

ASIAN DEVELOPMENT BANK

**REGIONAL TECHNICAL ASSISTANCE
TA NO: 5795-REG
INSOLVENCY LAW REFORM**

**SUPPLEMENTARY REPORT ON
MALAYSIA**

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A. Insolvency Processes

1. Please supply number and details of cases of:

- (a) **corporations whose financial affairs have been or are being handled under the relevant process, framework or agreement governing informal corporate debt restructuring [the numbers should be from the date that the process, framework or agreement was established to facilitate informal restructuring; details of the corporations should relate to size, industry type , debt level];**

The main informal insolvency process is the informal workout process overseen by the Corporate Debt Restructuring Committee (“CDRC”) established by Bank Negara Malaya (“Bank Negara”), the central bank, to provide impetus to informal workouts. The number of companies that are or have been involved in the CDRC is approximately 63. In 1999, the following public listed companies are a sample of those debtors that have successfully entered into debt restructuring agreements with their lenders via the CDRC process:

- (1) **Tongkah Holdings Berhad** [Engaged in manufacturing, IT services, financial services and healthcare]. Secured debt of RM392.447 million and unsecured debt of RM161.996 million.
- (2) **Lien Hoe Berhad** – [Property holding and development]. Debt level of RM212.062 million.
- (3) **Nam Fatt Corporation Berhad** – [Construction, engineering, property, leisure and manufacturing]. Secured debt of RM312.3 million and unsecured debt of RM207.8 million.
- (4) **Chongai Corporation Berhad** – [Consumer products] Secured debt of RM3.26 million and unsecured debt of RM55.75 million.

- (b) **corporations which have been placed in formal liquidation under the relevant insolvency law [numbers and details should be from January 1999].**

The number of corporations placed in formal liquidation in Malaysia between January 1999 and June 1999 are:

[Still awaiting statistics from Official Receiver’s Office]

- (c) **corporations whose financial affairs have been or are being handled under the relevant insolvency law governing reorganisation [numbers and details as in (b)].**

The main insolvency laws concerning reorganization of companies are:

- (i) **The scheme of arrangement and reconstruction law contained in section 176 of the Companies Act 1965.** No official statistics on the number of such companies exists. However, from a variety of sources, the approximate number of corporations whose financial affairs are still being handled under such a law are between 125–175.

Between July 1997 and December 1998, one source has put the number of companies that had resorted to the procedure as 131 private and 32 public listed companies. See R Thillainathan, Corporate Governance & Restructuring in Malaysia – A Review of Markets, Mechanisms, Agent and the

Legal Infrastructure, (1999) Paper prepared for joint OECD/World Bank Survey of Corporate Governance.

- (ii) The **Pengurusan Danaharta Nasional Berhad (“Danaharta”) Act** of 1998. The Special Administrators appointed by Danaharta over companies whose assets were taken over by Danaharta have the power to initiate workout proposals. The latest published figures are up to 30th June 1999. As at that date Danaharta had acquired the debts of 1,780 corporate debtors totaling RM39.3 billion. Of these, the loan workout progress is as follows:
- 1% representing 23 borrowers have been fully settled.
 - 6% representing 105 borrowers have proposals finalised and are pending implementation.
 - 3% representing 55 borrowers have proposals evaluated pending finalisation.
 - 15% representing 263 borrowers have had proposals submitted and are pending evaluation.
 - 20% representing 340 borrowers have had recovery initiated pending submission of proposal.
 - 54% representing 931 borrowers are awaiting initiation of recovery.

2. Provide details and copies of any published comments, opinions or statements describing how the above processes are working and the level of success or otherwise.

The Operations Report and Annual Report published by Danaharta contain comments and/or statements concerning the process of reorganizing distressed companies whose debts have been taken over by Danaharta and details of actual case studies of successful work-outs. Press releases are also issued from time to time advising of appointments of special administrators, loan restructuring guidelines, etc. These can be found at <http://www.danaharta.com.my>.

The CDRC periodically issues press releases that can be obtained via the Bank Negara Malaysia website at <http://www.bnm.gov.my>. The CDRC’s own website is not operational as at the date of this report.

B. Insolvency Reforms

1. Provide details of any reforms that have occurred in relation to insolvency law and practice and related areas (such as corporate governance, secured transactions and so forth) since January 1999.

There have been no statutory insolvency reforms of any great significance since January 1999.

However, in the sphere of corporate governance, at the initiative of the Hon. Minister of Finance, Malaysia, a committee was set up in 1998 to establish a framework for corporate governance in Malaysia and to set industry standards of best practice. This has resulted in the **‘Malaysian Code on Corporate Governance’** (February 1999). The Code can be viewed at <http://www.sc.com.my>. Briefly, the Code covers:

- Appointment and re-election of directors, supply of information, compositional balance within the board.
- Procedure and disclosure obligations in relation to directors’ remuneration.
- Communication/dialogue between company and shareholders.

