DEBT RESTRUCTURING AND CORPORATE RESCUES IN THE WAKE OF COVID-19: POINTERS AND OPTIONS

The ongoing COVID-19 pandemic has put SMEs and larger corporations to their greatest test in recent times, and potentially since the Great Depression of 1929.

By reason of the Movement Control Order in force in Malaysia, many non-essential businesses are closed and unable to generate much, if any, income in this period. Financial obligations however remain outstanding. There is no clear indication of when commerce will return to normal. Businesses facing cash flow difficulties during this lockdown need to quickly come to terms with the reality of their financial position, and consider the options that can help maintain them as going concerns. These could include the restructuring of their debts, or taking advantage of corporate rescue mechanisms afforded by the law.

A review of contracts with debtors, and various classes of creditors such as bankers and trade creditors, would be a good starting point. Our first issue in this series of articles will be of help to consider avenues that prevent mounting exposure to trade liabilities. The nature and extent of financial deficit would influence the choice of remedy.

Essentially, the restructuring of debt involves negotiations, but at a collective level with all creditors of the similar class, to accept payment of less than the full amount owing or on different terms to the original financing or debt. The motivation is the mutual benefit to creditors and the company to keep the business afloat as a going concern. The alternative could mean the winding-up of the company, with very much less recovered by all creditors.

In the face of the anticipated global economic meltdown, it makes good commercial sense for creditors and debtors to return to the drawing board to renegotiate their obligations and liabilities. A large-scale winding-up of businesses, with the consequential lay-off of employees and constriction in spending capacity, would carry dire knock-on effects that most would want to avoid.

In the remainder of this article, we set out a number of FAQs corporates may find useful when weighing their options in debt restructuring or rescue schemes. The suggestions we provide are generic. As each business is unique, and circumstances are varied, the answers given should not be construed as legal advice. We urge anyone with a specific problem to seek independent legal advice.

Our partners are happy to address any of your queries on this area of the law. We wish our clients and the wider business community the very best in these trying times. Stay safe, and stay informed.

AVAILABLE OPTIONS

(1) My company is facing liquidity issues, and would like to restructure our debts. What options do I have?

The Companies Act, 2016 provides three formal options :-

(i) Scheme of Arrangement;
(ii) Corporate Voluntary Arrangement; and
(iii) Judicial Management.

There is also the option of engaging the services of the Corporate Debt Restructuring Committee.

SCHEME OF ARRANGEMENT AND CORPORATE VOLUNTARY ARRANGEMENT

(2) What is the difference between the two?

A Scheme of Arrangement is an agreement between a company and either its shareholders or its creditors to reconstruct its capital, assets and liabilities, with the approval of the Court.

In the context of creditors, a Scheme of Arrangement requires the company to first engage an insolvency practitioner to prepare a scheme, setting out the proposed arrangement with the creditors. The company will then have to apply to Court to summon a meeting of its creditors to put forward its proposed scheme. If 75% of the total value of the creditors (or class of creditors relevant to the scheme) approves the proposed scheme, the company then makes a further application to have the scheme approved by the Court. Once the scheme is approved by the Court, it is binding on all the company's creditors relevant to that scheme.

The CVA is similar to a scheme of arrangement, save that the approved proposal need not be sanctioned by Court. To initiate a CVA, the directors of a company prepare a proposal for the creditors ("Proposal"), and then nominate an insolvency practitioner to act as a supervisor. The supervisor's main role is to give his / her feedback on the viability of the Proposal; lodge such Proposal with the Court; and summon a meeting of shareholders, and a meeting of creditors, to consider the Proposal. If the Proposal is accepted and passed by a simple majority of its shareholders AND 75% of the total value of creditors, the Proposal is binding on all the company's creditors.

However, if the Proposal affects the rights of secured creditors to enforce their security, their consent must be obtained before it can be approved.

SCHEME OF ARRANGEMENT AND CORPORATE VOLUNTARY ARRANGEMENT

(3) Once a Scheme of Arrangement is approved by the Court, or a CVA is approved with the requisite majorities, can opposing creditors object to the scheme or CVA?

No, they can't. An approved Scheme of Arrangement or CVA is binding on all creditors. These debt restructuring options are therefore more suitable for companies which are able to secure the support of their major creditors.

(4) Is every company entitled to restructure its debts by way of a Scheme of Arrangement or CVA?

All companies in financial distress may apply for a Scheme of Arrangement.

A CVA, on the other hand, does not apply to :-

- a public company or berhad;
- a company which is a licensed institution, or an operator of a designated payment system regulated under the laws enforced by the Central Bank of Malaysia;
- a company which is subject to the Capital Markets and Services Act, 2007, such as public listed companies, companies carrying on regulated activities such as dealing in securities or fund management, or issuers of local corporate bonds; and
- a company which creates a charge over its property or any of its undertakings.

The restrictions confine the application of CVA to private limited companies, sendirian berhads, which have no charges.

(5) If a company is applying for approval of a Scheme of Arrangement, or adopting a CVA, will there be a moratorium of pending legal suits or winding-up proceedings against the company?

Unlike CVAs and Judicial Management, there is no automatic moratorium in the course of pursuing a Scheme of Arrangement. The debtor company must apply to Court for a restraining order, and satisfy the following 4 criteria :-

- that there is a proposal for a scheme of arrangement between the company and its creditors or any class of creditors representing at least one-half in value of all the creditors;
- that the restraining order is necessary to enable the company and its creditors to formalise the scheme of arrangement;
- a statement of particulars as to the affairs of the company, made up to a date not more than 3 days before the application, is lodged in Court together with the application; and
- the Court approves the person nominated by a majority of the creditors to act as a director of the company, or if that person is not already a director, appoints that person to act as a director notwithstanding the provisions of the Companies Act 2016 or the constitution of the debtor company.

The Court may grant a restraining order for a period not more than 3 months, which period can be further extended up to a maximum of 9 months.

In a CVA, the moratorium commences automatically once the relevant documents including the Proposal are lodged with the Court. The moratorium will remain in force for 28 days, and can only be extended up to a maximum of 60 days.

SCHEME OF ARRANGEMENT AND CORPORATE VOLUNTARY ARRANGEMENT

(6) What should I bear in mind when applying for a Scheme of Arrangement?

In order to obtain the Court's permission to convene a meeting of the company's creditors, you must prepare a scheme that has realistic prospects of success. If a creditor who holds more than 25% of the value of debt of the company (or of a class of creditors) opposes the proposed scheme, then the Courts will dismiss the application because it is sure to fail.

There must also be full disclosure of the company's affairs, including accurate information about its creditors. The creditors must be classified into different classes based on their different legal rights, such as secured creditors and unsecured creditors.

(7) What are the pros and cons of applying for a Scheme of Arrangement?

A Scheme of Arrangement is suitable where the company wishes to have flexibility in negotiating the structure of the compromise with its creditors, whilst having the benefit of the Court's sanction of its proposed scheme in order to bind all creditors.

Schemes of Arrangement are also preferred by company directors who are reluctant to cede control over the company to a judicial manager. However, the moratorium against legal actions by creditors is not automatic, and is subject to the Court's discretion.

(8) What about the pros and cons of a CVA?

Not many companies are eligible to apply for a CVA, because most companies are likely to have some form of financing with a charge created over properties or assets, or business undertakings or revenue streams.

There appears to be only 2 companies which have adopted a CVA since its introduction in 2018. Further, the moratorium only lasts for a maximum of 60 days, which is far shorter than the moratorium that can be ordered by the Court in a Scheme of Arrangement.

A CVA is useful for companies who wish to restructure their debts in a quick and cost-effective manner, for the process only lasts a maximum of 60 days. There is also minimal Court process involved, as the supervisor is only required to lodge the Proposal with the Court, in the manner as prescribed under the Companies (Corporate Rescue Mechanism) Rules, 2018, and to notify the Court of the voting outcome of the meeting with shareholders and creditors. It is therefore a process that is driven and controlled by the management of the company.

JUDICIAL MANAGEMENT

(9) What is judicial management ("JM")?

Judicial management is a statutory scheme that places the management of a financially distressed company in the hands of a qualified independent person with the necessary skill and experience, known as a judicial manager (who has to be an insolvency practitioner). The judicial manager then finds ways to restructure the debts of the company, as well as to manage the business of the company for a period of time.

