High Court Provides Scheme of Arrangement Guidance on the Proof of Debt and Leave to Proceed against a Restraining Order

The High Court in the decision of ***Re Top Builders Capital Bhd*** **[2021] MLJU 693** set out important principles on scheme of arrangement law.

The decision dived deep into issues on assessing the proof of debt for the creditors' vote in a scheme and how to obtain leave to proceed against a restraining order.

Summary of Decision and Significance

Decision by Ong Chee Kwan JC

The debtor company, Ikhmas Jaya Sdn Bhd (Ikhmas Jaya), had obtained a restraining order as part of a scheme of arrangement involving a group of debtor companies.

A scheme creditor of Ikhmas Jaya, being Seng Long Construction & Engineering Sdn Bhd (Seng Long), intervened in the scheme of arrangement proceedings. Seng Long applied for leave to continue with the pending legal proceedings for an RM3.7 million claim against Ikhmas Jaya.

First, the Court usefully set out the rationale behind the scheme of arrangement to revive financially distressed companies as a going concern. The proceedings need to be a quick summary procedure and not a protracted trial-based hearing. It is debtor-in-possession driven. The Court also set out the difference between the restraining order moratorium compared with the moratorium under judicial management or corporate voluntary arrangement.

Second, the Court set out the procedure on how to admit or reject claims by persons asserting to be creditors for purposes of voting at the scheme creditors' meeting and for distribution of payments. The principles as well on the duties and powers of the decision-maker when admitting, rejecting and quantum of the proofs of debt. Importantly, the Court's eventual role and approach when hearing any appeal against the decision-maker's adjudication of the proof of debt. This is against the backdrop of allowing the debtor to expeditiously restructure its debts.

Third, the Court set out the test and considerations when granting leave to a creditor to proceed against the scheme company with a restraining order. The principle is that there must be exceptional circumstances such that there is sufficient weight to overcome the strong imperative to have the creditors' claims dealt with under the machinery of the scheme of arrangement.

Background Facts

At the end of December 2020, the public listed Top Builders Capital Berhad and two of its subsidiaries, including Ikhmas Jaya, filed for an application for leave for the creditors' meeting under a scheme of arrangement and obtained a restraining order.

However, prior to the filing of the scheme of arrangement application, one of Ikhmas Jaya's creditors, Seng Long, had in November 2020 filed a Writ action against Ikhmas Jaya. Seng Long is a construction and renovation contractor and where Ikhmas Jaya was the main contractor.

Seng Long claimed over RM3.7 million against Ikhmas Jaya. On 10 December 2020, Seng Long filed for a summary judgment application. However, on 31 December 2020, Ikhmas Jaya obtained a restraining order for three months to restrain any further legal proceedings.

In February 2021, Seng Long applied to intervene in the scheme of arrangement proceedings and to seek leave to continue with its Writ action and summary judgment against Ikhmas Jaya. Seng Long was listed as one of the unsecured creditors in the Ikhmas Jaya proposed scheme of arrangement. Seng Long's debt was listed as just over RM560,000 in Ikhmas Jaya's draft Explanatory Statement produced in the scheme of arrangement court papers.

Seng Long was allowed to intervene and the Court had to next decide on whether leave was to be granted.

Assessing Quantum of Claims in a Scheme, and Leave against a Restraining Order

The Rationale of the Scheme of Arrangement: The Greater Good of Many Outweigh the Interests of a Few

The Court usefully set out in detail the rationale behind the scheme of arrangement to revive financially distressed companies as a going concern. The proceedings need to be a quick summary procedure and not a protracted trial-based hearing. The application for a scheme of arrangement is time sensitive as the company is in distress and require decisions pertaining to the proposed scheme to be made as soon as possible.

The scheme of arrangement is debtor-in-possession driven. This is unlike winding up or judicial management. The scheme of arrangement process is managed and controlled by the company. The company remains in control of its management without any interference from any outside party save that the scheme is subject to the supervision and sanction of the Court. This means that at the very first instance, the company must determine the claims submitted by the creditors and to propose the pay out to be made to meet the company's debt obligations. The Court plays only a supervisory role in the process.

Scheme of Arrangement Mechanism to Establish Status as Creditor and Value of Claim

For a scheme of arrangement, it is necessary to have a mechanism to establish the status of a person as a creditor and for the value of his claims determined. This has a dual purpose. To entitle the person to attend and vote at the creditors' meeting and subsequently, to receive the payments under the proposed scheme if the scheme is approved and sanctioned by the Court.