- Financial reporting, internal controls and relationship between the board and the external auditors.

In late 1998, the Securities Industry Act 1983 was amended. The amendment provided, for the first time, that action could be taken by the Kuala Lumpur Stock Exchange ("KLSE") against a director of a company that is subject to the KLSE's Listing Requirements for failure to observe, enforce or give effect to the KLSE's rules and listing requirements. The same applies to directors of companies that are subject to the rule or any clearing house recognised under the said Act.

Also, the new Malaysian Code on Take-overs and Mergers 1998 came into force on 1.1.99. The new Take-overs Code greatly enhances the position and treatment of minority shareholders in public listed companies and larger private companies.

2. Provide details of any proposed reforms as above.

The only proposal of any significance in terms of insolvency law reform is the proposed judicial management provision. The proposed judicial management provision, which is envisaged as an amendment to the Companies Act 1965, has gone through various drafts and comments by various private bodies, such as the Malaysian Institute of Accountants, but has not seen the light of day as yet.

C. Corporations

1. Identify and detail the areas in which it is considered that relevant accounting practice or regulation is weak and could be strengthened [for example, accounting and financial information; projections of income/expenditure; valuation of assets; debtor and creditor control]

The Financial Reporting Act 1997 established the Financial Reporting Foundation and the Malaysian Accounting Standards Board ("MASB"). The MASB's functions under the act include:

- Issuing new accounting standards.
- Review, revise or adopt as approved accounting standards, current accounting standards.
- Issuing statements of principle for financial reporting.

In late 1998, various sections of the Companies Act 1965 *inter alia*, sections 169(15) and 174(2) were amended to require directors and auditors respectively to state whether the accounts have been prepared in accordance with applicable approved accounting standards.

The following areas of concern remain:

- Valuation of assets and of businesses. Recipients of valuation reports should ask themselves the question of for whom and for what purpose was the valuation prepared? The other weakness is that unrealistic valuations are not uncommon. In Malaysia, the Board of Valuers, a statutory body, regulates valuers, but their duties tend to be defined by the common law and not statute. Questionable valuations could lead to a mismatch of assets as against liabilities.
- Another weakness is the mismatch of, or imbalance in, information as between debtor (in control of the information) and the lender (dependent on disclosure by the debtor). This is a situation that is not addressed by the law, but dealt with by some

lenders by way of covenants requiring continuous quarterly or monthly disclosure. For publicly listed companies at least, the Kuala Lumpur Stock Exchange ("KLSE") has on 11th March 1999 announced new listing requirements dealing with quarterly reporting of financial statements, enhanced corporate disclosure, etc.

- Lax ethical standards amongst some segments of the accounting profession. There is now a willingness within regulatory bodies to initiate complaints to the governing body, the Malaysian Institute of Accountants, about non-compliance with approved accounting standards.
- 3. Identify and detail areas of weakness in corporate governance by reference to such factors as director's duties and their performance; financial management and responsibility; the interests of shareholders and creditors. If possible, provide specific examples of cases in which examples of such weaknesses have been found to exist.**

A survey undertaken in 1998 {Corporate Governance: 1998 Survey of Public Listed Companies, KLSE/PricewaterhouseCoopers} indicated the following areas of concern amongst those who sent in responses:

- Improve reporting standards including more disclosures in the accounts on related party transactions and directors' dealings;
- Maintain and enhance investors' interest and confidence in the capital market by improving reporting standards;
- Protect minority shareholders' interests by improving Board and management accountability;
- Clearly define the roles and responsibilities of directors including separating the ownership and management of the company; and
- Monitor and enforce rules and regulations by the regulatory authorities.

Further improvements in the dissemination of information to the market place and greater emphasis on the extent of disclosure of corporate information in annual reports.

The need to ensure greater protection of minority shareholders' interests and the need to further clarify the roles and responsibilities of directors.

The regulatory authorities should take the lead in identifying areas of improvements, formulating action plans and ensuring strict enforcement of all new and existing rules and regulations.

One weakness in the corporate governance systems of companies in Malaysia is in the failure, in certain instances, of management oversight procedures, such as failure to detect breaches of internal financial controls. Several examples have come to light now with the initiation of criminal proceedings against the persons involved. One example is the case of top management of a bank disbursing a loan in contravention of the conditions stipulated by the board of directors of the bank.