(10) Who may apply for judicial management?

Either the company or its creditors may apply to Court for a Judicial Management Order ("JMO"), if they consider that the company is or will be unable to pay its debts, and there is a reasonable probability of rehabilitating the company, preserving all or part of its business as a going concern, or if the interest of creditors would be better served by a JMO than a winding up of the company.

The debtor company, however, cannot be a licensed institution or an operator of a designated payment system regulated under the laws enforced by Bank Negara Malaysia, or a company which is subject to the Capital Markets and Services Act, 2007. Hence, a public listed company and a company that has issued bonds / sukuk which are outstanding may not apply for JM.

(11) What are the criteria for the Court to grant a JMO?

The Court may make a JMO if :-

(i) it is satisfied that the company is or will be unable to pay its debts; and

(ii) it considers that the making of the order would be likely to achieve one or more of the following purposes :-

- the survival of the company, or the whole or part of its undertaking as a going concern;
- the approval of a compromise or arrangement between the company and its shareholders and / or creditors; and
- a more advantageous realisation of the company's assets would be effected than on a winding up.

(12) How does a JMO work?

Once the Court grants a JMO, the judicial manager will take over the affairs, businesses and property of the company for 6 months, which can be extended for another 6 months.

The judicial manager will then have to present a statement of proposal for debt restructuring, for the company's creditors' consideration. Such statement of proposal must obtain the approval of 75% of the total value of creditors. Once approved by the requisite majority, the proposal shall be binding on all creditors of the company whether or not the creditors have voted in favour of the proposal.

(13) Does a JMO provide for a moratorium against legal action by creditors?

Once a company applies for a JMO (before obtaining the order), there will be a moratorium of any legal actions or execution proceedings in place that will prevent the company from being wound up, or any legal and execution proceedings by the creditors being pursued against the company. The moratorium will continue throughout the lifespan of the JMO.

JUDICIAL MANAGEMENT

(14) What is the effect of a JMO?

Should the Court make a JMO, the affairs, business and property of the company shall be managed by a judicial manager appointed by the Court. It should be noted that directors will no longer have any management powers over the company, unless allowed by the judicial manager.

(15) What are the pros and cons of applying for a JMO?

JM is suitable for companies which are financially distressed, but continue to have viable business operations worth rescuing with the aid of professional expertise. Creditors may find it more beneficial and attractive for the company to be operated by third party professionals, rather than putting the company into liquidation, or leaving the company in the hands of the old management during critical times.

The disadvantage of JM to certain stakeholders, is that management of the company will rest with the judicial manager, rather than the directors, during the lifespan of the JMO.

(16) What should be borne in mind when applying for a JMO?

There must not be evidence that creditors holding more than 25% of the total value of the company's debts will object to any proposal by the JM. It should also be noted that the Court will dismiss an application for a JMO if it is satisfied that :-

- a receiver or receiver and manager has been or will be appointed; and
- the making of the JMO is opposed by a secured creditor.

These considerations are particularly relevant as there must be full and frank disclosure of the company's affairs by the applicant (whether the company or its creditor) in the application.

It would therefore be prudent for applicants to obtain the support of 75% of the total value of the creditors, and the consent of its secured creditors, before applying for a JMO.

(17) If it appears that the purpose specified in the JMO either has been achieved or is incapable of achievement, what should the judicial manager do?

The judicial manager must apply to the Court for the discharge of the JMO.

CORPORATE DEBT RESTRUCTURING COMMITTEE ("CDRC")

(18) Can one's debts be restructured without going to Court or engaging an insolvency practitioner?

Companies facing difficulties with outstanding debts owed to financial creditors (banks and financial institutions) may seek the assistance of Bank Negara's CDRC, which serves as a mediation platform for debtor companies and their financial creditors to work out a viable debt restructuring arrangement.

(19) What are the eligibility criteria for companies to be admitted into the CDRC to restructure their debt obligations?