Unlike in Australia and Singapore, Malaysia does not have provisions to regulate the admission or rejection of the creditors' claims for the purposes of voting or for distribution of payments.

In practice, the determination of these claims made in the form of proofs of debt submitted to the company is by the chairman of the creditors' meeting or an appointed scheme manager (collectively referred to by the Court as the decision-maker).

The decision-maker is not an officer of the Court in the same way that a liquidator of a company under a winding up order is. Nevertheless, the Court applied the Singapore Court of Appeal decision in *TT International* [2012] SGCA 9 in that the decision-maker owes a fiduciary duty to act in good faith and with complete impartiality and would assume a quasi-judicial role when adjudicating the proofs of debt.

There are then other important points made by the Court.

First, the Court set out other requirements:

- The decision-maker's powers are exercised in a summary manner based on information and documents of the company and those produced by the creditors. Decision-maker is entitled to request for further proof if he deems fit.
- The decision on the adjudication of the proof of debt is typically undertaken just before the creditors' meeting. It is carried out without any lengthy and detailed evaluation in order to meet the deadline for the creditors' meeting.
- In evaluating the claims, the decision-maker may have to make fair estimates of certain claims. If there are little or insufficient materials, the decision-maker may have to ascribe nil or minimal amount to the claims.
- Where a particular proof of debt is rejected, this means that the person is excluded from attending the creditors' meeting and voting on the proposed scheme. If only a part of the proof of debt is admitted, this may have an effect on the weightage of the creditor's vote. Such decisions on admitting or rejecting the proof of debt, in whole or in part, may be determinative of the approval of the scheme.
- The decision made on the claims on the recognition of the debt and the quantum ought to be made known to the creditors prior to the creditors' meeting. This is so that the voting at the meeting can be made on an informed basis.
- A creditor or a person who is asserting to be a creditor who is aggrieved by the determination on the proof of debt may appeal to the Court.

Second, the Court then set out the combined approach for the Court to determine the "s*ingle correct answer to the questions whether a person is a creditor and entitled to vote and for what amount*" (applying the Federal Court of Australia decision in *Bacnet Ptd Ltd v Lift Capital Partners Ptd Ltd (in liq)* (2010) 78 ACSR 57).

Therefore, the Court advocated for a single approach to determine what is the value of the debt for purposes of voting at the creditors' meeting as well as for distribution under the scheme. The decision to admit or reject the proof of debt at the first instance should also be determinative of the quantum of the claims.

Third, the Court explained that the first instance decision by the decision-maker is made in a summary fashion. But the interests of the creditors are protected by the appeal to the Court. This appeal is in the nature of a re-hearing and the Court can exercise its discretion in appropriate cases to admit new evidence.

Fourth, the Court's approach on an appeal against the decision-maker's determination. The task of the Court is to examine the evidence placed before the decision-maker and to decide on the balance of probabilities whether the claim is established and if so, in what amount.

The appeal hearing should be on an expedited basis and preferably together with the sanction application for the scheme. This will obviate the need for another separate proof of debt exercise as the determinative final adjudication of the creditors' claim in respect of the quantum for the purposes of distribution of the payments under the scheme.

Nonetheless, this does not prevent the company, if deemed fit, to make appropriate provisions in the scheme for an adjudication process to determine the quantum of the creditors' claim after the voting has been completed and after the sanction of the scheme for the purpose of distribution.

The appeal hearing is a summary disposal. It should not be in the nature of a *de novo* hearing as that will entail the company and the creditor filing voluminous affidavits and adducing more evidence which will usually lead to conflicting versions.

Fifth, if there is any concern that a summary determination of the quantum of claims by the Court may prejudice any party, there is a safeguard in section 366(4) of the CA 2016. This provision allows the Court to grant its approval of the scheme subject to such alterations or conditions as the Court thinks just.

This provision vests upon the Court at the sanction stage some flexibility to deal with the cases where justice requires the quantum of the creditors' claims to be determined through the vigorous process of a trial or arbitration proceedings. In such a case, provisions may have to be made for sums to be set aside under the scheme to await the outcome of these proceedings.

Sixth, subject to the above principles, the scheme will invariably provide that the company will be completely and absolutely released and discharged from all claims.

Finally, the Court held that it is clear that Parliament intended through section 366 of the CA 2016 for the scheme of arrangement proceedings to serve as the preferred alternative platform for the determination and resolution of the claims by the creditors against the company.