The other weakness is the absence of adequate transparency in deals between two public listed companies, especially related party transactions. Two public listed companies linked to one controlling shareholder, were involved in a sale of a building that aroused much comment, and a concomitant dramatic drop in the share price when disclosed. The reason was the nominal price at which the building was sold. The same transaction gave rise to criminal proceedings against the controlling shareholder, for false disclosure of alleged interest in shares of the second company. The KLSE deals with this by the introduction, for public listed companies, of more exacting disclosure provisions through amendments to the

stock exchange listing requirements. Restrictions have been placed by the KLSE on the ability of controlling shareholders to exercise voting rights when the general meeting is considering related party transactions.

Clearly, shareholders and creditors are affected by these events, but without disclosure lack any real means of becoming aware of such situations, and therefore can only rely on the supervision of the regulatory bodies concerned, such as the Securities Commission and the Kuala Lumpur Stock Exchange. The new Corporate Governance Code proposes that the board of directors be composed of at least 1/3 'independent' directors.

4. Identify and detail areas of concern regarding political, government or commercial links with corporations, by reference to such factors as “cronyism”, “patronage” and corruption.

There have been studies conducted into the relationship between the state, the ruling political party and major corporate groups in Malaysia. These studies refer to a web of links between business and politics and conclude that there has a blurring of state, party and private interests giving rise to an amalgam of both rentier-capitalists and true entrepreneurs [For example, Searle, *The Riddle of Malaysian Capitalism* (1999)]. To this extent, there is some cause for concern over such links and the exposure to charges of cronyism and patronage that it can lead to.

There is no empirical evidence of corruption as such. A study of the correlation between time spent by managers of firms with government bureaucrats and levels of corruption contained in a World Bank report [Gray & Kaufman, *Corruption and Development* (March 1998)] indicated that corruption in Malaysia was neither particularly high or low.

5. Identify and detail areas of concern regarding the size and power of corporations, corporate groups or conglomerates.

The largest company in Malaysia in terms of market capitalization is Telekom Malaysia Berhad. Telekom Malaysia has a huge grip on the fixed line telephone network in Malaysia, having been, prior to its privatization, the sole provider of such services. Today, Malaysia has liberalised the telecommunications sector, and many other service providers are active. Telekom nevertheless still has a massive advantage in the fixed line sector. Its dominant position could give rise to concerns that are of interest to economists, but no legal concerns as such arise under Malaysian law.

As for corporate groups in Malaysia, there are several examples, and their size would ordinarily give rise for concern about the concentration of power and economic activity in certain sectors of the economy. A group could be involved in, inter alia:

- public transport;
- transport infrastructure;
- public engineering works, contracting and property development.
- telecommunications.
- banking

This kind of group, with its strategic ownership of infrastructure and other important segments of the economy, creates the potential conflicts of interest, and subordination of one group member's interest in favour of another.

Group-wide financial re-structuring, are problematic, particularly if borrowings of one member company have been guaranteed by another, or secured by assets of another within the group.

It could give rise to problems for bank creditors, particularly where national interests clash with lenders' interests and wishes, both foreign and domestic. Foreign lenders are usually less moved by national aspirations, and often have to be dealt with on their terms. This is the dilemma confronting the CDRC when attempting to work out group wide restructuring. Corporate governance issues could also arise, such as:

- Management oversight and financial irregularities in subsidiaries;
- Related party transactions on terms that are not truly arm's length;
- Failure of 'owner' nominee-directors sitting on boards of subsidiaries to protect the interests of external creditors and minority shareholders in listed subsidiaries; and
- In at least two instances, failure to undertake mandatory general offers under Malaysia's take-over laws to the possible detriment of minority shareholders.

6. Is it practical and might it be of benefit to introduce legal guidelines on director duties and responsibilities and to provide sanctions or penalties for breach or non-observance of such duties? If so, outline the areas to be covered and the nature of any sanctions.

The Law Society of England and Wales' Company Law Committee has recently rejected an attempt at codification of directors' duties in England [The Company Lawyer, March 1999]. The principal reasons are that it would be unrealistic to suppose that such duties could be simplified sufficiently to be readily intelligible without legal advice.

There is now a recommendation in Malaysia that directors' fiduciary duties should be codified in statutory form: the Finance Committee on Corporate Governance. This proposal is arguably subject to the criticism referred to above. Furthermore, the codification might endanger the development of a 'business judgment rule' that would encourage entrepreneurial activity.

Nevertheless, the 'Malaysian Code on Corporate Governance' (supra) will be used as broad standards of best practice when measuring actual exercise of directors' powers. It contains explanatory notes, explaining the provisions of the Code, for the benefit of those whose conduct it regulates.

There also exists a 'Code of Ethics for Company Directors' issued by the Registrar of Companies, Malaysia.

