CORONAVIRUS AND THE WORLD ECONOMY:

CORPORATE INSOLVENCY & RESTRUCTURING REVIEW

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The world learned of a new strain of virus now commonly known as 'Covid-19' which was thought to originate in the province of Wuhan, China. The virus attacks the human respiratory system causing difficulties in breathing, pneumonia and even death, particularly in vulnerable groups such as the elderly and immunosuppressed. But apart from human loss, the coronavirus has another victim: the World Economy. The virus has, as to date, extirpated billions from the world economy and seems to be the final nail in coffin of industries that are already being hit hard from plunging oil prices and looming global recession. Governments around the world are scrambling for formula, strategies, stimulus packages and bailout plans - often one after the previous – to try to keep their economy afloat in this troubling period.

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Stimulus Packages

MALAYSIA's 8th Prime Minister, Tan Sri Muhyiddin Yassin, unveiled the 2020 Economic Stimulus Package valued at RM20 billion on 16 March 2020. Amongst the strategies are:

a) a Special Relief facility worth RM2 billion predominantly in the form of working capital for Small Medium Enterprises (SMEs) to be provided by Bank Negara Malaysia at an interest rate of 3.75%;

b) Bank Simpanan Nasional (BSN) will allocate RM200 million in microcredit facility at an interest rate of 4% to affected businesses; and

c) all banks are required to provide financial relief in the form of a payment moratorium of up to six months comprising of restructuring and rescheduling of loans for affected businesses and individuals, with Bank Negara Malaysia issuing a directive on 24 March 2020 on the automatic moratorium.

A second Comprehensive Economic Stimulus Package and People's Aid, promising additional measures and initiatives to mitigate the impact of Covid-19, is expected to roll out on 30 March 2020.

SINGAPORE allocated SGD$4 billion in aid of businesses that are directly affected by COVID-19. Insofar as working capital is concerned, businesses are eligible up to a maximum loan sum of SGD$600,000 under the Enterprise Financing Scheme's Working Capital Loan programme. Government's risk-share will also be raised to 80% from the current 50%-70%.

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INDONESIA issued its second stimulus package valued at USD8 billion on 13 March 2020 (after announcing the first stimulus package worth USD$725 million) to combat Covid-19 impact, focusing on fiscal and non-fiscal incentives for SMEs businesses. Rules governing loan restructuring for SMEs are to be relaxed, allowing banks to restructure loans regardless of credit ceiling limits. SMEs with good credit history with repayment prospect are eligible for loans up to 10 billion rupiah (USD$655,000)[1].

In **AUSTRALIA**, the Federal Government released an economic response to withstand the impact of Covid-19 which includes temporary relief for financially distressed businesses. In an unprecedented move, the Government intends to temporarily amend its insolvency and corporation laws including:

a) relieving directors from any personal liability for trading whilst insolvent, which will apply for six months with respect to any debts incurred in the ordinary course of the company's business[2];

b) increasing the threshold for a creditor to issue a statutory demand on a company from AUD$2,000 to AUD$20,000. Since failure to respond to a statutory demand creates a presumption that a company is insolvent, the period to respond to the statutory demand will also increase from twenty-one days to six months. As for individuals, the Government will make temporary changes to the Bankruptcy Act 1966 whereby the threshold to initiate a bankruptcy proceedings against a debtor will increase from AUD$5,000 to AUD$20,000 and extending the period to respond from twenty-one days to six months to allow breathing room for repayment arrangements.[3]

[1] https://www.aseanbriefing.com/news/indonesia-issues-second-stimulus-package-dampen-covid-19-impact/

[2] https://treasury.gov.au/coronavirus/businesses

[3] https://www.afr.com/policy/economy/insolvency-law-to-be-changed-as-avalanche-expected-20200322-p54con

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Industry Focus: Aviation

The highly contagious Covid-19 compelled many countries across the globe to close their borders, institute travel bans and implement movement restrictions. Riddled by poor passenger loads, fear of travelling and massive cancellations, the aviation industry is one of the hardest hit by the virus.

As Covid-19 grinds air traffic to a halt, carriers from American Airlines to Qantas Airways have slashed capacity by almost 90% if not more. A simple online search would reveal other more chilling statistics. The nation's notable airline companies - national carrier Malaysia Airlines, Fireflyz, AirAsia, AirAsia X and Malindo - are not spared.

Prior to the nationwide Movement Control Order, AirAsia X cushioned the Covid-19 impact by launching an "unprecedented" RM499 one-year unlimited travelling pass to Australia, Japan, Korea, China and India. Malaysia Airlines resorted to pay cuts[4] and instituted a Voluntary Unpaid Leave Programme, whilst AirAsia and Malindo Air have opted to slash salaries of its employees and senior management[5]. With the nationwide Movement Control Order in effect and extended, more flights are reduced, suspended or cancelled.

