Restructuring & Insolvency

High Court Issues Key Decisions on Schemes of Arrangement

What's this Update about?

In the recent decision of the Malaysian High Court in *Re Top Builders Capital Bhd & Ors* [2022] MLJU 1 ("***Top Builders***"), Ong Chee Kwan JC reaffirmed certain principles for the sanction of a scheme of arrangement ("**SOA**") and also decided on some novel issues:-

1) the classification of creditors;
2) the threshold test for disclosures in the explanatory scheme;
3) the validity of virtual scheme meetings;
4) the extension of time for submission of proofs of debt ("**PODs**");
5) the inspection of other scheme creditors' PODs; and
6) the discounting of scheme creditors' votes.

This Update provides a summary of the above principles.

Restructuring & Insolvency

Introduction

In the earlier decision of the Malaysian High Court in *Re Top Builders Capital Bhd & Ors* [2021] 10 MLJ 327, Ong Chee Kwan JC examined the POD exercise in the SOA and the guiding principles governing the granting of leave to proceed with legal proceedings against a financially distressed company that has obtained a restraining order (moratorium) pursuant to a SOA.

This recent decision of *Top Builders* further reaffirmed some key principles in relation to a SOA as well as determined some novel issues.

Brief Facts

In *Top Builders*, Top Builders Capital Berhad, Ikhmas Jaya Sdn. Bhd. and Ikhmas Equipment Sdn. Bhd. (collectively, "**Applicants**") were construction companies in the process of undertaking a SOA pursuant to section 366 of the Companies Act 2016. In December 2020, the Applicants obtained a court order for permission to hold scheme meetings of its creditors and a restraining order on actions against the Applicants. The Applicants sought sanction for the SOA ("**Sanction Application**"). A few creditors opposed the Sanction Application ("**Opposing Scheme Creditors**") and raised various arguments against the same as set out below.

Key Legal Principles

1) <u>The Classification of Creditors</u>

   A scheme creditor, Seng Long Construction & Engineering Sdn. Bhd. ("**Seng Long**") contended that the Applicants should not list all their related company creditors ("**Related Company Creditors**") as unsecured scheme creditors as they had voluntarily agreed to waive the payment of their entitlements under the SOA to ensure the continuity of the Applicants.

   The Court disagreed with Seng Long's arguments and held that if the Related Company Creditors had not agreed to voluntarily waive their SOA entitlement, there would be no objections to being placed in the same class. Seng Long's argument would result in these Related Company Creditors being treated separately from the other unsecured creditors. Instead, the main principle that the Court followed was based on the similarities or dissimilarities of legal rights and not on their personal or commercial interests. Therefore, as the waiver did not change the legal rights of the Related Company Creditors, the Court ruled that the legal rights of the Related Company Creditors and the unsecured scheme creditors were similar and thus could be classed together.

2) The Threshold Test for Disclosures in the Explanatory Scheme

A scheme creditor, Star Effort Sdn Bhd ("**Star Effort**") raised several arguments on inadequate disclosure in the explanatory statement for the SOA.

The Court held that the contents of the explanatory statement should generally be clear, complete, and not misleading. The Court recognised that perfection is hardly attainable - it should be accepted that it is often possible to criticise the manner in which disclosure is made. It is further accepted that in complex cases, there is a need to be selective with the facts, confining them to those that are necessarily useful for the creditors to arrive at a commercial judgement on those schemes. As a matter of commercial reality, what is crucial is that the terms of the explanatory statement suffice to enable the members to exercise a reasonable commercial judgment on a fully and properly informed basis. On this basis, the explanatory statement was deemed sufficient.

3) The Validity of Virtual Meetings

A scheme creditor, Edwincom Enterprise ("**Edwincom**") contended that the Applicants' appointed service provider had prevented them from attending the virtual meeting and thus deprived Edwincom of its right to attend and vote. Further, Edwincom was aggrieved that the Applicants had summarily dismissed its complaint. Premised on the aforesaid, Edwincom contended that there was a breach of procedural fairness in the Applicants' conduct of the meeting and that it had been treated unfairly, with the Applicants disregarding the requirements of natural justice and making a decision to ignore its complaints in a procedurally unfair manner.

