a greater sum with high risks. The collective distribution regime upon liquidation aims to provide this, and allows for modification of pre-insolvency rights in favour of preferred creditors.

Insolvency law theory can therefore be seen to explain the three types of ex post legislative protection of creditors.[6] Creditor welfare maximisation is a powerful objective which underpins all three forms. In addition, deterring opportunistic behaviour upon approaching insolvency was also seen to be the aim of lifting the corporate veil to impose liability on directors. While contractarians generally support market mechanisms to protect against losses in the event of corporate insolvency, it was noted above that three forms of ex post legislative protection play an important role in safeguarding the entitlements of unsecured creditors.[7]

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4. Rizwaan J. Mokal, *The Authentic Consent Model: Contractarianism, Creditors' Bargain and Corporate Liquidation*, 21 Legal Stud. 400, 404 (2001).
5. If creditors knew their own ability to recover was based upon being the first to initiate action, they would each spend time and money monitoring the company's solvency. The costs of monitoring would be passed on to the company, making goods and services more expensive. This would affect the profitability of the enterprise or else the company would in turn pass these costs on to their own customers.
6. H. Anderson, *Theory and reality in insolvency law: Some Contradictions in Australia*, 27 Company & Sec. L. J. 506, 551 (2009).
7. Reinier R. Kraakman et al, The Anatomy of Corporate Law: A Comparative and Functional Approach 73 (1st ed., 2004).

In practice, however, insolvency law has been described as having a bias towards the interests of creditors, and it is also certain that Malaysia primarily has a creditor-focused system. Insolvency law in Malaysia is designed to help creditors to enforce their rights, recover their debts and protect their interests. However, there are indications of growing dissatisfaction with Malaysia's pro-creditor laws. In particular, there have been repeated calls for the introduction of an equivalent to the US Chapter 11 rescue procedures. Bankruptcy and Insolvency law in Malaysia has developed through the interaction and interdependence of case law that originated in England and Australia. Legislation dealing with personal bankruptcy consists of the Malaysian Bankruptcy Act of 1967 and the Bankruptcy Rules of 1969. These are both modelled after English bankruptcy law. Similarly, the Companies Act of 1965 which is the main corporate legislation in Malaysia ("the Act") is modelled after the English Companies Act of 1948 and the Australian Uniform Companies Act of 1961. Principles of common law that comprise English and Australian insolvency law are also reflected in the Malaysian insolvency regime. In view of this historical relationship, English and Australian judicial pronouncements on the interpretation of corporate legislation are still highly persuasive in interpreting Malaysian corporate law, even though there is increasing divergence in Australian and English judicial attitudes to corporate governance.[8]

The broad aims of Malaysian corporate insolvency law are similar to its Australian and English counterparts. The purposes and principles of insolvency law in many Western legal systems such as these and others include principles of equity like fairness, efficiency and impartiality.[9] The goals of Malaysian insolvency law are similar. They include the rehabilitation of debtors, fair and efficient distribution of debtors' assets to creditors, equality and impartiality of treatment of creditors, and the punishment of wrongdoers. The rehabilitative aim of the law is manifested in Section 176 of the Act, which deals with the schemes of arrangements and in the Pengurusan Danaharta Nasional Berhad Act of 1998. The 1998 Act states, *inter alia,* that its aim is to "assist the business sector by dealing expeditiously with financially distressed enterprises." Part X of the Act demonstrates a distributive philosophy especially in Sections 212 to 318, and in Division 4, which deals with priorities. Provisions of the Act also punish

8. Krishnan Arjunan & Low C. Keong, Lipton & Herzberg's Understanding Company Law in Malaysia (1995).

9. Roman Tomasic & Keturah Whitford, Australian Insolvency and Bankruptcy Law 4 (2nd ed., 1997).

wrongful trading and fraudulent trading, as well as non-compliance with the insolvency provisions.[10]

The Act provides two basic types of insolvency measures. Firstly, creditors have the ability to appoint a receiver and manager.[11] Secondly, an application may be made to court for winding up in three different ways: a members' voluntary winding up, a creditors' voluntary winding up, and a winding up by the court.[12] In addition, the possibility of using a scheme of arrangement for the restructuring of companies is provided.[13] Winding up of insolvent companies is not always the best option when all parties are concerned. The interest of the company, its creditors, shareholders and employees, as well as the larger interests of the community itself, may make the reorganization of the business preferably within the protection and control of corporate restructuring legislation. This is certainly true in cases where companies are essentially healthy and have honest, competent management, but face temporary cash flow problems by external factors[14].

The pre-1998 Malaysian insolvency and restructuring framework is contained in the Companies Act and the Companies (Winding Up) Rules of 1972. In response to the severe financial crisis that started in mid-1997, the Malaysian Government swiftly implemented several new measures to address the myriad challenges of the crisis. In mid-1998, the Government initiated the establishment of a new restructuring infrastructure headed by three agencies: Pengurusan Danaharta Nasional Berhad ("Danaharta")[15]an asset management company;

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10. Nathan, *supra* note 1. *See also* Aishah Bidin, *Perkembangan Undang-undang syarikat di Malaysia* [The Development of Company Law in Malaysia], *in* Aishah Bidin et al., *Companies Act*, vol. 5, ch. 1, Dewan Bahasa dan Pustaka [Institute of Language and Literature] (1st ed., 2007).

11. Companies Act 1965, pt. VIII (1965) (Malay.).

12. *Id*. pt. X.

13. Companies Act 1965, Part VII.

14. *See* Shereen Khan et al., *Recent Developments of Insolvency and Restructuring in Malaysia*, [2013] 7(14) AUST J. BASIC & APPL. SCI. 9 (Austl.) [hereinafter Insolvency and Restructuring Malaysia]; *See also*_Aishah Bidin, *Restructuring of large Companies–A Malaysian Perspective*, *in* REBECCA PERRY, TOO BIG TO FAIL–LARGE NATIONAL AND INTERNATIONAL FAILURES UNDER THE SPOTLIGHT, ch. 8 (INSOL Europe, 2013).

15. Pengurusan Danaharta Nasional Berhad ("Danaharta") was established by the Malaysian Government in June 1998 to address the problem of non-performing loans ("NPLs") plaguing the banking system during the Asian financial crisis. BANK NEGARA MALAYSIA ANNUAL REPORT 2000, http://w2.bnm.gov.my/index.php?ch=en_publication &

Danamodal Berhad ("Danamodal")[16] a bank recapitalization agency; and the Corporate Debt Restructuring Committee ("CDRC")[17] to accelerate restructuring of the banking and corporate sectors. Danaharta was set up by way of legislation to remove non-performing loans ("NPL") from the banking sector. However, Danaharta was officially dissolved on December 31, 2005.[18] A detailed discussion on Danaharta (as well as on CDRC, officially closed in August 20, 2002) follows below[19]. However, Danaharta resumed operation in 2009 and in May, 2013 finally announced[20] that it has ceased accepting new applications effective May 2, 2013. On the other hand, Danamodal was created as a special purpose company to recapitalize the banks. Danamodal was a special purpose vehicle ("SPV") in the form of a company set up by the government to recapitalize banks by injecting capital to assist financial distressed companies. This is the first time an SPV was introduced to the financial system, and such

pg=en_ ar&ac =4 (last visited Nov. 17, 2015).

16. Danamodal Nasional Berhad ("Danamodal") was established in August 1998 to recapitalise viable banking institutions. *Id*.

17. The CDRC was formed in July 1998 to provide a platform for both borrowers and creditors to workout feasible debt restructuring schemes without having to resort to legal proceedings. With a goal of restructuring of corporate debts, the CDRC was to provide the impetus for informal workouts between financial institutions and borrowers through compromise and consensus. *See* PAMELA HANRAHAN ET AL., COMMERCIAL APPLICATION OF COMPANY LAW IN MALAYSIA, ch. 21 (3rd ed., 2008).

18. *See* DANAHARTA FINAL REPORT 1998-2005, sec. A, http://www.prokhas.com.my/images/stories/final_report.pdf. On December 31, 2005, seven and a half years after its establishment, Danaharta ceased all operations and became a dormant company. Despite Danaharta's rigorous efforts to convert all the non-cash recovery assets into cash by December 31, 2005, some of them remained unconverted. Control of these assets, known as "residual recovery assets", were handed over to the Minister of Finance Incorporated as Danaharta's sole shareholder. A wholly-owned subsidiary of the Minister of Finance Incorporated, Prokhas Sdn. Bhd. ("Prokhas"), undertook the conversion. *See* HANRAHAN ET AL., *supra* note 17.

19. A press conference was held on August 15, 2002 to officiate the closure of the Corporate Debt Restructuring Committee ("CDRC"). *See* Release of the 2002 Bank Negara Malaysia Annual Report (Mar. 28, 2003), BANK NEGARA MALAYSIA, http://www.bnm.gov.my/?ch=en_press&pg=en_press_all&ac=633&lang=en (last visited June 30, 2008).

20. CDRC, http://www.cdrc.my/index.php (last visited May 26, 2013).

action was backed by the Government and the approval of Parliament. The establishment of such agencies expanded the avenues for debt resolution on behalf of distressed companies since restructuring could be carried out with or without formal legal sanctions.

As described below, formal restructuring is effected through the Scheme of Arrangement under the Act (commonly referred to as Section 176), together with the utilization of Receivers and Managers under common law and of Liquidators under Part Vii and/or Part X of the Act. Whereas the informal restructuring is effected through (i) the company voluntarily undertaking private negotiations, and (ii) the company voluntarily seeking the CDRC's assistance.[21]

Ⅱ. Recent Development of Laws Relating to Corporate Restructuring in Malaysia

The Companies Commission of Malaysia (CCM) took the initiative to review Malaysian corporate law under its Corporate Law Reform Programme (CLRP). To ensure that the reform programme was conducted effectively and objectively, the CCM established the Corporate Law Reform Committee (CLRC), which reviewed current law and practices relevant to corporate insolvency, including priority of debts, the winding up process, administrative and judicial receivership and corporate rescue mechanisms. The results of the review were to recommend the creation of a corporate insolvency framework that:

- Facilitates the winding up of companies where there is no prospect of the business becoming profitable and viable;
- Provides an efficient system to rehabilitate companies where appropriate;
- Ensures the protection of rights of creditors and members by providing enforcement mechanisms accessible without undue delay or difficulty;
- Ensures accountability of the persons involved in the process and transparency of the process itself. [22]

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21. Aishah Bidin et al., *Corporate Governance and Restructuring of SMEs in Malaysia*, *in* 22nd IBIMA Conference Proceeding, Nov. 13-14, 2013, p. 1.

22. Corporate Law Reform Committee ("CLRC"), Review of the Companies Act 1965 – Final Report 9 (2008), *available at* http://www.maicsa.org.my/download/technical/technical_clr_final_report.pdf.

The CLRC also recommended the reform and restatement of the law on company liquidation and the liquidation process. As a result, in 2007 ,Act 1299 of the original Companies Act 1965 was passed. However, none of the provisions in this amendment reflects on the formal restructuring of a company. The only proposal of any significance in insolvency law reform is the proposed judicial management provision. As for the Scheme of Arrangement under Section 176 of the Act, the CLRC recommended that:

(i) The scheme of arrangement should remain but only be used in connection with solvent companies;
(ii) The provision under Section 176 should revert to its pre-amendment form, i.e. before the 1998 amendment, with an emphasis on finality of the moratorium period. The moratorium period should be limited and the current practice of allowing for an extensions of the moratorium period should stop; and
(iii) The moratorium period should only apply to creditors and not against regulators.

