

Take5

for business

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Companies (Amendment) Act 2024

Enhancing Malaysia's corporate
rehabilitation framework

EY

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Enhancing Malaysia's corporate rehabilitation framework

The Companies (Amendment) Act 2024 (Amendment Act) was brought into force on 1 April 2024, except for four sections that are to be enforced on a date to be announced later.

The objectives of the amendments in the Act are to strengthen Malaysia's corporate rehabilitation framework and enhance corporate transparency in the Companies Act 2016 (CA).

The corporate rehabilitation processes available in the CA include:

- ▶ Arrangements and Reconstructions (Scheme of Arrangement)
- ▶ Corporate Rescue Mechanisms (CRM)
 1. Judicial Management (JM)
 2. Corporate Voluntary Arrangement (CVA)

Financial distress can affect even well-managed companies, stemming from a variety of factors, e.g., an economic downturn, regulatory changes and market dynamics. Companies with viable businesses should consider options for turnaround, financial and debt restructuring, or fund-raising depending on their specific circumstances and long-term business objectives.

In this Take 5 alert, we summarize the new and enhanced provisions in the Amendment Act relating to the Scheme of Arrangement and CRM, and highlight the five key amendments that in our view would encourage greater participation in the rehabilitation of financially-distressed companies in Malaysia.

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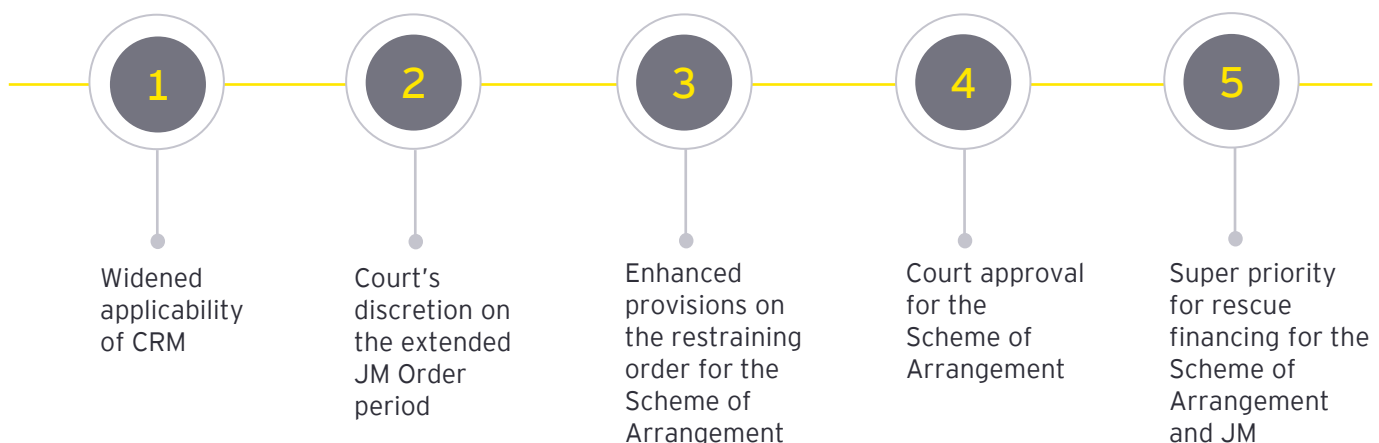
A robust corporate rehabilitation framework plays a critical role in fostering a business environment where companies with viable businesses that are facing financial distress have better opportunity to restructure and recover.

Toward this end, the enhanced provisions on corporate rehabilitation in the Companies (Amendment) Act 2024 have widened the applicability of Corporate Rescue Mechanisms, which now include pre-pack and cram down provisions for the Scheme of Arrangements, and introduced super priority for rescue financing. Winding-up should be a last resort.



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Five key amendments



Improved provisions on CRM

1 Widened applicability for CRM

The limiting non-applicability criteria for CVA and JM precluded many companies from being able to use the CRM to formalize their rescue plans. This may be the main contributing factor in the low level of usage despite the CRM provisions coming into force since 1 March 2018.