7. Would directors of corporations benefit from education and training on such areas such as financial management and responsibility, negotiation of a financial restructure, informal work out techniques? If so, detail the areas and the type of program.

There is no empirical evidence to suggest it, but it would not be unrealistic to generalise that many directors of corporations are ignorant of these areas. They should be educated on:

- (a) First, the philosophy underlying insolvency laws.
- (b) The importance that creditors' rights be recognised.
- (c) The mechanics of a workout, particularly in multi-banked companies;
- (d) The fact that to build trust and confidence, it is preferable for the corporation to initiate the process when in financial difficulties rather than be 'found out' by creditors;
- (e) The fact that creditors require up to date information to make assessments of prospects of turnaround;
- (f) The dangers of withholding such information from creditors and of carrying on trading when the corporation is or is nearly insolvent;

- (g) The fact that the accounting records of the company have to be maintained as accurately as possible to facilitate workouts.
- (h) The various methods of informally restructuring debt.
- (i) Corporate governance generally.

D. Banks/Finance Providers

1. Identify and detail the areas in which it is considered that the lending practices of domestic banks are weak and might be improved or strengthened.

The reasons for the banking crisis in Asia have been explored in various papers [Asian Development Bank, *The Financial Crisis in Asia*, Asian Development Outlook 1999; Demigurgic-Kunt and Enrica Detragiache, *The Determinants of Banking Crises: Evidence from Developed and Developing Countries*, World Bank/IMF, May 1997].

The areas in which domestic banks in Malaysia could be said to be weak are:

- Over-concentration of lending in one sector of the economy thereby concentrating, rather than spreading, sector risks. In other words, failure to diversify their loan portfolio.
- Failing to appraise exchange control movement risks and taking currency stability for granted.
- Failure to appreciate the return mismatch between loaning to domestic lenders in local currency and borrowing from foreign sources in foreign currencies.
- Excessive enthusiasm for property based lending.
- Failure to make informed credit evaluations and failure to conduct adequate credit screenings;
- Failure to monitor collateral adequacy on an ongoing basis.
- Overemphasis on relationship lending.

2. Identify and detail areas of concern regarding the involvement of banks with corporations (for example, through equity holding, long term relationship, government association).

Equity holding by banks and financial institutions in Malaysia in companies is prohibited except with Bank Negara Malaysia approval: section 66 of the Banking and Financial Institutions Act 1989 ("BAFIA"). Therefore the dangers are minimal.

Banks and financial institutions are permitted however to acquire an interest in shares by way of security for giving any credit facility: *ibid*.

BAFIA contains strict prohibitions on lending to parties related to the lender, including parties related to directors of lenders. Therefore although some banks are part of a large corporate group, there is no danger of lending within the group as such.

Relationship banking does pose problems because of the close ties over a long period of time between a lender and a borrower. In such cases, the lender pays less attention to and consequently fails to appreciate the reality of borrower's current debt servicing capability, and focuses on the borrower's long-term ability to repay. This leads to problems when the economy as a whole is in decline and the long term view is thrown into disarray.

There is no overt 'government association' that can be pointed to in the case of any bank or financial institution in Malaysia. Nor is there any empirical evidence of any policy direction to banks to lend to certain companies.

The government owns or controls some of the local banks, including Malaysia's largest bank. There is no empirical evidence of any overt government policy direction in relation to the lending practices of such banks.

3. Would officers/employees of banks/finance institutions benefit from education and training on such areas as lending practices, formal insolvency practices, informal work out techniques and practices? If so, detail the areas and the type of program.

Bank officers in Malaysia now routinely attend seminars, both in-house and external, on these areas. An education program should include the following areas:

Lending Practices

- Understanding how to sort out viable from non-viable businesses.
- Learning how to evaluate whether the business' income can support the debt servicing obligations.
- Critical analysis of adequacy of collateral being offered.
- Avoiding over-concentration in certain economic sectors and ensuring loan portfolio diversification.
- Scrutiny of adequacy of corporate governance procedures adopted by the borrower.

Formal Insolvency Practices

- An understanding of philosophy underlying the law of insolvency in Malaysia.
- Understanding the ranking of claims and of distributions of estates.
- Understanding the roles and functions of receivers & managers and liquidators.
- Understanding the procedures and aims of rehabilitation laws such as s. 176 of the Companies Act 1965 and special administration under the Danaharta Act 1998.

Informal Work Out Techniques & Practices

- Appreciation of the advantages/benefits of a work out.
- Formulating a set of objectives to be achieved during the work out, and ensuring that these are fulfilled.
- Understanding the typical inter-creditor issues within a work out.
- Understanding the roles of component parts of a typical workout, such as the steering committee, creditors' committee, lead bank and independent consultants.
- How to handle potential investors.
- Strategies for asset disposals.
- Ways of enhancing borrower incentives to turnaround.