To resolve the national insolvency issues, an Insolvency Draft Bill was drafted to consolidate existing legislation into a single statutory regime and to introduce new provisions to boost reform and enhance the insolvency process. At the same time, the Malaysia Department of Insolvency (MDI) undertook a project to clear the number of backlogged court cases and outstanding winding-up cases. Strenuous efforts are also continuously being made to simplify further the process of closing a business, including publication of a designated Asset Search Director to assist liquidators in tracing assets in connection with the liquidation process.

The latest Insolvency Draft Bill introduces the role of an Insolvency Practitioner (“IP”), an individual who is a member of any professional body that the Minister may prescribe by notification, which includes members of the Malaysian Bar, except for the Malaysian Institute of Certified Public Accountants (“MICPA”). The proposal to recognize MICPA as one of the prescribed professional bodies which an IP may qualify from is still under consideration. The main objective of the Draft Bill is to introduce judicial management and voluntary corporate arrangements such as corporate rescue mechanisms for the companies with financial difficulties, and to clarify provisions relating to schemes of arrangement. The Draft Bill also seeks to modernize the enforcement regime by introducing administrative sanctions as tools to compel compliance and to assist in the understanding of the legislative provisions and to address practice issues by providing guidelines and practice notes.

To recap, with respect to insolvency proceedings the proposed Insolvency Draft Bill emphasizes:

(1) Simplifying, refining and expediting the winding up process by shortening the time taken to wind up a company; and
(2) Modernising the insolvency law by introducing alternative corporate rescue mechanisms for companies whose businesses are still viable.

The significance of the Insolvency Draft Bill is that it envisions, among other things, the development of a modern, dynamic and relevant regulatory framework, the facilitation of the growth of interest schemes, a simplification of the relevant laws and of procedures to raise capital, and the enhancement of a governance framework. In addition, for the first time an introduction of judicial management; a tool which gained popularity in Singapore. However, inclusion of these reforms does not mean that the Insolvency Draft Bill is without weaknesses, thus, all of these proposed legislative remedies should be examined in detail.

For the time being, the CCM, in its regulatory role over corporate and business affairs in the country is overseeing a review of the Act to simplify the process of incorporating of companies in Malaysia. Many of these changes are significant, and the Consultative Council has done a laudible job in proposing a revamp of the entire insolvency law of Malaysia by incorporating more options to the restructuring process. The Insolvency Draft Bill is timely and it should be implemented soon to ensure that Malaysia's insolvency laws are on par with other international jurisdictions.

Ⅲ. Formal Restructuring

A. Scheme of Arrangement

When a company is in financial distress but its members and creditors believe that there is some advantage in the company continuing its business rather than taking the drastic step of winding up, a proposal for a "scheme of arrangement" may be made.[23]

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23. Companies Act 1965, *supra* note 11, §§ 176-81, enables the rights and liabilities of members and creditors of a company to be reorganised by a scheme of compromise or arrangement which complies with section 176.

In Malaysia, the use of the schemes to procure a compromise of debts owing to creditors came into prominence during the Asian financial crisis around 1997. A unique feature of the scheme of arrangement process is that a court order restraining creditors from commencing or continuing legal proceedings against the distressed company is obtainable while the proposal for compromise is being put together. This intends to promote an orderly settlement of the claims against the company instead of creditors rushing after the company's assets. On the other hand, after a restraining order ("RO") is obtained, the company is prohibited from acquiring or disposing of assets other than those disposed of during the ordinary course of business, unless the court orders otherwise. The underlying wisdom is that a higher return to creditors can be achieved via an orderly settlement of claims, where assets are protected, as compared to liquidation of the company.

A scheme of arrangement is essentially an "agreement" between the company and its creditors which may be used to vary existing rights and obligations. This may take place by settling claims of creditors at less than their full amount. Alternatively, a scheme of arrangement might defer creditors' claims by extending the due dates of debt obligations, with or without interest. This in effect would result in a deferment of the right of the creditors to insist on an immediate full payment. New obligations may be imposed on the company. These may include the forced disposal of valuable assets, implementation of a sale-and-leaseback arrangement, or other strategies to realise value from the company's existing structure. This procedure is utilised where it is impossible to get all creditors to agree to a settlement using a consistently applied formula. Its utility lies in its ability to bind dissenting minority creditors. To resolve the issue , the minority creditors who opposed the scheme are required to accept a lesser amount than the full debt owing in full in order to discharge of the debts owed to them by accepting the settlement Court intervention is required to ensure that the scheme proposed is bona fide.

As the first step of the process, it is necessary to apply to the court to seek an order to convene a meeting or meetings of creditors. Such meetings may similarly be requested where a composite arrangement is sought, i.e. an arrangement involving multiple distressed companies within a group, or where a single company owes different classes of creditors. It is not unusual to seek an order for several meetings in respect of each company or for several companies, within a group to consider their respective schemes. The discretion of the court to order such a meeting is provided by Section 176 of the Act. Without such court order, a company may not seek an approval of a scheme that will bind dissenting minority creditors. To proceed to the next stage of requesting the court's approval to the scheme, a majority in number and at least a 75% majority of the value owed to creditors must vote in favour of the company's proposed scheme.

Although the scheme mechanism allows dissenting minority creditors to be bound, schemes may not always be successful. In structuring a scheme, several fundamental considerations are necessary to bear in mind. First, a meaningful settlement consideration should be offered to the creditors. The consideration must be at least greater than what creditors stand to recover if the company is liquidated. Secondly, creditors must be grouped into correct classes. Creditors with dissimilar rights against the company should not be placed into the same class and asked to vote together. Thirdly, creditors with similar rights that are placed in the same class must be treated similarly. A consistent formula should be applied in proposing the compromise to them. The use of different settlement formulas for each creditor within the same class would be unfair. If the scheme is challenged when the approval is sought, the meetings may be found to be improperly convened. Lastly, the scheme must turn the company around and make it solvent again.

Ten years ago, an RO frequently could continue for a period in excess of 90 days. Applicants in the past abused the availability of ROs by seeking them without any real effort of a credible proposal for a scheme acceptable to creditors. Today, courts are less likely to grant ROs which are intended to continue for long periods unless the application is already firmly supported by a majority of creditors. The preferred approach today is to grant ROs of shorter duration and then have the company return to seek extensions. This way, the company's progress in putting together the scheme can be monitored. If there are significant, well-founded objections by creditors to the merits of a potential scheme, the court may discharge the RO and allow the winding-up actions that are pending to proceed. The workability of a scheme is becoming an increasingly common question. Previously, it was not uncommon for scheme advisors to suggest a rights issue simply to raise funds to be used to settle the claims of creditors, with little remaining for use as working capital for the company. Although some schemes were approved on the assumption that a single rights issue would successfully raise requisite funds, the Malaysian experience appears that companies have to "come back" for multiple rounds to attempt new schemes. Sometimes, the rights issue does not take off or too little working capital is raised. Increasingly, major creditors require the appointment of an independent financial adviser to study the feasibility of the proposed scheme and present a report to the majority of creditors before the company calls a meeting of creditors, or to require that the company make changes to the scheme before formally proposing it.

The administration of restructuring cases has become more pragmatically focused on achieving a plan or deal, often to the detriment of the legal rights of particular stakeholder groups. There is no other alternative to the scheme of arrangement under Section 176 of the Act; if such arrangement does not work out, a winding up will commence. However, because more companies are trying to revive or introduce turn-around plans, more options with structured and organized restructuring processes should be introduced to the existing system.[24] Unsurprisingly, companies in distress are taking cover under Section 176 of the Act; using the stay of proceedings available under Section 176(10) allows them to take refuge from creditors.[25] A scheme of compromise or arrangement with creditors commonly takes one of the two forms: either a moratorium scheme of arrangement, or a compromise scheme.[26] The first judicial stage in a compromise or arrangement is an application pursuant to Section 176(1) to the High Court ordering that meetings of the company's creditors and, separately, of its members be called for the purpose of voting on the scheme. If different classes of creditors or members exist, then the class meetings should be convened. Proponents of a scheme should carefully and accurately classify the company's creditors and members, because improper classification may result in the court's disapproval under Section 176(4) of the Act.[27]

Section 176 allows the restructuring to proceed under the court's supervision, with the decisions of the majority of creditors binding the minority; this section also gives some assurances against the destruction of a viable business by unreasonable creditors. In cases where restructuring is not the desired objective, Part X of the Act provides creditors instead to choose a wind-up a distressed company.

A 'moratorium' is a type of scheme characterized by deferment of payment of certain debts for a specific period of time. During a moratorium, the company's affairs are run by a scheme administrator or manager appointed by the creditors. Although the directors of the company remain in office, their functions are taken

24. Shereen Khan et al., *supra* note 14.

25. Mohamad Illiayas, *Scheme of Arrangement under s.176 of the Companies Act 1965: The Criticalness of Correct Classification of Creditors and the lot of providers of Islamic Credit*, 1 MALAY. L. J. 47, 50 (1999).

26. Roman Tomasic, *Insolvency law reform in Asia and emerging global insolvency norms*, 15 INSOLVENCY L. J. 229, 235 (2007).

27. Re Butterworth Prods. & Industries Sdn Bhd., 1 MALAY. L. J. 429 (1992) (High Ct.); Re Albert Life Assurance Co. [1871] 6 Ch. App. 381, 386; Re Midland Coal, Coke and Iron Co. [1895] 1 Ch. 267.

over by a scheme administrator who exercises broadly defined powers including sale of the company's business, and in some cases, sale of the members' shares. Usually a provision is made for the appointment of an advisory committee to supervise the work of the administrator. Typically, the committee consists of both creditor and member representatives, with the creditor representatives speaking for the majority.[28] Another type of scheme is a compromise scheme in which creditors agree to accept payment of less than the amounts they are owed in full satisfaction of their debts. On the payment of the compromised amount, the creditors release the company from further obligation, permitting it to continue with business. In other compromise schemes, the creditors may agree to convert their debts into shares in the company, thereby releasing the company from its debt obligations.

Another type of scheme involves a reorganisation of the rights and liabilities of members, including a reorganisation of the share capital of a company by a consolidation of different classes of shares namely by the division of shares into different classes, or both. In some schemes, the assets of one company controlled by the shareholders are transferred to another company under the control of the same shareholders. This may involve a reconstruction of the company, where the reconstruction shares in the original company are cancelled and shares of varying classes in the new company are issued. Nevertheless, there are other schemes allowed under the legislation that involve amalgamation or a takeover of a company.