The list of companies that cannot utilize JM has now been narrowed down to only the following types of companies that are subject to other regulatory and legislative requirements under the supervision of the relevant authorities:

- ▶ Licensed financial institutions
- ▶ Operators of designated payment systems, capital market intermediaries and central depositories carrying out certain regulated activities.

The same non-applicability criteria as above is also introduced for CVA. However, the relevant provision has not been brought into force yet.

2 Court's discretion on an extended JM Order period

The previous maximum cap on the duration of the extended JM Order period has now been removed. The Court now has the discretion to allow for an extension to the initial six months of the JM Order period, upon application by the Judicial Manager, subject to any terms the Court may impose.

Statistics: CVA and JM Order

Year	CVA	
	Lodgement	Plan approved by Creditors
2018	3	3
2019	1	1
2020	1	1
2021	2	2
2022	1	1
2023*	0	0

Year	JM Order	
	Application made to the Court	Granted by the Court
2018	14	5
2019	12	5
2020	35	15
2021	27	15
2022	41	11
2023*	48	17

*As of 31 October 2023

Source: Suruhanjaya Syarikat Malaysia

The widened applicability of JM (and CVA, once the relevant provision is brought into force) and the removal of the maximum cap on the extended JM Order period would enable most companies to also consider the suitability of CVA or JM in facilitating the formulation and implementation of rescue plans more efficiently and effectively.

Restraining Order for the Scheme of Arrangement

3 Enhanced provisions on the Restraining Order (RO)

Unlike CVA or JM, there was previously no automatic moratorium for a company applying for a Scheme of Arrangement. If the company was not already winding-up or under JM, obtaining an RO as soon as possible was often critical to restrain certain actions and proceedings being taken against the company.

The objective of an RO is to preserve the assets and business of the company while it focuses on formulating and formalizing a rescue plan.

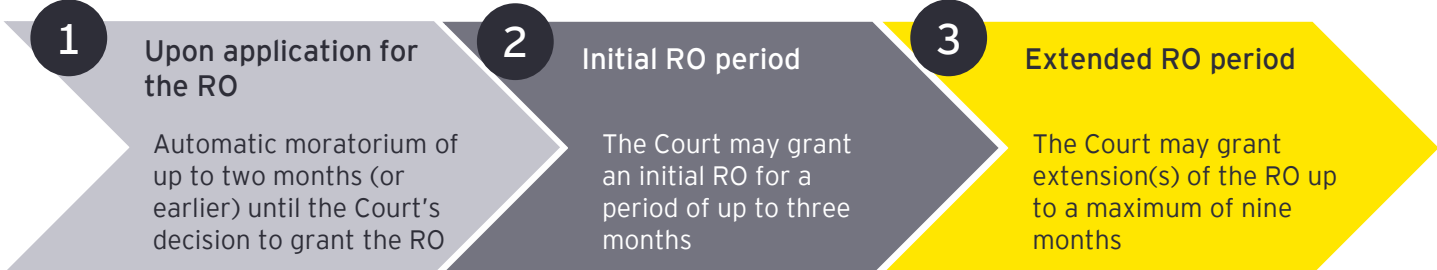
Actions and proceedings to be restrained or allowed have now been made explicit in the Amendment Act:

Restrained actions	Actions and applications allowed	Actions and applications allowed (with the Court's permission)
<ul style="list-style-type: none"> ▶ Winding up ▶ Appointment of receiver 	<ul style="list-style-type: none"> ▶ Scheme of Arrangement ▶ Disposition of property, shares transfer and/or alteration of members' rights ▶ Cross-class cram down ▶ Revote of the Scheme of Arrangement's pre-Court approval ▶ Scheme of Arrangement for reconstruction or amalgamation 	<ul style="list-style-type: none"> ▶ All other executions, distress proceedings or legal processes

The following enhanced provisions on the RO address some of the previous shortcomings and include safeguards against the potential abuse of ROs:

- ▶ Automatic moratorium upon the submission of the RO application to the Court
- ▶ An RO against the related company may be granted for a period not exceeding the RO period or an extended period of the subject company
- ▶ Limitation to extensions of the RO period
- ▶ Cooling-off period for subsequent ROs

Limit of protection period when applying for an RO, and during the initial RO period and extended RO period



Note: The Court cannot grant an RO if an earlier RO was granted to the company or its related company within the last 12 months.