[4] https://www.theedgemarkets.com/article/malaysia-airlines-risks-bankruptcy-amid-plunging-demand-travel-bans-says-cfo

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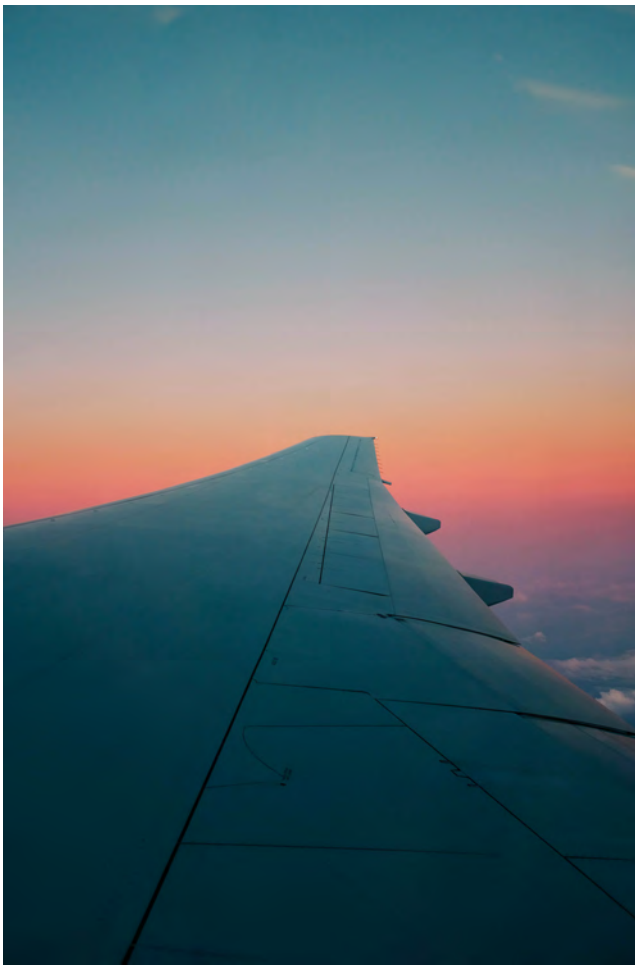

It remains unclear whether the reliefs under the 2020 Economic Stimulus Package, mainly in the forms of 15% electricity discount and rebates on landing and parking charges, are sufficient to keep these airlines airborne. Local airlines are reported to have requested the government for direct financial aid. Another government bailout would be the silver lining for Malaysia Airlines but given the frail economy, it is controversial and riddled with difficulties. Resources are better used elsewhere, where it is crucially needed – in strengthening and supporting the healthcare system. It is also difficult to envisage if a merger between Malaysia Airlines and AirAsia X – an idea mooted by many - could happen in light of their failed collaboration in 2011[6]. Whatever the plan is, it appears that the airlines must fend for themselves for now.

Without a proper rescue mechanism from the Government and industry, the Centre for Asia Pacific Aviation (CAPA) estimates that most airlines in the world will be forced into bankruptcy by the end of May 2020 amid the current Covid-19 scare.[7] AirAsia Group Berhad already cautioned it may have to ground its airline altogether and shift to e-commerce business.

Flybe, Europe's biggest regional airline, is flying no more. Citing financial difficulties as a direct result of the global pandemic, it became the first casualty by filing for administration in March 2020[8]. It may not be long before other airlines follow suit.

[5] https://themalaysianreserve.com/2020/03/11/airasia-shares-drop-further-salary-cut-for-top-management/; https://www.theedgemarkets.com/article/airlines-hit-covid19-cash-flow-constraints-malindo-air

[6] It was also reported that Tan Sri Tony Fernandes was considering merging AirAsia with AirAsia X.

[7] https://centreforaviation.com/analysis/reports/covid-19-by-the-end-of-may-most-world-airlines-will-be-bankrupt-517512

[8] https://www.theguardian.com/business/2020/mar/05/flybe-collapses-two-months-after-government- announces- rescue

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CORPORATE RESCUE MECHANISMS IN MALAYSIA

Judicial Management, Corporate Voluntary Arrangement and Scheme of Arrangement

We have previously written on the Companies Act 2016 ("CA 2016") and the changes it brought to the Malaysian corporate insolvency regime through the introduction of the Judicial Management and Corporate Voluntary Arrangement, in addition to the existing Scheme of Arrangement mechanism [see Sections 365 – 371 CA 2016].[9]

A) Judicial Management (Sections 403 – 430 CA 2016, Ninth Schedule)

A financially distressed company may apply to the Court for appointment of an independent 'judicial manager' who would be responsible in managing the company's affairs, business and property for the purpose of preparing a restructuring scheme which would be presented to creditors for which a 75% majority sanction is required.

