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### **COVID-19: Time for Businesses to Rethink and Restructure**

On 27 March 2020, Kristalina Georgieva, the managing director of the IMF, declared that “*we have entered a recession as bad or worse than in 2009*”.<sup>[1]</sup> Notably, this happened on the same day that the Prime Minister announced the RM250 billion Prihatin Economic Stimulus Package (PRIHATIN). Of that amount, RM100 billion would be used to support businesses, including SMEs, and RM2 billion to strengthen the economy.<sup>[2]</sup> But SMEs, which contributed RM521.7 billion, or 38.3%, to Malaysia’s GDP in 2018,<sup>[3]</sup> did not think it was enough.<sup>[4]</sup>

On 30 March 2020, the World Bank revised Malaysia’s GDP growth projection for 2020 from 4.5% to -0.1%.<sup>[5]</sup> This was perhaps not unexpected. Prior to 27 March 2020, AmBank Group Research had already said the coronavirus crisis-induced recession is expected to place the global economy, Malaysia included, into technical recession.<sup>[6]</sup>

It is hard not to be pessimistic. But, I say, all is not lost.

#### *Rethink, restructure*

This is a time for Malaysian businesses, with financial difficulties, to rethink and restructure for continuity. Bank Negara Malaysia has already announced that banking institutions will offer to defer or restructure all loan/financing repayments in a way that will enable viable companies to preserve jobs and resume economic activities. In connection with this, there are legal mechanisms, such as corporate voluntary arrangement, judicial management and scheme of arrangement, that would enable companies to enter into workouts with their creditors.<sup>[7]</sup>

#### *Corporate Voluntary Arrangement (CVA)*

CVA enables a company experiencing financial difficulties to enter into an arrangement with its creditors without the need to have the proposed arrangement approved by court. This is a distinct advantage compared to the traditional scheme of arrangement. Further, unlike judicial management, the company proposing a voluntary arrangement

need not be insolvent.

Directors of a company may propose a voluntary arrangement to the company and its creditors. The directors need to appoint a nominee, who is an insolvency practitioner, to prepare a statement setting out his opinion:

- (a) the proposed voluntary arrangement has a reasonable prospect of being approved and implemented;
- (b) the company is likely to have sufficient funds available during the proposed moratorium to enable the company to carry on its business; and
- (c) that meetings of the company and its creditors should be summoned to consider the proposal.

Upon making an application for voluntary arrangement, the company enjoys a 28-day moratorium. No winding-up petition can be presented. Except with leave of court, legal proceedings cannot be brought, hirers cannot repossess and no landlord can exercise any right of forfeiture. The moratorium may be extended for not more than 60 days with the consent of the nominee, creditors and members of the company.

The nominee is obliged to summon separate meetings of the company and the company's creditors during the moratorium period to approve the proposed voluntary arrangement. A proposal, duly approved by the company's creditors and members, is binding on all creditors. Implementation of the approved proposal will be overseen by a supervisor.

#### *Judicial Management (JM)*

JM is a court-supervised rescue plan. The court appoints a judicial manager to manage the affairs, business and property of the company. He has extensive powers, which include taking possession of the property of the company, selling the property of the company and borrowing money and grant security for the borrowing.

The judicial manager is obliged, within 60 days or such longer period allowed by court, to prepare a proposal to achieve one or more of the following purposes:

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

The judicial manager must also circulate the proposal to all creditors as well as summon a meeting of creditors to approve the same. A duly approved proposal is binding on all creditors. The judicial manager is statutorily obliged to manage the affairs, business and property of the

company in accordance with the approved proposal.

The company enjoys an automatic moratorium upon filing an application in court for JM until the court makes an order for JM. During this time, no resolution can be passed or order made to wind up the company. No steps can be taken to enforce any charge on or security over the company's property or repossess any goods under hire purchase, leasing or retention of title. No other proceedings and no execution or other legal action can be commenced or continued against the company.

If a JM order is made, a receiver and manager appointed over a company shall vacate office. No receiver and manager can be appointed. The protection which the company enjoyed prior to the JM order will continue after the JM order is made.

### *Restrictions*

CVA is not available to a public company. CVA and JM are also not available to companies subject to the Capital Market and Services Act 2007 (CMSA), which seems to include public companies as well.

More importantly, CVA is not available to a company that has created a charge over its property or any of its undertakings. It is unclear why such a restriction is necessary when voluntary arrangements do not in any event bind secured creditors, unless with their consent.<sup>[8]</sup> As for JM, the court is not entitled to make a JM order if it is satisfied that —

(a) a receiver or receiver and manager over substantially all the assets of the company have been appointed or will be appointed; or

(b) the making of the order is opposed by a secured creditor.<sup>[9]</sup>

These restrictions effectively preclude a large number of companies, which obtained financing by providing security, from relying on CVA and JM. The government should immediately reconsider these provisions, including whether to temporarily exempt certain classes of corporations from these restrictions.

### *Scheme of arrangement (SOA)*

SOA is another mechanism that allows a company to propose a workout arrangement with its creditors in a court-ordered meeting. A workout arrangement, although approved by the majority of the company's creditors, is subject to the court's approval. This gives dissenting creditors the right to oppose the proposed scheme of arrangement and, hence, does not have the cram down effect of a CVA and JM.

However, when the court approves a proposed scheme, the court has extensive powers to enable reconstruction and amalgamation of companies. This is not available in a JM and CVA. The powers include ordering a transfer of property or liabilities between companies and allotting or appropriation of shares.

But, unlike CVA and JM, the company does not enjoy an automatic moratorium upon making an application to convene a meeting to consider a proposed scheme of arrangement. The company can, however, apply for an order to restrain further proceedings in any action or proceeding against the company.

There are, however, a number of conditions to be fulfilled under s 368 (2) of the CA 2016 before the court grants such an order. Among others, the court needs to be satisfied the restraining order is necessary to enable the company and its creditors to formalise the proposed scheme and the court approves a person nominated by a majority of the creditors to act as a director. The court may grant such an order for a period of not more than three months and, thereafter, extend the same for not more than nine months.

The statutory restrictions arose largely from abuses that occurred during the financial crisis in the late 1990s. However, given the unprecedented crisis that Malaysia now faces, the government should consider whether all the restrictions are necessary. Under s 368(4) of the CA 216, any disposition of the company's property after a restraining order is made is void.

#### *Bona fide proposals*

From experience, whichever mechanism is employed, the key to a successful corporate restructuring depends entirely on whether the proposals are bona fide. No creditor, particularly a financier, in the current situation wants to think that he has been taken for a ride. Corporate rescue mechanisms are, after all, not intended to hoodwink creditors.

Genuine proposals are essential to persuading creditors to buy-in. Companies need to be transparent with their affairs, in particular with their assets and liabilities. The proposals, taking into account the companies' cash flow and projected revenue, need to be realistic. Business stakeholders must seek proper financial and legal advice to ensure their proposals are not only workable but also palatable to creditors.

Finally, and for corporate rescue mechanisms to work, the ultimate business stakeholders with their advisers must reach out and have that candid conversation with the creditors. Businesses through their stakeholders must instil trust and confidence in their creditors that they are viable; and that everyone can ride out this unprecedented crisis.

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- [1] Transcript of press briefing by Kristalina Georgieva following a conference call of the International Monetary and Financial Committee, 27.3.2020, IMF website  
2 [PM's speech on Prihatin Rakyat Economic Stimulus Package \(PRIHATIN\) on 27.3.2020](#)
- [3] Arjuna Shankar, *Covid-19: Malaysia SMEs see zero cash inflow for at least three months due to MCO*, theedgemarkets.com, 30.3.2020
- [4] Small and Medium Enterprises (SMEs) Performance 2018, Department of Statistics, 31.7.2019
- [5] East Asia and Pacific Economic Update April 2020, pp 178-180
- [6] Surin Murugiah, *Covid-19 to place Malaysian economy into technical recession, says AmBank*, theedgemarkets.com, 26.3.2020
- [7] Division 8 of Part III of the Companies Act 2016
- [8] CA 2016, s 400(4)
- [9] Companies (Amendment) Act 2019. Came into force on 15.1.2020.