LITIGATION - MALAYSIA

Apex court rules that maintenance charges owed by parcel proprietors constitute unsecured debts

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Introduction

As a statutory creature under the Strata Titles Act 1985,(1) a management corporation (MC) is tasked to maintain and manage subdivided buildings and their common properties, such as common facilities, in a good state. An MC may impose and collect maintenance charges from the parcel proprietors of subdivided buildings in accordance with the Strata Management Act 2013.(2) As Section 77 of the Strata Management Act further provides that the amount due to an MC is a 'guaranteed sum', issues arise as to whether an MC is a secured creditor in the event that a parcel proprietor is insolvent and wound up. This question was answered in *Dubon Bhd v Wisma Cosway Management Corporation*,(3) where the Federal Court decided that the outstanding amount due to an MC is an unsecured debt.

Facts

The appellant was a company in liquidation (the company), which owned a unit in a building known as 'Wisma Cosway'. The respondent was the MC of Wisma Cosway. In January 2000 the company was wound up and, to liquidate its assets, the liquidator required the developer to execute the transfer of the unit into the company's name for the liquidator to sell the unit to pay the company's debts.

The developer refused to effect the transfer to the company, unless the company obtained a clearance letter from the MC stating that the outstanding sum of RM183,070.26, which comprised RM4,028 in administrative and application fees owed to the developer and RM179,042.26 payable as outgoings and service charges owed to the MC, had been paid off by the company.

The company denied the claim on the basis that:

- it was not liable to pay the outstanding sums because it was in liquidation and any payment of its liabilities was subject to the availability of funds for unsecured creditors; and
- any such payment must adhere to the order of priority of creditors as well as the *pari passu* rule. In this context, the MC had not filed any proof of debt with the liquidator.

When no resolution was reached, the company filed a claim with the Strata Management Tribunal (ST proceedings), seeking an order that, among other things:

- the developer executes the memorandum of transfer for the unit without imposing any administrative and application fees; and
- the MC issues the clearance letter on the company's payment of RM43,805.34.

The MC counterclaimed for the sum that it was owed and simultaneously filed an application in the winding-up court for leave to commence or proceed with its counterclaim in the ST proceedings under Section 226(3) of the then Companies Act 1965.

The dispute centred on Section 77 of the Strata Management Act in light of the insolvency regime in Malaysia.

Section 77(1) reads:

> ***Recovery of sum as a debt due to management corporation or subsidiary management corporation***
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> *The payment of any amount lawfully incurred by the management corporation or the subsidiary management corporation in the course of the exercise of any of its powers or functions or carrying out of its duties or obligations shall by virtue of this section be* ***guaranteed*** *by the proprietors for the time being constituting the management corporation or the subsidiary management corporation.* (Emphasis added.)

High Court

The High Court refused the MC's application for leave to commence or proceed with any action against the company on various grounds, including the fact that:

- any claim made by the MC before 31 May 2011 was time barred as at 31 May 2017 as no claim could be brought six years after the cause of action had accrued;
- the MC was an unsecured creditor and the remaining assets of the company had to be distributed *pari passu* among its unsecured creditors; and
- the MC had not filed its proof of debt in relation to its claim and therefore sought to circumvent the prescribed winding-up process for creditors. The counterclaim sought to be brought was purely monetary in nature and the MC should have filed its proof of debt to enable the liquidator to deal with it in the course of the winding-up process.

Dissatisfied with the High Court's decision, the MC appealed to the Court of Appeal.

Court of Appeal

The Court of Appeal reversed the High Court's decision. The Court of Appeal(4) decided, *inter alia*, as follows:

- Section 77 of the Strata Management Act provides that the amount due to the MC was a guaranteed sum and therefore a valid point of law had arisen – namely, whether the MC would remain an unsecured creditor that was entitled together with other unsecured creditors to the remaining assets of the company on a *pari passu* basis or whether it would be elevated to the status of secured creditor of the company by virtue of the fact that the monies owed to it by the company constituted a guaranteed sum under Section 77 of the Strata Management Act.
- While the test relating to the grant of leave to commence or proceed against a company in liquidation was not in dispute, the MC was entitled under the Strata Management Act to recover the guaranteed sum in the tribunal as a debt due and owing thereto.
- As Section 77 of the Strata Management Act uses the word 'shall', it imposes a mandatory obligation on the parcel proprietor – in this case, the company – to pay any outstanding amount due to the MC before the property is disposed to third parties.
- Section 105(2) of the Strata Management Act clearly states that the Limitation Act 1953 will not apply to proceedings of the tribunal. The payment of management charges amounts to a running account such that limitation does not come into play.

Federal Court

In essence, the company was granted leave to appeal to the Federal Court for the determination of the following issues:

- whether Section 77 of the Strata Management Act ousts the priority regime set out in Section 292 of the then Companies Act 1965 (now Section 527 of the Companies Act 2016); and
- whether the Strata Management Act elevates the payment of the arrears of the management fees to a secured debt by virtue of the term 'guaranteed' in Section 77(1).

The Federal Court allowed the appeal unanimously, overruled the Court of Appeal's decision and affirmed the High Court's decision. The Federal Court ruled that Section 77 neither dislodges the statutory priority of debts provided within the insolvency regime nor elevates the payment of management fees to a secured debt. The grounds in supporting the decision are summarised as follows:

- The word 'guarantee' in Section 77(1) denotes a statutory obligation and ensures the fact of the existence of a debt between an MC and a parcel proprietor. This would entitle the MC to recover maintenance and other related service charges from the parcel proprietor. This position is reinforced by Section 77(3),(5) which refers to the sum due to an MC by a parcel proprietor as a 'debt' which is actionable by the MC

through a suit filed in court or the strata tribunal to recover the debt from the parcel proprietor.
- There is nothing in the language of Section 77 where Parliament intends to oust the priority rule in the insolvency principles – any provision which seeks to achieve priority can be done only by way of a statutory provision with positive, clear and unambiguous wording.

Comment

The Federal Court has made it clear that the service charges owed by a parcel proprietor constitute an unsecured debt which is to be ranked *pari passu* among the unsecured creditors. The word 'guarantee' under the Strata Management Act only denotes the legal obligation on parcel proprietors to pay service charges, and does not go so far as to elevate the status of an MC to a secured creditor in the event of the insolvency of the parcel proprietor. This is arguably an accurate interpretation of the Strata Management Act. With this in mind, MCs of stratified properties should be vigilant in collecting outstanding sums from parcel proprietors.

The Federal Court did not rule on the issue of limitation. Thus, although the Court of Appeal's decision was overruled, the decision on the limitation issue is arguably upheld as Section 105(2) of the Strata Management Act clearly stipulates that the Limitation Act does not apply to proceedings of the tribunal.

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Endnotes

(1) Act 318.

(2) Act 757.

(3) [2020] 6 CLJ 589.

(4) *Wisma Cosway Management Corporation v Dubon Bhd* [2019] 3 CLJ 240.

(5) Section 77(3) reads:

> *Where any proprietor has not discharged or fully discharged his liability for the purpose of subsection (1), the management corporation or the subsidiary management corporation shall be entitled to recover from the proprietor in a court of competent jurisdiction or before the Tribunal as a debt due to it.*