The scheme of arrangement provides a framework for an indebted company and its creditors to develop a workable solution agreeable to both the debtor and its creditors; the High Court is usually willing to grant a RO for the company to continue as a going concern, without worrying about legal disputes. In essence, Section 176 grants a distressed company some time to attempt a restructuring from the leave granted by the court.[29] Section 176 of the Act offers a company broad power to compromise with creditors and its members. It provides a statutory mechanism by which creditors are allowed to voice about a proposed scheme of arrangement via creditors' meetings; with the scheme, if approved by the court, being binding upon dissenting creditors.[30] Section 176 (1) of the Act also allows a liquidator to initiate a scheme of arrangement in connection with the company being wound up. By such, companies heavily burdened with debt

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28. Tomasic, *supra* note 26, at 237.
29. Aishah Bidin, *Insolvency and corporate rescues in Malaysia*, 15 INT'L COMMERCIAL AND COMPANY L. REV. 334 (2004).
30. Re Hellenic & General Trust Ltd., [1975] 3 All E.R. 382 (U.K.).

may be viable if they are able to persuade that it is in the creditor's interest to accept a compromise of debt. With such compromise instead of enforcing their debts or winding up the company, the creditors will accept less than the full amount in final satisfaction. However, this approach is not as simple as it may appear. Some creditors may not agree to the compromise and be interested in enforcing their debts in full. If that happens, then Section 176 of the Act would be triggered.[31]

However, a scheme of arrangement is not an ordinary contract, but a statutory one. By Section 210(3) of the Act the Parliament has made an exception to the normal contractual requirement of consideration (i.e. that to be bound a party must have *bargained for* some exchange), instead it mandated that as long as the requisite statutory majority of creditors agree to be bound by a scheme of arrangement (and themselves receive the specified consideration in exchange), *all* creditors will be bound by that scheme, even those who did not so agree or receive consideration. In *Oriental Insurance Co Ltd, The v Reliance National Asia Re Pte Ltd.,* it was held, *inter alia,* that the purpose of Section 210 of the Act was to overcome "the impossibility or impracticability of obtaining the individual consent of every member of the class intended to be bound by the scheme of arrangement."[32] Hence as long as the party is a "creditor" within the meaning of Section 210 of the Act, they are bound by the terms of the scheme.

However, the scheme of arrangement and reconstruction under Section 176 are not limited to companies under financial distress. The scheme of arrangement may also be utilised for solvent restructurings, giving healthy companies the ability to also invoke the section to embark on any scheme of arrangementand restructuring, including mergers and acquisitions, de-mergers, management buyouts, downsizing, and other external growth strategies.[33] However, in reality,

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31. Dato' Haji Abdul Malik, *Summons for Directions and other related issues together with case management – A Synopsis*, 3 Malay. L. J. 88 (2004).
32. Oriental Insur. Co. Ltd. v. Reliance Nat'l Asia Re Pte Ltd., 3 Sing. L. Rep. 121, 132 (2008) (Sing.).
33. In the case of Lingui Developments Berhad, the company applied for privatisation by way of a members' scheme of arrangement and a majority of Scheme Shareholders representing 92.27% of the total nominal value approved. The company then requested a sanction from the High Court under Section 176. This shows that Section176 can be used for privatisation purposes. Julia Yap, *Scheme Shareholders approved scheme to privatise Lingui Developments Berhad*, Lingui Devs. Berhad, Jan. 10, 2013, http://www.lingui.com.my/mediaReleases/Scheme_Shareholders_approved_scheme_to_privatise_Lingui_Developments_Berhad_10Jan2013.pdf.

even though the section is not intended specifically as a corporate rescue mechanism, it is usually invoked by companies under financial distress.

In response to constant criticism from industry, in 1998 the legislature amended Section 176 of the Act to better protect creditors by ensuring a more transparent process.[34] Here, a company may obtain a RO, and thus creating stricter time periods for extension of the RO and preventing the company from disposing of its assets during the period that the RO is in effect.[35]

For several reasons, the scheme under Section 176 is still seen as very costly, cumbersome, and slow in its procedures and implementation, especially for corporate rehabilitation or rescue purposes. First, it is subject to delays within the court system. For example, the company must properly identify and divide the creditors into separate classes, and it risks the court's refusal to approve a scheme if the court does not consider the creditors properly classified. Furthermore, creditors are restrained from enforcing their security for an unduly long period due to the existence of a RO of up to 90-days, where the court may extend the RO if the company has fulfilled the requirements under Section 176(10A) of the Act. Additionally, the company lacks real protection as well because the stay is effective only from the date of the commencement of the the notice of the proposed compromise, as opposed to the more effective duration namely during the development of the proposal.[36]

About forty companies applied for restraining order (RO) under Section 176 in the period up to December 1998.[37] As court protection under this Section allows the moratorium period for the companies that applied, many criticisms of the process surfaced, mostly regarding the ease with which a company could secure a RO against its creditors. Also it was criticized that most of the applications were done *ex parte*, resulting in court orders made without the knowledge or consent of the creditors. In addition, the waiting period for RO approvals were very long, since the court usually granted applications for their extension. And

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http://www.lingui.com.my/mediaReleases/Scheme_Shareholders_approved_scheme_to_privatise_Lingui_Developments_Berhad_10Jan2013.pdf assessed (5 Jan 2013).

34. Companies (Amendment) Act (No.2), A1043 (1998) (Malay.).

35. Bidin, *supra* note 29, at 343.

36. *Id*. at 345.

37. Ramasamy Thillainathan, *Corporate Governance and Restructuring in Malaysia: A Review of Markets, Mechanisms, Agents and the Legal Infrastructure*, *in* OECD, Corporate Governance Corporate Governance in Asia: A Comparative Perspective 275, 282 (2001), *available at* https://bvc.cgu.gov.br/bitstream/123456789/3586/1/corporate_ governance_in_asia.pdf.

the court often granted such orders without strictly undertaking from the applicant companies not to transfer or dispose of their assets[38].

In Section 176, there were a number of other weaknesses: lack of transparency, loss of confidence and distrust of current management, and doubts as to the credibility or viability of any scheme put forward by a given company were reiterating issues. Only a conceptual scheme was in place before a RO was granted, and creditors were not consulted about the scheme before they were served with the RO. Secured creditors' rights and security were prejudiced, as companies were able to dispose of their assets during the period of RO. These weaknesses, and the government's subsequent decision to amend certain provisions, show that the previous Section 176 process was open to wide interpretation and not well understood. Thus, in November 1998, Section 176 was amended to make the process of securing a RO more transparent. It now requires that the proposal be supported by at least 50 percent of creditors.[39] Since its amendment, the popularity of the Section 176 route has decreased considerably among companies.

However, the spate of Section 176 applications seeking court protection in the first half of 2014 coupled with actions by financial institutions to initiate insolvency proceedings has unveiled the existence of several shortcomings in the current insolvency legislation. Specifically, the current legislation does not provide the range of solutions required to preserve value for affected stakeholders, especially in complex, multi-lender situations. For the most part, the usual receivership and liquidation administration do not differentiate between businesses that are viable and those that are not; thus very frequently resulting in the inevitable demise of affected companies. The distress for many companies is often simply related to existing financing, if resolved, significantly improves their prospects and viability.[40] Also, Malaysia does not have a formal system yet that is comparable to Singapore's 'judicial management,' Australia's 'official management,' or Chapter 11 of the Bankruptcy Act in the United States; whereby further alternatives can be offered in attempt to nurse back to health a company presently unable to pay its debts.[41] Hence, a more balanced approach to address corporate financial distress

38. Bidin, *supra* note 29, at 344.

39. The other requirements are as follows: A Statement of Affairs made up to a date not more than three days before application for RO and the appointment of a director nominated by a majority of the creditors. *See Id.*

40. Philip T.N. Koh, *Country Report for Malaysia*, *in* OECD, Insolvency Systems in Asia: An Efficiency Perspective 230, 233 (2001), http://www.oecd.org/corporate/ca/corporategovernanceprinciples/45747128.pdf.

is needed for restructuring distressed companies.

Although there is no strict rule for the classification of creditors, for a scheme to be fair and just, it should not prefer one creditor within the same class over another. In the United Kingdom, pursuant to the Practice Statement 2002,[42] all judges are encouraged to deal with classification from the outset. In the Malaysian case *Twenty First Century Oils Sdn Bhd v. Bank of Commerce (M) Bhd*, the court pointed out that if a creditor has more than 25% shares in a class, the creditor will effectively have a negative veto right.[43] The Court further called for enhanced disclosure rules for transparency and clarity of management, especially with regard to the valuation of assets and on the possibility of the allegations of the existence "woodwork creditors" against the company by other creditors, i.e. a creditor that _remain by name but no appropriate disclosure was made.

From the Regulators' point of view, this poses a concern, namely the practical difficulties in interpreting the word "proceedings" in the context of a RO that is frequently sought in connection with a scheme.[44] Also there is the question of whether it extends to their inability to pose questions to enforcement proceedings undertaken by regulators. Typically, such orders simply echo the words of Section 176(10) of the Act. The current trend is to let the court interpret the word in the statute on a case-to-case basis. Since lack of clarity resulting from the section has caused a lot of intervening proceedings, increased the costs, and caused inconvenience to the Regulator in the performance of an essentially public function, the parties should be obligated to list all anticipated proceedings

41. Siti Naaishah Hambali & Hasani Mohd Ali, *The Role of Pengurusan Danaharta Nasional Berhad in Corporate Restructuring*, 4 Current L. J. 1, p. iThii (2000).

42. Statement of Insolvency Practice (SIP) is one of a series of guidance notes issued to licensed insolvency practitioners in the U.K. The guidelines were issued under procedures agreed between the insolvency regulatory authorities acting through the Joint Insolvency Committee (JIC), produced by the Association of Business Recovery Professionals, and approved by the JIC and adopted by the regulatory authorities. *See* Legal Services Act: New forms of practice and regulation – Consultation paper 10, Apr. 25, 2008, Solicitors Regulation Authority, http://www.sra.org.uk/documents/sra/consultations/799.pdf.

43. Twenty First Century Oils Sdn Bhd. v. Bank of Commerce (M) Bhd. & Ors. (No. 2), 2 Malay. L. J. 353, 355 (1993) (High Ct.).

44. Regulators in this context refers to the regulatory authorities namely the Companies Commission of Malaysia ("CCM") and the Insolvency Department of the Prime Ministers Department.

to allow greater clarity and more full disclosure in connection with the order.

In *Metroplex Bhd. & Ors v. Morgan Stanley Emerging Markets Inc. & Ors; RHB Sakura Merchant Bankers Bhd. & Ors (Interveners*),[45] Justice Vincent Ng stated that Section 176(10A) not only provides that a RO may only be granted if a proposed scheme of compromise involves creditors representing at least one-half in value of all the creditors, it may only be extended for a longer period "'if and only if' there is a 'good reason' to do so." Courts have construed phrase 'good reason' to mean: (i) a *bona fide* scheme of arrangement presented with sufficient detail to enable the creditors to make informed decisions as to its feasibility and merits;[46] (ii) the scheme of arrangement presented must not be bound to fail;[47] and (iii) the interest of creditors which were the beneficiaries of the proposed arrangement was safeguarded.[48] Meanwhile, a 'good reason' exists when the applicant's exhibits *bona fide* conduct to achieve a feasible and detailed scheme of arrangement to the general body of creditors.[49] Section 176(10A)(a) does not require that more than 50% of creditors to approve a proposed scheme of arrangement. Such approval was only required during the creditors' meeting under Section 176(3) of the Act, but not at the stage of asking for an extension of the RO under Section 176(10A). The applicant required only to show that the proposed scheme involved over 50% of all its creditors.

