

# A Consultative Document

On Company Liquidation -  
Reforms and Restatement of the Law

by the Corporate Law Reform Committee  
for the Companies Commission of Malaysia



SURUHANJAYA SYARIKAT MALAYSIA  
COMPANIES COMMISSION OF MALAYSIA

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**CORPORATE LAW REFORM COMMITTEE**  
**A CONSULTATIVE DOCUMENT**  
**COMPANY LIQUIDATION-REFORMS AND RESTATEMENT OF THE LAW**

MARCH 2006

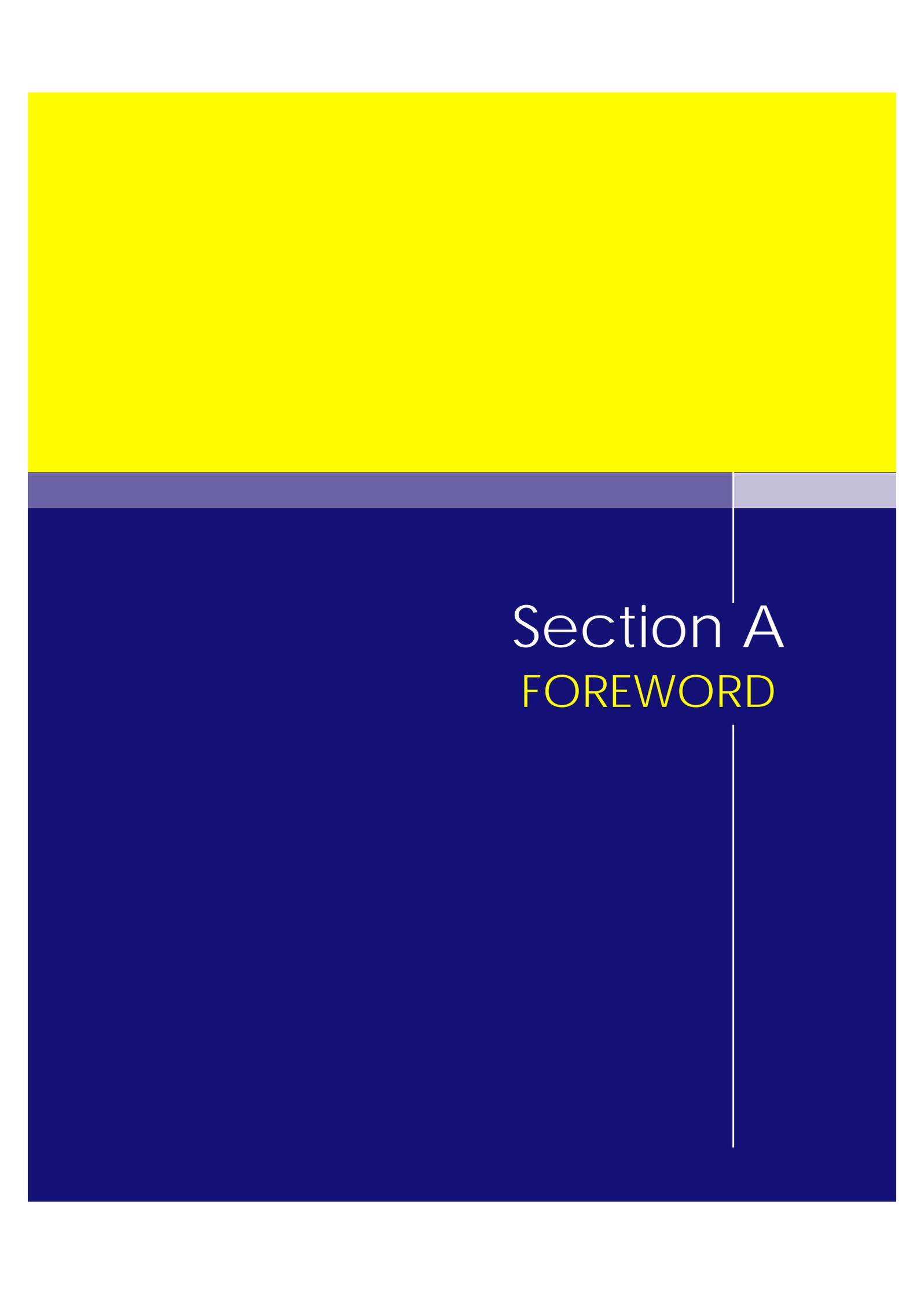
The Corporate Law Reform Committee invites comments, by **14 June 2006** on the issues set out in this consultative document.

You are invited to send comments, together with any supporting evidence on any part of this consultation. We would be grateful if you could refer to the recommendation number(s) and/or paragraph number(s) in your feedback, preferably by email, to:

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Section A  
FOREWORD



## SECTION A - FOREWORD

The remit of Working Group D (Insolvency and Corporate Securities) of the Corporate Law Reform Committee (CLRC) is to consider the current law and practice relevant to corporate insolvency. The objective of the review of this area of the law is for the creation of a corporate insolvency framework:

- that is facilitative to the winding up of companies where there is no prospect of the business becoming profitable and viable;
- that is able to provide an efficient system to rehabilitate companies where appropriate;
- that is able to ensure the protection of rights of creditors and members by providing enforcement mechanisms that may be accessed without undue delay or difficulty;
- that ensures accountability of the persons involved in the process and transparency of the process itself.

This Consultation Paper focuses on the reform and restatement of the liquidation scheme.<sup>1</sup> The laws and procedures on winding up are necessary parts in the operations of a company since the law and procedure will enable proper closure of a company which may not be able to continue its business. The review conducted by Working Group D of the CLRC in relation to the liquidation process starts on the premise that the law and procedures for company liquidation are well-known and familiar to practitioners. Thus, the gist of this structure will be retained. However, in line with simplification of the law, the review focuses on the following areas:

(a) **Reform and restatement of the law on company liquidation** - There are specific recommendations made in relation to the following:

- Commencement of winding up and termination of winding up;
- Review of void and voidable dispositions, undue preference transactions, effect of floating charges and liquidator's right of recovery under section 295;
- The powers and duties of a liquidator and interim liquidator;
- The appointment and qualification of a liquidator and interim liquidator;
- The rights of secured creditors;

<sup>1</sup> The CLRC is also deliberating on other insolvency procedures specifically areas pertaining to receivership, judicial management and schemes of arrangement and will be releasing consultation papers on these areas subsequently.

- Mutual credit and set-off;
- Preferential debts; and
- The deregistration process under section 308 of the Companies Act 1965.

**(b) Reform and restatement of the liquidation process**

**(c) Reform and restatement on the law and procedure in relation to company charges.**

In conducting the review, the CLRC is aware of views that there should be an Omnibus Insolvency Act which would combine both corporate and individual insolvency and operate as a separate legislation from the company legislation. However, even in jurisdictions that adopt this approach, there is still no total fusion between corporate and individual insolvency.<sup>2</sup> The CLRC is of the view that the review exercise should focus on clarification and uniformity of the law and procedure on corporate insolvency in general and company liquidation in particular. Unity of the law on corporate and individual insolvency into a single legislation should not be the overriding concern. One of the means identified by the CLRC on achieving clarification and uniformity of the law is by reducing confusion in the application of the existing framework especially in relation to unnecessary and extensive cross-references to the Bankruptcy Act 1967.

We hope to receive views and comments on the recommendations stated in this Consultation Paper. Please reply to Puan Nor Azimah Abdul Aziz at the Companies Commission of Malaysia (CCM) by **14 June 2006**.

Thank you.

Yours truly,

**Dato' K.C. Vohrah**  
Chairman  
Corporate Law Reform Committee

**Lim Tian Huat**  
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<sup>2</sup> The Australian Law Reform Committee (ALRC) *Final Report on Insolvency* (1988) Vol. 1 & 2.



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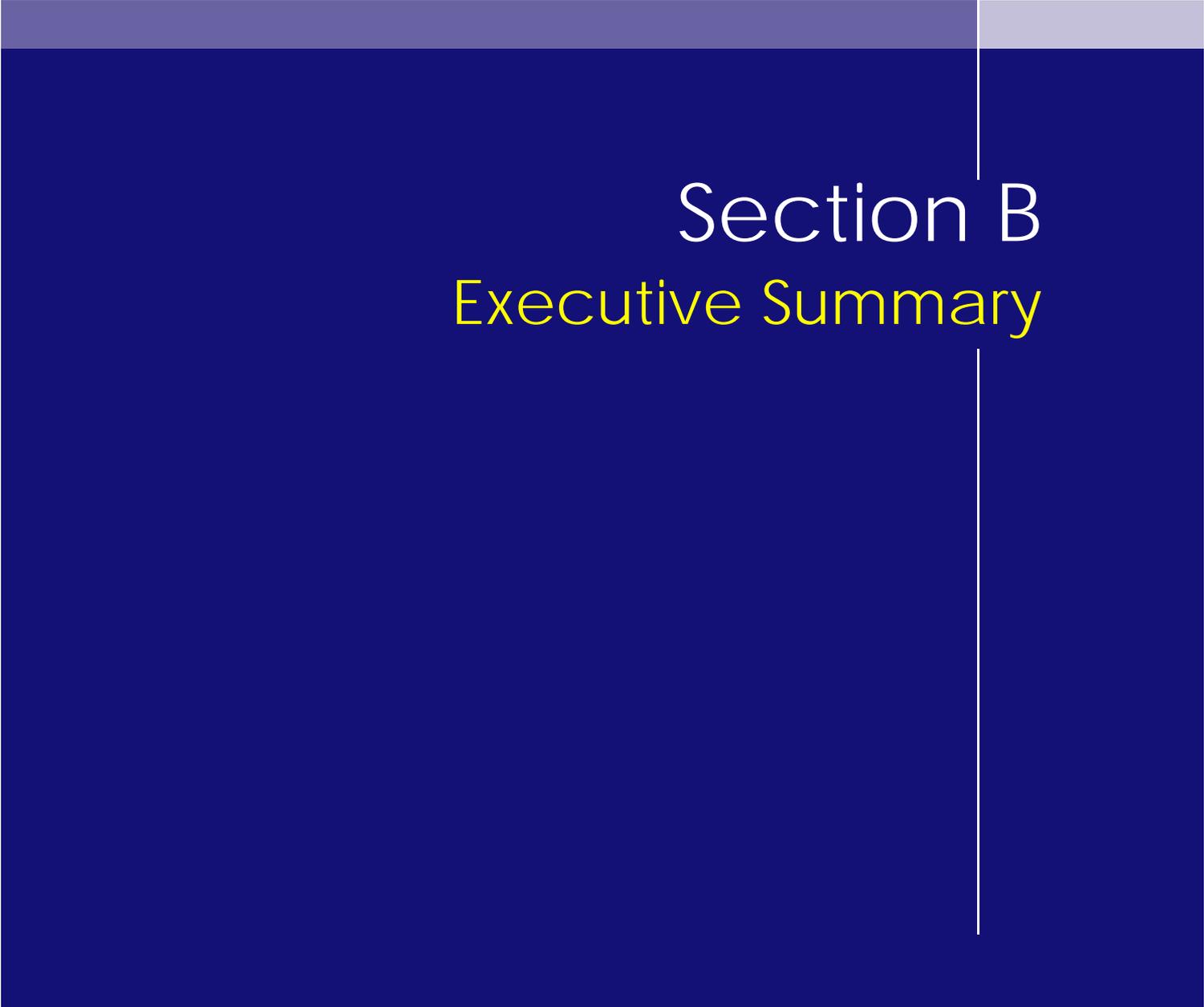
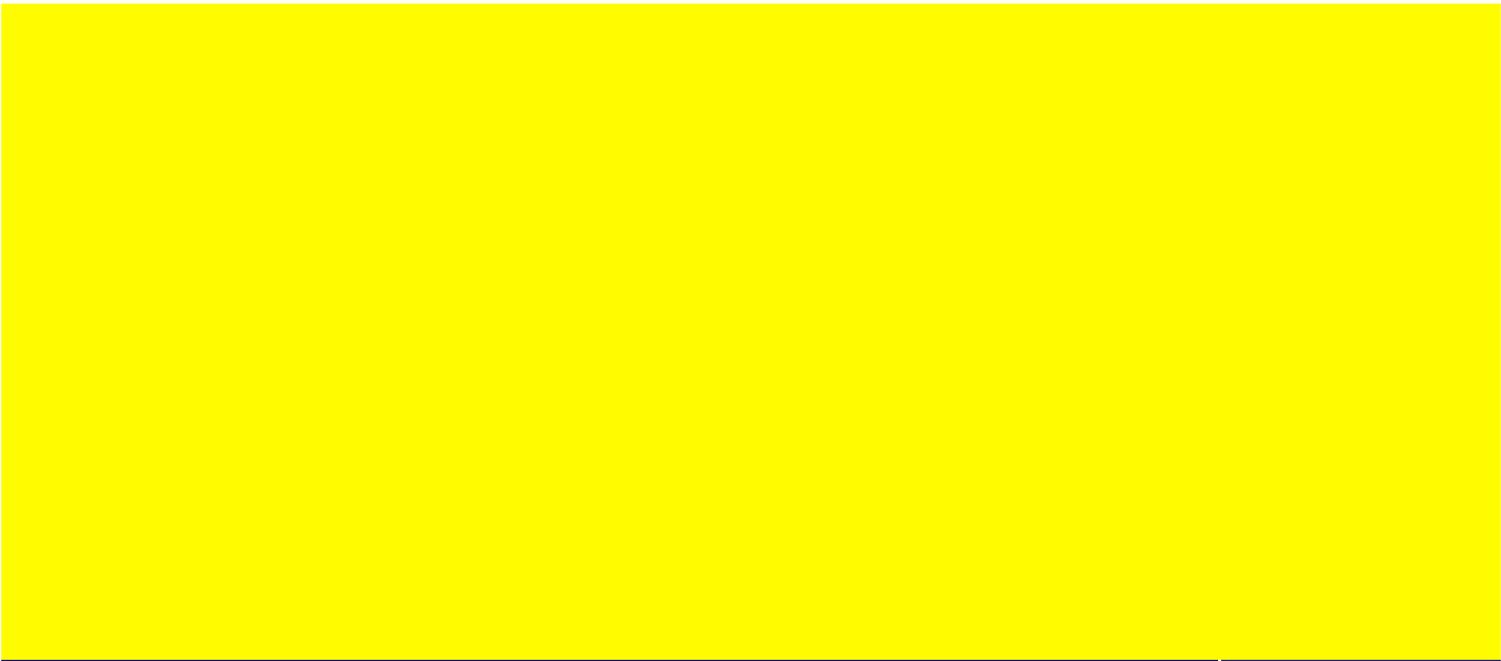
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Section B  
Executive Summary