Further, Star Effort raised its discontent with the virtual meeting contending that the said meeting failed to meet the legal requirement of a 'meeting'. Unlike a physical meeting, questions that were posed had to be typed up and when answers were given to the questions, there was a lack of facility for an immediate follow up to the answers. This is because the proceedings were not conducted via the normal video platforms where parties are able to engage with each other, as in the case of a virtual meeting via the zoom platform, for example. There was therefore a lack of fluency in the exchange. In addition, there was also no facility for participants to engage with one another during the meeting by way of 'breakout rooms'. It is said that this 'defect' had resulted in the participants not being able to come together to discuss among themselves before casting their votes, hence, defeating the very notion of a 'meeting'.

The Court upheld the validity of the virtual meeting proceedings especially taking into account the unprecedented COVID-19 environment. The objections raised by the scheme creditors did not invalidate the virtual meeting as the Court was satisfied that the scheme creditors were already fully aware of the details and effect of the SOA and the consequences if the SOA was approved. The Court was also satisfied that there were no critical questions that were deliberately ignored nor were there any unanswered questions that could have cast a different perspective on the schemes in question. In addition, the disadvantages were not such that there was no effective deliberation and discussion of the issues amongst the participants.

Finally, the contention lodged by Edwincom was dismissed for two reasons. The first was that the Court was satisfied that the exclusion of Edwincom was not intentional. Second, the Court found that Edwincom's value of claim (0.05% of the scheme debt) was so small that their vote would not have affected the outcome of the meeting and votes.

4) The Extension of Time for Submission of Proofs of Debt

Seng Long objected to the chairman of the SOA's ("**Scheme Chairman**") decision to extend the deadline of the PODs submission. In reply, the Scheme Chairman stated that he had exercised his discretion to fairly extend the PODs submission deadline and to adjudicate on the late PODs for the benefit of all the unsecured scheme creditors. If the PODs were not admitted and adjudicated on by the Scheme Chairman, the claims of those relevant scheme creditors would be completely extinguished if this Court sanctioned the SOA. The relevant scheme creditors would receive zero distribution under the SOA.

The Court did not adopt the Singapore Court of Appeal approach of The Royal Bank of Scotland NV (*formerly known as ABN Amro Bank NV*) *and others v TT International and another appeal [2012] 2 SLR 213* ("***TT International***") that decided that a scheme chairman would have to first obtain court permission to extend the time for submission of PODs. The Court does indeed have the discretion to extend the admission of the PODs during the sanction hearing. The Court held that the Scheme Chairman had acted in good faith by trying to ensure that the relevant scheme creditors with legitimate claims against the Applicants would not be substantially prejudiced by submitting their PODs late. It also held that there was no prejudice to any of the unsecured creditors for allowing the extensions.

5) The Inspection of Other Scheme Creditors' Proofs of Debt

Some of the scheme creditors raised the issue of the failure to allow inspection of the PODs of the other scheme creditors, especially the Related Party Creditors.

The Court adopted the approach in *TT International*, which held that a scheme creditor is entitled to examine the PODs submitted by other scheme creditors in respect of a proposed SOA, as long as the information sought is relevant to his voting rights. However, the scheme creditor is entitled to access only if he is able to produce *prima facie* evidence of impropriety in the admission or rejection of the PODs. Where a scheme creditor's request for disclosure of other scheme creditors' PODs is rejected by the scheme company, the scheme creditor can apply to Court for an order that the PODs and supporting documents be disclosed to it. In this case, the Court ruled that the scheme creditors did not produce any *prima facie* evidence of impropriety in the admission or rejection of PODs by the Scheme Chairman. Therefore, they were not entitled to inspect other PODs.

6) The Discounting of Scheme Creditors' Votes

A few of the Opposing Scheme Creditors alleged that some of the Related Party Creditors' scheme debts should be discounted to zero. That discounting, depending on what configuration or calculation was used by the Opposing Scheme Creditors, would result in only 62% in value of creditors having voted in favour of the SOA – failing the statutory majority.