First, the proposed scheme must be approved by the relevant authorities, including the Securities Commission, before being put for the creditors meeting. The scheme should take care of all of applicant's creditors, whether secured or unsecured, and irrespective of whether they were subsidiaries of the applicant or not. All unsecured creditors must be treated equally if the scheme is approved. If the court is satisfied that 'good reasons' exist for an extension and the opposing creditors have failed to cast sufficient doubt on such 'good reasons,' then court will overrule the opposition and approve the application for an extension of the RO.[50]

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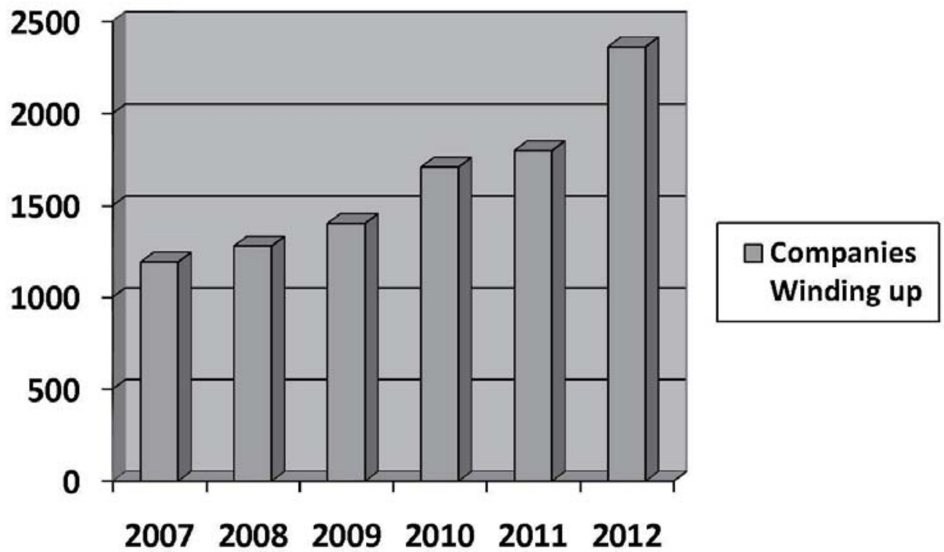
45. Metroplex Bhd. & Ors. v. Morgan Stanley Emerging Markets, Inc. & Ors.; RHB Sakura Merchant Bankers Bhd. & Ors. (Interveners), 6 Malay. L. J. 487, 490 (2005) (High Ct.).
46. Re Kuala Lumpur Indus. Bhd. & Ors, 2 Malay. L. J. 180, 183 (1990) (High Ct.).
47. Twenty First Century Oils, *supra* note 43, at 354.
48. Sri Hartamas Dev. Sdn Bhd. v. MBF Finance Bhd., 2 Malay. L. J. 31, 35 (1990) (High Ct.).
49. Re Kai Peng Bhd., 8 Malay. L. J. 122, 123 (2007) (High Ct.).
50. *Id*. at 128.

Section 176(10A) contains peculiar and unusually strong wording in which stipulates that the 90-day period may be extended for 'such longer period...for good reason if and only if' conditions (a) to (d) are satisfied. The new Section 176(10A)(a) continues to mandate, *inter alia*, application of the phrase 'if and only if' in connection with obtaining the required consent of at least one-half of the represented value of all of the company's creditors and a re-certification of compliance with the condition imposed by (10A)(c) before the court may exercise its discretion to extend the RO. Furthermore, for extension, the court has to be satisfied that the other conditions in sub-s (10A) are also met and there is reasonable progress towards the achievement of a viable and feasible creditors' scheme of arrangement. Thus, all the provisions of Section 176(10) of the Act must be met before the grant of any extension of a RO. A restraining order may only be extended for such longer period for 'good reasons' and 'if and only if' conditions (a) to (d) of Section 176(10A) were satisfied. This has resulted in reasonable progress toward achievement of a viable and feasible creditors' scheme of arrangement.[51]



Number of Companies wound up from 2007 to 2012 Source: Malaysia Insolvency Department (MDI)[52]

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51. Metroplex Bhd. & Ors., *supra* note 45.
52. Liquidation Statistics, INSOLVENCY DEPT. MALAY., http://www.insolvensi.gov.my/about-us/resources/statistics/liquidation/245-liquidation-statistics (last visited Jan. 25, 2014).

Based on the data from the CCM, there are 305 companies that had filed a RO with the CCM from 2005 to March 2013.[53] This number is comparatively very small since the number of companies filing for liquidation every year is more than triple that number. These companies were wound up either by voluntary liquidation or a compulsory winding up process. Although it is uncertain if any of these companies could have otherwise restructured and be saved from the wound up; recently the number has clearly increased, and there should be a change of law to tackle this issue.

In summary, greater transparency and clarity about the process to obtain a RO is needed so that courts can reach better informed decisions in granting them. Inconsistency remains when the granting of extensions of ROs; some courts leniently extending them while on other courts not allowing them. Recently in *PECD Bhd (in liquidation) v. Amtrustee Bhd*, the application for a 30-day extension of an RO was rejected by the High Court, and also the application was dismissed by the Court of Appeals.[54] However, there was no explanation about the rejection of application. In another recent case, *Johan Shipping Sdn Bhd (in liquidation) v. Public Bank Bhd*, the court extended the RO twice, but achieved no positive result in the case because no scheme of arrangement or restructuring was ever agreed upon by the companies and their creditors.[55] Unfortunately, in neither case the court provided its rationale for rejecting or allowing the extension RO. Hence, clear guidelines are necessary to ensure consistency in the extension of ROs and that there has been no abuse of the process to obtaining them.

In relation to ROs, CLRC recommended that any extension of the 90-day moratorium should only be for a maximum of one year.[56] CLRC noted that Section 176 of the Act has been used as a delaying mechanism by companies to frustrate the enforcement by creditors of judgments on debts. Further, CLRC recommended that a RO should not be allowed to restrict securities market regulators to prevent them from commencing actions in connection with their enforcement of the law or guidelines governing securities or other corporate law. Moreover, CLRC stated that requiring the appointment of a qualified insolvency

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53. Interview with Sohinah Mohd Zain, Marketing and Business Development Division, CCM (Mar. 4, 2013).
54. PECD Bhd. (in liquidation) v. Amtrustee Bhd., 1 MALAY. L. J. 91, 92 (2014) (Fed. Ct.).
55. Johan Shipping Sdn Bhd. (in liquidation) v. Pub. Bank Bhd., 9 MALAY. L. J. 473, 478 (2013) (C.A.).
56. CLRC Final Report, *supra* note 22, at 81.

practitioner to assess the viability of a scheme of arrangement between a company and its creditors.

B. Reduction of Share Capital

A reduction of share capital can be employed for a myriad of purposes. Broadly, a capital reduction can simply require book entries only, or it may go so far as to result in a distribution of assets. A formal restructuring process can be done by removing the losses by way of a capital reduction under Section 67, which requires a majority of 75% in the value of shareholders' approval. However, this is not time sensitive enough to cope with changing market conditions. Meanwhile, a distribution of all the assets of a company is more common when a company has disposed of its entire business. This is considered to be merely a distribution of capital and not income, thereby resulting in any profit from disposal of the business being classified as a gain and not income that would be subject to payment of income tax. Where a distribution of proceeds from the sale of the entire business to the shareholders is sought, the most important interest to take into account is that of creditors.

In *Lim King Kow v. Indra Kemajuan Sdn Bhd & Ors*, a dispute erupted between the creditors and the shareholders, and a reduction of share capital seemed the most appropriate solution to the problem.[57] The court stated that reduction of share capital would kill two birds with one stone, allowing the majority to continue with the company, and the minority to be free of the troubling matters that gave rise to their complaint. At the hearing of an application under Section 64(3) of the Act, the primary concern of the court was to ensure that any interests of the creditors are not prejudiced. In such situation the author is of the view that the court ought to make an order for dispensation, if there are no creditors, by taking into account various factors which include : the size of the company's assets, the amount owed to the creditors is minimal, or where the company is willing to set aside the amount claimed.[58]

In *Ex parte Westburn Sugar Refineries, Ltd.,* Justice Lord Reid stated that it is the duty of a court to consider the interests of creditors first, followed by the interests of shareholders, and, lastly, the public interest.[59] In exercising its

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57. Lim King Kow v. Indra Kemajuan Sdn Bhd. & Ors., 8 MALAY. L. J. 831, 832 (2010) (High Ct.).
58. MTD Intraperdana Bhd. (formerly known as Dewina Bhd.), 1 MALAY. L. J. 162, 165 (2004) (C.A.).
59. Ex parte Westburn Sugar Refineries, Ltd., [1951] A.C. 625 (H.L.) 629.

discretion, the court must always strive to see that the reduction is fair and equitable. In *British and American Trustee and Finance Corp. v. Couper*, the court remarked that no scheme ought to be confirmed unless it was satisfied that the scheme would not work unjustly or inequitably, though it seems odd for a court to deeply concern about the motive for the reduction, since it appears to be of little significance.[60]

Distribution of payment to shareholders is only possible if there is sufficient cash and cash equivalents exist to discharge the claims of all creditors. In the established order, shareholders must take after creditors. Sometimes, a disposal of the entire business may result in a capital loss to the company. Interestingly, a capital reduction that results in cancellation of all a few shares may result in the remaining issued shares becoming largely unrepresented by assets. Thus, leaving some shares outstanding may be useful if a company with large number of shareholders is a listed on an exchange and the company has identified an interested party wishing to inject assets into the listed shell. The company could then invite the remaining shareholders of the listed shares to participate in a rights issue to raise working capital for the company, which can then undertake a new business. This may be a win-win situation for both existing shareholders and the new investor.

To effectuate, or "vest," a proposed compromise or arrangement for the purpose connected with a scheme for the reconstruction of one or more companies, or the amalgamation of any two or more companies, the parties may seek a court order to transfer the whole or part of the undertaking or the property of one or more scheme companies to another company. This type of order is known as a "vesting order," which when ordered by a court at the behest of the parties is a particularly useful and efficient tool. It is also applicable where the transfer of numerous assets is sought because the vesting order eviscerates the need to effectuate such transfer via numerous, even hundreds, of instruments transferring title. However, there are limits to what may be transferred using this approach.

The current Section 64 of the Act only allows a company to reduce its capital if it has obtained the shareholder approval via a special resolution, and confirmed by the court. CLRC recommends retention of this procedure.[61] The committee goes on even further by recommending an alternative capital reduction procedure based on the company's ability to pass the solvency test and obtain shareholders' approval. The solvency test requires a determination and a statement of solvency by the directors of whether the company satisfies the requirements of the test. In

60. British & Am. Trustee and Fin. Corp. v. Couper, [1894] A.C. 399 (H.L.) 406.

61. CLRC Final Report, *supra* note 22, at 150 (Recommendation 3.8).

such case, no court confirmation would be required. Nevertheless, due to the need to satisfy the solvency test, reduction of capital would no longer be available as the means to restructure a company when it is having significant financial problems.

Ⅳ. Other forms of external administration of corporate rescues mechanism: Procedures under the Pengurusan Danaharta Nasional Berhad Act 1998.