In addition to inability to pay debts, the Court must be satisfied there is a reasonable probability of rehabilitating the company's finances and operations and that the interests of creditors would be better served than resorting to winding up proceedings.

A unique feature of judicial management is the implementation of an automatic moratorium on all enforcement proceedings against the company upon submission of the application to Court. If granted, a restraining order will be valid for six months and may be extended for a further six months. This suggests a fair balance between protecting creditor interest and encouraging rehabilitation of a company.

However, secured creditors have the power to veto the application and, subject to the discretion of the Court to make a judicial management order if public interest requires it, proceed to appoint a receiver or receiver and manager.

[9] http://www.taypartners.com.my/en/index.php/legaltaps-201710

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B) Corporate Voluntary Arrangement (Sections 395 – 402 CA 2016, Seventh & Eighth Schedule)

As a new corporate rescue mechanism, the CVA functions to provide a quick and minimal court-intervention process for companies under financial difficulties to enter into a debt restructuring agreement with its creditors.

Available only to private companies, the application of a CVA similarly imposes an automatic moratorium on any action by creditors which remains in force for twenty-eight days.

To initiate a CVA, the company is required to appoint a nominee, to wit, a licensed Insolvency Practitioner who will then submit a statement indicating his opinion on whether the debt restructuring proposal has a reasonable prospect of being approved and implemented and whether the company will have sufficient funds to carry on its business during the moratorium period.

A creditors meeting will be held to discuss the proposed voluntary arrangement where a 75% majority vote in favour of the proposal is required to see it through (and binding on all creditors regardless of how they voted). Under the proposed CVA, the nominee will also be appointed as a supervisor of the agreement to oversee its implementation.

C) Scheme of Arrangement (Sections 367, 368 CA 2016)

Apart from the two significant updates to the CA 2016 discussed above, additional controls are imposed on court-sanctioned schemes of arrangement to ensure the rehabilitation of the company is made more effective as a mode of corporate debt restructuring.

The previous Section 176, Companies Act 1965 is prone to abuse by companies without a bona fide scheme of arrangement to achieve temporary protection from creditor actions. The CA 2016 provides two key improvements in the scheme of arrangement to avoid abuse of the moratorium provisions whereby:-

a) a restraining order can now only be extended to a maximum period of nine months (as opposed to “any such longer period as the Court may for good reason allow” in Section 176(10) CA 1965);

b) an approved liquidator may be appointed by the Court to assess the viability of the proposed scheme of arrangement and to prepare a report for submission to the creditors meeting in an attempt to obtain a more objective viewpoint and assessment.

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Statutory Update

Certain provisions of the CA 2016 were amended by way of the Companies (Amendment) Bill 2019 which came into effect on 15 January 2020. Previously, Section 409 empowers the Court to dismiss an application made by a company for judicial management order where:

(a) a receiver and manager has been or will be appointed; and
(b) the making of the order is opposed by a secured creditor.

The new amendment to Section 409 (a) replaces the word "and" with "or" which makes it easier for Courts to dismiss a judicial management application in line with the policy to protect creditors. Criticism includes diluting the aims of judicial management as part of a corporate rescue mechanism to save ailing companies.

Recent cases

1. **Barakah Offshore Petroleum Berhad and PBJV Group Sdn Bhd v Mersing Construction & Engineering Sdn Bhd & 3 Ors [2019] 3 AMR 673; [2019] MLJU 338, HC**

Facts: The High Court allowed the *ex parte* application by Barakah Offshore Petroleum Berhad and its subsidiary ("Applicants") for a restraining order under Section 368(1). Upon expiry, the Applicants sought for an extension of the restraining order. This was opposed by some creditors on the ground that the Applicants did not comply with the statutory pre-conditions prior to the grant of the restraining order.

Issue: Whether the pre-conditions in Section 368 (2) CA 2016 must be satisfied at the initial stage of the application, or only upon the extension of the restraining order period.

Held: The Court allowed the creditors' application to set aside the restraining order. The conditions of Section 368(2) must be complied with despite the difficulties in doing so due to the drastic effect of a restraining order which would prevent creditors from pursing legal remedies.

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2. CIMB Islamic Bank Bhd v Wellcom Communications (NS) Sdn Bhd & Anor [2019] 4 CLJ 1, CA

Facts: Two applicant companies, Wellcom Communications and Rangkaian Minang applied for a judicial management order. However, the application was opposed by CIMB Islamic Bank Berhad, the secured creditor and debenture holder of both companies and subsequently dismissed by the High Court.

Issue: If the Court dismisses an application for judicial management, whether a stay on the automatic moratorium under S 410, CA 2016 would be allowed.