E. Property Law

1. To what extent might the law relating to ownership, mortgages and the creation of other security interests in land and other property be improved/reformed to enable secured transactions to be transacted more efficiently?

The law relating to security interests in land in Malaysia could be reformed in the following ways:

- There are doubts over recognition and enforcement of equitable fixed charges over land contained in debentures. Presently, doubts exist over the efficacy of such equitable fixed charges and anything short of registered charges under the National Land Code, in light of certain dicta in the decision of the Supreme Court of Malaysia in *Kimlin Housing Development Co. Sdn Bhd (In Liquidation) (Receiver and Manager Appointed) v Bank Bumiputra Malaysia Berhad* [1997] 2 MLJ 805 (details are set out in the Main Report for Malaysia). The decision provides that where land is subject to a fixed charge in a debenture and a registered charge under the national Land Code 1965, the land must be sold by judicial sale. A receiver and manager cannot apparently sell the land by entering into a private treaty sale.
 - Remove the inflexibility of judicial sales for landed assets held under loan cum assignment documentation for landed not held under titles, and restore the lender's ability to sell by private treaty coupled with re-assignment by the lender, holding a power of attorney, in favour of third party purchasers.
 - In this regard, a contrast may be drawn between the ease with which Danaharta can exercise rights as chargee over land, which rights were acquired by stepping into the shoes of lenders holding charges. Amendments to the National Land Code provided for this, and allow sales by private treaty after the expiry of 30 days from a notice to remedy a breach under a charge. On the other hand, as stated above, court decisions have made private treaty sales of land all but impossible for chargee banks.
 - Issuing strata titles expeditiously for property such as floors in office and apartment buildings over which security interests can be created and enforced in the same manner as landed property.
2. **Are there particular commercial or other practices (as distinct from formal laws) associated with the laws relating to property and secured transactions which impede or restrict the latter?**

No.

F. Secured Transactions

1. What are the major impediments to the enforcement of security rights over property?

- From a creditor's perspective, in so far as landed property is concerned, the major impediments are the insistence of the courts that such land be sold by judicial sale under the auspices of the Courts, ostensibly on the grounds that such a sale affords valuable safeguards to the registered owners, and the delays attendant upon such judicial sales. Naturally, borrowers would not share that perspective. This emphasis on judicial sale negates the effectiveness of receiverships.
- In so far as apartments and office floor space based security is concerned, by analogy with landed security, the same courts are insisting on judicial sale.

- In so far as movable property is concerned such as shares, there are no major impediments save for one. This is the need for regulatory approvals when selling certain categories of shares, such as shares of a company that is the controlling shareholder of a licensed financial institution, where Bank Negara Malaysia approval is required under the Banking and Financial Institutions Act 1989 (“BAFIA”), which regulates ownership and control of banks and financial institutions. The need to apply for such approval delays the expeditious sale of shares and rules out taking speedily advantage of favourable market conditions by creditors holding charges over publicly quoted shares.

2. How might these impediments be best overcome?

- In the case of land, the solution may be to expressly recognise equitable fixed charges and permit receivers and managers to sell such land, in the process of which receivers and managers will be subject to a duty to act in good faith and to realise the market price.
- The same solution is suggested for apartments and office floor space based security.
- In the context of selling bank holding company shares, the regulatory body to confer, at the time the security over shares is created (which requires prior regulatory body approval), on the lender in advance the future right to sell without the need to seek further approval. However, it is conceivable that this may cause unease at the inability of the state to control, in the public interest, the identity of the new owner of the bank or financial institution concerned.

3. Is there a fair balance between the enforcement of secured property rights and the restraint on those rights under relevant insolvency law? If not, in which areas is there an imbalance and outline what improvements might be made.

The discussion takes place in two different contexts. The first is under the Danaharta Act of 1998 and the second is under the scheme of arrangement provisions in section 176 of the Companies Act 1965.

Under the **Danaharta** legislation, there is a fair balance between the enforcement of secured property rights on the one hand, and the restraint on those rights under the moratorium provisions in section 41 of the Danaharta Act (as to which see the Main Report for Malaysia).

There is a one year period during which the exercise of rights of secured creditors are restrained as against companies that have had a special administrator appointed. This period can be extended. During this time, the Special Administrator will conceive of a workout proposal to be placed before the creditors of the company.

Because the process is under the control of the Special Administrator, overseen by the Oversight Committee constituted under the same act, there is no room for abuse of the moratorium by management of the debtor. Management’s powers are in fact suspended whilst a special administrator is in place. (Abuse is prevalent and is a feature of moratoriums under scheme of arrangement procedures, see below).

