

Predicaments in Obtaining a Restraining Order in a Scheme of Arrangement



by Andrea Chew Mei Yng

Without a doubt, a scheme of arrangement is a preferred corporate rescue mechanism for a company in financial distress. It allows the management of a company to retain control while carrying out an approved debt restructuring compromise or arrangement with creditors of the company. The ultimate goal is to restructure the debts of the company in a manner acceptable to at least 75% of its creditors in value so that the company can continue as a going concern.

A key instrument in a scheme of arrangement is a restraining order. The order stops any legal actions or proceedings against the company which would affect the financial viability of the company and hinder the progress of the scheme. Strategically, a company should apply for a restraining order from the High Court the soonest possible, at the very preliminary stage of formulating the intended scheme.

Creditors who become aware of the company's financial difficulties will naturally seek to protect their interests against the company. In line with this, legal suits, winding-up petitions or execution proceedings against the company will be expedited. A restraining order is thus crucial to prevent a scheme from becoming an exercise in futility even before it is implemented.

Pre-conditions to be fulfilled

The difficulty of obtaining a restraining order lies in the statutory pre-conditions imposed by s 368(2) of the Companies Act 2016 (**the Act**) before a restraining order may be granted.

Pursuant to the section, a High Court granting the order must be satisfied that:

- (a) there is a proposal for a scheme of arrangement between the company and creditors holding more than 50% in value of debt owed by the company;¹
- (b) the restraining order is necessary to enable the company and its creditors to formalise the scheme for the approval of the company's creditors and members under s 366 of the Act;
- (c) the company provides a statement of particulars as to the affairs of the company made up to a date not more than three days before the application is filed;
- (d) there is a person nominated by a majority of the creditors to act as a director of the company throughout the duration of the restraining order.

¹ All the company needs to show is that the proposed scheme of arrangement involves more than 50% in value of all its creditors: see *Re Kai Peng Berhad* [2007] 8 MLJ 122 (HC)



“Majority of the creditors” in this context mean creditors comprising a majority in value of creditors, not the majority in number.²

It is mandatory to fulfil all four pre-conditions. Otherwise, a creditor may later apply to set aside the restraining order on the basis of non-compliance with the statutory pre-conditions.³ The pre-conditions are imposed to ensure that creditors of the company are aware of the company’s intention to apply for a restraining order and as a safeguard to ensure that a restraining order is not an abuse of process.⁴

The pre-conditions essentially compel the company to inform creditors holding more than 50% in value of debt

owed by the company of its intention to implement a scheme of arrangement. The company is also obligated to obtain the support of these creditors on the person whom the company intends to retain in management throughout the duration of the restraining order. This is indubitably the biggest hurdle to overcome.

It is quite likely that a disagreement on who should retain control of the company will arise now that the company has disclosed its financial difficulties to its creditors holding more than 50% in value of the debts owed. On the one hand, without the support of these creditors, the scheme may not receive the sufficient support required for the scheme to be approved in a meeting of creditors. On the other hand, the company may not even reach the stage of being able to convene the meeting to consider the proposed scheme without the stand-still offered by a restraining order.

Issue of when pre-conditions need to be fulfilled

The manner in which s 368(2) of the Act is phrased raises the question of when it would be necessary to fulfil the statutory pre-conditions discussed. The section reads as follows:

“(2) The Court may grant a restraining order under subsection (1) to a company for a period of not more than three months and the Court may on the application of the company, extend this period for not more than nine months if – ...”

There are two possible interpretations:

- (1) The company must comply with the pre-conditions even in an application for an initial restraining order that will last for a period of not more than three months;

² *In Re Sumatec Resorts Berhad & Anor* [2011] 1 LNS 1538 (HC)

³ *Re PECD Bhd & Anor (No 2)* [2018] 10 CLJ 486 (HC); *Pelangi Airways Sdn Bhd v Mayban Trustees Bhd* [2001] 2 MLJ 237

⁴ See *Mansion Properties Sdn Bhd v Sham Chin Yen & Ors* [2021] 1 MLJ 527 at para [52]

(2) It is only mandatory for the company to comply with the pre-conditions when applying to extend the initial restraining order.

The latter interpretation would make more sense to the intention and purpose of a restraining order. Arguably, the three-month period is crucial to allow the company to formalise the scheme of arrangement with its creditors and to garner sufficient support of the scheme when it is formally proposed to a meeting of creditors and members.

Under the equivalent s 176(10A) of the repealed Companies Act 1965, the former interpretation was accepted to be the correct interpretation.⁵ Nevertheless, s 176(10A) reads slightly differently from the present section:

“(10A) The Court may grant a restraining order under subsection (10) to a company for a period of not more than ninety days or such longer period as the Court may for good reason allow if and only if — ...”

In comparison to the present section, the language of the repealed section is clear. The pre-conditions will apply to any application for a restraining order, regardless of whether it is an application for an initial restraining order or a subsequent application to extend the initial restraining order.⁶

Effect of recent Federal Court decision

The Federal Court decision in *Mansion Properties*⁷ is very much a welcomed decision. It affirms that an application for a restraining order may be made

ex parte; the court may hear and grant a restraining order to the company without hearing any other parties who may be affected by the order.

The Federal Court recognises the purpose of a restraining order is to ensure that a company’s restructuring efforts were not rendered nugatory pending the approval of a scheme of arrangement. It sought to preserve the status quo and to prevent efforts to develop and approve a scheme of arrangement from being thwarted by the dissipation of the company’s assets. In the light of the potential necessity for immediate action and speedy procedures, an *ex parte* application was suitable and appropriate to achieve the legislative purpose.

In arriving at this decision, the Federal Court considered that there will not be an abuse of process as an affected creditor may later apply to intervene in the proceedings and to set aside the restraining order. The Federal Court further recognises that there are specific statutory safeguards to prevent a hopelessly insolvent company from abusing this process such as the conditions imposed under s 368(2) of the Act.

It should be noted that the facts of *Mansion Properties* concern an initial restraining order. This decision implies that a company applying for an initial restraining order is required to fulfil the pre-conditions set out under s 368(2) of the Act. Should this be the case, it will diminish the purpose of allowing an application for a restraining order to be made *ex parte* in the very first place.

Conclusion

Despite being onerous, the pre-conditions under s 368(2) of the Act

are not impossible to fulfil and have been fulfilled by companies seeking for a restraining order. Most recently, Boustead Naval Shipyard Sdn Bhd successfully obtained an initial restraining order for a period of three months from the Kuala Lumpur High Court.⁸

While these pre-conditions are necessary to balance the rights between the company and its creditors and to avoid the abuse of process, in order to avoid a genuine scheme of arrangement from being defeated before it can even be proposed, perhaps it is best for the law to allow initial restraining orders to be granted without the need to comply with the stringent pre-conditions under s 368(2) of the Act. **LH-AG**

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⁵ *Re PECD Bhd & Anor (No 2)* [2018] 10 CLJ 486

⁶ *Ibid*, see para 10

⁷ *Mansion Properties Sdn Bhd v Sham Chin Yen & Ors* [2021] 1 MLJ 527 (FC)

⁸ Hafiz Yatim, ‘Boustead Naval obtains restraining order, green light for scheme of arrangement with creditors’ *The Edge Markets* (2 June 2021) <https://www.theedgemarkets.com/article/boustead-naval-obtains-restraining-order-green-light-scheme-arrangement-creditors>