Approval process for the Scheme of Arrangement

4 Court approval for the Scheme of Arrangement

Typically, the approval process for a Scheme of Arrangement involves:

1. Obtaining a Court order to convene a scheme meeting (“Court convened meeting”)
2. Conducting the Court-convened meeting for the different classes of creditors to obtain the requisite approval for the Scheme of Arrangement
3. Obtaining the Court order approving the Scheme of Arrangement.

Stakeholder management is crucial in formulating and implementing a rescue plan.

Obtaining a Court approval can now be expedited under certain conditions:



Pre-pack

- ▶ The Court now has the power to approve a Scheme of Arrangement without a Court-convened meeting of creditors. Disclosure of information, negotiations, and relevant notices can be made between the scheme company and creditors meant to be bound by the Scheme of Arrangement.
- ▶ The Court will grant its approval for the pre-pack Scheme of Arrangement if it is satisfied that the above actions have been carried out and that the requisite majority has been achieved from the scheme meetings summoned to table the proposed scheme.
- ▶ Essentially, the company and its creditors can pre-pack a Scheme of Arrangement before applying for Court approval.

This can reduce the time and cost in obtaining Court approval for a Scheme of Arrangement.



Cram down

- ▶ The Court can now balance the interests of the majority creditors who voted for the Scheme of Arrangement with the interests of the minority group of dissenting creditors who voted against the Scheme; and make an order approving the Scheme of Arrangement binding the company and all the classes of creditors concerned.
- ▶ Essentially, one or more classes of the approving creditors can cram down a class or classes of dissenting creditors if there is overall support from at least 75% of all the creditors present through voting at the Court-convened meeting; and the Court is satisfied that the Scheme of Arrangement is fair and equitable to the dissenting creditors.

This can prevent the minority group of dissenting creditors from obstructing the implementation of a feasible Scheme of Arrangement that may be beneficial to the majority of creditors where the outcome is expected to be better than a winding-up.

Once the Court grants an order approving the Scheme of Arrangement, it is binding on the scheme company and the creditors or class of creditors meant to be bound by the scheme.

Rescue financing for the Scheme of Arrangement and JM

5 Super priority for rescue financing for the Scheme of Arrangement and JM

Companies in financial distress face difficulties in securing funding for their rescue plan. Traditional lenders may not be willing or are unable to readily extend credit to financially-distressed companies. Identifying and securing a potential investor as the “White Knight” for the rescue plan can be challenging as financially distressed companies may typically be facing going concern issues, unavailability of unencumbered assets or poor asset quality.

The introduction of rescue financing for the Scheme of Arrangement or JM in the Amendment Act would improve a company’s chances to obtain funding for its rescue plan or attract potential investors to become its “White Knight”. Under the new provisions on super priority for rescue financing provided to a company, the Court may grant an order for one or more of the following:

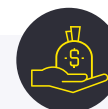


Debt arising from rescue financing obtained by the subject company is given priority in the event of the winding-up of the company.



Security for rescue financing:

- ▶ Unencumbered assets
- ▶ Subordinate security interest over existing charged assets



Security for rescue financing:

- ▶ Same-rank security over existing security
- ▶ Higher-ranking security over existing security

Subject to the protection of interests of existing security holder(s).

Enhanced role of Court appointed Insolvency Practitioner in Scheme of Arrangement

In a Scheme of Arrangement, the Court shall appoint an Insolvency Practitioner in the following applications:

- ▶ Pre-pack
- ▶ Cram down
- ▶ Super priority for rescue financing
- ▶ Restraining order against related company

The appointed Insolvency Practitioner will chair all scheme meetings, prepare and submit a progress report to the Court on the proposed scheme prior to Court sanction.

In a cram down, the Court may require the Insolvency Practitioner to assist in estimating the amount that a creditor is expected to receive under the Scheme of Arrangement compared to not having the Scheme of Arrangement.

Snapshot: New and improved provisions on corporate rehabilitation

The new and improved provisions relating to the Scheme of Arrangement and CRM are as follows:

	Previous provisions	New or improved provisions
1 Applicability of CVA and JM	Despite the CRM provisions which came into force on 1 March 2018, the limiting non-applicability criteria for CVA and JM precluded many companies from being able to use the CRM to formalize their rescue plans.	The widened applicability of JM (and CVA once the provision comes into force) would enable most companies to use CRM in facilitating the formulation and implementation of rescue plans more efficiently and effectively.
2 Court's discretion on the extended JM Order period	<p>The duration of the JM Order is for an initial period of six months. The Court was empowered to grant an extension for another six months subject to terms that the Court may impose.</p> <p>This explicit maximum duration of the JM Order was impractical as the formulation and formalization of a viable rescue plan by the Judicial Manager may be frustrated merely due to the expiration of a JM Order with no further extension being available beyond 12 months.</p>	<p>The Court now has the discretion to allow for the extension of the JM Order to longer periods, subject to any terms the Court may impose.</p> <p>Secured creditors' rights to recovery during the JM Order period are now allowed, after giving notice to the Judicial Manager, if:</p> <ol style="list-style-type: none">The judicial manager confirms that the goods or movable property is not required by the company under JM;The JM Order poses a high risk of dissipation of the company's assets; and/orThe value of the assets decreases due to the JM Order.
3 RO for the Scheme of Arrangement	If the company is not already winding-up or under JM, obtaining a restraining order as soon as possible is often critical to enable the company to preserve its assets and allow for time for it to focus on formulating and formalising a rescue plan.	The enhanced provisions on the RO address some of the previous shortcomings and include safeguards against the potential abuse of ROs.
4 Court approval for the Scheme of Arrangement	<p>The approval process for a Scheme of Arrangement involves:</p> <ol style="list-style-type: none">Applying to the Court for Court-convened meeting dateConducting the Court-convened meeting for the different classes of creditors to obtain the requisite approval for the Scheme of ArrangementApplying to the Court for approval of the Scheme of Arrangement	<p>Obtaining Court approval for the Scheme of Arrangement can now be expedited under certain conditions:</p> <ul style="list-style-type: none">Pre-pack - The Court approves a pre-negotiated Scheme of Arrangement without a meeting of creditorsCram down - The Court approves a Scheme of Arrangement even though there are dissenting creditors or classes of creditors who voted against the Scheme of Arrangement at the meeting of creditors
5 Super priority for rescue financing for the Scheme of Arrangement and JM	<p>Financially-distressed companies may typically be facing going concern issues, unavailability of unencumbered assets or poor asset quality.</p> <p>Traditional lenders may not be willing or are unable to readily extend credit to financially distressed companies. Identifying and securing a potential investor as the "White Knight" for the rescue plan can be challenging.</p>	Super priority for rescue financing for the Scheme of Arrangement and JM would improve a company's chances to obtain funding for its rescue plan or attract potential investors to become the "White Knight".

Snapshot: New and improved provisions on corporate rehabilitation (cont'd)

Previous provisions

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Role of a Court-appointed Insolvency Practitioner for the Scheme of Arrangement

The Court may appoint an approved liquidator to assess the viability of the proposed Scheme of Arrangement. The approved liquidator shall prepare a report to be tabled at the Court- convened meeting.

7

Procedures on proof of debt for the Scheme of Arrangement

There was no statutory requirement for proof of debt for the creditors' vote in a Scheme of Arrangement. To minimize potential disputes, a company applying for a Scheme of Arrangement would usually implement a mechanism to determine the amount owed to creditors and the nature of their debts.

8

Restricted rights to terminate contracts for essential goods and services

Continued operations of the distressed company may be critical to the successful implementation of a rescue plan whether via the Scheme of Arrangement, JM or CVA. As such, it is crucial to ensure a continued supply of essential goods and services.