The Court held that the discounting of the votes of wholly-owned subsidiary creditors is not a universal approach by all courts. The issue of whether to discount or to disregard the votes is a matter of discretion for the Court based on the particular facts of the case.

The Court will consider the following:

a) whether the benefits that the creditors would likely derive from the SOA are clearly better than the alternative liquidation scenario;
b) whether there is any clear and obvious likelihood of the creditors achieving a better SOA;
c) whether the exercise of the votes by the intercompany creditors and/or related party creditors was driven by any special or ulterior interest that was 'adverse' to the interests of the creditors;
d) whether the opposing creditors pressing for the votes of the intercompany creditors and/or related party creditors to be discounted or disregarded have any self-interest and/or ulterior motive;
e) whether the adjudicated debts of the intercompany creditors and/or related party creditors are genuine or questionable; and
f) whether the percentage of independent creditors who had voted in the SOA is such that it reflects a desire on the part of an overwhelming majority in value and in number of the scheme creditors wanting the SOA.

Conclusion

This comprehensive decision in *Top Builders* dealt with important aspects of a SOA. Some of the issues above have been decided for the first time under Malaysia law which would set as guidance / reference for other SOA related cases and help to streamline the processes and promote fairness and transparency.

If you have any queries on the above, please feel free to contact our team members below who will be happy to assist.

Contacts

John Mathew
Partner

T +603 2267 2626
M +601 2377 7792
john.mathew
@christopherleeong.com

Chua See Hua
Partner

T +603 2273 1919
M +601 2311 3666
seehua.chua
@christopherleeong.com

Heng Yee Keat
Partner

T +603 2267 2723
M +601 7278 0107
yee.keat.heng
@christopherleeong.com

Contribution Notes

This Update is contributed by the Contact Partners listed above with the assistance of **Ooi Tian Hong.**

Our Regional Contacts

RAJAH & TANN | *Singapore*
Rajah & Tann Singapore LLP
T +65 6535 3600
sg.rajahtannasia.com

R&T SOK & HENG | *Cambodia*
R&T Sok & Heng Law Office
T +855 23 963 112 / 113
F +855 23 963 116
kh.rajahtannasia.com

RAJAH & TANN 立杰上海
SHANGHAI REPRESENTATIVE OFFICE | *China*
Rajah & Tann Singapore LLP
Shanghai Representative Office
T +86 21 6120 8818
F +86 21 6120 8820
cn.rajahtannasia.com

ASSEGAF HAMZAH & PARTNERS | *Indonesia*
Assegaf Hamzah & Partners

Jakarta Office
T +62 21 2555 7800
F +62 21 2555 7899

Surabaya Office
T +62 31 5116 4550
F +62 31 5116 4560
www.ahp.co.id

RAJAH & TANN | *Lao PDR*
Rajah & Tann (Laos) Co., Ltd.
T +856 21 454 239
F +856 21 285 261
la.rajahtannasia.com

CHRISTOPHER & LEE ONG | *Malaysia*
Christopher & Lee Ong
T +60 3 2273 1919
F +60 3 2273 8310
www.christopherleeong.com

RAJAH & TANN | *Myanmar*
Rajah & Tann Myanmar Company Limited
T +95 1 9345 343 / +95 1 9345 346
F +95 1 9345 348
mm.rajahtannasia.com

GATMAYTAN YAP PATACSIL
GUTIERREZ & PROTACIO (C&G LAW) | *Philippines*
Gatmaytan Yap Patacsil Gutierrez & Protacio (C&G Law)
T +632 8894 0377 to 79 / +632 8894 4931 to 32
F +632 8552 1977 to 78
www.cagatlaw.com

