Reforming the Corporate Insolvency Regime

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Introduction

In our first article "*An insight to Corporate Law Reform in Malaysia"*, we mentioned that the Corporate Law Reform Committee, (CLRC) established by the Companies Commission of Malaysia (CCM) for the purpose of reviewing the Companies Act 1965 (Act), has divided its review work into four separate Working Groups. Working Group D is reviewing the current law and practice relevant to corporate securities and insolvency.

In conducting its review of this core area of company law, Working Group D is guided by the objectives that its review and recommendations, if any, must amongst other things, reduce the cost of compliance, increase efficiency and protect the interests of stakeholders. These objectives are in tandem with the overall objectives of the CLRC as set out in its consultative document titled *'**Strategic Framework for Corporate Law Reform Programme**'*.

Reviewing the current corporate insolvency regime

There is a discernable international trend in various jurisdictions to move towards corporate rescue mechanism as part and parcel of the corporate insolvency regime. In these jurisdictions, liquidation or winding up is no longer considered as the main outcome of an insolvent company. It is noted that the corporate insolvency framework in other jurisdictions covers matters pertaining to pre-insolvency procedures, liquidation process, consolidation of corporate and personal insolvency laws and corporate rescue mechanisms.

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

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

In most jurisdictions, an effective corporate insolvency regime is seen to be one that should be able to provide a system to enable the winding up of companies where there is no future prospect of the business becoming profitable and viable with the least possible cost and delay. At the same time, an effective corporate insolvency regime should be able to provide for mechanisms to rehabilitate companies and rescue companies from being wound up. The Harmer Report of Australia[2] for example, whilst acknowledging the general principles of corporate insolvency law, stated that there should be an effective release of the insolvent company from financial obligations and liabilities.

Whilst most of the general principles of corporate insolvency law stated above are found in company's liquidation provisions within the Companies Act 1965, the present

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

framework is very much focussed on the liquidation or winding up of a company. Liquidation has also often been seen as the only viable option for companies which are insolvent. The corporate insolvency law in Malaysia, under the Companies Act 1965, envisages the following methods for dealing with company insolvency. The first is a receivership process where creditors may appoint a receiver and manager. Most often, the company will be wound up and the company's assets are hived off and sold separately. The second is where an application for winding up may be made to the court (through a members' voluntary winding up, creditors' voluntary winding up or winding up by the court). It is also possible to use a scheme of arrangement for the reconstruction of companies. However, the present framework is inadequate as there has been a lack of focus on rescue mechanisms or attempts to rehabilitate companies.

By combining a corporate insolvency regime that deals with company liquidation as well as corporate rescue mechanism, there will be rules which are more commercially realistic in terms of addressing the needs of companies and investors. Companies are primarily used as a vehicle to conduct business. It is a fact that just as there are businesses that prosper, there are also just as many businesses that fail. A company that is used as a vehicle to conduct business should be allowed to wind up its business where there is no viable prospect of the business becoming profitable. In such an instance, the corporate insolvency regime must be facilitative in that it should provide for the efficient winding up process of that company. The corporate insolvency regime should also be protective of the rights of creditors and members especially in cases where the company is wound up on the grounds that it is insolvent.

Many factors can contribute to the failure of a business. In some instances, business failure may be attributed to mismanagement. Yet, in some cases, a business may fail not because of mismanagement but because of external economic factors which are beyond the company's control.

Where the failure of a company's business is attributed to mismanagement by persons in control of the affairs of a company, one of the concerns is making those responsible for

such mismanagement accountable for their actions. Further, there is also the need to prevent such persons in the future from setting up new companies with the view of doing the same with those new companies. Enhancing the accountability of those involved in the company's management and liquidation process are one of the major issues that must be considered when reviewing the corporate insolvency regime.

In some instances, where a company's failure is not contributed by mismanagement but due to temporary financial difficulties or external economic factors, a rescue mechanism may enable the company to be rehabilitated and preserve its business as a going concern. A corporate rescue mechanism may also enable better returns for creditors and shareholders as fragmented sale of a company's business in most cases may not be in the best interest of the company's creditors and shareholders.

Is there a need for a single Omnibus Insolvency Act?

One issue that has often been raised in respect to corporate insolvency in Malaysia is whether there is a need to legislate a single Omnibus Insolvency Act. There are two approaches being adopted as far as the corporate insolvency regime is concerned.

- The first is the creation of an Omnibus Insolvency Act which consolidates both the corporate and individual insolvency and operates as a free-standing legislation from company legislation.

