

COVID-19: Legal Mechanisms for Companies and Individuals Facing Financial Distress

Background

On 27 March 2020, the International Monetary Fund (IMF) officially declared that the global economy has entered a recession as a result of the spread of the COVID-19 pandemic which has shut down the economic activities across the world.¹

Malaysia is not spared from the impact of the outbreak of COVID-19 which then exacerbated the already dire economic situation. The economic uncertainty will burden repayment capability of a large part of the business community in Malaysia. Yet, there are contractual obligations of which the failure to perform will inevitably result in legal suits followed by the consequent liquidation process upon enforcement of judgments. The business community is therefore under the threat of financial distress.²

Can the financial distress be avoided?

A moratorium mechanism will certainly come as a rescue to the business community to avoid the threat of financial distress caused by the COVID-19. A moratorium is a legally authorised period of delay in the performance of a legal obligation or in taking legal action for the payment of a debt.

The Singapore government has proposed to pass the COVID-19 (Temporary Measures) Bill whereby a 6-month moratorium on the taking of certain legal action is provided.

Despite the various rescue measures announced by the Malaysian government and Central Bank of Malaysia³, including *PRIHATIN*⁴ and *PRIHATIN TAMBAHAN*⁵, there is no indication that Malaysia is going to enact similar law on moratorium in relation to contractual obligations, particularly on commercial or construction contracts.

However, the business community may look to the moratorium mechanisms already available under the Companies Act 2016 (“**CA 2016**”) and the Insolvency Act 1967 (“**IA 1967**”).

The statutory moratoriums

The CA 2016 is applicable for body corporates while the IA 1967 is for individuals, sole proprietors or partners in a partnership.

CA 2016 There are two types of moratorium provided under the CA 2016. One is a Corporate Voluntary Arrangement⁶ (“**CVA**”) and the other is a Judicial Management⁷ (“**JM**”).

¹ The New Times, *IMF officially declares global economic recession*, 27.3.2020 <https://www.newtimes.co.rw/news/imf-officially-declares-global-economic-recession#.XoLIE_JFmPc.whatsapp>.

² The Edge Markets, *Covid-19: Malaysia SMEs see zero cash inflow for at least three months due to MCO*, 30 March 2020 <<https://www.theedgemarkets.com/article/covid19-malaysia-smes-see-zero-cash-inflow-least-three-months-due-mco>>.

³ Bank Negara Malaysia, Press Release, 25.3.2020, *Measures to Assist Individuals, SMEs and Corporates Affected by COVID-19*, <https://www.bnm.gov.my/index.php?ch=en_press&pg=en_press&ac=5018&lang=en>; Bank Negara Malaysia, Notices and Announcements, 25.3.2020, *FAQ on Measures to Assist Individuals, SMEs and Corporates Affected by COVID-19*, <https://www.bnm.gov.my/index.php?tp=en_faqqoid19loan>.

⁴ *PRIHATIN Economic Stimulus Package*, <<https://www.pmo.gov.my/prihatin-economic-stimulus-package/>>

⁵ *Langkah Tambahan Bagi Pakej Rangsangan Ekonomi Prihatin Rakyat (PRIHATIN)*, 6 April 2020, <<https://www.pmo.gov.my/2020/04/langkah-tambahan-bagi-pakej-rangsangan-ekonomi-prihatin-rakyat-prihatin/>>

⁶ The CVA provisions are however not available to a public company, a company regulated by the Central Bank of Malaysia (“**BNM**”) or Capital Markets and Services Act 2007 (“**CMSA**”), and a company which has created a charge of its property or any of its undertaking.

⁷ The JM provisions are similarly not available to a company regulated by the BNM or CMSA.

IA 1967 A moratorium is made available under the IA 1967 where the debtor proposes to his creditors a scheme of arrangement of the business affairs before he is adjudged a bankrupt. This is known as a Voluntary Arrangement (“VA”).⁸

How long are the moratorium?

CVA A CVA moratorium commences automatically for a period of 28 days from the time of the filing of the requisite documents⁹ by the company to the Court and can be extended for a period of not more than 60 days by the company’s creditors of at least 75% in value.

JM A JM moratorium commences automatically from the date of the filing of the Court application for JM and it will last until a decision is made by the Court. The JM order remains in force for a period of 6 months from the date it is granted by the Court, unless otherwise discharged, and may be extended by the Court for another 6 months.

VA The moratorium under the VA commences when the Court makes an interim order for the VA which shall be valid for a period of 90 days.

The Key Consideration

The purpose of CVA, JM and VA is to provide temporary cash-flow relief for both businesses and individuals so that they can regularize their financial position with a view to avoid liquidation or bankruptcy.

Generally, to resort to these rescue mechanisms, there must be a plan or scheme supported by evidence to prove that there is prospect of recovering money or assets within a reasonable time to pay the debts. In addition to that, for a CVA, the company must be able to show that the company is likely to have sufficient funds during the proposed moratorium to carry on its business. The Court in a JM application will also consider whether the making of the order will allow the business to continue for the foreseeable future.

As for a VA, the repayment plan should be based on an amount the debtor can reasonably afford after taking into account his financial capacity.

In view of the above, the key to the viability of the rescue mechanisms is whether the financial repayment plan is acceptable to the creditors. The statutory moratorium provides breathing space for a company or individual to come up with the financial repayment plan without the threat of legal proceedings or liquidation process.

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⁸ The VA provisions are not applicable to a limited liability partnership registered under the Limited Liability Partnerships Act 2012.

⁹ Section 398, CA 2016