However, most commercial contracts would contain a trigger mechanism (i.e., an ipso facto clause) that allows a counterparty to terminate the contract due to the other party entering into insolvency-related proceedings such as entering into a compromise with its creditors, receivership, JM or winding-up.

9

Revote of the Scheme of Arrangement's pre-Court approval

Once the Scheme of Arrangement is agreed by the requisite majority of creditors or class of creditors at the Court-convened meeting, the Company will apply for Court approval of the Scheme of Arrangement. The Court may grant its approval for the Scheme of Arrangement subject to such alterations or conditions as the Court thinks just.

10

Review of acts, omissions or decisions made in a Scheme of Arrangement's post- Court approval

Once the Court order approving the Scheme of Arrangement is granted and lodged with the Registrar, the Scheme of Arrangement shall be binding on the company and all creditors or class of creditors.

New or improved provisions

The role of the Court-appointed Insolvency Practitioner in a Scheme of Arrangement has now been further enhanced. The Court may, or shall in any of the following applications, appoint an Insolvency Practitioner:

- ▶ Super priority for rescue financing
- ▶ Pre-pack
- ▶ Cram down
- ▶ Restraining order against related company

The appointed Insolvency Practitioner will chair all scheme meetings, prepare and submit a progress report to the Court on the proposed scheme prior to Court sanction. In a cram down, the Court may require the Insolvency Practitioner to assist in estimating the amount that a creditor is expected to receive under the Scheme of Arrangement compared to not having the Scheme of Arrangement.

The codified procedures on proof of debt for the Scheme of Arrangement provide more certainty on the submission requirements including the dispute resolution mechanism in relation to the rejection, inspection or admission of the proof of debt.

Now, suppliers of essential goods and services listed under the Ninth A Schedule are not allowed to exercise their rights pursuant to the insolvency-related clauses of the supply contracts merely because a company is entering into a Scheme of Arrangement, CVA or JM unless they have given written notice of at least 30 days to the company.

The 30-day notice period would enable the management of the company, or Judicial Manager if the company is under JM, to liaise with the suppliers for their continued support or look for alternative suppliers.

At the Court hearing of the application for the Court's approval of a Scheme of Arrangement, before granting its approval, the Court can now consider whether the class of creditors was fairly represented and order a revote of the Scheme of Arrangement if the Court thinks fit. This may include directions on the classification of any creditor, admission and weightage of their debt for the revote.

Notwithstanding that Court approval has been granted for a Scheme of Arrangement, any creditor bound by the Scheme of Arrangement can apply to Court for an order to reverse, modify and/or rectify the act, omission or decision of the subject company resulting in the breach of any term in the Scheme of Arrangement.

Considerations

Financially-distressed companies, with viable businesses, can be attractive to investors. The introduction of super priority for rescue financing under the Amendment Act may spur more interest from potential investors to inject fresh capital into businesses in need of financial restructuring.

Making a strategic decision on whether to revive a financially distressed company and determine the suitable corporate rehabilitation process or mechanism depends on the circumstances of the troubled company and nature of its indebtedness.

Each corporate rehabilitation process available under the CA has their own distinct features and practical uses. Some of the factors for consideration include the:

- ▶ Viability of the business and the main cause of its financial problems
- ▶ Takeout source of funding
- ▶ Creditor profile
- ▶ Legal protection
- ▶ Support of major stakeholders, e.g., shareholders, management, employees and key suppliers

The effectiveness of a restructuring plan depends on the viability of the business, a robust legal framework, stakeholder cooperation, and skilled professionals guiding the process.

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Today's corporate restructurings are complex and demand that stakeholders engage with more nuanced strategies than ever before.

Taking a strategic approach to corporate restructuring and insolvency is crucial. This does not only ensure a better likelihood of a successful corporate rehabilitation but delivers value to all stakeholders - whether you are a company facing financial distress, a creditor seeking to optimize recovery or protect your interests, or an investor looking to invest in financially-distressed companies.



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