Held: The Court of Appeal overturned the stay of the automatic moratorium granted by the High Court on the following grounds:

(i) In granting a judicial management order, the Court must consider the real prospect of a company recovering its finances and operations. Strict proof and evidence is necessary and the court cannot merely rely on surmise and conjecture as to ensure creditors are not frustrated from pursuing legal remedies against the company.

(ii) The Court must justly, economically and expeditiously dispose of a judicial management application and any appeal process. This is in line with the effects of the order which prevents any creditor action and without any chance of rehabilitating the company, weight must be given towards protecting creditors' interests.

(iii) An element of *bona fide* must be reflected in a judicial management application and the Court suggested an approach to write to all the concerned parties to obtain their views prior to filing the application and to disclose the creditors' view to the Court.

Although the Court did not elaborate on the threshold of 'strict proof and evidence', it is suffice to say that sufficient evidence must be placed to satisfy the requirements under Sections 404 and 405, CA 2016 prior to a judicial management order. There must be a fine balance between rescuing a 'drowning' company and to protect creditor's interests to avoid an abuse of process of court.

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3. Sham Chin Yen & 15 others v Mansion Properties Sdn Bhd [2019] 1 LNS 781, C

Facts: The Respondent, a housing developer, initiated a scheme of arrangement and obtained a restraining order to restrain any other legal proceedings against the company. The Appellants comprised of 15 condominium purchasers who had earlier filed legal action for liquidated damages against the Respondent due to the delay in delivering vacant possession of the condominium units.

Chronology: The Respondent obtained an *ex parte* order on 9.11.2017 to convene a creditors meeting for a scheme of arrangement and restrain all other proceedings. The scheme was approved by the creditors on 14.12.2017.

The Appellants sought to set aside the *ex parte* order and while this application was pending, the Respondents secretly obtained a second ex parte order on 7.2.2018 which sanctioned the scheme of arrangement and maintain the restraining order given in the first ex parte order until the terms of the scheme is carried out/implemented. The Appellants challenged on the second ex parte order was dismissed by the High Court.

Held: The Respondent's action to file a second application in a different court to sanction off the scheme of arrangement when there was pending legal challenge to the first *ex parte* order was deemed an abuse of court process. Since the first judge had given directions for the Respondent to convene the creditors meeting for the scheme of arrangement and restrain of proceedings, it is only fair for the second application to be heard by the same judge. This is to maintain the High Court's visionary duties over the scheme and ensuring that the views and interests of those who have not approved the proposal are preserved.

The Respondent's action of obtaining the second *ex parte* order without the knowledge of the Appellants renders their action to be *mala fide* against the Appellants and the Court of Appeal set aside both *ex parte* orders.

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Recent Deals

1. Creditors of Kinsteel Group Berhad agree to proposed scheme of arrangement

Creditors of steelmaker, Kinsteel Group Bhd, have approved a scheme of arrangement to rescue the company from its Practice Note 17 status which is issued by Bursa Malaysia to companies in financial distress. The scheme of arrangement involves reducing its share capital, disposal of properties and fund raising. It also offers its corporate guarantee holders RM25 million worth of irredeemable convertible preference shares and redeemable convertible preference shares each.

Companies may fall within the ambit of PN17 by having its shareholder's fund equal or less than 25% of the total issued paid up capital of the listed company or a receiver/manager has been appointed to manage at least 50% of the total assets listed under the company on a consolidated basis. Adverse opinions on the company's latest audited accounts or the ceasing of all major operations may also contribute to the company's PN17 status.

2. BIMB Holdings Bhd to transfer listing status to Bank Islam Malaysia Berha

In December 2019, BIMB Holdings Bhd had proposed a series of restructuring exercises that was intended to move its listing status to its subsidiary, Bank Islam Malaysia Bhd. Details of the restructuring plan include placement of new BIMB shares of up to RM800 million which will go towards settling an outstanding 'sukuk' under Lembaga Tabung Haji.

A scheme of arrangement will take place to pay warrant holders in cash consideration for the cancellation of exercise rights in respect of the warrants. The group will also undertake an internal reorganization whereby stock-broking and leasing subsidiaries will be sold to Bank Islam according to the net asset value of the units in an effort to simplify the corporate structure of the company. These exercises will be an effort to expand its customer base and improve the position of Bank Islam in the Islamic finance and Islamic capital market.

Should you have any queries or require more information, please do not hesitate to contact us.

WONG WENG YEW
Partner

For further information and advise on this article and/or on any areas of Litigation and Dispute & Resolution, please contact: wengyew.wong@taypartners.com.my

FARINA HANIM
Associate

For further information and advise on this article and/or on any areas of Litigation and Dispute & Resolution, please contact: farina.hanim@taypartners.com.my