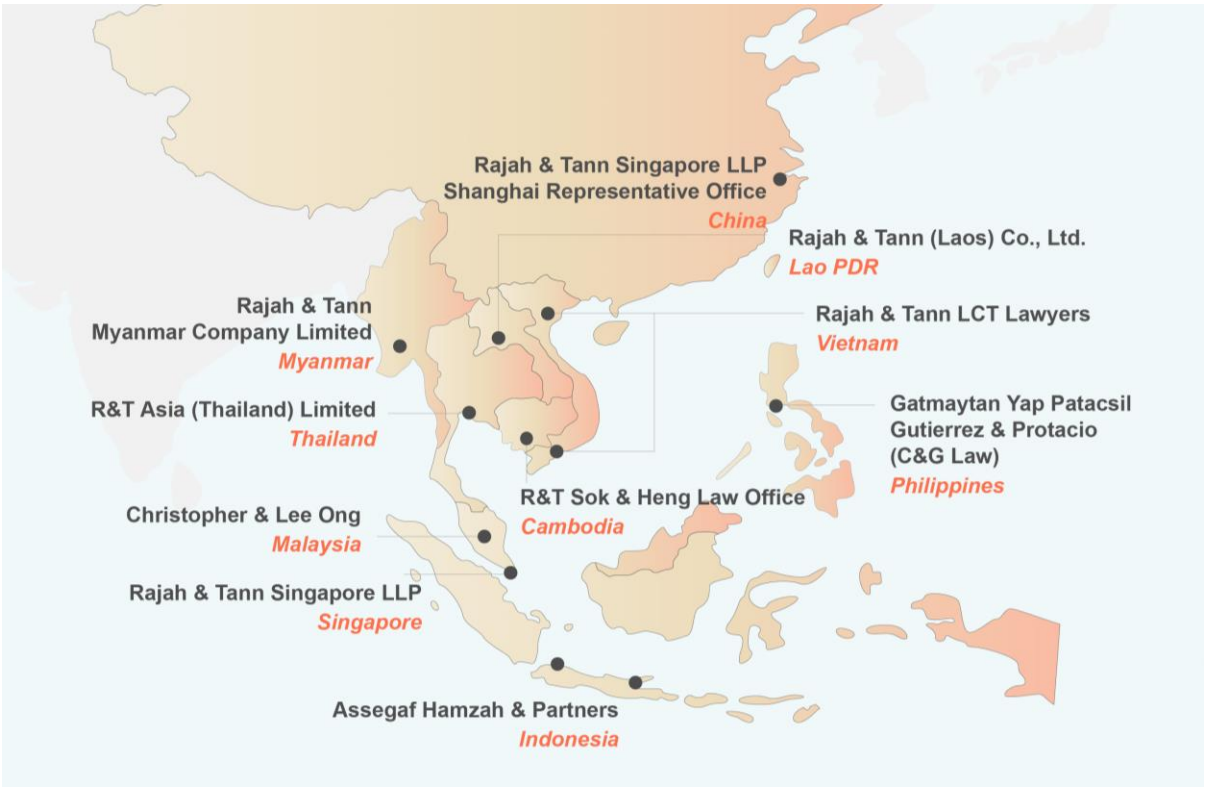
RAJAH & TANN | *Thailand*
R&T Asia (Thailand) Limited
T +66 2 656 1991
F +66 2 656 0833
th.rajahtannasia.com

RAJAH & TANN LCT LAWYERS | *Vietnam*
Rajah & Tann LCT Lawyers

Ho Chi Minh City Office
T +84 28 3821 2382 / +84 28 3821 2673
F +84 28 3520 8206

Hanoi Office
T +84 24 3267 6127
F +84 24 3267 6128
www.rajahtannlct.com

Our Regional Presence



Christopher & Lee Ong is a full service Malaysian law firm with offices in Kuala Lumpur. It is strategically positioned to service clients in a range of contentious and non-contentious practice areas. The partners of Christopher & Lee Ong, who are Malaysian-qualified, have accumulated considerable experience over the years in the Malaysian market. They have a profound understanding of the local business culture and the legal system and are able to provide clients with an insightful and dynamic brand of legal advice.

Christopher & Lee Ong is part of Rajah & Tann Asia, a network of local law firms in Cambodia, China, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam. Our Asian network also includes regional desks focused on Brunei, Japan and South Asia.