## SECTION B - EXECUTIVE SUMMARY

This Consultation Paper focuses on the review conducted by Working Group D of the Corporate Law Reform Committee ('CLRC') on liquidation of companies.

### 1. Proposals

1.1 The following areas of corporate liquidation were examined by the CLRC and the recommendations of the Steering Committee are as follows:-

1.1.1 *The Commencement of Winding up*: The CLRC recommends that section 219 (2) of the Companies Act 1965 ('Companies Act 1965') is to be amended to reflect that the commencement of a compulsory winding up is from the date the order was made by the court.

1.1.2 *Voidable Dispositions*: The CLRC recommends the introduction of a list of exempt dispositions into section 223 of the Companies Act 1965 (similar to section 468(2) of the Australian Corporations Act 2001) to ease the burden faced by a company in having to apply for a monthly validation order under section 223 in order for the company to carry on with its day-to-day business operation. These exempt dispositions are transactions which do not require any validation order from the court.

1.1.3 *Undue Preference Transactions*: The CLRC recommends that section 293 of the Companies Act 1965 be amended in the following manner:

(a) to delete any cross references to the Bankruptcy Act 1967 and to specify the list of undue preference transaction as follows:

- (i) a conveyance or transfer of property by the company;
- (ii) the giving of a security or charge over the property of the company;
- (iii) the incurring of an obligation by the company;

- (iv) the acceptance by the company of execution under a judicial proceeding;  
and
  - (v) the payment of money by the company, including the payment of money under a judgment or order of a court;
- (b) to state that in the case of a compulsory winding up, an undue preference transaction is one that is entered into :
- (i) within 6 months of the date of the presentation of the petition to wind up the company; or
  - (ii) where, before the presentation of the petition, the company passed a resolution to voluntarily wind up the company within 6 months of the time when the resolution was passed, whichever is earlier; and
- (c) to clarify that there is no need to prove that there is an intention to prefer creditors and that the transaction should be set aside if the effect is that it prefers one creditor over another.
- 1.1.4 *Invalid Floating Charges:* The CLRC recommends that in the case of a compulsory winding up, a floating charge shall be voidable at the option of the liquidator if it was created within 6 months of the presentation of the petition for compulsory winding up.
- 1.1.5 *The Liquidator's Right of Recovery:* The CLRC recommends:
- (a) that section 295 of the Companies Act 1965 should be amended to allow the liquidator, in a compulsory winding up, to set aside transactions coming under the section if these were entered into within 2 years from the date of the presentation of the petition or from the date the company passes a resolution to voluntarily wind up the company, whichever is earlier;

- (b) that section 295 of the Companies Act 1965 should be amended to allow the liquidator, in a voluntary winding up, to set aside transactions coming under this section if these were entered into within 2 years from the date upon which the voluntary winding up is deemed by this Act to have commenced; and
- (c) that section 295 of the Companies Act 1965 should be amended to extend the application of section 295 to 'persons connected to directors' and to 'substantial shareholders of the company'.

1.1.6 *Insolvent Liquidation and the Presumption of the Inability to Pay:* The CLRC proposes the retention of the present provision on the presumption of inability to pay debts under section 218(2) of the Companies Act 1965.

1.1.7 The CLRC proposes the increase of the liquidated amount from RM500 to RM5,000. The CLRC believes that the amount of RM5,000 is appropriate as this amount is not too high that it precludes small creditors from initiating claims and it is high enough to remove the likelihood of any trivial claims.

1.1.8 The CLRC also proposes the introduction of a time frame to file a petition to wind up a company after the expiry of the period of 21 days to minimise the possibility that the statutory demand procedure may be abused as a means of pressuring the company to pay its debts without having to require the creditors to proceed by way of a judgment debt. The proposed time frame is three months after the expiry of the period to comply with statutory demand i.e. 21 days.

- 1.1.9 *Termination of Winding up*: The CLRC recommends the introduction of an express provision for the termination of winding up. The proposed provision will enable companies to either apply for a stay or a termination of a winding up.
- 1.1.10 The CLRC proposes that an application to terminate a winding up proceeding may be made by a liquidator, or a director or shareholder of the company or any other entitled person or a creditor of the company, or the Registrar.
- 1.1.11 *Interim Liquidator*: The CLRC recommends that section 231 of the Companies Act 1965 be amended by substituting the term 'an approved liquidator who is appointed provisionally' with the term 'interim liquidator' to avoid confusion in the usage of terminology.
- 1.1.12 *Powers and Duties of Liquidator and Interim Liquidator*: The CLRC recommends the adoption of the UK approach particularly sections 165, 166 and 167 of the Insolvency Act 1986 and to follow the structure of Schedule 4 of the Insolvency Act 1986 to simplify the structure in relation to powers of the liquidator in different types of winding up. Any modifications will have to take into account its suitability with the local environment.
- 1.1.13 The CLRC recommends that the interim liquidator should have the same powers as the liquidator but such powers are exercisable for the purposes of maintaining and preserving the value of the company's assets.

1.1.14 Where specific powers are concerned, the CLRC recommends that:

- (a) The appointment of an advocate under section 236(1)(e) of the Companies Act 1965

The CLRC recommends that the appointment of an advocate (to assist a liquidator in areas that the liquidators are unable to do in a winding up process) should no longer require the authority of the court or the Committee of Inspection (COI) as the present requirement hinders the smooth running of the liquidation process.

- (b) Power to compromise debts due under section 236(2)(b) of the Companies Act 1965

The CLRC recommends that a liquidator be allowed to compromise debts owed to the company if the amount is less than RM10,000 and this power shall be exercisable without the sanction of the court or the COI. However, to facilitate the liquidation process, the court or the COI should be authorised with a discretion to grant a blanket approval or mandate to the liquidator to compromise debts above RM10,000 subject to a limit of RM50,000. This discretionary power of the court and the COI must be exercised with caution and on a case to a case basis.

- (c) Limitation to trade up to 4 weeks after the winding up order under section 236(1)(a) of the Companies Act 1965

The CLRC recommends that the existing time frame for a liquidator to trade after the grant of a winding up order be extended and that the appropriate time frame should be 6 months after which time, the liquidator is required to obtain

the sanction of the court to carry on the business of the company so long as such exercise is necessary for the beneficial winding up of the company. The current time frame of 4 weeks is too short and may not be able to assist the liquidator to perform his functions efficiently.

- (d) Restriction to retain a sum exceeding of RM200 for more than 10 days under section 238(2) of the Companies Act 1965

The CLRC recommends that section 238(2) of the Companies Act 1965 in relation to 'the liquidator to retain more than 10 days a sum exceeding RM200 unless he explains the retention of such sums to the satisfaction of court...' be deleted as this provision is obsolete.

- (e) Duty to submit the statement of affairs under section 234 of the Companies Act 1965

The CLRC recommends the amendment of section 234 of the Companies Act 1965 by deleting the requirement that the company secretaries shall submit the statement of affairs.

- (f) Duty to settle the list of contributories under section 244 of the Companies Act 1965

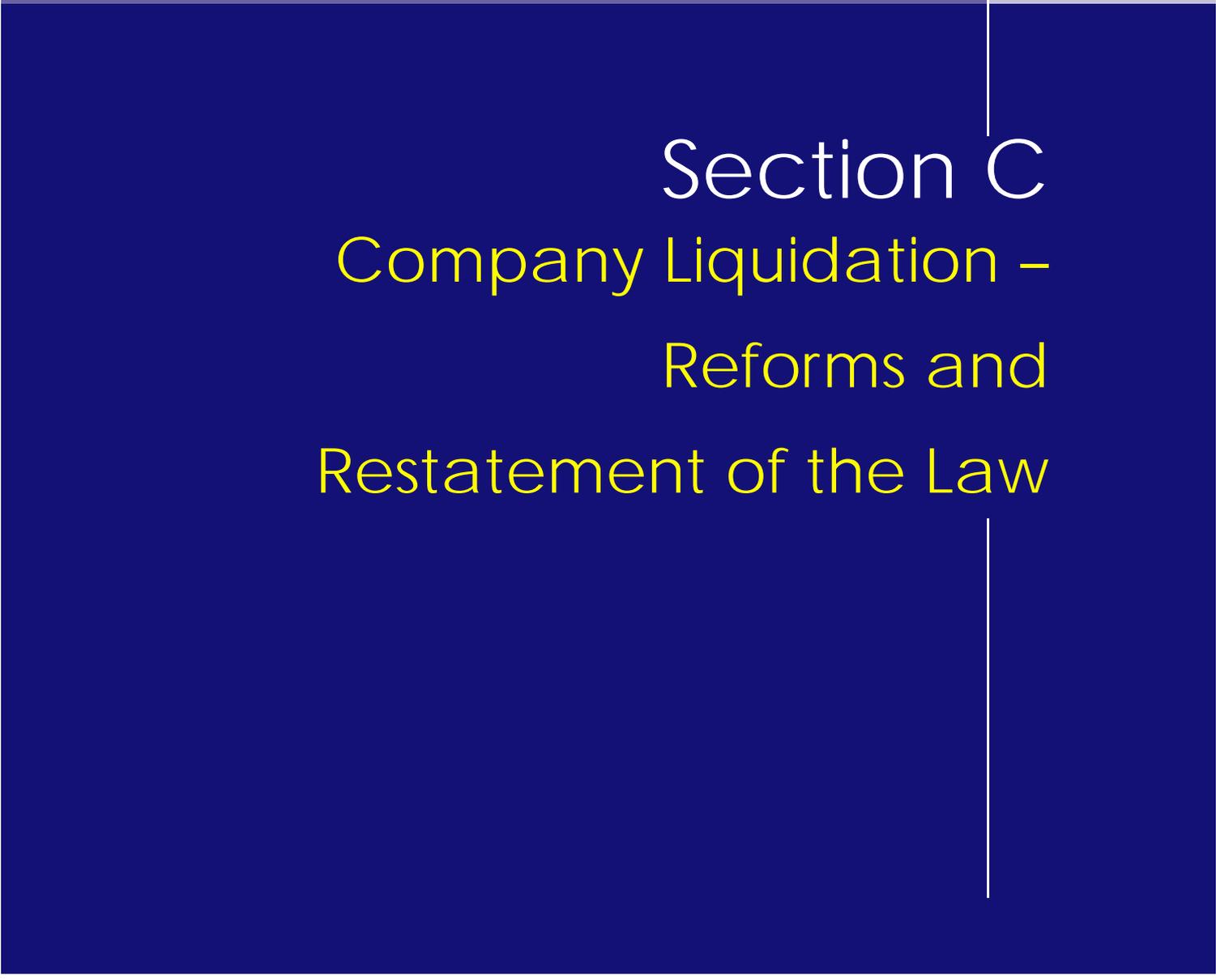
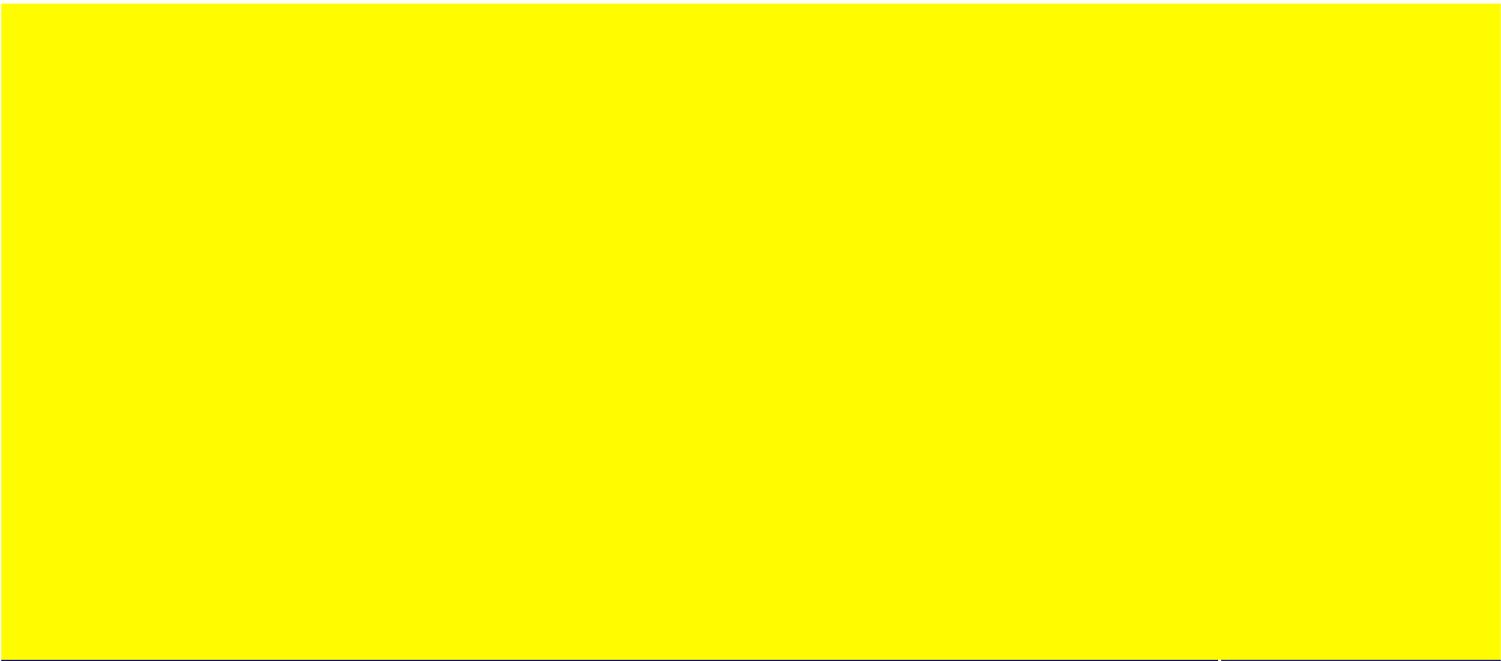
The CLRC recommends that this mandatory requirement be amended to make it discretionary on liquidators to prepare a list of contributories only in the following situations:

- (i) if there are surplus capitals for distribution; and
- (ii) if there are likely to be contributories in the company's liquidation.

- 1.1.15 *Rights of the Secured Creditors*: The CLRC believes that the rights of secured creditors vis-à-vis the charged assets should be clearly stated in the Companies Act and recommends the adoption of section 305 of the New Zealand Companies Act 1993 as a model for such a provision. At present, the rights of secured creditors in the liquidation process are provided under the common law which gives them priority over the unsecured creditors. The rights of secured creditors are not statutorily provided for under the Companies Act.
- 1.1.16 The CLRC recommends that the right to set-off should not be limited to contributories only but should be extended to creditors of the company in the case of mutual debts for both solvent and insolvent liquidations.
- 1.1.17 *Preferential Debts*: The CLRC proposes to amend section 292(1)(b) by increasing the present quantum of RM1,500 for wages and salary of each employee entitled to priority to the sum of RM15,000. In addition, the CLRC also proposes for the introduction of a new definition on 'wages and salary of employees' to include wages in lieu of notice of termination of employment and amount of gratuity on termination of employment. The rationale is that the CLRC sees the necessity to upgrade the social obligation of a company for the general benefit and wellbeing of its employees.
- 1.1.18 The CLRC also recommends the abolition of any preferences given to all federal taxes. Federal taxes should not be accorded preferential treatment among the unsecured creditors simply because the Government should require the company to pay all its taxes well before the company is wound up and not after the commencement of winding up of the company. If this practice is allowed to continue, rights of other unsecured creditors, especially the employees, would be greatly affected as they would be deprived of their entitlements. However, the CLRC

took into account that the abolition of federal taxes may have an impact on the government policy-decision as it may in some ways affect the government's revenue.

1.1.19 *Deregistration*: The CLRC noted that the procedures for deregistration of a company under the Companies Act 1965 are adequate. However, the CLRC was concerned with the enforcement of these provisions by the Registrar which is not fully utilised. The CLRC proposes that the liquidator should be allowed to make an application to the Registrar to strike-off a company which has been wound up that is no longer in operation. In this respect, the Registrar should design a simple form in the Companies Regulation 1966 for the liquidator to fill up when applying to dissolve this type of company.



Section C  
Company Liquidation –  
Reforms and  
Restatement of the Law



## SECTION C - COMPANY LIQUIDATION – REFORMS AND RESTATEMENT OF THE LAW

### 1. COMMENCEMENT OF COMPULSORY WINDING UP

1.1 Currently under section 219(2) of the Companies Act 1965, a compulsory winding up commences from the date the petition to wind up the company was filed. The rationale for the provision that the compulsory winding up is deemed to have commenced at the time of the presentation of the winding up petition is to ensure that the company's assets are preserved for creditors.

1.2 The CLRC noted that Australia provides that the commencement of winding up in a compulsory liquidation is when the order is made.<sup>3</sup> New Zealand provides that a winding up commences from the date the liquidator is appointed.<sup>4</sup> The liquidator may be appointed by a special resolution of the shareholders, a board resolution or by the court upon an application by specified persons. Both these jurisdictions essentially do not relate the commencement date to the date of the presentation of the petition. However, Australia has a provision specifying a 'relation-back day' which is either the date of the presentation of the petition or the day on which the winding up is deemed to have begun.<sup>5</sup> This provision is applicable for the purpose of ascertaining whether the transactions entered into the company are voidable transactions.

1.3 Singapore's provision is similar to Malaysia in that commencement of the compulsory winding up is from the date of the presentation of the petition. However, the Singapore Company Legislation and Regulatory Framework Committee (CLRFC)<sup>6</sup> have made the recommendation to adopt the Australian approach in dealing with void and voidable disposition. The CLRFC has recommended that the date of commencement of winding up be changed to the date the winding up order was made.

<sup>3</sup> See section 513A of the Australian Corporations Act 2001.

<sup>4</sup> See section 241 of the New Zealand Companies Act 1993.

<sup>5</sup> See section 9 of the Corporations Act 2001.

<sup>6</sup> Singapore, Company Legislation and Regulatory Framework Committee (CLRFC) *Final Report* (October 2002).

## RECOMMENDATIONS

- 1.4 The CLRC recommends that section 219(2) of the Companies Act 1965 be amended to provide that in the case of a compulsory winding up, the commencement date of winding up is the date the order to wind up the company is made by the court.

### Question for Consultation

#### Question 1:

Do you agree that the date for the commencement of compulsory winding up should be the date that the order was made by the court to wind up the company?

## 2. VOID, VOIDABLE DISPOSITION, UNDUE PREFERENCE TRANSACTION, EFFECT OF FLOATING CHARGES AND LIQUIDATOR'S RIGHT OF RECOVERY UNDER SECTION 295 OF THE COMPANIES ACT 1965

- 2.1 The CLRC noted that the recommendation in relation to the commencement date for compulsory winding up may impact on other provisions of the Companies Act 1965 specifically sections 223, 224, 293, 294 and 295. These sections are intended to protect against the dissipation of company's assets during the period leading to the winding up. Thus, corollary changes to these sections will also be made as a result of the amendment as to the date of commencement of a compulsory winding up. There are also specific changes proposed to these sections. These specific changes are set out below.

## A. VOID AND VOIDABLE TRANSACTIONS

- 2.2 Under section 223, all dispositions of the company after the presentation of the winding up petition are void unless the court otherwise orders. Under section 224, any attachment, sequestration, distress or execution put into force against the company is also void.
- 2.3 Section 223 creates difficulty for the company to carry on its day-to-day business operations. It is noted, that even after the order has been made, the company may still need to carry on business to enable the company's assets to be realised or any other transactions in the ordinary course of business. The practice is for the company to obtain a validation order on a monthly basis which the CLRC believes is unduly cumbersome and costly for companies already facing the threat of winding up. Thus, the CLRC proposes to introduce into section 223 a list of exempt dispositions so as to enable transactions in the ordinary course of business to be carried out after the presentation of the petition but prior to the winding up order without having to obtain a validation order.
- 2.4 Section 259 of the Singapore Companies Act (Cap 50) is in *pari materia* with section 223 of the Companies Act 1965. However, the CLRFC has recommended adopting the Australian approach of exempting transactions in the ordinary course of business and disposition for valuable consideration equivalent or exceeding the value of the property so disposed.<sup>7</sup>

<sup>7</sup> Singapore, Company Legislation and Regulatory Framework Committee (CLRFC) *Final Report* (October 2002).

- 2.5 Section 468(1) of the Australian Corporations Act 2001 provides that any disposition of the company's property other than an exempt disposition, after the commencement of winding up is void unless the court validates the disposition. Under section 468(2) of the Australian Corporations Act 2001, the exempt dispositions are:
- (a) a disposition made by the liquidator, or by a provisional liquidator, of the company pursuant to a power conferred on him or her by:
    - (i) this Act; or
    - (ii) rules of the Court that appointed him or her; or
    - (iii) an order of the Court; or
  
  - (aa) a disposition made in good faith by, or with the consent of, an administrator of the company; or
  
  - (ab) a disposition under a deed of company arrangement executed by the company; or
  
  - (b) a payment of money by an Australian ADI (*Authorized Deposit-taking Institution*) out of an account maintained by the company with the Australian ADI, being a payment made by the Australian ADI:
    - (i) on or before the day on which the court makes the order for the winding up of the company; and
    - (ii) in good faith and in the ordinary course of business of the banking business of the Australian ADI.

In this respect, disposition does not necessarily have to be 'by the company'. Disposition could also be made by third parties e.g. a bank. Since the term 'Australian ADI' under section 468(2)(b) means a bank, a disposition by a bank may be exempted. This provision allows a bank to authorise the payment of money out of the company's account up to the day on which the winding up order is made by the court. The operation of section 468(2) does, however, depend upon the bank acting in good faith and in the ordinary course of business. Thus, the payment of a cheque by a bank after the commencement of winding up of a company amounts to exempt disposition and is therefore valid.<sup>8</sup>

- 2.6 The CLRC noted that in New Zealand, sections 223 and 224 of the Companies Act 1965 are conceptually similar to section 292 of the New Zealand Companies Act 1993. Section 292 of the New Zealand Companies Act 1993, however, has been the subject of a review by the New Zealand Insolvency Law Review (NZILR).<sup>9</sup> One of the recommendations of the NZILR is for the removal of the phrase 'ordinary course of business' that is an exception under section 292(2) and (3) as this has given rise to evidential difficulties and costs associated in proving such an element as the knowledge of the other party to the transaction is still a factor in establishing whether payment was made in the ordinary course of business. It is to be pointed out that unlike section 468 of the Australian Corporations Act 2001 that sets out the list of exempted dispositions, section 292 of the New Zealand Companies Act 1993 does not do so and this may be the reason why there are evidential difficulties and cost issues in relation to the section.

<sup>8</sup> In *Putnin as Liquidator of Rampton Holdings Pty Ltd v Timber Traders Cockburn* (1990) 8 ACLC 896, the Court validated the payment made by the bank to the respondent (the supplier of timber) who had supplied timber to the appellant. The payment by the bank through a cheque was made after the commencement of winding up of the appellant. The decision was based on section 368(1A) of the Australian Companies Code which is in *pari materia* with section 468(2) of the Corporations Act 2001.

<sup>9</sup> New Zealand, Ministry of Economic Development Insolvency Law Review, *Draft Insolvency Law Reform Bill* (April 2004).

## RECOMMENDATION

- 2.7 The CLRC recommends to introduce into section 223 of the Companies Act 1965 a list of exempt dispositions (similar to section 468(2) of the Australian Corporations Act 2001) and to state that these exempt dispositions are transactions which do not require any validation order from the court.

### Question for Consultation

#### Question 2:

Do you agree that section 223 of the Companies Act 1965 should be amended to include a list of exempt dispositions (similar to section 468(2) of the Australian Corporations Act 2001) which would not require a validation order from the court?

### B. UNDUE PREFERENCE TRANSACTION UNDER SECTION 293 OF THE COMPANIES ACT 1965

- 2.8 Section 293 of the Companies Act 1965 is a provision for setting aside undue preference transactions. Section 293 of the Companies Act 1965 must be read with section 53 of the Bankruptcy Act 1967 -
- in order to determine what are undue preference transactions; and
  - to ascertain the time frame for a transaction to be set aside as being an undue preference transaction.
- 2.9 In essence, section 53 of the Bankruptcy Act 1967 as applied to companies avoids certain transactions that have the effect of giving a creditor preference over the

other creditors where the transaction was entered into by a company when the company is unable to pay its debts and if entered into within 6 months of the commencement of winding up.<sup>10</sup>

- 2.10 Under section 293 of the Companies Act 1965, it is unclear what type of transactions are considered as undue preference transactions unless cross referencing to section 53 of the Bankruptcy Act 1967 is made. It is unclear from section 293 the specific time frame within which a transaction is considered an undue preference transaction. A person would not be aware of the time frame unless he cross refers to section 53 of the Bankruptcy Act 1967.
- 2.11 In line with the objective to simplify and clarify the law, the CLRC recommends to omit extensive cross-referencing to the Bankruptcy Act 1967. The effect of this recommendation is that there is a need to incorporate within the company legislation itself what are the transactions deemed as undue preference transactions. This may be done by adopting section 292 of the New Zealand Companies Act 1993.<sup>11</sup> This will provide clarity as to what are undue preference transactions.

<sup>10</sup> Section 53(2) of the Bankruptcy Act 1967 excludes certain transactions namely if the dealings are made in good faith and for a valuable consideration. Under the Bankruptcy Act 1967, the transaction, if made or done by or against any person unable to pay his debts within six months of the presentation of the bankruptcy petition, is void. However, for the purposes of the compulsory winding-up of a company, the 6 months is counted from the presentation of the petition to wind up the company. Where, before the presentation of the petition, the company passed a resolution to wind up voluntarily, then the date is from the date the resolution is passed.

<sup>11</sup> (1) In this section, 'transaction', in relation to a company, means—

- (a) A conveyance or transfer of property by the company;
- (b) The giving of a security or charge over the property of the company;
- (c) The incurring of an obligation by the company;
- (d) The acceptance by the company of execution under a judicial proceeding;
- (e) The payment of money by the company, including the payment of money under a judgment or order of a court.

- 2.12 Section 292 of the New Zealand Companies Act 1993 states that certain transactions are identified to be transactions having preferential effect and can be set aside on the application of the liquidator. The transactions are: a conveyance or transfer of property by the company, the giving of a security or charge over the property of the company, the incurring of an obligation by the company, the acceptance by the company of an execution under a judicial proceeding, the payment of money by the company, including the payment of money under a judgment or order of a court. Further, transactions occurring within the specified period (two years) of formal insolvency and was not transacted in the ordinary course of business can be challenged and the liquidator must prove that the transaction:
- (i) took place within two years of liquidation;
  - (ii) was transacted at the time the company was unable to pay its debts; and
  - (iii) enabled the recipient to receive more than they would have received on liquidation.

If the transaction took place within the restricted period (6 months) of formal insolvency, it will be presumed that it took place when the company was technically insolvent (or unable to pay its debts) and that it was not in the ordinary course of business.<sup>12</sup> However, the transactions cannot be set aside if those transactions were entered into in the ordinary course of business.

- 2.13 As was noted earlier, section 292 of the New Zealand Companies Act 1993 has been the subject of review by the New Zealand Insolvency Law Review (NZILR) in relation to the term 'in the ordinary course of business'. In addition, the NZILR recommended that there should be a period in which voidable transactions may be set aside and

<sup>12</sup> See section 292(3) of the New Zealand Companies Act 1993.



that the recommended time period in which payments may be recovered is *6 months from the date of filing the application commencing formal insolvency procedures*. The reason for this recommendation is that the two different periods are often criticised as being arbitrary and lengthy.

- 2.14 Whilst the CLRC recommends the adoption of section 292 of the New Zealand Companies Act 1993 in relation to identifying the types of undue preference transactions, the CLRC is of the view that in the case of a compulsory winding up, the time frame should be within 6 months from the date of the presentation of the petition, or where before the presentation of the petition the company passed a resolution to voluntarily wind up the company, the 6 month period is counted from the time when the resolution was passed, whichever is earlier. In the case of a voluntary winding up, the time frame should be within 6 months from the date upon which the voluntary winding up is deemed by this Act to have commenced. Thus, the CLRC does not recommend the 'two different time period' found in section 292 of the New Zealand Companies Act 1993.
- 2.15 The CLRC also noted that it is uncertain whether there is a need to prove intention by the company to prefer some creditors over other creditors under section 293 of the Companies Act 1965. On this point, the CLRC noted that under section 292 of the New Zealand Companies Act 1993, the test in determining whether a transaction is a voidable transaction and is capable of being set aside is an 'effect-based' test. An 'effect-based' test means a voidable transaction can be set aside based on its effect, regardless of the intention, motive or knowledge of the debtor or the recipient of the transaction. New Zealand has introduced this test in its Companies Act 1993.

The amendment was made on this point as there were two key problems in using intention to prefer as a standard of proof in determining whether a transaction should be set aside. First, proving a subjective element such as intention can be difficult. Second, such a test is inconsistent with the general objective of avoidance provisions which is to achieve equality between creditors. This is because under such a test a transaction that has the effect of preferring one creditor may be allowed to stand, depending on what can be proved to be the debtor's intention in entering into that transaction. Thus, the CLRC is of the view that the undue preference transaction should be clarified so that the transaction may be set aside based on its effect, regardless of the intention, motive or knowledge of the debtor or recipient of the transaction similar to the approach found in section 292 of the New Zealand Companies Act 1993.

## RECOMMENDATIONS

- 2.16 The CLRC recommends for section 293 of the Companies Act 1965 be amended in the following manner:
- (a) to delete any cross references to the Bankruptcy Act 1967 and to specify the list of undue preference transactions as follows:
    - (i) a conveyance or transfer of property by the company,
    - (ii) the giving of a security or charge over the property of the company,
    - (iii) the incurring of an obligation by the company,
    - (iv) the acceptance by the company of execution under a judicial proceeding,
    - (v) the payment of money by the company, including the payment of money under a judgment or order of a court;

- (b) to state that in the case of a compulsory winding up, an undue preference transaction is one that is entered into :
  - (i) within 6 months of the date of the presentation of the petition to wind up the company, or
  - (ii) where before the presentation of the petition the company passed a resolution to voluntarily wind up the company, within 6 months of the time when the resolution was passed, whichever is earlier; and
  
- (c) to clarify that there is no need to prove that there is an intention to prefer creditors and that the transaction should be set aside if the effect is that it prefers one creditor over another.

### Questions for Consultation

#### Question 3:

Do you agree that the current practice of cross-referencing to the provisions of the Bankruptcy Act 1967 in relation to undue preference transactions under section 293 of the Companies Act 1965 be done away with?

#### Question 4:

Do you agree that the following transactions:

- (a) a conveyance or transfer of property by the company,
- (b) the giving of a security or charge over the property of the company,
- (c) the incurring of an obligation by the company,
- (d) the acceptance by the company of execution under a judicial proceeding, and
- (e) the payment of money by the company, including the payment of money under a judgment or order of a court;

may be set aside as undue preference transactions if they were entered into within a specified period?

Question 5:

If yes, do you agree that the specified period in the case of a compulsory winding up, be:

- (a) within 6 months of the date of the presentation of the petition to wind up the company by an order of the court; or
  
- (b) where before the presentation of the petition the company passed a resolution to voluntarily wind up the company, the 6 month period is counted from the time when the resolution was passed, whichever is earlier?

Question 6:

Do you agree that section 293 of the Companies Act 1965 should be amended by clarifying that there is no necessity to prove that there is an intention to prefer certain creditors and that the transaction should be set aside if the effect is that it prefers one creditor over another?

### C. INVALID FLOATING CHARGES

2.17 Where section 294 of the Companies Act 1965 is concerned, the CLRC is of the view that the section should be retained. The CLRC agrees that the floating charge created within the time specified under section 294 of the Companies Act 1965 should be voidable at the option of the liquidator unless the company is proved to be solvent and except to the amount of any cash paid to the company. However, in view of the recommendation to amend the commencement date of a compulsory winding up to commence from the date the winding up order is made,

there could be reduced protection of the creditors' interest if the commencement date is from the date the winding-up order was made.

2.18 Australia provides that where a company is being wound up under insolvency, a floating charge created within 6 months ending on the relation-back day or between the relation-back day and the start of the winding up is void unless the company is proved to be solvent and except to the extent that the company benefits from the charge.<sup>13</sup> New Zealand also has a similar provision where the charge created within the specified period is voidable at the option of the liquidator. The specified period is one year before the date of the commencement of the winding up including the date of commencement and ending at the time the liquidator is appointed.<sup>14</sup>

2.19 Therefore, the CLRC is of the view that section 294 of the Companies Act 1965 should be amended to state that in the case of a compulsory winding up, a floating charge is voidable at the option of the liquidator if it was created within 6 months of the presentation of petition for a compulsory winding up.

## RECOMMENDATION

2.20 The CLRC recommends that in the case of a compulsory winding up, a floating charge shall be voidable at the option of the liquidator if it was created within 6 months of the presentation of the petition for a compulsory winding up.

<sup>13</sup> See section 566 of the Australian Corporations Act 2001.

<sup>14</sup> See section 293 of the New Zealand Companies Act 1993.



## Question for Consultation

### Question 7:

Do you agree that section 294 of the Companies Act 1965 should be clarified to state that in the case of a compulsory winding up, a floating charge is voidable if it was created within 6 months of the presentation of petition for a compulsory winding up?

#### D. THE LIQUIDATOR'S RIGHT OF RECOVERY UNDER SECTION 295 OF THE COMPANIES ACT 1965

2.21 Section 295 of the Companies Act 1965 provides for a claw back provision which allows a liquidator to apply to the court to set aside:

- the acquisition or disposal of any property, business or undertaking from any of its directors, or
- the acquisition or disposal of any property, business or undertaking from a company in which any of its directors is a director of the acquiring company.

The transaction may be set aside if it was entered into within 2 years prior to the commencement of winding up.

2.22 The UK Companies Act 1985 allows a liquidator to set aside transactions having preferential effect which have been transacted by a person connected with the company (an insider of a company) if the transaction was entered into within the period of 2 years preceding the date of the commencement of winding up of the company.<sup>15</sup>

<sup>15</sup> See sections 239 and 240 of the Insolvency Act 1986.



- 2.23 Section 298 of the New Zealand Companies Act 1993 has a similar provision. However, the period within which such transactions may be set aside is 3 years before the commencement of liquidation. In the case of liquidation by the court, the period is 3 years before making the application to the court to wind up the company. The NZILR recommended that this 3 year period be amended to 2 years.
- 2.24 The Australian provision allows a liquidator to recover certain transactions conferring preference upon other creditors of the company which have been transacted by an insider of the company if the transaction was entered into within 4 years before the relation back day.<sup>16</sup>
- 2.25 In view of the recommendation of the CLRC to amend the date of compulsory winding up to commence from the date of the order of winding up is made by the court, for the purposes of section 295 of the Companies Act 1965, it is recommended that the liquidator's right of recovery in a compulsory winding up is applicable for transactions entered into within 2 years of the presentation of the petition to wind up or from the date the company passes a resolution to voluntarily wind up the company, whichever is earlier. It is also recommended that in the case of a voluntary winding up, the period within which a liquidator may set aside the transactions under section 295, is 2 years from the date upon which the voluntary winding up is deemed by this Act to have commenced.
- 2.26 The CLRC also noted that there are jurisdictions which have extended the liquidators' right of recovery to connected persons or associates of directors: e.g. the Australian Corporations Act 2001 and the New Zealand Companies Act 1993. In 1998,

<sup>16</sup> See section 567 of the Australian Corporations Act 2001.



the Hong Kong Law Commission<sup>17</sup> also suggested that for the purpose of its unfair preference transactions, the liquidators' right of recovery be extended to persons connected to directors. The Hong Kong Companies Ordinance (Cap 32) provides that this right is exercisable if the transaction was entered into within two years before the date of the presentation of the petition to wind-up a company in respect of a person who is an associate of the company, and 6 months before the presentation in respect of anyone else.<sup>18</sup> The CLRC is of the view that the current section 295 of the Companies Act 1965 may be defeated by the use of interposed entities and in such cases the mischief behind section 295 may be easily circumvented. Thus, section 295 should be made applicable to disposal or acquisitions of property to directors, persons connected to director<sup>19</sup> and to the substantial shareholders of the company.

## RECOMMENDATIONS

2.27 The CLRC recommends the following:

- (a) that section 295 of the Companies Act 1965 should be amended to allow the liquidator, in a compulsory winding up, to set aside transactions coming under the section if these transactions were entered into within 2 years from the date of the presentation of the petition or from the date the company passes a resolution to voluntarily wind up the company, whichever is earlier; and
- (b) that section 295 of the Companies Act 1965 should be amended to allow the liquidator, in a voluntary winding up, to set aside transactions coming under this section if these transactions were entered into within 2 years from the date upon which the voluntary winding up is deemed by this Act to have commenced.

<sup>17</sup> The Law Reform Commission of Hong Kong, Sub-Committee on Insolvency, Consultation Paper on Winding up Provisions of the Companies Ordinance (1998). The Hong Kong Law Commission proposed the adoption of section 249 of the UK Insolvency Act 1986, which provides that a person is connected with a company if he is a director or shadow director of the company or an associate of such a director or shadow director, or he is an associate of the company. The Law Commission also proposed the adoption of section 435(6) of the UK Insolvency Act 1986 that defines a company's association with another company.

<sup>18</sup> Section 266B(1)(b) of the Hong Kong Companies Ordinance (Cap 32) and section 51B of the Bankruptcy Ordinance.

<sup>19</sup> 'Persons connected to directors' should be defined in accordance to section 122A of the Companies Act 1965.



- (c) that section 295 of the Companies Act 1965 should be amended to apply to 'persons connected to directors' and to 'substantial shareholders of the company'.

### Questions for Consultation

#### Question 8:

Do you agree that section 295 of the Companies Act 1965 should be amended to allow the liquidator, in a compulsory winding up, to set aside transactions coming under the section if these transactions were entered into within 2 years from the date of the presentation of the petition or from the date the company passes a resolution to voluntarily wind up the company, whichever is earlier?

#### Question 9:

Do you agree that section 295 of the Companies Act 1965 should be amended to allow the liquidator, in a voluntary winding up, to set aside transactions coming under this section if these transactions were entered into within 2 years from the date upon which the voluntary winding up is deemed by this Act to have commenced?

#### Question 10:

Do you agree that section 295 of the Companies Act 1965 should be amended to extend the application of section 295 to 'persons connected to directors' and to 'substantial shareholders of the company'?

### 3. INSOLVENT LIQUIDATION AND THE PRESUMPTION OF INABILITY TO PAY DEBTS

3.1 A company's inability to pay its debts is one of the grounds on which a petition for winding up could be presented to court. A company is presumed to be unable to pay its debts under section 218(2) where:

(a) A creditor to whom the company is indebted to for the sum exceeding RM500 has served a demand notice on the company demanding for the payment of the debts within 3 weeks from the date of the notice and the company after being served with the statutory demand notice, has neglected to pay the debts within the stipulated period;

(b) execution or other process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part;  
or

(c) the court is satisfied that the company is unable to pay its debts. In determining whether a company is insolvent, the court will take into account the contingent and prospective liabilities of the company.<sup>20</sup>

3.2 The failure of the company to pay its debts within the stipulated demand period as demanded raises a rebuttable presumption that the company is unable to pay its debts. The onus is on the company to show that it is able to pay its debts. A company

<sup>20</sup> Section 123(2) of the Insolvency Act, 1986 provides for a balance sheet test as follows:

'A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities'.

Section 288(4) of the New Zealand Companies Act, 1993 states the following:

'In determining whether a company is unable to pay its debts, its contingent or prospective liabilities may be taken into account'

Section 459D(1) of Australia Corporation Act 2001 states the following:

'In determining, for the purposes of an application of a kind referred to in subsection 459C(1), whether or not the company is solvent, the Court may take into account a contingent or prospective liability of the company'.

Section 254(1) of the Singapore Companies Act (Cap 50) is similar to section 218 of the Companies Act, 1965.

cannot simply refuse to pay its debts. Therefore, as long as the demand is clear and the company has not given any acceptable reason for non-payment, the court can safely presume that the company is insolvent due to its inability to pay its debts. This principle has been adopted by the courts in Malaysia in deciding cases on presumed insolvency.<sup>21</sup>

3.3 The CLRC noted that the provision dealing with presumed insolvency of a company is a rebuttable presumption. When a petition is filed by the creditor under section 218(2), the company can rebut the presumption by showing that it is able to pay its debts by either having a cash flow solvency or a balance sheet solvency. The salient point is that the company is able to pay its debts and section 218 should not be allowed to be used by creditors to blackmail a company. These tests, however, are questions to be decided by the courts and are not specified under the statute.

3.4 The CLRC is of the view that any introduction of a solvency test in relation to winding up needs to consider whether the existing test adopted by the court is clear and this has to be balanced against a too prescriptive approach that will stifle the company's ability to rebut the presumption of insolvency.

#### **A. INCREASING THE LIQUIDATED AMOUNT UNDER SECTION 218(2) OF THE COMPANIES ACT 1965**

3.5 Under section 218(2) of the Companies Act 1965, the company must be indebted to a creditor, for a liquidated amount of RM500 and above before the creditor can exercise his right to issue a statutory demand.

<sup>21</sup> *Re Sunshine Securities Pte Ltd* [1978] 1, MLJ 57 (CA), *Lian Keow Sdn Bhd v Overseas Credit Finance (M) Sdn Bhd* [1988] 2 MLJ 449,454 (SC), *Pioneer Concrete (M) Sdn Bhd v Cellini Corp Sdn Bhd* [1998] 3 MLJ 810, 814 (HC).

3.6 Singapore has increased the liquidated amount of the debt from S\$500 to S\$2,000<sup>22</sup> and later, further raised the amount to S\$10,000.<sup>23</sup> In Hong Kong, the amount of the debt must exceed HK\$10,000.<sup>24</sup> Under section 123(1) of the UK Insolvency Act 1986, the amount to support a statutory demand shall be exceeding £750 of which such amount must be due and outstanding.

3.7 The CLRC is of the view that the present amount of RM500 is too low as compared to other jurisdictions. However, the suggested prescribed amount should not be too high that it precludes small creditors from initiating a claim, but it should be high enough to remove the likelihood of trivial claims.

## RECOMMENDATION

3.8 The CLRC recommends to amend section 218(2)(a) by raising the present amount of RM500 to RM5,000.

## Question for Consultation

### Question 11:

**Do you agree that section 218(2)(a) of the Companies Act 1965 should be amended by raising the statutory amount of debt from RM500 to RM5,000 for the purpose of a statutory demand?**

<sup>22</sup> Singapore Companies (Amendment) Act 1987 which came into force on the 15 May 1987.

<sup>23</sup> See section 254(2)(a) of the Singapore Companies Act (Cap 50).

<sup>24</sup> See section 178(1)(a) and (3) of the Hong Kong Companies Ordinance (Cap 32).



**B. SPECIFYING A TIME FRAME TO FILE THE PETITION TO WIND UP THE COMPANY UNDER SECTION 218(2) OF THE COMPANIES ACT 1965**

- 3.9 Section 218(2) of the Companies Act 1965 does not provide for a time frame within which a petition to wind up a company must be filed in court. At present, a creditor who gives a statutory demand to a debtor company has to wait until the expiry of 21 days before the creditor can file any petition to wind up the company for its inability to pay its debts. It is the creditor's option to either file the petition to wind up the company or not. There is no time limit within which the creditor has to file the petition.
- 3.10 The CLRC acknowledges the possibility that there might be creditors who will abuse the use of the statutory demand as a means of pressuring the company to pay its debts without having to require the creditor to proceed by way of a judgment debt. This could affect the company's business due to the threat of insolvency.
- 3.11 However, the CLRC is of the view that if a time frame is specified within which a petition to wind up a company must be filed by a creditor who has given the statutory demand, this may reduce the possibility of the statutory demand being abused. The CLRC recommends that the period within which the petition must be filed is 3 months after the expiry of the 21-day period given to the company to comply with the statutory demand. The effect of this proposal is that if the creditor who serves the statutory demand fails to file the petition in court within the time frame given, the creditor will have to give a fresh demand and if there is no filing of a winding up petition by the creditor at the expiry of the 3 month period, the company is no longer presumed to be unable to pay its debts.

## RECOMMENDATION

3.12 The CLRC recommends amending section 218(2) of the Companies Act 1965 by introducing a time frame for the creditor to file a petition to wind up the company. The suggested time frame is 3 months after the expiry of the period for the company to comply with the statutory demand notice.

### Question for Consultation

#### Question 12:

**Do you agree that there should be a time limit within which the application for winding up must be filed? If yes, what would be the appropriate period?**

## 4. TERMINATION OF WINDING UP

4.1 Section 243 of the Companies Act 1965 empowers the court to stay a winding up order on the application of the liquidator or of any creditor or contributory of the company. The application for a stay of winding up may be made at any time after the order for winding up has been made by the court. The court in making the order for a stay of winding up may, upon its satisfaction, make an order staying the proceedings either altogether or for a limited period on such terms and conditions as the court thinks fit.

4.2 An application for a stay of winding up may be made by way of a summons-in-chambers and supported by the affidavit of the applicant and the onus is on the applicant to prove why an order for a stay of winding up is necessary at that

particular stage.<sup>25</sup> The court may require the liquidator to furnish a report with respect to any facts or matters relevant to the application.

- 4.3 The power to order a stay of winding up is discretionary in nature. Although the application is usually supported by the recommendation from the liquidator, the court will not necessarily accept this recommendation for a stay and the court may draw its own conclusions from the facts of each case. There are cases where the court declines to grant a stay of winding up proceedings despite a strong recommendation by the liquidator.<sup>26</sup>
- 4.4 The court may also stay a winding up proceedings before a winding up order is made, usually when there is an interim order and appeal against it. The paramount consideration governing whether a stay should be granted in such cases is that the appeal should not be rendered nugatory if successful.<sup>27</sup>
- 4.5 It is also possible for an aggrieved person who has been affected by the winding up order to apply for a stay order,<sup>28</sup> and upon obtaining such an order, to proceed to invoke section 307 for an order to declare the dissolution of the company as void, as if not having been dissolved.
- 4.6 The CLRC noted that in practice where there is an application to stay a winding up order, the court will usually grant a conditional stay or a permanent stay. A permanent stay has the actual effect of terminating a winding up and an application to set aside the dissolution order should usually be made under section 307 of the Companies Act 1965.

<sup>25</sup> Rule 7(2) of the Companies (Winding Up) Rules 1972.

<sup>26</sup> *Ting Yuk Kiong v Mawar Biru Sdn Bhd* [1995] 2 MLJ 700.

<sup>27</sup> As per Gopal Sri Ram JCA in *See Teow Guan v Kian Joo Holdings Sdn Bhd* [1995] 3 MLJ 598 (CA) at page 610.

<sup>28</sup> See section 243 of the Companies Act 1965.

- 4.7 The CLRC is of the view that the introduction of an express provision for termination of a winding up would clarify the status of the company and resolve a lot of difficulties and uncertainties as to the status of the company. The absence of a specific provision on termination of a winding up in the Companies Act 1965 is considered as an impediment to the smooth implementation of the liquidation process under the Companies Act 1965 especially in view of the CLRC's proposal to provide for the rehabilitation of ailing companies. The CLRC is also of the view that the provisions relating to the termination of a winding up should be applicable to both a voluntary winding up as well as a winding up by the court.
- 4.9 The New Zealand Companies Act 1993 provides for a specific provision on the termination of liquidation. This is in addition to section 247 of the New Zealand Companies Act 1993 which allows the court to stay or restrain proceedings against a company at any time after or before the appointment of a liquidator. Under section 250 of the New Zealand Companies Act 1993, the court may make an order terminating the liquidation of the company at any time after the appointment of a liquidator of the company. An application to terminate liquidation may be made by the liquidator, or a director or shareholder of the company or any other entitled person or a creditor of the company, or the Registrar. The court may also require the liquidator to furnish a report to the court with respect to any facts or matters relevant to the application. The effects of a termination order under section 250 are that the company ceases to be in liquidation and the liquidator ceases to hold office with effect from the making of the order or on such date as may be specified in the order.

- 4.10 The Australian Corporations Act 2001 confers on the court the power to stay or terminate a winding up proceedings.<sup>29</sup> Under this provision the court is authorised, on application and at any time during the winding up of a company, to make an order staying the winding up either indefinitely or for a limited time or terminating the winding up on a day specified in the order. The application for an order to stay or the termination of the winding up may be made by the liquidator, or a creditor or contributory of the company. A report by the liquidator shall also be handed over to the court and shall contain facts or matters relevant to the application. Once the court has made the order terminating the winding up of a company, the court may give such directions as it thinks fit for the resumption of the management and control of the company by its officers, including direction for the convening of a general meeting of members of the company to elect directors of the company to take office upon the termination of the winding up.
- 4.11 The UK has a similar provision which confers on the court the power to make an order 'staying or sisting the proceedings.'<sup>30</sup>
- 4.12 The general power of the court to grant a stay of proceedings in the winding up of a company can be found in section 279 of the Singapore Companies Act (Cap 50) and section 209 of the Hong Kong Companies Ordinance (Cap 32). The provisions in these jurisdictions are in *pari materia* with our section 243 of the Companies Act 1965 and none of these jurisdictions have a provision for the termination of a winding up unlike the Australia and New Zealand legislations.

<sup>29</sup> See section 482 of the Australian Corporations Act 2001.

<sup>30</sup> See section 147 of the Insolvency Act 1986.



## RECOMMENDATIONS

4.13 The CLRC recommends:

- (a) to introduce a provision where the court is given the power to terminate the winding up proceedings on the application of the relevant party; and
- (b) to provide that an application to terminate a winding up proceeding may be made by a liquidator, or a director or shareholder of the company or any other entitled person or a creditor of the company, or the Registrar.

### Question for Consultation

#### Question 13:

**Do you agree that the Companies Act 1965 should be amended to introduce a provision for termination of the winding up proceedings?**

## 5. INTERIM LIQUIDATOR

- 5.1 Section 231 states that the court may appoint an approved liquidator provisionally at any time after the presentation of a winding up petition and before the making of a winding up order.
- 5.2 In practice, the term 'provisional liquidator' is used exclusively for the Official Receiver (OR) who is appointed prior to the order for winding up is made or after the order of winding up is made but before the first creditors' meeting is summoned. However, the person other than the OR i.e. a private liquidator who is appointed prior to the order of winding up is made is referred to under section 231 of the Companies Act 1965 as 'a liquidator appointed provisionally'.

5.3 The CLRC is of the view that to ensure clarity, the phrase 'interim liquidator' should be used to replace the term 'an approved liquidator appointed provisionally' to refer to the appointment of a private liquidator.<sup>31</sup>

## RECOMMENDATIONS

5.4 The CLRC recommends substituting the phrase 'interim liquidator' for the phrase 'an approved liquidator who is appointed provisionally'. The proposed amendment should consider section 246 of the New Zealand Companies Act 1993 as a model in the drafting of the legislative text.

### Question for Consultation

#### Question 14:

Do you agree that the terminology for 'an approved liquidator provisionally appointed' be replaced with the term 'interim liquidator'?

## 6. POWERS OF LIQUIDATOR AND INTERIM LIQUIDATOR

6.1 The Companies Act 1965 provides for powers of liquidators. In general, the liquidator's power is to take into his control all the properties or assets of the company under liquidation. The powers of a liquidator in a compulsory winding up may be exercised by the appointed liquidator either discretionally or with the approval of the court or

<sup>31</sup> Section 246 of the New Zealand Companies Act, 1993 uses the phrase of 'interim liquidator' to refer to the appointment of a private liquidator where it is stated that:

- (1) If an application has been made to the court for an order that a company be put into liquidation, the court may, if it is satisfied that it is necessary or expedient for the purpose of maintaining the value of assets owned or managed by the company, appoint a named person, or an Official Assignee for a named district, as interim liquidator.
- (2) Subject to subsection (3) of this section, an interim liquidator has the rights and powers of a liquidator to the extent necessary or desirable to maintain the value of assets owned or managed by the company.
- (3) The court may limit the rights and powers of an interim liquidator in such a manner as it thinks fit.'

the committee of inspection as stated in section 236(1) and (2). Section 269(1) of the Companies Act confers the same powers to a liquidator appointed in a voluntary winding up.

6.2 The powers of a liquidator are categorised according to whether the powers are exercisable with or without the sanction of the court or the committee of inspection (COI). The powers exercisable with the sanction of the court or the COI are as follows:<sup>32</sup>

- carrying on the company's business so far as necessary for the beneficial winding up thereof, but the authority shall not be necessary to so carry on the business during the four weeks next after the date of the winding up order;
- subject to section 292 (*priorities*) paying off any class of creditors in full;
- making a compromise or arrangement with the creditors;
- compromising any debts owed to the company by contributories or other debtors; and
- appointing an advocate to assist him in his duties.

