

Malaysian Insolvency Laws

What is insolvency?

A company is insolvent when it cannot pay its debt as and when it falls due. The Companies Act states that a company shall be deemed insolvent if a creditor to whom a company owes more than RM500 (and such sum is due for payment) serves a written notice of demand for payment and the company neglects to pay such sum for three weeks after the notice is given, or to secure or compound such sum to the satisfaction of the creditor. (Companies Act, section 218(2))

What are the options in insolvency?

An insolvent company is faced with two options, informal and formal procedures.

Work-out A workout is an informal procedure that does not involve any legal process. In a workout the major creditors of the company will meet with the company to agree to some kind of arrangement to reschedule or compromise part of the debts owed.

The process may begin with a standstill agreement whereby the banks will agree in principle not to take any action against the debtor company for a certain period whilst the workout is in progress. In most cases the standstill agreement may not be legally binding. There may also be an agreement for interim funding of the company whereby the creditor banks will provide additional funds for the company to keep its business running.

Scheme of Arrangement (Companies Act, section 176)

Section 176 allows a company, its shareholders and its creditors to apply for a Court sanctioned compromise or arrangement. Under this section any scheme or arrangement that is agreed to by $\frac{3}{4}$ ths of the creditors of each affected , class of creditors, and approved by the Court will be binding on all affected creditors.

Once a proposal has been made, the Court can make an order for the restraint of all proceedings against the company until an order is has been made under section 176 in respect of the proposal or a resolution has been passed for the winding-up of the company.

Winding-Up (Section 217 and 218)

A company that is insolvent may be wound-up by the Court upon the petition of amongst others (a) the company, or (b) any creditor (including contingent and prospective creditors). This is the most drastic of all the options and once wound-up the company will be liquidated and struck-off the register of companies. The assets of the company will be liquidated or sold off; the proceeds of the sale will be distributed according to law.

Generally secured creditors and preferred creditors will be paid ahead of the unsecured creditors.

What are some of the duties facing directors of insolvent companies?

Section 303 - Incurring debt without reasonable expectation of repayment

It is an offence for a director to incur debt in circumstances where (a) the director has been knowingly a party to the contracting of a debt and (b) at the time the debt was incurred the director had no reasonable ground of expectation of the company being able to repay the debt.

Section 304 - Fraudulent Trading

This section says that where it appears that any business of the company has been carried on with intent to defraud creditors or for any fraudulent purpose, the Court may declare that any person who was knowingly a party to the carrying on of the business in that manner will be personally liable for the debts or other liabilities of the company. Submit your questions and comments: