

RELATIONSHIP BETWEEN INFORMAL WORKOUTS AND THE COURTS IN MALAYSIA

Prepared by
Mr. Chris Wai Kit Lee,
Corporate Debt Restructuring Committee
Kuala Lumpur, Malaysia

Malaysia has a traditionally strong judiciary system and an established insolvency legislation derived from the British and Australian models. This legal infrastructure has served Malaysia well in dealing with insolvency proceedings for distressed companies, especially those that resulted from the recessions of the 1970s and 1980s.

However, over the last 5 years, the approach in Malaysia has shifted away from formal insolvency proceedings towards a restructuring-based approach. This is due to the perception that the existing legal infrastructure is not as responsive and is inadequate to deal with present day's problems although the mechanisms are in place to provide a solution. The impetus for this change came in the 1997 financial crisis when Malaysian companies, same as its counterparts in the region, required help in over-coming financial problems arising from both a currency depreciation and the overnight collapse of the economy. The magnitude of the problem is just beyond the capacity of the legal infrastructure, thereby prompting the advent of informal workout proceedings best reflected in the creation of the Corporate Debt Restructuring Committee ("CDRC").

Whereas insolvency proceedings are commonly associated with liquidation of assets for the benefit of creditors (and therefore are viewed to be destructive in nature), the restructuring-based approach advocates creation of value for all stakeholders. Insolvency proceedings also suffer from the rigidity of complying with a set of lengthy legal procedures. The result of which is a lack of flexibility to meet specific demands of stakeholders in a restructuring case. Nonetheless, insolvency proceedings remain an important arsenal in dealing with problem companies. This is because not all companies can be restructured.

The task given to CDRC is to assist in the restructuring of large "viable" corporate borrowers. It was important for these engines of growth of the economy to be restructured so as to avoid unnecessary collapses of viable companies as well as to avoid large scale job losses. Insolvency proceeding for so many large and strategic companies was never an option due to the systemic risks they posed to the financial system. Furthermore, many of these companies were financially sound just before the crisis. This fact has been confirmed by independent studies including that of the World Bank that concluded Malaysian companies were suffering from a liquidity crisis and not financial insolvency.

The CDRC's framework has been structured to avoid moral hazard issues. Firstly, CDRC will only mediate between debtor companies and their creditors if it is acceptable to both parties. Secondly, the legal rights of creditors are never compromised throughout the informal workout process. Thirdly, the solution proposed under the CDRC workout require the unanimous consent of creditors before a restructuring scheme can be implemented. These conditions ensure that CDRC's restructurings are done with maximum transparency for all stakeholders. This formula has helped CDRC to complete the restructuring of 33 Groups of companies involving debts of RM25.5 billion (US\$6.7 billion) as at end-January 2001.

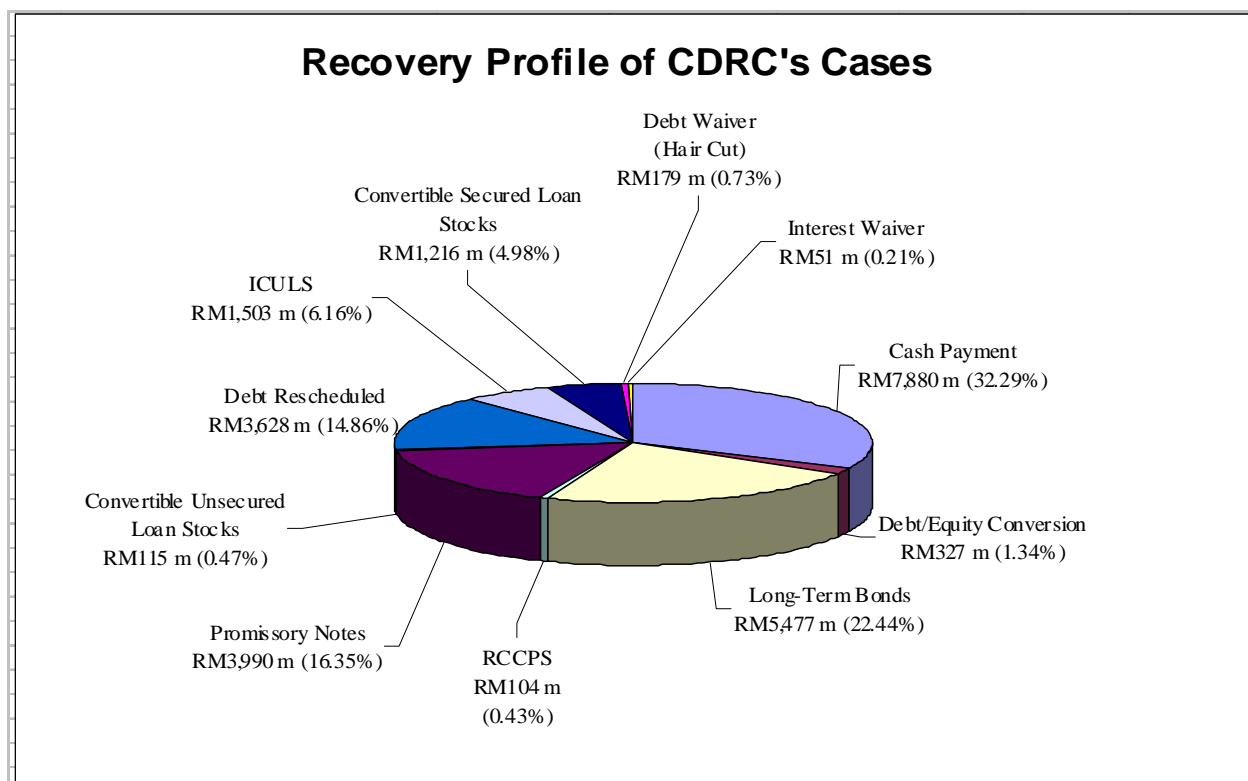
Table: Number of Applications Made to CDRC