6.3 On the other hand, the powers exercisable without sanction are as follows:<sup>33</sup>

- to bring or defend any action or other legal proceeding in the name and on behalf of the company;
- to compromise any debts due to the company where the amount claimed by the company to be due to it exceeds RM1,500;
- to sell the immovable and movable property of the company by way of public auction, public tender or private contract with power to transfer the whole thereof to any person or company;

<sup>32</sup> See section 236(1) of the Companies Act 1965.

<sup>33</sup> See section 236(2) of the Companies Act 1965.



- to do all acts and execute in the name and on behalf of the company all deeds, receipts and other documents and for that purpose use when necessary the company seal;
- to prove rank and claim in the bankruptcy of any contributory or debtor for any balance against his estate, and receive dividends in the bankruptcy in respect of that balance as a separate debt due from the bankrupt;
- to draw, accept make and endorse any bill of exchange or promissory note in the name and on behalf of the company;
- to raise on the security of assets of the company any money requisite;
- to take out letters of administration of any deceased contributory or debtor;
- to appoint an agent to do any business which the liquidator is unable to do himself; and
- to do all such other things as are necessary for winding up the affairs of the company and distributing its assets.

6.4 Where the interim liquidator is concerned, his powers are not expressly provided in the Companies Act 1965. However, since the definition of the term 'liquidator' includes 'a liquidator provisionally appointed' i.e., the 'interim liquidator', the practice is that the interim liquidator is presumed to have the same powers as the liquidator. However, in practice the powers conferred and exercisable by an interim liquidator are not as extensive as those of a liquidator because the purpose of appointing an interim liquidator is to preserve the status quo of the company and the company's assets. Thus, the CLRC recommends that there should be an express provision that the powers of the interim liquidator are exercisable for the purpose of preserving the assets of the company.

6.5 The CLRC noted that the provisions on the powers of liquidators are found under different parts of the Companies Act 1965 depending on the different types of winding up. This structure is confusing for users. In order to avoid such confusion, the CLRC proposes to adopt sections 165, 166 and 167 of the Insolvency Act 1986 and to follow the structure found under Schedule 4 of the Insolvency Act 1986 with some modifications to suit the local business environment. This will provide the basis for a liquidator's powers.

6.6 Nonetheless, the CLRC identified a few specific problems in relation to the powers of a liquidator, which are stated below.

**A. THE APPOINTMENT OF AN ADVOCATE UNDER SECTION 236(1)(E) OF THE COMPANIES ACT 1965**

6.7 Under the present provision, the appointment of an advocate shall be with the authority of the court or the committee of inspection (COI). The CLRC proposes that the appointment of an advocate shall no longer require the authority of the court or the COI. The CLRC is of the view that the present requirement hinders the smooth running of the liquidation process as a solicitor is required to assist the liquidator in areas that he is unable to do himself.

6.8 The UK legislation does not have a specific provision for the appointment of an advocate but has a general provision for the appointment of an agent to do any business which the liquidator is unable to carry out himself. This provision does not require any sanction of either the court or the COI for the appointment of any agent.<sup>34</sup> Australia has a similar provision allowing the liquidator to appoint an agent

<sup>34</sup> Paragraph 12 of Part III of the 4th Schedule of the Insolvency Act 1986.



to do any business that a liquidator is unable to carry out in person. Unlike the UK, the power to appoint a solicitor and an agent in Australia is discretionary in nature.<sup>35</sup> The appointment of a solicitor is specifically provided under the New Zealand Companies Act 1993 without having to obtain a sanction from the court or the COI.<sup>36</sup>

**B. POWER TO COMPROMISE DEBT DUE TO THE COMPANY FOR ANY AMOUNT BELOW RM1,500 UNDER SECTION 236(2)(b) OF THE COMPANIES ACT 1965**

- 6.9 The current position allows a liquidator to exercise his power to compromise debts or claims due to the company for any amount below RM1,500. This means that if the amount due to and claimable by the company is more than RM1,500, a liquidator is required to obtain the court's or the COI's approval before he may compromise such debts.
- 6.10 The Australian provision requires a sanction from either the court or the COI or a resolution passed by the creditors before a liquidator can compromise debts due to and claimable by the company if the amount exceeds \$20,000.<sup>37</sup>
- 6.11 The CLRC noted that paragraphs 3(a) and (b) of Part 1 of Schedule 4 of the Insolvency Act 1986 and paragraph (e) of Schedule 6 of the New Zealand Companies Act 1993 have a general provision on the power of a liquidator to compromise debts generally.

<sup>35</sup> Section 477(2) of the Australian Corporations Act 2001.

<sup>36</sup> Schedule 6 of the New Zealand Companies Act 1993.

<sup>37</sup> Section 477(2A) and (2B) of the Australian Corporations Act 2001.



- 6.12 The CLRC noted that, in practice, the liquidator has to get the approval from the court or the COI if he wishes to exercise his power to compromise debts owed to the company for any sum exceeding RM1,500. The practitioners are of the view that this practice is too cumbersome.
- 6.13 It is noted that the reason for the current practice of allowing a liquidator to compromise any debt due to the company, if the amount is less than RM1,500, is to get rid of a small debt due to the company. The CLRC is of the opinion that the current threshold of RM1,500 is far too small and the requirement to obtain the court's or the COI's approval may cause a delay in the liquidation process.
- 6.14 To overcome this problem, the CLRC recommends that a threshold of RM10,000 be introduced in which the liquidator should be allowed to compromise debts owed to the company without having to first obtain a consent from the court or the COI if the amount so owed to the company is less than RM10,000. However, if the amount is more than the threshold, the liquidator must first get the sanction from either the court or the COI before he may be allowed to compromise such a debt. Nonetheless, to facilitate the liquidation process, the court or the COI should be authorised with a discretion to grant a blanket approval or mandate to the liquidator to compromise debts subject to a limit of RM50,000. However, this discretionary power of the court and the COI should be exercised with caution on a case to a case basis.

C. **LIMITATION TO TRADE UP TO 4 WEEKS AFTER THE WINDING UP ORDER UNDER SECTION 236(1)(a) OF THE COMPANIES ACT 1965**

- 6.15 The CLRC noted that in a winding up by a court order under section 236(1)(a) of the Companies Act 1965, the liquidator may carry on the company's business so far as necessary for the beneficial winding up for a period of up to 4 weeks after the making of the winding up order. Thereafter, the liquidator must obtain the authority of either the court or the COI to continue with the carrying on of the company's business.
- 6.16. The CLRC noted that the existing provision is too restrictive and recommended that the liquidator should be allowed to carry on the business of the company without any limitation period so long as such an exercise is necessary for the benefit of the winding up. The CLRC further noted that paragraph 5 of Part II of Schedule 4 of the Insolvency Act 1986 does not state a specific period.
- 6.17 It is also noted by the CLRC that in a members' or creditors' voluntary winding up under section 256(1) of the Companies Act 1965, the liquidator may carry on the business of the company after the commencement of the winding up if the liquidator is of the view that the carrying on of the company's business is necessary for the beneficial winding up of the company.
- 6.18 The inclusion of a time frame acts as an incentive for a liquidator to complete their tasks within the stipulated time period. However, the existing time period of 4 weeks is far too short as, in practice, the liquidator requires time to investigate and to decide on the viability of the company to carry on its business especially if it involves a holding company which has a number of subsidiaries.

6.19 The CLRC is concerned that the current time frame does not enable the liquidator to perform his functions efficiently.

6.20 In this respect, the CLRC is of the view that the current time frame should be extended and the appropriate time frame should be 6 months after which time, the liquidator is required to obtain the sanction of the court to carry on the business of the company for the beneficial winding up of the company.

**D. RESTRICTION TO RETAIN A SUM EXCEEDING RM200 FOR MORE THAN 10 DAYS UNDER SECTION 238(2) OF THE COMPANIES ACT 1965**

6.21 The CLRC noted that section 238(2) of the Companies Act 1965 restricts a liquidator from retaining, for more than 10 days, a sum exceeding RM200 unless the liquidator explains the purpose such retention to the satisfaction of the court failing which he should pay interest at the rate of 20 per centum per annum or face disallowance of remuneration or removal from office or pay expenses occasioned by his default. The CLRC is of the view that the restriction is too burdensome as section 238(1) is sufficient to cater for the requirement for a liquidator to keep whatever monies he received in a specific bank account. The CLRC, therefore, recommends the deletion of section 238(2) of the Companies Act 1965 as it is now obsolete.

**RECOMMENDATIONS**

6.22 The CLRC recommends:

- (a) to simplify the structure in relation to the powers of a liquidator in different types of winding up by adopting the UK approach, in particular, sections 165, 166 and 167 of the Insolvency Act 1986 and to follow the structure of Schedule 4 of the Insolvency Act 1986 with some modifications to suit the local environment.

- (b) to provide that the interim liquidator has the same powers as the liquidator but that such powers are exercisable for the purposes of preserving company's assets.
- (c) the appointment of an advocate shall no longer require the authority of the court or the COI.
- (d) to allow a liquidator to compromise debts owed to the company if the amount is less than RM10,000 and this power shall be exercisable without the sanction of the court or the COI.
- (e) that to further facilitate the liquidation process, the court or the COI should be authorised with a discretion to grant a blanket approval or mandate to the liquidator to compromise debts above RM10,000 subject to a limit of RM50,000 and this discretionary power of the court or the COI must be exercised with caution and on a case to a case basis.
- (f) to extend the existing time frame for a liquidator to trade after the winding up order has been made and the appropriate time frame should be 6 months after which time, the liquidator is required to obtain the sanction of the court to carry on the business of the company so long as such exercise is necessary for the beneficial winding up of the company.
- (g) to delete the section 238(2) of the Companies Act 1965 in relation to 'the liquidator to retain more than 10 days a sum exceeding RM200 unless he explains the retention of such sums to the satisfaction of court...' as this provision is obsolete.

## Questions for Consultation

### Question 15:

Do you agree that the structure concerning the provisions on the powers of the liquidator in different types of winding up be streamlined and modified to avoid confusion? If yes, how may this be achieved?

### Question 16:

Do you agree that the appointment of an advocate requires no prior approval from the court or the committee of inspection (COI)?

### Question 17:

Do you agree that the liquidator should be allowed to compromise debts owed to the company if the amount is less than RM10,000 and this power is exercisable without the sanction of the court or the COI?

### Question 18:

Do you agree that the court or the COI should be given a discretionary power to give a blanket approval to the liquidator to compromise debts above RM10,000 subject to a limit of RM50,000 and this discretionary power of the court or the COI must be exercised with caution and on a case to a case basis?

### Question 19:

Do you agree that the time frame for the limitation to trade up to 4 weeks after the winding up order under section 236(1)(a) be extended to 6 months after the grant of the winding up order?

**Question 20:**

Do you agree that section 238(2) in relation to 'the liquidator to retain more than 10 days a sum exceeding RM200 unless he explains the purpose of such retention to the satisfaction of the court...' be deleted?

**E. DUTIES OF A LIQUIDATOR AND INTERIM LIQUIDATOR**

6.23 The CLRC is of the view that the following provisions should be retained as they are relevant to the proper control over the conduct of the liquidator and interim liquidator:

- Section 278 – Powers of the Official Receiver when there is no Committee of Inspection (COI);
- Section 279 – Appeal against the decision of the liquidator;
- Section 280 – Notice of and appointment and address of the liquidator;
- Section 283 – Notification that a company is in liquidation.