In January 1998, the Malaysian Government established the National Economic Action Council ("NEAC") as a consultative body to the Cabinet, to guide the country out of the ensuing financial crisis. Its primary objectives were to deal with the economic problems confronting the country and to revive the economy. Through the NERP, the Malaysian Government instituted both short-term and long-term measures to deal with the contagion effect of the Asian economic crisis.[62] This led to the establishment of Pengurusan Danaharta Nasional Berhad ("Danaharta") in June 1998 and Danamodal Nasional Berhad ("Danamodal") in August 1998.

The Danaharta was established via a "special administration" process allowed under the *Pengurusan Danaharta Nasional Berhad* Act of 1998 ("the Danaharta Act"), the legislature established an asset management company to remove non-performing loans ("NPL") exceeding RM5 million from the banking sector. Incorporated under Section 3 of the Danaharta Act as an asset management company, Danaharta was given power to acquire, manage, finance and dispose of assets and liabilities that belonged to financially distressed companies; where assets and liabilities had been charged, pledged or otherwise encumbered.

In addition, the preamble to the Danaharta Act makes clear that the act was enacted to provide for the appointment of special administrators with powers to

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62. The National Economic Recovery Plan (NERP) is a National Plan implemented by the Malaysian Government to address the national economic crisis in 1997. It was one of the key findings formulation of the National Economic Action Council (NEAC) which was established on 7th January 1998, a consultative body to the Malaysian Cabinet to deal with economic problems and situation of financial crisis. The purpose of the NEAC is to make recommendations to the Government on how to restore the economy and prevent it from going into a recession. The NERP document presents six strategic areas for action to address the crisis and its pervasive negative effects on the Malaysian economy and people that was brought about by the ringgit depreciation and the collapse of the stock market.

administer and manage persons whose assets or liabilities were acquired by Danaharta; where Danaharta acts as an asset management company, as well as for matters connected therewith or incidental thereto.

The legislation requires Danaharta to act in public interest to (1) assist financial institutions by removing impaired assets, (2) assist the business sector by dealing expeditiously with financially distressed enterprises, and (3) promote the revitalisation of the nation's economy by injecting liquidity into the financial system.

Working in parallel with Danaharta toward removal of NPLs, Danamodal injected fresh capital to meet the capital adequacy requirements of distressed companies that are unable to raise their own funds due to drastic changes in economic conditions and market. In August 1998, a committee under the auspices of the central bank, Bank Negara Malaysia ("BNM") was formed. As introduced above, CDRC served to facilitate discussions between borrowers and financial institutions to enable expeditious and voluntary restructuring of debts to realise a greater collective benefit. While Danaharta[63], Danamodal[64] and CDR C[65] were governed by their respective operational frameworks, their roles were complementary.

Danaharta's main objectives were to remove the NPL distractions from the financial institutions and maximize the recovery value from the NPLs. In doing so, Danaharta chose to adopt an asset management company approach by dealing with the NPLs on an account-by-account basis, choosing the recovery strategy that would reap the best recovery value in each case. Danaharta was given special powers to resolve NPLs by virtue of the Danaharta Act, which conferred upon Danaharta three special powers:[66]

1. The ability to buy assets through statutory vesting.

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63. The establishment of Danaharta was to manage weak corporate entities and the NPLs in the banking sector. HANRAHAN ET AL., *supra* note 17, ch. 19.
64. Danamodal was a special-purpose vehicle to recapitalise weak banks. It was established by the government, as a subsidiary of Bank Negara, to restore soundness to the banking sector. It is a temporary institution whose main objectives are to recapitalise, revitalise and restructure the financial sector. It is also involved in the government's programme of consolidating and restructuring the banking system. It ceased operations in 2003. *Id*.
65. CDRC was established to provide assistance to firms requiring corporate restructuring. HANRAHAN ET AL., *supra* note 17, ch. 19.
66. DANAHARTA FINAL REPORT 1998-2005, *supra* note 18, at 12.

2. The ability to appoint Special Administrators to manage the affairs of distressed companies.
3. The ability to sell foreclosed assets quickly

The characteristic of Danaharta which empowers it to buy assets through statutory vesting would provide certainty of title and maximise value. In addition Danaharta's ability to sell foreclosed assets quickly also resulted in the consequential amendments made to the Malaysian National Land Code.

Such powers given to Danaharta were extreme, particularly the fact that Danaharta could bypass the court process in the course of its operations. Although its powers were strong, they seem clearly warranted in view of the greater national interest of preventing a collapse of the banking system. In actual fact, the statutory vesting process, the appointment of Special Administrators and foreclosures outside of the court system were all inspired by legal mechanisms in other jurisdictions, e.g. the United Kingdom. The special administration features under the Act combined those of administration in Australia and the United Kingdom with Chapter 11 of the U.S. Bankruptcy Act.

Danaharta's aim was to elicit maximum recovery from its NPLs portfolio. As a matter of policy, all borrowers were given a chance to restructure their loan according to Danaharta's Loan Restructuring Principles and Guidelines.[67] If the NPL continued, after reviewing the nature and circumstances of each NPL account, Danaharta chose a recovery method. For example, if a borrower's business was viable, a "soft approach" would be used that included plain loan restructuring,[68] settlement of loans[69] and schemes of arrangement.[70] However, if a borrower's business was deemed non-viable, or if a borrower failed to comply with the guidelines established to restructure its loans, Danaharta used a "hard approach," which involved the sale of the borrower's business and assets, or of the underlying collateral of an NPL. Some methods under the hard approach

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67. *Id*. The guidelines provided borrowers with acceptable parameters to formulate loan workout plans.
68. *Id*. There were cases where recovery was by way of rehabilitating an NPL to become a performing loan. This could involve an extension of the loan repayment period, or the rescheduling of loan repayments.
69. *Id*. at 73. There were cases where borrowers opted for a quick settlement of the loans, normally within 12 months.
70. *Id*. These were voluntary schemes formulated by both borrowers and creditors to restructure the loans. They included schemes under section 176 of the Act and the CDRC.

were: appointment of special administrators,[71] foreclosure,[72] and legal action.[73] Generally, the soft approach resulted in better recovery than the hard approach. As such, Danaharta was generally used the soft approach.

As noted above, Danaharta adopted an asset management company approach and dealt with NPLs in its portfolio on an account-by-account basis to choose the recovery strategy that would reap the best value in each case. The Danaharta Act also allowed Danaharta to buy NPLs from the financial institutions through statutory vesting. Essentially, this allowed Danaharta to step into the shoes of the selling financial institution, whereby it obtained the same interest and enjoyed the same priority as the selling financial institution; subject to registered interests and disclosed claims. For example, if the selling financial institution had a first mortgage over land as security for an NPL, Danaharta would have the first mortgage over the land. If a second mortgage was recorded against the land by another financial institution, that second mortgage would simply continue to exist without any change in priority. Likewise, any covenants recorded against the land would remain. This meant that although statutory vesting allowed Danaharta to buy the NPL, Danaharta had to deal with recorded interests existed if it wished to sell the land. In this manner, the Danaharta Act preserved essential third party rights.

Meanwhile, if Danaharta acquired a secured loan from a financial institution, the ownership of the security or collateral did not change, i.e. it did not transfer to Danaharta. It merely "stepped into the shoes" of the selling financial institution and assumed the selling financial institution's rights as a chargee of the asset, e.g. land. If Danaharta needed to sell the land to recover the loan, it was required to adhere to the provisions of the National Land Code (as amended by the National Land Code Act of 1998 . In other words, the Danaharta Act allowed Danaharta to obtain and convey title to assets subject to a defined set of

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71. *Id*. The Danaharta Act enabled Danaharta to appoint Special Administrators over certain companies, e.g. a corporate borrower that failed to fulfil its loan obligations. Once appointed, the Special Administrators assumed temporary control and management of the assets and affairs of the company and prepared a workout scheme aimed at maximising the recovery value of the business.

72. Foreclosure involved the sale of property or share collateral pledged as security for a loan. Danaharta could foreclose on the collateral if a borrower failed to repay its loan. HANRAHAN ET AL., *supra* note 17, ch. 19.

73. Taking legal action against a borrower was a last resort for Danaharta. This option was considered after all other recovery strategies had been exhausted as it was lengthy and costly and usually generated minimal recovery. *Id*.

obligations that did not unduly disturb the interests of others.[74]

Danaharta also had the right to appoint a special administrator over a corporate borrower (or a subsidiary), a security provider, or a company whose shares were pledged to Danaharta if the borrower was unable to pay its debts or fulfil its obligations. In addition, Danaharta had to be satisfied that the appointment would maximise value or was in the public interest. Before a Special Administrator could be appointed, Danaharta had to seek the approval of an Oversight Committee formed for this purpose. This Oversight Committee was made up of regulators, namely a representative from each of the Ministry of Finance, the Securities Commission and BNM. (Bank Negara Malaysia/Central Bank of Malaysia) After the appointment, the Special Administrator would take over control and management of the assets and affairs of the company. To preserve those assets until the Special Administrator was able to complete his task, a 12-month moratorium automatically went into effect. During that time, the company under administration was protected from all adverse action.

The Special Administrator would prepare a workout proposal which was then given to an Independent Adviser to review its reasonableness, taking into consideration the interests of all creditors (secured and unsecured) and shareholders. The proposal, with the Independent Adviser's report, was then submitted to Danaharta for review. If Danaharta approved the proposal, the Special Administrator would call for a meeting of secured creditors to consider and vote on the proposal. A majority in value of secured creditors at the meeting had to approve the proposal before it could be implemented. Relevant regulatory approvals, such as those from the Securities Commission, also had to be obtained. The special administration of companies provided a much-needed option for maximising value through the use of skilled specialists to turn around distressed companies. The appointment of Special Administrators helped to preserve the value of a company's assets, allowing it to continue as on-going concern or utilized for the current business of the company . Without this option, lenders might have increasingly looked to liquidation, and holders of security might have rushed to enforce their security interests against collateral. In turn, this would have brought down weakened companies and greatly reduced their value.