	Number		Amount	
	Units	%	RM million	%
Applications Received	75	100.00	47,209.75	100.00
Less: Withdrawn/Rejected Cases	21	28.00	7,825.89	16.58
Less: Transferred to Danaharta	9	12.00	1,813.54	3.84
Cases under CDRC	45	60.00	37,570.32	79.58

Table: Statistics on Status of CDRC's Cases

	Number		Amount	
	Units	%	RM million	%
Cases under CDRC	45	100.00	37,570.32	100.00
Less: Restructured Cases	33	73.33	25,476.92	67.81
Outstanding Cases	12	26.67	12,093.40	32.19

CDRC's restructuring schemes have relied on the full spectrum of capital market instruments to give excellent recoveries (> 99%) for creditors. Only 0.9% of the debt amount has to be written-off, comprising 0.7% of principal hair-cut and 0.2% in interest waiver. This 99% recovery in NPLs comprise 32.3% in the form of cash repayment; 50.8% in debt/quasi-debt instruments; 1.3% in debt-equity conversion and 14.9% in rescheduled term loans (see pie chart below). Upon the listing of Time dotCom Berhad in March, the cash portion will improve to 48.6% with the scheduled redemption of RM3,990 million (US\$1,050 million) promissory notes.



CDRC's experience shows that informal workouts can co-exist with formal insolvency proceedings. For informal workouts to be effective, there must be mechanisms in place within the existing legal infrastructure to translate the informal agreements into legally effective solutions. This is a process often

CDRC's experience shows that informal workouts can co-exist with formal insolvency proceedings. For informal workouts to be effective, there must be mechanisms in place within the existing legal infrastructure to translate the informal agreements into legally effective solutions. This is a process often taken by the CDRC to conclude difficult restructurings.

In any restructuring, the support of all stakeholders is essential to reach a common goal, that is, to achieve a solution that is supported by creditors, shareholders and management. In Malaysia, such proposal must also comply with companies and securities laws and would be subject to the approval of the Securities Commission and also shareholders of the distressed company. It is therefore an arduous task which is best taken one step at a time.

First and foremost, the idea of a workout is to package a solution to a problem. Unlike a formal process which does not have the flexibility of material variation once a restructuring scheme is proposed, an informal process based on negotiation allow a scheme to obtain support of creditors before it is formally proposed. This friendly approach can be conducted on a discrete basis, thereby shielding the company from unwanted publicity. At all times, we ensure that the restructuring schemes offered to creditors have taken into account their different security rankings prior to restructuring and must be consistent for different creditors within the same security ranking.

It is not necessary for informal workouts to seek the assistance of the courts should there be unanimous approval from creditors. Under this scenario, the restructuring could be effected through the signing of a Debt Restructuring Agreement between the debtor company and its creditors. However, due to the diverse demands of different classes of creditors, it may not always be possible to obtain unanimous approval of all creditors. In this situation, it would be necessary to pre-package a solution that is acceptable to the majority to move the restructuring forward. Section 176 of the Malaysian Companies Act 1965 allow for such a legal remedy. The law requires creditors to vote in their respective classes. As long as more than 75% in value and 50% in number of creditors in each class support the restructuring scheme, then the proposed scheme will be made binding on all creditors by the courts. Thus, the role of courts would be very important in most debt restructuring as it is difficult to ensure 100% of creditors sign a Debt Restructuring Agreement to restructure debts.

The role of the courts is also indispensable in cases where companies have to undertake a capital reduction. This is because the court is the sole authority under the Companies Act for this purpose.

Thank you.

The chart below summarised the common link between informal workout proceedings and legal recourse to speed up the restructuring of distressed companies in Malaysia