Applicants must :-

- have an aggregate indebtedness of RM10 million or more, involving at least 2 financial creditors;
- not be in receivership or liquidation, except for those where receivers have been appointed only over certain specified assets and the directors remain in control over the companies' overall operations; and
- be experiencing or anticipating difficulties in servicing their debt obligations but may not have already defaulted, OR be a company listed on the Main Market or ACE Market of Bursa Malaysia that has been classified as a PN17 or GN3 company respectively.

(20) Does a debtor company enjoy any form of moratorium if it applies to the CDRC?

If the CDRC issues a notification of the acceptance of an eligible debtor's application, the participating financial creditors must observe a standstill until such time as may be advised by the CDRC. This is in effect a moratorium that protects the eligible debtor company against legal actions by financial creditors.

(21) Can the CDRC mediate a debt restructuring arrangement for trade or non-financial institution creditors?

No, it can't. Nor does applying to the CDRC provide any standstill / moratorium against legal actions by trade or non-financial creditors.

As the CDRC only applies to debts owed to financial creditors, eligible debtor companies will still have to consider other debt restructuring options for claims by other creditors.

Having a CDRC arrangement in place, would in practice facilitate cooperation and restructuring with other creditors.

GOVERNMENT INITIATIVES SINCE THE MOVEMENT CONTROL ORDER

(22) Are there any initiatives from the Government since the Movement Control Order to avoid companies from becoming insolvent?

Under the Companies Act, 2016, a company is deemed unable to pay its debts if it cannot pay a sum of RM10,000-00 within 21 days from the date of the creditor's written demand. If a company is unable to pay its debts, it may be wound-up by the Court upon the creditor's petition.

On 10th April 2020, the Companies Commission of Malaysia stated its intention to raise the statutory winding-up threshold from RM10,000-00 to RM50,000-00, and to increase the period to make payment on the creditor's written demand from 21 days to 6 months. It is said that this initiative will operate until 31st December 2020.

At the time of writing, we have not sighted any legislation giving effect to these initiatives by the Companies Commission of Malaysia.

(23) Will these initiatives affect existing Section 466 Notices or winding-up proceedings?

Unless there are amending laws passed by Parliament, we doubt these initiatives will affect the existing Section 466 Notices or winding-up proceedings, as they are based on the statutory definition of “inability to pay debts” in the Companies Act, 2016 at the time of the issuance of the Section 466 Notice, which as of 31 January 2017, stood at RM10,000-00.

(24) Are there any other existing initiatives by the Government?

SMEs may consider participating in Bank Negara’s Small Debt Resolution Scheme (“SDRS”), which is similar to the CDRC, but applies to SMEs.

The eligibility requirements to participate in the SDRS are as follows:-

- the applicant is a Malaysian-owned company (at least 51%) carrying on business in any economic sector;
- the applicant meets the definition criteria of a SME, i.e. number of full time employees not exceeding 200 or annual sales turnover not more than RM50 million;
- the applicant is a viable SME facing financial difficulties with financing from multiple financial institutions; and
- applicable for business related financing only (excluding share financing and personal consumption).

Further details on the SDRS can be seen at the following link :-

https://www.bnm.gov.my/documents/2015/SDRS.pdf

Another potential initiative is the reinstatement of the now dormant Pengurusan Danaharta Nasional Berhad Act, 1998, which is a special law that was enacted by Parliament during the Asian Financial Crisis in 1997, for the acquisition, management, financing and disposition of assets and liabilities by Pengurusan Danaharta Nasional Berhad (“Danaharta”). Danaharta successfully re-invigorated the lending abilities of the Malaysian financial sector by buying non-performing loans (“NPLs”) from financial institutions.

The debtor companies also benefitted because Danaharta was able to maximize the recovery values from those NPLs, whether by restructuring those debts or an orderly disposal of the secured assets. The Danaharta Act also empowered the appointment of Special Administrators over affected companies whose NPLs had been bought over by Danaharta, with an automatic moratorium over legal proceedings against such companies. Restructuring of debts under the purview of the Special Administrators then ensued.

Danaharta however ceased these activities on 31st December 2005, with its residual assets being managed by Prokhas Sdn Bhd, a private limited company wholly-owned by Minister of Finance, Incorporated. At the time of writing, we are unaware of any Government initiative to reactivate the provisions of the Danaharta Act.

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