One remarkable feature of special administration under the Danaharta Act compared to the scheme of arrangement is that special administration is a non-court based procedure that operates along commercial principles by adopting a market driven approach; despite the fact that the Danharta is a government entity. As time is essential in the formulation of a workable restructuring plan,

74. Hambali & Ali, *supra* note 41.

the appointment of a special administrator to devise a workable restructuring plan must ensure that the plan is carried out within the period of three to six months after the appointment. This is a prompt process compared to the procedures in Section 176 of the Act, where the normal court process usually takes longer to complete.[75]

After receivers and managers are appointed as the agents of Danaharta, they are to be accorded the same immunity and protection as given to Danaharta.[76]

According to Section 72(a) of the Danaharta Act, a court is prohibited from granting an injunction against Danaharta as a corporation. In both cases, *Danaharta Urus Sdn Bhd. v. Kekatong Sdn Bhd.*[77]and *Pengurusan Danaharta Nasional Bhd. v Tang Kwor Ham & Ors.,*[78] the Federal Court held that no injunction can lie against Danaharta when exercising its power under the Danaharta Act. In *Kekatong Sdn Bhd.,* the Federal Court held that there was a rational basis between the classification in Section 72 and its object in relation to the Act. Here, the Parliament's clear intention in enacting the Act was to ensure that the acquisition of non-performing loans by the appellant would ease the pressure upon banks and other financial institutions. In addition as the nation's Asset Management Company, Danaharta is being entrusted to take over these bad loans (together with securities, where available) with a view to maximise recovery values. In order to accomplish these objectives the appellant was given sufficiently wide and broad statutory powers to acquire loans and credit facilities by statutory vesting to manage the affairs of corporate borrowers through special administrators formulating workout plans to repay debts to creditors, and to dispose charged assets. Hence, receivers and managers should also be accorded the same immunity and protection as are given to Danaharta, whether acting as oversight committee, special administrator or independent advisor.[79]

Meanwhile, in *Tang Kwor Ham & Ors,* the primary issue was whether Section

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75. Aishah Bidin, Corporate Law Reform and Corporate Governance in Malaysia: Responses to Globalization 13 (2005), http://docs.business.auckland.ac.nz/Doc/Corporate-governance-symposium-paper-Corporate-law-reform-in-Malaysia.pdf.
76. Pengurusan Danaharta Nasional Berhad Act of 1998 [hereinafter Danaharta Act] § 66 (1998) (Malay.).
77. Danaharta Urus Sdn Bhd. v. Kekatong Sdn Bhd., 2 Malay. L. J. 257 (2004) (Fed. Ct.).
78. Pengurusan Danaharta Nasional Bhd. v Tang Kwor Ham & Ors., 5 Malay. L. J. 125, 129 (2007) (High Ct.).
79. Dato' Seri Dr Kok Mew Soon & Ors. v. Mustapha bin Mohamed & Ors., 7 Malay. L. J. 486 (2008) (C.A.).

72 of the Danaharta Act supplanted the jurisdiction of the court in an application for judicial review against Pengurusan Danaharta Nasional Berhad, as appellant.[80] In allowing the appeal, the court held: although the authorities dealt with applications for injunction, the principles therein were equally applicable to certiorari and mandamus applications. Therefore, in the present case judicial review by way of certiorari was not available by reason of section 72 of the Act. Section 72 clearly prohibits an order of court which stays, restrains or affects the powers and any action taken or proposed to be taken by Danaharta, the special administrators or independent advisors under the Act.

In another case, *Tan Sri Dato' Tajuddin Ramli v. Pengurusan Danaharta Nasional Bhd & Ors,* the court found that Section 76 incontrovertibly denied court's jurisdiction to grant a RO.[81] Danaharta has the statutory power to appoint special administrators for the purpose of applying its strategies to manage the affairs of distressed companies. This empowerment is sensible given the heavy burden imposed on special administrators to fulfill their primary duty of nursing distressed companies that failed to recover through the first rehabilitation effort.

Section 25 of the Danaharta Act provides that the objective of appointing a special administrator is to fulfil a public interest, to ensure continued survival of the company and , to achieve a better return for its creditors than they would receive if the company is wound up. The special administrator accomplishes this by taking over the control and management of the assets and affairs of the corporate borrower. They then play an active role in preparing a workout proposal. A special administrator is to act independently as an impartial third party, disinterestedly exercising its powers vis-a-vis the interests of any party. Special administrators are also expected to introduce new ideas, new management skills and dynamic proposals to speed up the process of recovery of an ailing debtor company. Danaharta acts as a safeguard to creditors by carefully examining for its possible approval the proposals prepared by the special administrators, which proposals are only submitted to Danaharta after first being approved by the majority votes in value of secured creditors.

The Danaharta Act provides that upon approval of the proposal by the company's secured creditors, the proposal becomes known as the "Danaharta Scheme," it becomes binding on others and creditors. Then Special Administrator must send the Danaharta Scheme to each of the company's secured creditors that are known. However, in addition to being binding upon the company as the

80. Pengurusan Danaharta Nasional Bhd., *supra* note 78.

81. *Id*. at 722.

affected person, the proposal is also binding on all members and creditors; whether or not the person had the knowledge or notice of the proposal.[82] In RNC Corp. Bhd. v. Kesvaran a/l TP Murugasu[83], the court held that upon approval by the secured creditors of RNC, the Danaharta Scheme also became binding on other RNC creditors. This is a very distinguished feature of Danaharta. Without court involvement, the Danaharta Act grants such power, the act also stipulates that a company and its assets are shielded by a moratorium from all execution proceedings while it remains under special administration.[84]

Based on the final report, Danaharta was part of a larger plan to restructure Malaysia's banking sector to a stronger footing. In 2002, BNM estimated the total cost of restructuring the banking sector, including the resolution of NPLs through Danaharta and recapitalisation of the banks through Danamodal, will not exceed 5% of the nation's Gross Domestic Product (GDP) or approximately RM20 billion. It turned out that the actual cost was only about RM12.5 billion, or 3% of GDP; far less than the 18% that the International Monetary Fund (IMF) estimated during the Asian financial crisis. Out of the RM12.5 billion, about RM12 billion was attributed to NPL resolution efforts by Danaharta. Danaharta's Acquired NPL[85] component accounted for approximately RM1 billion, which was largely due to its heavy financing cost while the Managed NPL[86] component accounted for the remaining RM11 billion, which was the shortfall that could not be recovered on the book values of the Managed NPLs.

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82. Danaharta Act, *supra* note 76, § 46(4).
83. RNC Corp. Bhd. v. Kesvaran a/l TP Murugasu, (2009) 3 MALAY. L. J. 178, 190 (C.A.).
84. Danaharta Act, *supra* note 76, § 41(1)(e) provides: *"(e)* no proceedings and no execution or other legal process may be commenced or continued with, and no distress may be levied, against the affected person or its assets except with the prior written consent of the Corporation."
85. To effect the acquisition in an orderly manner, Danaharta prioritised its acquisition according to the seriousness of the NPL situation in a particular financial institution. The financial institutions were sorted into four tiers, with Tier 1 institutions being those with high levels of NPLs and most likely to sell the loans while Tier 4 institutions were those most unlikely to sell their NPLs. The classification helped to lend some order and controlled the flow of the NPLs coming in. The NPLs that Danaharta acquired from financial institutions were termed as "*Acquired NPLs.*"
86. Apart from the Acquired NPLs, the Government and the Central Bank, BNM, gave some NPLs to Danaharta to manage on their behalf. These were NPLs that belonged to the Sime Bank Berhad Group (Sime Bank Group) and the Bank Bumiputra Malaysia Berhad Group (BBMB Group). The aim was for Danaharta to provide its professional expertise in managing NPLs to recover as much as possible from these NPLs. This component of NPLs was termed as "*Managed NPLs.*"

In fact, Danaharta actually managed to meet or exceed the benchmarks set in its Key Performance Indicator. Having completed its mission, Danaharta was concluded on December 31, 2005 after seven and a half year of its establishment.[87] Closure of the NPL resolution agency indicated the ultimate sign of success. Ending Danaharta was necessary because if it remained permanently, it would pose a moral hazard to the banking system.[88] Banks would have no incentive to improve operations and guard against future NPLs. In addition, other agencies established during crisis, like Danamodal and CDRC, had already concluded their operations. Danaharta's recovery operations generated recovery assets in both cash and non-cash form. Despite Danaharta's rigorous efforts to convert all the non-cash recovery assets into cash by its closure of December 31, 2005, some remained unconverted. Control of these assets, known as "residual recovery assets," were handed over to the Minister of Finance Incorporated ("MOFI") as Danaharta's the sole shareholder. In this regard, a wholly-owned subsidiary of the MOFI, Prokhas Sdn. Bhd. took over and acted as a collection agent for Danaharta. The Danaharta experience confirmed that the restructuring process can be successful without court interference if the administrative body is given proper and sufficient statutory power and immunity to perform its duties efficiently. Danaharta's performance was a great success not only within the nation, but in the region as well since neighbouring countries look at the Danaharta model as valuable precedence for tackling corporate restructuring issues.

Ⅴ. Informal Restructuring

A. Voluntarily Private Negotiations

A private workout refers to a negotiated agreement between a debtor and its creditors outside of the formal restructuring process.[89] Only a few large companies have embarked on restructuring voluntarily without formal legal sanction. Without a formal process, the schemes that result may not be collectively binding on creditors. There is no real uniformity in what motivates the corporations to attempt an informal workout instead of undertaking a formal restructuring

87. Danaharta Final Report 1998-2005, *supra* note 18, at 28.

88. A moral hazard is a situation where something that was created to solve a problem may end up encouraging the problem instead. *See* Bidin, *supra* note 75.

89. Vanessa Finch, Corporate Insolvency Law: Perspectives and Principles, ch. 11 (Cambridge Univ. Press, 2002).

process or enforcement of their security rights. However, the fact that significant debt is owed to a number banks and other financial institution creditors; generally causes for attempting private negotiations or workouts are that the debtor being unable to service that debt. Perhaps there is a perception that it is more preferable to negotiate between the debtor and the financiers; and also among the financiers themselves. Nevertheless, this method of agreement would be applicable only if the corporate borrower has a good reputation and relationship with its financiers. The upside and downside for the respective parties is that if the negotiation process cannot be started or starts to breaks down, relatively swift and effective resort to the formal application of either a restructuring process or enforcement of security by creditors is possible.

B. The Role of Corporate Debt Restructuring Committee (CDRC)

Due to the financial crisis and unfavourable economic condition in July 1997, an increasing number of corporations faced financial difficulties. Many publicly listed corporations had successfully obtained ROs pursuant to Section 176(10) of the Act, while they proposed a scheme to restructure the companies and their debts.[90] Companies increasingly petitioned to wind up,[91] and others were still put into receivership.[92]

To facilitate the restructuring of large corporate debts, the CDRC was formed to provide a platform for both the borrowers and creditors to workout feasible debt restructuring schemes without having to resort to legal proceedings.[93] With the establishment of the CDRC in July 1998, instead of going to court to defend against the creditors, many companies opted for CDRC's friendlier arrangement to resolve debt. CDRC allowed companies to sit down with the creditors to work out a joint arrangement acceptable to all the parties concerned. The arrangement was informal, not legally binding, and cancellable by either side at any time. This was preferable to the insolvency legislation at the time, which did not provide a wide range of solutions for preservation of the value of the stakeholders in

90. BIDIN, *supra* note 75.

91. Statistic on winding up of companies, MALAYSIA DEPT. OF INSOLVENCY, http://www.insolvensi.gov.my/about-us/resources/statistics/liquidation/245-liquidation-statistics (last visited Jan. 21, 2014).

92. Wendy Smith & Asma Abdullah, *The impact of the Asian financial crisis on human resource management in Malaysia*, 10(3) ASIA PAC. BUS. REV. 402, 404 (2004).