Genuine efforts are made by special administrators to come up with a workable and acceptable proposal. Secured creditors will be less likely to feel that they are being unfairly

restrained. Conversely, many, though not all, restraining orders granted by courts under **section 176(10)** of the Companies Act 1965 have been abused.

The average duration of the initial orders granted when the economic crisis first hit was 9 months, with extensions of three months at a time being granted in many cases. Even if creditors exercised procedural rights to intervene and set aside the restraining orders, the inability of the court to expeditiously dispose of such an application owing to heavy judicial lists inevitably negated the effectiveness of such procedural maneuvers. In many cases, management simply did not bother to use the breathing space created by such restraining orders to produce a workable scheme that could be proposed to creditors. Management simply carried on business during the period of restraint, and funds otherwise available for distribution to creditors in a liquidation would be dissipated.

Creditors did not initially have any check or balance on the free hands that management had. An amendment to section 176 sought to redress the balance by, amongst others, providing creditors with a representative on the board, and by limiting the life span of such orders to 90 days. Concerns about the possibility of shadow directorship liability, and fears of potential nominees about director-liabilities have deterred creditors from nominating persons and individuals from taking on such appointments.

Secured creditors, and even unsecured creditors, suffer in the meantime. It is here that the balance may need to be tilted back to neutral, not necessarily in favour of creditors, if anything by expediting hearings of applications by creditors, particularly those wishing to enforce security.

G. Insolvency Law

1. What are the major substantive defects in the corporate insolvency law viewed from the respective positions of:

- (a) banks/financial providers**
- (b) secured creditors**
- (c) unsecured creditors**
- (d) employees**
- (e) corporations**
- (f) directors**
- (g) shareholders?**

(a) Banks/Financial Providers

- Uncertainty over interpretation of insolvency law provisions.
- Court imposed restrictions on methods of sale of landed property otherwise than through judicial sales.
- Restructuring not sufficiently quick.
- Imbalance in information known to borrowers and what is made available to banks.

(b) Secured Creditors

- Uncertainty over interpretation of insolvency law provisions.
- Court imposed restrictions on methods of sale of landed property otherwise than through judicial sales.
- Recent ruling by an appeals court (Kimlin Housing Development Company Sdn Bhd (In Liquidation)(Receiver and Manager appointed) v Bank Bumiputra Malaysia Berhad [1997] 2 MLJ 805) that receiverships come to an end once a liquidator is appointed.

- Abuse of section 176(10) restraining orders.
- Shareholders remain owners and management often remains in control.
- Moral hazard.
- Restructuring not sufficiently speedy.
- Imbalance in information known to borrowers and what is made available to banks.

(c) Unsecured Creditors

- Delays in court recovery procedures.
- Limited influence over and little say in formal and informal restructuring processes.
- Little or no information provided to them for an informed decision to be made.

(d) Employees

- Limited influence over and little say in formal and informal restructuring processes.
- No security or assurance of jobs.
- Little or no information provided to them about the restructuring process.
- Very limited preferential claims in a winding up

(e) Corporations

- Limited options available in terms of formal and informal insolvency procedures.
- Inability to seek court protection such as Chapter 11 type protection in the United States.

(f) Directors

Same as (e) above.

(g) Shareholders

Same as (f) above.

2. What are the major practical defects in the application of the insolvency law viewed from the respective positions of:

- (a) corporations**
(b) creditors?

(a) Corporations

Inability of creditors, courts and other bodies to distinguish between the causes of insolvency i.e. situations where external circumstances have wrought financial distress upon a well run borrower, and on the other hand, borrowers that are mismanaged and over-gearred. Consequently, the absence of a US style Chapter 11 provision to assist distressed borrowers of the first variety.

(b) Creditors

- Delays in court enforcement and recovery procedures.

- The existence of moral hazard when debtors realise that procedures exist for their reorganization without relinquishment of control of management.
- Inability to prevent and/or redress corporate fraud and mismanagement.

H. Judicial System

- 1. Has there been any discernable improvement or change in the operation of the judicial system in relation to the conduct of:**
- debt collection/recovery processes;**
 - enforcement processes in respect of secured property rights;**
 - recovery or enforcement processes in respect of leased property;**
 - formal corporate insolvency processes?**

If possible, provide some detail of cases in which any such change or improvement has been made apparent.

There has been little or no improvement since the Main Report.

- 2. What reforms, if any, have been made to improve the operation of the judicial system in relation to the above 4 areas?**

Apart from the addition of two additional commercial courts in the High Court at Kuala Lumpur, as at to date, there has been no other improvement.

- 3. Are there any identifiable proposals for reforms in these areas?**

No.