If the scheme is to have any chance of succeeding, the scheme must take precedence over the normal legal proceedings filed in court or before an arbitral tribunal. The adjudication of the creditors' claims under the scheme of arrangement is in a summary fashion as opposed to the normal legal proceedings where an elaborate investigation into the evidence is conducted for establishing the merits of the claims.

Rationale for the Restraining Order and Principles for Leave

Next, the Court set out the rationale for the scheme of arrangement and cited the Federal Court in *Mansion Properties v Sham Chin Yen & Ors*. Having touched on that, the Court proceeded to deal with the principles when leave can be granted.

First, the Court held that leave will only be granted in 'exceptional circumstances'. The burden will be on the applicant to show so.

Second, it would be unwise to attempt at defining what would constitute 'special circumstances'. The guiding principle must be such that the circumstance or combination of circumstance must be of sufficient weight to overcome the strong imperative to have the claims dealt with under the machinery of the scheme of arrangement.

Third, the fact that the applicant's claim may have a 'real prospect of success' alone cannot constitute 'special circumstances'.

Fourth, the contention that the legal proceedings if permitted to proceed would finalise the quantum of the applicant's claim and therefore assists the applicant in its claim as a recognised scheme creditor cannot constitute 'special circumstances'. This would defeat the very purpose of the scheme of arrangement which depends on summary determination of the claims to achieve an expedited solution to the financially distressed company.

Fifth, leave will likely be granted where the commencement or continuation of the legal proceedings does not impede the achievement of the scheme. Or where it would in fact facilitate and or assist towards the achievement of the scheme. For instance, where the claim is proprietary in nature and the applicant is not seeking anything other than to reclaim possession or ownership of property said to belong to him, leave will normally be granted.

Finally, the Court has to balance between the harm or loss to the applicant if leave is not granted with the harm and loss to the general body of creditors under the scheme of arrangement if leave is granted.

The Court will take into consideration, among others, the structure and terms of the scheme and how the company seeks to implement the same, the support of the creditors for the scheme, the company's financial position, the *bona fide* of the company in proceeding with the scheme, the stage of the legal proceedings and whether the outcome of the legal proceedings would have a determinative impact to the approval of the scheme.

Decision on Seng Long's Leave Application

First, Seng Long's claim was, in essence, a pure monetary claim for RM3.7 million. Seng Long's legal proceedings are not at an advanced stage and the summary judgment application had not been heard yet.

Second, Seng Long's real prospects of success in its summary judgment application do not amount to special circumstances justifying leave.

Third, this was not a case where the determination of the disputed part of Seng Long's claim would have a significant impact on the approval of the proposed scheme. Seng Long could submit its proof of debt under the proposed scheme and if dissatisfied, appeal to the Court.

Fourth, Seng Long did not provide any reason as to why it ought not be treated in a similar fashion with the other general body of creditors subject to the scheme.

Fifth, Seng Long had raised a challenge on the feasibility of the proposed scheme that will be presented to the scheme creditors. That could not be a reason to grant leave to Seng Long. The proper forum for Seng Long to raise its objections or dissatisfaction is at the scheme creditors' meeting and to express their position through the voting process.

Finally, the Court noted that what Seng Long was really seeking to avoid is the cram down provision under section 366 of the CA 2016. There are policy considerations why such a cram down provision is put in place by Parliament. The paramount reason being to prevent dissenting and disgruntled creditors who are in the minority to frustrate a scheme accepted by 75% or more of the creditors. To require 100% acceptance of a scheme is impracticable.

Comments

This is an extremely comprehensive decision for an important aspect of the scheme of arrangement. The scheme mechanism to assess the quantum of the creditors' claims as this directly impacts whether the scheme has achieved more than 75% in value creditors' approval at the creditors' meeting.

This is the first Malaysian decision to explain the rationale and spell out the procedure to be followed for the proof of debt in a scheme. The procedure balances the rights of the creditors in having certainty on the debt they can vote on and also the rights of the debtors to have an expeditious summary process. The Court can ultimately act as a one-stop platform to decide whether there is a debt and the quantum that follows. That will resolve the issue of both voting at the creditors' meeting and the entitlement for the pay out under the scheme.

This is also the first Malaysian decision to explain the principles for allowing to leave to proceed against the company despite the restraining order. In the end, special or exceptional circumstances must be demonstrated and assessed against the backdrop of the rationale of the scheme of arrangement.