  The United Kingdom through its Insolvency Act (UK IA) has, since 1986, consolidated personal and corporate insolvency laws into a single insolvency regulatory framework although extensive cross-reference is made in the companies legislation to the insolvency legislation. Singapore's Report on the Company Legislation and Regulatory Framework Committee (CLRFC) issued in October 2002 has proposed the introduction of an Omnibus Insolvency Act and subsidiary legislation that are applicable to both companies and individuals to harmonise and consolidate any uncertainty in areas specifically relating to undue preference transactions, avoidance of dispositions of company's property and floating charges.

- The second approach is to maintain two separate regulatory regimes between the corporate and personal insolvency where the corporate insolvency framework is integrated into company legislation.

  Australia and New Zealand maintain separate insolvency regulatory frameworks for individual and corporate insolvency. In Australia, for example, the Corporations Act contains provisions relevant to corporate liquidation, receivership process and rescue mechanism. New Zealand has a similar regime although the receivership procedures are found in a separate Receiverships Act.

Essentially, in Malaysia, support for a single Omnibus Insolvency Act for Malaysia is fuelled by the argument that the current corporate liquidation or winding up framework is confusing due to the fact that extensive cross-reference needs to be made to the various bankruptcy principles and rules provided for in the Bankruptcy Act 1967. One conspicuous example is the application of section 53 of the Bankruptcy Act 1967 under section 293 of the Companies Act 1965 for undue preference transactions. This has caused confusion and in some instances, fails to facilitate easy understanding of the corporate insolvency regulatory framework.

However, the more important concern in relation to reviewing and reforming the corporate insolvency regime for Malaysia is creating a corporate insolvency regime that is both facilitative to the winding up process and protective of the rights of creditors and stakeholders of the company by providing a mechanism to enforce these rights without undue delay and difficulty. For example, this over-dependency on the bankruptcy laws may be resolved by incorporating into the company legislation provisions on corporate winding up and removing any cross references to the provisions of the Bankruptcy Act 1967 that are incompatible with corporate insolvency.

It should be pointed out that with or without an Omnibus Insolvency Act, further improvements can and should be made to reduce any confusion that may exist in respect to our existing corporate insolvency regime. This can be done by refining and

streamlining existing provisions in respect of corporate insolvency as is currently provided for in the Companies Act 1965.

Refining the provisions in respect to corporate liquidation

There are several improvements in terms of substantive and procedural changes that may and should be made to the current company liquidation framework in Malaysia. This is in line with the objective of the CLRC to facilitate and provide simplified yet effective procedures in every aspect of company administration including the procedures for the proper closure of a company that may not be able to continue its business.

Some of the issues that have been considered in relation to liquidation in other jurisdictions relate to the following:

- the commencement and termination of winding up

  Currently, in Malaysia in the case of compulsory winding up of a registered company, the commencement of winding up is not on the date the order is made but is instead deemed to have occurred from the date the petition for winding up is presented to the court.

  Several jurisdictions have actually departed from this approach and have provided, that the commencement of winding up in the case of compulsory winding up, occurs either from:

  (i) the date the order for winding up is made, as ii the case in Australia; or

  (ii) the date the liquidator is appointed, as is the case in New Zealand.

  Another area of concern relates to the persons who have the authority to apply to terminate the winding up process. Currently, there is no provision empowering the courts to discharge a winding up order that has been made. However, the

Companies Act 1965 does empower the court to order a stay of winding up. Case law has held that a stay order can also be of permanent effect.

Australia and New Zealand have actually provided, by way of legislation, that its court can make an order terminating the winding up of a company.

- the powers and duties of liquidator and an interim liquidator

Some jurisdictions such as Australia and United Kingdom have codified the duties and powers of liquidators and interim liquidators.

- the appointment and qualification of liquidator

Several jurisdictions have revised the necessary qualifications for liquidators specifically and corporate insolvency practitioners in general.

- the rights of secured creditors and the rights of creditors to mutual credits and set-off

Currently in Malaysia, this issue is dealt with by the development of case. However, several jurisdictions such as New Zealand and Australia have codified the rights of secured creditors and the rights of creditors to mutual credits and set-off.

- setting aside void and voidable transaction.

As noted earlier, one of the general objectives of corporate insolvency is the avoidance of transfers and transactions which unfairly prejudice the general body of creditors. It is important that adequate powers are given statutorily to recover assets of a company transferred in dubious circumstances. Several provisions of the Companies Act 1965 need to be considered for example sections 223, 224 and 293 of the Companies Act 1965.

Conclusion

As the liquidation process remains an integral part of the corporate insolvency law, there should also be a move towards enacting a comprehensive framework on the rescue mechanisms to help rehabilitate ailing companies that have the potential to be revived and to make profits. The CLRC will constantly monitor the progress in other jurisdictions to ensure that its recommendations, if any, will be on par with and in conformity to the international standards, without compromising the values and needs of companies and investors locally. In this respect, the review of the existing corporate insolvency regime is a gargantuan task as it requires the balancing of numerous interests which, at times, may be in conflict with each other.