- 4. What are the main problems or difficulties regarding the operation and application of the corporate insolvency law through the court system?**

The main problems and difficulties are:

- Judges who are not experienced in personal bankruptcy, liquidation and reorganization thereby unable to appreciate concepts peculiar to these areas, including appreciating the philosophy underlying insolvency law in general and the protection of secured creditor's rights.
- Heavy court hearing lists, leading to lengthy periods in between hearings, resulting in some though not all cases the inability of creditors to effectively oppose or challenge proceedings commenced by debtors.
- Appeals process that can take up to a year, if not longer.

- 5. What practical improvements might be made to overcome these problems/difficulties?**

- Training of judges, or alternatively selection of judges with experience in personal bankruptcy, corporate liquidation and reorganization.
- Creation of special insolvency courts as a sub-division of the Commercial Division of the High Court.
- Creating more judges and courts to speed up hearing of cases.
- Emphasising the need to understand the underlying concepts and philosophy in insolvency law generally. Judges should understand the goals of

bankruptcy laws and to appreciate the economic rationale for respecting the priority of claims.

I. Informal Work Out Techniques

1. Provide detailed examples of some cases of successful informal work outs and also cases of genuine attempts at informal work outs which have not been successful.

There are no useful known examples of unsuccessful workouts at this stage of this report. There are several examples of successful informal workouts. The examples below represent one from each of the CDRC, Danaharta and Section 176 procedures:

The CDRC Example: The Restructuring of the Renong Group/UEM

The restructuring of the Renong Berhad (“Renong”) and United Engineers (Malaysia) Berhad (“UEM”), both public listed companies under the same stable, was conducted under the auspices of the CDRC. Renong holds 37.1% of UEM, and UEM holds 32.4% of Renong.

The indebtedness of the group totalled over RM8 billion. Renong did not consider a capital raising exercise or an asset disposal programme to be viable in the economic climate in Malaysia. Renong would not be able to meet pre-requisites for raising of capital, and the asset disposal programme would be construed as a distress sale, thereby not maximising values. Accordingly, the proposal was:

- to settle the debts of secured creditors of Renong and UEM in full in cash (in original currency of indebtedness) at completion by reference to the amount outstanding as at 30th June 1999 (exclusive of default interest and charges); and
- the unsecured creditors were to be paid 50% of the amount as at 30th June 1999 in cash and in the original currency of indebtedness at completion and 50% would be settled in PLUS Bonds (PLUS or Projek Lebuhraya Utara-Selatan Berhad is another company that is 100% owned by UEM). PLUS holds the lucrative concession over the North-South Highway in West Malaysia.

Completion was supposed to be 2nd August 1999 according to the proposal.

A Section 176 Example: The Case of Taiping Consolidated Berhad

Taiping Consolidated Berhad (“TCB”) is a public listed company. Through various subsidiaries, before the restructuring, TCB owned the Marriott Hotel building and Star Hill Shopping Complex in Kuala Lumpur, and the neighbouring Lot 10 shopping complex. These properties were in a prime and prestigious location. The properties were charged under registered National Land Code charges and debentures to secure borrowings from a syndicate of lender banks and insurance companies.

TCB and its subsidiaries obtained a restraining order under section 176 of the Companies Act 1965 on 30th July 1998 pending a scheme of arrangement being proposed.

On 20th October 1998, TCB entered into a conditional sale and purchase agreement for the sale of the properties to YTL Land Sdn Bhd (“YTL Land”), a subsidiary of another public listed company known as YTL Corporation Berhad.

From the disposal of the properties, TCB was able to pay the syndicate lenders the principal amounts in full. Under the scheme of arrangement, the lenders, together with other creditors of TCB and/or its subsidiaries, would receive Irredeemable Convertible Preference

Shares (“ICPS”) on the basis of 1 ICPS for every RM1-00 of debt. The interest payable to the syndicate lenders would therefore be settled via the ICPS.

The sale of the properties has been completed, the lenders have been paid, and the scheme of arrangement has been approved.

A Danaharta Example: The Case of Capitalcorp Securities Sdn Bhd

Prior to the restructuring of its debt, Capitalcorp Securities Sdn Bhd (“Capitalcorp”) was a licensed stockbroking company. In 1997 it ran into financial difficulties.

Throughout 1998, there were three attempts to resolve Capitalcorp’s financial problems under the section 176 scheme of arrangement provisions. These failed.

On 4th January 1999, Danaharta appointed special administrators over Capitalcorp. A workout proposal was submitted to creditors within 2 ? months and was approved by the secured creditors on 16th March 1999. The salient features of the workout proposal are:

- Secured creditors will be paid in full in cash by way of instalments.
- Unsecured creditors will be repaid with a combination of redeemable convertible preference shares, redeemable non-convertible preference shares and loan stocks.
- Shareholders’ contributions are a combination of cash and asset injection, waivers of inter-company debts into equity and a capital reduction of existing shares.
- 97% of the secured creditors voted in favour of the workout proposal.