93. WONG S. CHING ET AL., MALAYSIAN "BAIL OUTS"?: CAPITAL CONTROLS, RESTRUCTURING AND RECOVERY 32 (Sing. Univ. Press, 2005).

complex, multi-lender groups. The usual receivership and liquidation administrations did not discriminate viable businesses from non-viable ones, this ordinarily resulted in the inevitable demise such affected companies. Section 176 was very unpopular with financial institutions.[94]

CDRC was set-up to provide the impetus for informal workouts between financial institutions and borrowers by compromising and consensus to expedite the restructuring of corporate debts. CDRC acts as an advisor and a mediator between debtors and creditors during the restructuring negotiations. After either the debtor or creditor applies to the CDRC, an independent consultant is appointed to come up with a restructuring programme for the debtor. Then, CDRC evaluates the application, considers its viability and acceptability to the bankers and shareholders of the companies. If all parties agree to the structure of the proposal, the proposal is implemented. CDRC's framework relies on cooperation, persuasion, and a collegial approach to reconcile the interests of the financial institutions and the borrower.

CDRC was established to assist restructuring of large corporate debts in excess of RM50 million, and emulate the "London Approach" used in the United Kingdom.[95] Under this approach, banks are urged to take a supportive attitude toward debtors experiencing financial difficulties. The "London Approach" has three objectives: (1) to avoid liquidation costs; (2) to minimize losses to banks and other creditors; and (3) to provide financial support for surviving companies.[96] Essentially, a financial rescue of a company takes place outside of the confines insolvency law; it is an informal way to restructure the company since there is no court administration, similar to the informal arrangements provided in "pre-packaged" proceedings in Chapter 11 of the United States.

All applications to CDRC are voluntary, and it relies on the use of moral suasion to encourage creditors and borrowers to reach mutual agreement. CDRC works within the auspices of BNM. Restructuring efforts under CDRC have succeeded where the creditors were willing to abstain from exercising their legal rights to enforce their security over troubled loans. This allowed all the parties

94. Bidin, *supra* note 29, at 442.

95. The British Bankers Association defines the "London Approach" as: "A non-statutory and informal framework introduced with the support of the Bank of England for dealing with temporary support operations mounted by banks and other lenders to a company or group in financial difficulties, pending a possible restructuring". British Bankers Ass'n, Description of the London Approach (1996) (unpublished memo).

96. Gerald E. Meyerman, *The London Approach and Corporate Debt Restructuring in East Asia*, Rep. for the World Bank, p. 12 (Nov. 27, 2000); Pendarell Kent, *The London Approach*, 6 INT' L INSOLVENCY REV. 42 (1997).

involved to work out mutually beneficial solutions.

The task given to CDRC is to assist the restructuring of large "viable" corporate borrowers, to avoid the unnecessary collapse of viable companies that served as the engines of economic growth; and to avoid large-scale job losses. Insolvency proceedings for many large strategic companies were never an option due to the systemic risks they posed to the financial system. The CDRC framework was structured to avoid several moral hazards. First, CDRC became involved as a mediator between debtors and their creditors only if this was agreeable to both parties. Secondly, the legal rights of creditors were never compromised throughout the informal workout process. Thirdly, the solution proposed under the CDRC workout requires the unanimous consent of creditors before implementation of the restructuring scheme. These conditions ensured that CDRC restructurings were done with maximum transparency for all stakeholders. These workouts were based on a five-step process: (1) a meeting between creditors and the debtor; (2) appointment of consultants; (3) consultants report their findings on the viability of the business; (4) formulate strategies; and (5) the implementation of these strategies.

After the restructuring plans are fully implemented, CDRC workouts process ends. CDRC's experience shows that informal workouts can co-exist with formal insolvency proceedings. For informal workouts to be effective there must be mechanisms in place within the existing legal infrastructure to translate the informal agreements into legally binding solutions. This is a process often taken by CDRC to conclude difficult restructurings. Unlike the formal process which lack flexibility after a restructuring scheme was proposed, an informal process based on negotiation allowed a scheme to obtain the support of creditors before it was formally proposed. As a result, informal workouts did not need court's assistance since they were unanimously approved by the creditors; the debtor company and its creditors set forth the details of the restructuring on a Debt Restructuring Agreement signed among them.

However, due to the diverse demands of different classes of creditors, a unanimous approval of all the creditors is not always possible. In such situation, Section 176 of the Act allows a legal remedy since the law requires creditors to vote in their respective classes. If more than 75% in value and 50% of the creditors in each class support the restructuring scheme, then the proposed scheme will be binding on all creditors by courts. Thus, the role of courts may be very important in most debt restructurings.[97] This role is also indispensable in

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97. Chris W. K. Lee, *Relationship between informal workouts and the courts in Malaysia*, *in* OECD, Insolvency Reform in Asia Conference Proceeding: An assessment of the recent developments and the role of judiciary, Feb. 7-8, 2001, p. 3 (2001).

cases where companies have to undertake a capital reduction, since the court has the sole authority to such procedure under the Companies Act of Malaysia. As of August 15, 2002, CDRC had resolved 47 cases with debts totalling RM43.971 billion. 28 cases out of the total resolved cases have been fully implemented and the remainder of 19 cases are pending to be implemented. Corporations that have undergone restructuring process through CDRC includes: Johor Corporation, Sistem Transit Aliran Ringan Sd Bhd ("STAR"), Projek Usahasama Transit Ringan Automatik Sdn Bhd ("PUTRA"), Mycom Group of Companies and Gadek (M) Bhd.

Although CDRC resolved many cases, its informal workout process was not very efficient or fast. It was problematic that it did not have jurisdiction over small and medium sized corporate debtors, there was an imposed debt floor of RM50 million, and it was difficult to achieve consensus when creditors were involved. Additionally, it was cumbersome to appoint consultants to ensure that the financial and other affairs of the debtor were fully analysed to provide the basis for a plan. As such, a press conference held on August 20, 2002 announced the closure of CDRC, but the cases pending implementation would be monitored by the respective account's Creditors Steering Committee and Pengurusan Danaharta Nasional Berhad. However, the function of CDRC resumed in 2010, after the changes to the Code of Conduct which specifies CDRC's conduct expectations of debtors and creditors applying for or participating in a debt restructuring workout.[98] The eligibility under the jurisdiction of CDRC was lowered to RM30 million, but the procedure remained the same as before 2002. Upon receipt of confirmation from at least seventy five percent (75%) of each class of creditors, CDRC notifies the eligible debtor and its participating institutions that CDRC deems the proposed debt restructuring scheme binding on all parties.[99] They may then proceed to prepare and execute the final restructuring agreement within a period specified. But CDRC announced on its official website that it ceases to accept new applications; effective May 2, 2013.[100]

The restructuring procedures by CDRC can be illustrated in *Integrated Rubber Corp Bhd's (cited as IRCB)*,[101] on January 22, IRCB has announced that it faced

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98. CDRC, *Participants' Code of Conduct*, http://www.cdrc.my/download/CDRCCode-%28updated030210%29.pdf [hereinafter CDRC Code of Conduct].

99. *Id*. at ¶ 8.8.

100. CDRC, *supra* note 20.

101. Ho W. Foon, *Hot Stock IRCB rises to 21 month high on debt restructure, share buy by substantial holder* (Feb. 13, 2013), The Edge Malaysia, *available at* https://sg.finance.yahoo.com/news/hot-stock-ircb-rises-21-044505193.html (last visited Nov. 19, 2015).

possible wind up if it failed to pay RM16.89 million debt to Maybank Bhd. It further announced that there will be a major impact on its financial results and operations if a winding up process took place. On February 8, IRCB announced to the Malaysian Stock Exchange (also known as Bursa Malaysia) that CDRC had approved its application to mediate with its creditor banks over loans of RM16.89 million, upon which it defaulted the previous December. In order to continue the protection from its bankers under an Informal Standstill Arrangement for up to 60 days, beginning February 6, IRBC was had to submit a restructuring scheme in compliance with CDRC's restructuring principles. However, on June 24, 2013, IRCB announced that it had filed a winding up petition to court. The last case that applied for assistance of the CDRC is Syarikat Prasarana Negara Bhd, the biggest urban public transport owners in Malaysia.[102] This company has revamped its corporate structure and embarked on a massive restructuring to attain more financial stability implemented into its five-year plan. The company is still undergoing the process.

The success of CDRC's performance is difficult to assess since all applications were highly confidential. CDRC's restructuring process gives companies more time to stay afloat since they still have the chance to restructuring again under Section 176 of the Act if the CDRC process fails, as in *Metroplex Bhd. Ors. v. Morgan Stanley Emerging Markets Inc. & Ors; RHB Sakura Merchant Bankers Bhd. & Ors. (Interveners).*[103] Ceasing CDRC's function means that there will be no informal restructuring process currently available in Malaysia. However, CDRC was never intended to be a permanent institution. It was introduced when the country was in urgent need. Therefore, other informal options available to restructure the system should be initiated. These informal proceedings outside of court undermine the global efforts by the World Bank, the IMF and the other international entities to promote and rescue financially weak companies. These proceedings are cheaper and faster than court-driven ones; also keeping the businesses afloat secures jobs and promotes the interest of creditors. In the United Kingdom, out-of-court proceedings form a crucial part of insolvency laws and the recovery rate is among the highest in the world.[104]

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102. Sharidan M. Ali, *Massive Restructuring Plan for Syarikat Prasarana Negera Bhd* (Jan. 4, 2013), The Star Online, http://www.thestar.com.my/story.aspx/?file=%2f2013%2f1%2f4%2fbusiness%2f12531903&sec=business.

103. Metroplex Bhd. & Ors., *supra* note 45, at 492.

104. Press Release, *European Parliament Proposals Block Rescue of Companies by the Law Society of England and Wales* (Jan. 31, 2014), The Law Society, http://www.lawsociety.org.uk/news/press-releases/european-parliament-proposals-block-rescue-of-companies/.

C. Differences between Formal and Informal Rescue

Comparison of Danaharta and a Scheme of Arrangement under Section 176 of the Act

Danaharta	Scheme of Arrangement
- Initiated by Danaharta on its own initiative or at request of company's management or shareholders	- Initiated by the company, shareholders, creditors or liquidator
- Requires approval of the Oversight Committee	- No equivalent
- Special Administrator prepares workout proposal	- Person initiating the scheme prepares it
- Independent Advisor reviews reasonableness of proposal	- No independent review, but court sanction required
- Requires approval of majority in value of secured creditors	- Requires approval of majority in number representing 75% in value of creditors
- Automatic 12-month moratorium on all claims and proceedings	- Moratorium with court approval

Comparing the procedures of Danaharta and a Scheme of Arrangement under Section176 of the Act, the procedures to initiate the proceedings are similar. They both have the dual advantage of being protected by a moratorium period and being backed by the statutory power to enforce the agreement. A significant factor of Danaharta's process is appointing an independent advisor to review the proposal, which is an advantage of it compared to the scheme created under Section 176. This allows an independent advisor to access the viability of the proposal and the business before it is actually implemented. Time is another factor that Danaharta offers an efficient method to restructure corporations, since there are no delays as in the Scheme of Arrangement where the moratorium period can be extended reasons acceptable to a court.

As noted previously, in *Metroplex Bhd. Ors. v. Morgan Stanley Emerging Markets Inc. & Ors; RHB Sakura Merchant Bankers Bhd. & Ors. (Intervener s)*[105], the court held that Section 176(10A) of the Act not only provides that a RO may only be granted if a proposal for a scheme of compromise exists which

105. Metroplex Bhd. & Ors., *supra* note 45, at 499.

involving creditors representing at least one-half in value of all the creditors, it also stipulates that a RO may only be extended for a longer period 'if and only if' there is a 'good reason' to do so. The words 'good reason' have been construed by the courts to mean: (i) a bona fide scheme of arrangement presented in sufficient detail to enable the creditors to make informed decisions as to its feasibility and merits; (ii) such scheme of arrangement must not be likely to fail; and (iii) the interests of creditors which were the beneficiaries of the proposed arrangement were safeguarded.

