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Case Update: High Court Decision on Interaction between Judicial Management and Insolvency

The High Court in ***Exxobrite Sdn Bhd v Value Plus Industries Sdn Bhd*** **[2022] 12 MLJ 425** dealt with the moratorium effect of a judicial management order and the insolvency repercussions arising from the judicial management process.

Summary of the Decision and Significance

The company, Value Plus, was placed into judicial management. As part of the judicial management process, the judicial manager had carried out the proof of debt exercise and drew up the judicial manager's Statement of Proposal. The creditor, Exxobrite, had its debt admitted in the judicial management process.

While the judicial management order was still subsisting, Exxobrite issued a winding up statutory demand for the sum of approximately RM73,000.00.

Subsequently, Exxobrite filed a winding up petition based on both section 466(1)(a) and 466(1)(c) of the Companies Act 2016 (**CA 2016**). Section 466(1)(a) is where there is the presumption of the inability to pay debt when the statutory demand is not complied with. Section 466(1)(c) is where the inability to pay debt is after taking into account the contingent and prospective liabilities of the company.

First, the Court held that the statutory demand was defective as the issuance of the demand was a commencement of a legal process during the period of the judicial management order. This was contrary to section 411(4)(c) of the CA 2016 where "*no … other legal process shall be commenced …against the company … except with the consent of the judicial manager or with the leave of the Court …*"

Second, the Court still granted the winding up order based on the alternative ground of section 466(1)(c) of the CA 2016. There was an admitted debt through the judicial manager's admission of the proof of debt. The judicial manager's Statement of Proposal also showed that Value Plus' current liabilities far exceeded its current assets. This was evidence of Value Plus' commercial insolvency. Therefore, taking into account the contingent and prospective liabilities of the company, the Court found that Value Plus was unable to meet its existing debts.

Background Facts

On 16 February 2021, a judicial management order (**JM Order**) was granted over Value Plus. The JM Order lasted for 6 months and was then extended until 15 February 2022.

During the JM Order, the judicial manager carried out the proof of debt exercise. The judicial manager admitted the debt of approximately RM73,000 owing to Exxobrite through a Notice of Admission dated 24 November 2021.

On 25 January 2022, Exxobrite issued a statutory demand against Value Plus for the payment of the debt within 21 days.

On 15 February 2022, the JM Order lapsed.

On 15 June 2022, Exxobrite filed its winding up petition against Value Plus based on, among others, sections 466(1)(a) and 466(1)(c) of the CA 2016.

Value Plus filed an application to, among others, strike out the winding up petition. This is on the ground that the statutory demand was invalid as it was in breach of the moratorium under the JM Order.

The Court proceeded to hear the winding up petition along with the striking out application.

Decision

First, the Court considered whether the statutory demand was defective and invalid.

Exxobrite argued that the statutory demand was not the commencement of a legal process and therefore did not contravene section 411 of the CA 2016. The argument was that a legal process meant a summons, writ, warrant, mandate or other process issued from a court.

The Court referred to the High Court of Justice in Northern Island case of ***Fulton and another v AIB Group (UK) plc*** **[2014] Nich 8** concerning administration, being an equivalent process like judicial management. The case held that a statutory demand was a legal process for the purposes of a moratorium in administration.

The Court held that the term "*legal process*" for a moratorium in judicial management must include a statutory demand for winding up. It is the statutory demand issued under section 466(1)(a) of the CA 2016 which triggers the right to file or commence a winding up petition premised on section 465(1)(e) read with section 466(1)(a) of the CA 2016.

Further, the moratorium in judicial management was drafted wide enough to cover the terms "*other proceedings*", "*execution*" and "*or other legal process*". Parliament would have intended the moratorium to be applicable over not only legal proceedings in the normal sense (i.e. applications, proceedings or matters in Court) but also a wider spectrum of 'legal processes'.

The moratorium is intended for the underlying purpose of the corporate rescue mechanism, being the survival of the company or the rehabilitation of the company. The

statutory demand would undoubtedly put pressure on the company to make payment to the creditor and the creditor, Exxobrite, would consequently obtain an advantage over other creditors.

Nonetheless, in deciding whether to strike out the winding up petition, the Court noted that the petition was also based on the alternative ground of section 466(1)(c) of the CA 2016. It would not be a plain and obvious case for striking out.

Second, the Court proceeded to hear the petition itself and decided to wind up the company.

Exxobrite was already an admitted creditor by way of the judicial management process. The judicial manager had accepted Exxobrite's proof of debt.

Next, the judicial manager's statement of proposal reflected the company's current liabilities at RM19.4 million but with current assets only at RM8.7 million. The Court applied the test of commercial insolvency in whether the company is able to meet its current debts.

Finally, the Court also took into account the various serious allegations of misappropriation of funds and dissipation of assets. The assets of the company were in jeopardy. There was a fall-out between the different factions of the directors and shareholders. The Court found that there was an overwhelming evidence of the company's commercial insolvency and that the company was now paralysed and in a state of defunct. It was just and equitable that the company be wound up.

Comments

This decision does demonstrate the wide protection offered by a moratorium in judicial management. This case was decided in a situation of the moratorium after the JM Order is granted. But this would similarly apply to the initial moratorium after the filing of the judicial management application under section 410(c): "*no other proceedings and no execution or* ***other legal process*** *shall be commenced … against the company*".

Nonetheless, where the judicial management process is unsuccessful, it does expose the company to the immediate threat of winding up.

After all, even the filing of a judicial management application must be where the Court considers that "*the company is or will be unable to pay its debts*" (under section 404(a) of the CA 2016) i.e. where the company is essentially insolvent.

If the judicial manager is appointed, the judicial manager would have to ascertain and admit to the existence of the debts owed to the creditors.

The Statement of Proposal would also admit to the financial position of the company, and where it is likely that the company would be cashflow insolvent and balance sheet insolvent.

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