2. In practice, are such technique/s operating efficiently and successfully?

The only informal workout procedure is the one overseen by CDRC. This may not be the most efficient or speedy, but it is a major step in the right direction.

3. What are the major problems in the application of these technique/s?

Applying moral suasion over all the secured bank creditors, particularly foreign bank creditors, within the CDRC framework is the single biggest problem in the application of the CDRC procedures.

4. Is it considered that training and education in the operation of these technique/s would be valuable and, if so, in what areas and to whom should the training be directed?

Education for bank officers in the culture of informal workouts would be useful, as such procedures are new to most officers. Officers should also be trained to approach such workout efforts in ways other than by focussing on financial restructuring only, and not with, in the words of one expatriate manager, “minimal attention to wider business functions and necessary improvements required in financial controls, management information systems;K”. [T.R. Slater, ‘Corporate Debt Restructuring: Framework, Options & Challenges’, March 1999].

J. Insolvency Administration System

1. **Comment on the extent of development, expertise and efficiency regarding both public and private sector administration of formal cases of:**
 - (a) **corporate liquidation; and**
 - (b) **corporate reorganisation**

Public Sector Administration

Public sector administration of formal cases of **corporate liquidation** is through the office of the Official Receiver's Department. It is adequate and there is acceptable expertise, but given the volume and the number of staff available, the process can be slow and decision-making is frequently cumbersome.

The Official Receiver's Department does not typically get involved in reorganization of companies. It may be reasonably surmised that the Department would not have the requisite expertise.

On the other hand, Danaharta, assuming it is appropriate to class Danaharta as 'public sector', is staffed by professionals who have experience and expertise in **corporate reorganization** of companies whose debts have been acquired by Danaharta, and they are efficient.

CDRC is also assisted by individuals on the staff who have expertise in the various disciplines such as economics and law. CDRC is also advised by experienced external insolvency practitioners.

Private Sector Administration

Private sector administration of formal cases of **corporate liquidation** is through the appointment of private liquidators from among the licensed, approved company liquidators. Private appointments are preferred by secured creditors, and with the staff of the accounting firms to which these liquidators come from providing back up services, the expertise is there, and the process can be said to be adequate.

The same can be said of private sector involvement in **corporate reorganization**.

2. **Is it considered that education and training in these areas would be valuable and, if so, in what areas?**

It may be good to expose the Official Receiver's Department to other aspects of insolvency than the typical case of formal liquidation. Other than that, there does not appear to be any especial need for education and training as such.

3. **Is it considered desirable to introduce more formal structures of both public and private sector administration of insolvency cases?**

The present set up is adequate.

K. Information & Statistics

1. **Is it desirable to establish systems to gather information concerning:**
 - **Incidence and results of formal insolvency cases under the insolvency law**

- **Incidence and results of informal work out cases**
- **Statistics of value of assets and liabilities**
- **Causes of financial failure, main area/s of business?**

Yes, it would be desirable.

2. If so, how best might such system/s be established?

It may be best if such statistics were maintained by the Central Bank, Bank Negara Malaysia, on the basis of statistics provided to them by licensed banks and financial institutions since these banks and financial institutions are usually best placed to provide such feed-back.

L. General Insolvency Information and Developments

1. Provide details of any other relevant information or developments since January 1999 in regard to such issues as the effect of insolvency law policies on areas such as employment, fiscal/revenue debts, detection and recovery of corporate fraud, domestic and foreign investment and etc.

There have been no major developments since January 1999. There has however been remarkably greater emphasis by the regulatory authorities on prosecuting individuals for suspected securities and corporate governance offences.

2. Is there any evidence of a change in attitudes (such as social/commercial stigma, aversion to strict legal processes, fear of loss of control) toward the use of:

- (a) formal insolvency processes; and**
- (b) informal insolvency processes**

in respect of corporations in financial difficulty or insolvent corporations? If possible, provide details of any specific cases which might reflect evidence of change.

If anything there is a greater inclination on the part of debtors to initiate either CDRC or section 176 procedures, having seen that these can bring some measure of respite from their secured lenders whereas at the initial stages of the economic crisis, there was some element of complacency. By resorting to these procedures, debtors maintain their control of management. Other than this, there is no real discernible change in attitudes. Many managers and controllers still exhibit indifference to lender's concerns, and past mistakes are glossed over or blamed on lenders themselves. There is no discernible aversion by borrowers to legal process at least in so far as measures are available for their protection.