The existence of a 'good reason' ought to be predicated upon the applicants' bona fide conduct towards achieving a feasible and detailed scheme of arrangement for presentation to the general body of creditors. By law, the extension of ROs requires all the provisions of Section 176(10A) of the Act to be met afresh in order to empower the court to grant an extension to the RO. Likewise, a RO may only be extended for a long period for good reasons and 'if and only if' conditions (a) to (d) of Section 176(10A) have been satisfied; also a reasonable progress towards the achievement of a viable and feasible creditors' scheme of arrangement are required. The facts must show that applicants, within 25 months after the beginning of a RO, were still at the initial stage of attempting to achieve a feasible scheme of compromise or arrangement between the company and its creditors. Hence, Section 176 of the Act should be amended to create finality of the moratorium period. The moratorium period should be limited, and the current practice of allowing an extension of the moratorium period end; in addition, the moratorium period should only be applicable to creditors but not against regulators.[106]

D. The Role of Regulatory Bodies in Restructuring Process

The Companies Commission of Malaysia (“SSM”) is a statutorily created body that came into operation on April 16, 2002, as a result of a merger between the Registrar of Companies (“ROC”) and the Registrar of Businesses (“ROB”), to regulate companies and businesses.

The main activity of SSM is to serve as an agency to incorporate companies, register businesses, and to provide company and business information to the public. As the leading authority for the improvement of corporate governance, SSM fulfills its function to ensure compliance with business registration and corporate legislation through comprehensive enforcement; it also does monitoring activities to sustain positive developments in the corporate and business sectors

106. CLRC Final Report, *supra* note 22, at 14.

of the nation.[107] One of its main functions is to ensure that the provisions of the Companies Commission of Malaysia Act and laws are administered, enforced, given effect to, and carried out and to record the court order relating to Section 176 of the Act.[108] The Insolvency Section of the SSM handles matters relating to the winding-up of companies and regulates companies which were strike off from the Registrar's list and the asset management of defunct companies. The Insolvency Section also keeps records of companies that are in the process of winding up, either by a court order or voluntarily, and regulates compliance with the Act in the winding up and dissolution of companies.[109]

Another body which oversees the insolvency of companies is the Malaysia Department of Insolvency ("MdI"), which has significant roles in administering the affairs of companies which have been wound up. The main activities of MdI are discovery of assets, realization of assets, ascertainment of debts, and the distribution of payments to creditors. The Director General of Insolvency at MdI also acts as receiver, in which he administers, either as a provisional liquidator or a liquidator, companies that have been wound up by the court, provided a private-sector insolvency practitioner has not been appointed.[110] Hence both statutory bodies namely Companies Commission of Malaysia and Malaysian Department of Insolvency mostly emphasize the winding up of companies, and no institution to oversee their restructuring.

In contrast, in the United Kingdom, the nation's Insolvency Service operates under a statutory framework, mainly under the Insolvency Acts 1986 and 2000, the Company Directors Disqualifications Act 1986, the Employment Rights Act 1996, and the Companies Acts of 1985 and of 2006, as well as a range of secondary legislation relating to these acts.[111] The Insolvency Service deals with the disqualification of unfit directors in all corporate failures, authorises and

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107. Suruhanjaya Syarikat Malaysia (SSM), http://www.ssm.com.my/en/about-ssm.

108. It keeps the records of companies that filed for a Scheme of Arrangement under Section .176 of the Act, since it is a requirement under the Act to file the RO with the Registrar of the Company. Other than that, SSM is not involved in the affairs of the company or serving as a watch dog over the performance of the company whether the company filed for formal restructuring under Section176, has successfully restructured, or ended up in liquidation. SSM regards it as an internal affair of the company.

109. *See* Annual Report Section, SSM, *supra* note 107.

110. *See* About Us Section, Malaysia Department of Insolveny, *supra* note 91.

111. *See* Insolvency Service, Government of U.K., http://www.bis.gov.uk/insolvency/About-us#sthash.PxRQVXQY.dpuf (last visited Dec. 20, 2013).

regulates the insolvency profession, assesses and pays statutory entitlements to redundancy payments (such as wages namely when an employer cannot or will not pay its employees), administers and investigates the affairs of companies and partnerships wound up by the court, and establishes why they became insolvent.

If information comes to light that a director's conduct (considered either alone, or along with their conduct as a director of another company) makes that director unfit for involvement in a company's management, company investigation teams of the Insolvency Service, may also conduct investigations after other formal insolvency proceedings. In cases where the Insolvency Service have received information to suggest corporate abuse, these teams also have the power to conduct confidential investigations into limited companies and limited liability partnerships that may or may not have entered into insolvency proceeding; namely administration, administrative receivership, voluntary and compulsory liquidation, and which may or may not still be actively trading.[112] If there is misconduct, the Insolvency Service can seek to secure remedies, where in the public interest, the institution of civil proceedings (such as director disqualification) and also report criminal allegations to prosecuting authorities.[113]

Meanwhile, in Australia, the insolvency of companies are handled by Australian Securities and Investments Commission ("ASIC"), which was set up under the Australian Securities and Investments Commission Act, and carry out their duties under the Corporations Act.[114] Not only does the ASIC oversee the affairs of companies, it examines and analyzes the affairs of insolvent companies in detail.[115] As these examples from other nations show, it is possible to create and rely upon a single body to administer and investigate the companies winding up by the court, and establish why these companies became insolvent.

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112. The Insolvency Service: Annual Report and Accounts 2012 to 2013, GOVERNMENT OF U.K., https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/288385/inss_annual_report_and_accounts_2013.pdf.

113. *See* Insolvency Service, *supra* note 111.

114. *See* About ASIC, AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION (ASIC), http://www.asic.gov.au/asic/asic.nsf/byheadline/Reports?openDocument#2014 (last visited Jan. 21, 2014).

115. *See e.g.*, Report 372 Insolvency statistics: External administrators' reports (July 2012 to June 2013), *available at* http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-372-insolvency-statistics-external-administrators-reports-july-2012-to-june-2013/ (last visited Nov. 19, 2015). The analysis was so detail including the causes of company failure, the number of employees affected, the industry types and estimated number and value of a company's unsecured creditor debts.

Ⅵ. Conclusion

In Malaysia, the use of schemes and capital reductions as restructuring tools has gained popularity in recent times. This is not surprising given that they are capable of accommodating many circumstances. These processes, however, require making applications to court. Most corporate restructurings are time sensitive as they are likely to be structured within a certain band of assumed market conditions. Nevertheless, with the recent administrative reforms made to court processes, applications to court are now resolved much more speedily, which contributes to overall reduction in time to implement restructurings. To continue to increase efficiency of the restructuring process and better understanding of court-aided processes, it is apparent that more corporate restructuring activity of an international standard should be introduced in Malaysia.[116] With a rise in the number of businesses seeking restructuring, the demand for more legal options to address situations of financial distress or insolvency has increased. The closure of Danaharta and the CDRC, both which contributed to the restructuring of the insolvent companies, creates a void for informal rescue procedures in Malaysia. The only formal rescue procedure available now for restructuring is the scheme of arrangement available pursuant to Section 176 of the Act. HHHowever, this process is often marked by lengthy delays, uncertainty, and the possibility of abuse. Although creditors may still petition to the court for relief under Section 181 of the Act, a scheme that is oppressive or in disregard of some creditors' interests may not be approved in the end.

In the United Kingdom, the Scheme of Arrangements is often used to resolve the claims relating to insolvent companies. Such Scheme of Arrangement often includes Alternative Dispute Resolution ("ADR") procedures, which normally obviates the need for litigation in court.[117] For example, in the administration of Lehman Brothers International Europe Limited, administrators in the United Kingdom entered into a contractual arrangement with a large group of creditors. However, in getting to that point there were uncertainties and disputes as to the ownership of assets. Some assets were held in trust for the benefit of third

116. Aishah Bidin et al., *Corporate Governance and Restructuring of Companies in Malaysia*, *in* Tuanku Ja'afar Law Conference 2010 Proceeding: International Conference on Corporate Governance and Corporate Responsibility, Oct. 19-20, 2010.

117. Antonia Menezes, Mediation to Rescue: How to Develop a Negotiation Culture in Business Restructurings 21 (2010), *available at* http://www.insol.org/emailer/sep_2010_downloads/Highlight%20Article-Sep2010.doc.

parties, which resulted in claims outside of the scope of administration. To resolve these problems effectively, a creditors' Claim Resolution Agreement was entered by a compromise of their claims. The benefits of having a forum for negotiation and compromise using a third party neutral are widely known to reduce both the time and cost of the disputing parties. In fact, in the United States, ADR has evolved into a key feature in the legal system, and is now regularly used in insolvency disputes.[118]

Mediation is the preferred method of dispute resolution for issues ranging from simple claims to Chapter 11 proceedings; approximately half of bankruptcy courts in the United States use mediation. In 2008, when Lehman Brothers filed the largest bankruptcy ever in the United States history, it requested ADR to save time and cost in its complex Chapter 11 case.[119] Although some parties objected, the bankruptcy court agreed with Lehman Brothers and mandated via court order that the parties participate in ADR, to resolve both affirmative claims where Lehman was the claimant and claims against the bankrupt estate. To enforce participation in ADR, the Court issued a temporary litigation injunction which would expire only after claims were settled. The court also had the power to sanction parties which failed to participate in ADR in good faith. These procedures resulted in a very timely and efficient way to settle the disputes, and there is no reason why such processes should not be adopted in other jurisdictions. Hence, it is proposed that ADR be introduced into insolvency proceedings in Malaysia for timely and efficiently settle disputes during the restructuring process.

Malaysia should attempt a major overhaul of its insolvency law system to include many of the elements in the United Kingdom and Singapore, since their schemes and provisions have close similarities to the current Malaysian legislation. The momentum for the introduction of a modern, more efficient and effective formal rescue process in Malaysia appears to have been slowed down. Some aspects of Malaysian law on insolvency need to be addressed and reformed, and such reforms should include drafting specific legislation on insolvency law to address the existing issues. These include a specific legislation on insolvency law to resolve judicial administration procedures as well as voluntary arrangements

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118. Jacob A. Esher, *Alternative Dispute Resolution in U.S. bankruptcy Practice*, 4 Mass. L. Rev. 76 (2009).

119. *See* Lehman Brothers Case in Publications Section, Haslaw, http://www.hinckleyallen.com/publications/?search%5Bkeyword%5D=lehman&search%5Byear%5D=Filter+by+Year&search%5Bperson%5D=Search+by+Person&search%5Bpractice%5D=Filter+by+Practice+Areas (last visited Sept. 2, 2009).

available to companies. Given the limited options currently available in Malaysia, the nation would clearly benefit from a new formal rescue procedure, and a distinct model should be formulated to create more effective procedures to rescue of insolvent companies. In conclusion, the introduction of both informal and formal restructuring processes is critical.

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