6.24 The CLRC is also of the view that where the responsibility of the liquidator to make good defaults under section 282 of the Companies Act 1965 is concerned, this section should be clarified so as to make this provision applicable to the interim liquidator. This is to ensure compliance by both the interim liquidator and liquidator so that the court has a proper avenue to control the conduct of the liquidator and interim liquidator.

## F. DUTY TO SUBMIT THE STATEMENT OF AFFAIRS

- 6.25 Section 234 of the Companies Act 1965 requires the submission of the statement of affairs (SOA) of the company to the Official Receiver (OR) within 14 days from the date of the winding up order was made. The SOA must show the particulars of assets, debts, liabilities, creditors of the company and any securities held by the company. The SOA shall be submitted by one or more of the persons who are directors or company secretaries. The Official Receiver or liquidator may also require other persons, such as the court may order, to submit the SOA.<sup>38</sup> Failure to submit the SOA will attract the maximum penalty of imprisonment of three years or RM10,000 fine or both.
- 6.26 Section 270 of the Singapore Companies Act (Cap 50) is in *pari materia* with section 234 of the Companies Act 1965 which requires the director and company secretary to submit the SOA to the Official Receiver within a specified period. Section 475 of the Australian Corporations Act 2001 requires the director or company secretary to submit the SOA to the liquidator whilst section 255 of the New Zealand Companies Act 1993 requires the liquidator to prepare a list containing the SOA of the company. Section 190 of the Hong Kong Companies Ordinance (Cap 32) requires the submission of the SOA but does not specify the persons who have the responsibility of submitting the SOA.
- 6.27 The CLRC noted that the imposition of a duty to submit the SOA on the company secretary is rather unfair and has caused problems to the company secretary since in practice, the secretary does not keep the SOA. It is the director or officers-in-

<sup>38</sup> Under section 234(2) of the Companies Act 1965, these other persons are:

- (a) persons who are or have been officers of the company;
- (b) who have taken part in the formation of the company, at any time within one year before the date of the winding up order; or
- (c) who are or have been within that period officers of or in the employment of a corporation which is, or within that period was, an officer of the company to which the statement relates.

charge of the financial affairs of the company who usually know the detailed particulars of the SOA and keep it. The CLRC believed that the company secretary should not be imposed with this obligation and suggested the amendment to be made to section 234 of the Companies Act 1965 i.e. to state that there is an obligation on the directors to submit the SOA. However, the CLRC is of the view that the Official Receiver or liquidator's power to request other persons to submit the SOA, as the court may order, should be retained.

- 6.28 The obligation imposed on directors is appropriate since directors should not be allowed to avoid being responsible by stating that they were not aware of the company's affairs. This is the usual defence put up by the directors of a company who failed to submit the SOA within the stipulated time. The CLRC is of the view that such an excuse is unacceptable and that there is a need for directors to be aware of their company's management.

## RECOMMENDATION

- 6.29 The CLRC recommends the amendment of section 234 of the Companies Act 1965 by deleting the requirement that the company secretaries shall submit the SOA.

## Question for Consultation

### Question 20:

**Do you agree that the company secretary should not be imposed with a duty to submit the statement of affairs?**

**F. DUTY TO SETTLE LIST OF CONTRIBUTORIES**

6.30 Under section 244 of the Companies Act 1965, there is a requirement for the court to settle a list of contributories. The requirement to settle such a list is for the following purposes:

(a) to enable a liquidator to request the uncalled capital to be paid up; and

(b) to enable the liquidator to distribute any surplus capital after the creditors have been paid so that the contributories will not be allowed to challenge the distribution.

6.31 Section 478(1A) of the Australian Corporations Act 2001 states that the list of contributories is only necessary if the liquidator arrives at a conclusion that there is surplus capital to be distributed to the contributories or there are persons likely to contribute.

6.32 The CLRC noted that an uncalled capital is practically non-existent in new corporations and in public companies although there may be some private companies still practising the issuance of partly paid up shares.

6.33 In practice, it is usually the case that there is no surplus capital to be returned to contributories. There are also cases where the contributories could not agree amongst themselves on the proper amount to be distributed based on their contribution especially in cases where deadlock arises. Since the requirement to settle the list of contributories is a mandatory requirement, the liquidator must still carry out this duty irrespective of whether there is any surplus capital for distribution or there are contributories that are likely to contribute. The CLRC is of the view that the current practice is an inefficient use of resources and time.

## RECOMMENDATION

6.34 The CLRC recommends that the current position on the mandatory requirement to settle a list of contributories should be amended to make it discretionary on the liquidator to do so if there is surplus capital for distribution or if there are contributories who are likely to contribute their unpaid portion of capital.

### Question for Consultation

#### Question 21:

Do you agree that the liquidator is required to settle the list of contributories only if there is surplus capital for distribution or if there are contributories who are likely to contribute their unpaid portion of capital?

## G. COMPARATIVE JURISDICTIONAL STUDY

### United Kingdom

6.35 Under the Insolvency Act 1986, powers of liquidators in the case of a voluntary winding up can be found in section 165(1) and (2) whilst section 167 provides for the powers of the liquidator in a compulsory winding up.

6.36 Section 165(2) states the following:

- (a) 'In the case of a members' voluntary winding up, with the sanction of an extraordinary resolution of the company; and

- (b) In the case of creditors' voluntary winding up, with the sanction of the court or the Liquidation Committee (or if there is no such committee, a meeting of the company's creditor) exercise any of the powers specified in Part 1 of Schedule 4 to this Act (payments of debts, compromise of claims etc)'.
- 6.37 Section 166(2) states 'powers conferred on the liquidator by section 165 shall not be exercised, except with the sanction of the court, during the period before the holding of the creditors' meeting under section 98 in Chapter IV'.
- 6.38 Section 167(1) states 'where a company is being wound up by the court, the liquidator may -
- (a) with the sanction of the court or the liquidation committee, exercise any of the powers specified in Parts I and II of Schedule 4 to this Act (payment of debts; compromise of claims, etc; institution and defence of proceedings; carrying on of the business of the company), and
- (b) with or without that sanction, exercise any of the general powers specified in Part III of that schedule'.
- 6.39 Schedule 4 of the Insolvency Act 1986 provides for the specific powers of liquidators.
- Part I - Powers exercisable with sanction
1. Power to pay any class of creditors in full.
  2. Power to make any compromise or arrangement with creditors
  3. Power to compromise, on such terms as may be agreed-
    - (a) all calls and liabilities to calls, all debts and liabilities capable of resulting in debts, and all claims subsisting between the company and a contributory or other person apprehending liability to the company, and

- (b) all questions in any way relating to or affecting the assets or the winding up of the company,  
and take any security for the discharge of any such call, debt, liability or claim and give a complete discharge in respect of it.

Part II - Powers exercisable without sanction in voluntary winding up, with sanction in winding up by court

4. Power to bring or defend action or other legal proceeding in the name and on behalf of the company.
5. Power to carry on the business of the company so far as it may be necessary for its beneficial winding up.

Part III – Powers exercisable without sanction in any winding up

6. Power to sell any of the company's property by public auction or private contract, with the power to transfer the whole of it to any person or sell the same in parcels.
7. Power to do all acts and execute in the name and on behalf of the company, all deeds, receipts and other documents and for that purpose to use, when necessary, the company's seal.
8. Power to prove rank and claim the bankruptcy, insolvency or sequestration of any contributory for any balance against his estate, and to receive dividends in the bankruptcy, insolvency or sequestration in respect of the balance, as a separate debt due from the bankrupt or insolvent, and rateably with the other separate creditors.
9. Power to draw, accept, make and indorse any bill of exchange or promissory note in the name or on behalf of the company, with the same effect with

respect to the company's liabilities as if the bill or note had been drawn, accepted, made or indorsed by or on behalf of the company in the course of its business.

10. Power to raise on the security of the assets of the company any money requisite.
11. Power to take out in his official name letters of administration to any deceased contributory, and to do in his official name any other act necessary for obtaining payment of any money due from a contributory or his estate which cannot conveniently be done in the name of the company. In all such cases the money due is deemed, for the purpose of enabling the liquidator to take out the letters of administration or recover the money, to be due to the liquidator himself.
12. Power to appoint an agent to do any business which the liquidator is unable to do himself.
13. Power to do all such other things as may be necessary for winding up the company's affairs and distributing its assets.

### Australia

6.40 Section 477 of the Australian Corporations Act 2001 provides for powers of the liquidator. The discretionary powers of a liquidator include the carrying on of business of the company for the beneficial disposal or winding up of that business, the making of any compromise or arrangement to compromise calls, to obtain credit whether on the security of the company or not, to take out a letter of administration of the estate of the deceased contributory, to appoint agent, to draw or accept any bill of exchange or promissory note on behalf of the company.

- 6.41 Sections 477(2A) and (2B), on the other hand, require the sanction of either the court or of the committee of inspection or of a resolution by the creditors in the following:
- to compromise a debt of the company if the amount claimed by the company is more than \$20,000;
  - to enter into an agreement on behalf of the company.

### New Zealand

- 6.42 The powers of liquidators can be found under section 260 and Schedule 6 of the New Zealand Companies Act 1993. Section 260(2) states 'without limiting subsection (1) of this section, a liquidator has the powers set out in the Sixth Schedule to this Act'.
- 6.43 The 6th Schedule of the New Zealand Companies Act 1993 provides for similar powers of the liquidator as provided for in the Insolvency Act 1986, the Australian Corporations Act 2001 and our Companies Act 1965 except with the additional powers as follows:
- to call for a meeting of creditors and shareholders for the purposes of informing them of the progress of the liquidation and ascertaining the views of creditors and shareholders of any matter arising in such liquidation;
  - to change the registered office or address for service of the company.
- 6.44 The New Zealand Companies Act 1993 does not have any separate provisions for any different types of winding up. There is also no requirement for the application of a sanction from the court or committee of inspection as in other jurisdictions. The reason for this is that the New Zealand Companies Act 1993 makes no distinction between a voluntary winding up and a compulsory winding up. The New Zealand Companies Act 1993 uses the phrase 'liquidation' throughout the Act.

### Singapore

6.45 The provision for the powers of the liquidator in the Singapore Companies Act (Cap 50) is similar to that found under the Companies Act 1965. The powers of the liquidator in a compulsory winding up exercise are stated under section 269 whilst the discretionary powers of a liquidator are exercisable in pursuance to section 272(2) of the Singapore Companies Act (Cap 50).

### Hong Kong

6.46 The provision for the powers of the liquidator in the Hong Kong Companies Ordinance (Cap 32) is covered under section 199 and the provision is similar to other jurisdictions with the exception found under section 199(4) which gives powers to a provisional liquidator to take under his control and custody all property to which the company appears to be entitled and to sell and dispose of perishable goods or other assets with the estimated value of less than HK\$100,000 and is likely to significantly diminish if they are not immediately sold or disposed of.

## **7. RIGHTS OF SECURED CREDITORS**

7.1 At present, the rights of secured creditors in a liquidation process are provided for under the common law whereby they are given priority over the unsecured creditors. The Companies Act 1965 has no statutory provision in relation to the rights of secured creditors.

- 7.2 The CLRC noted that the Companies Act 1965 is silent on the statutory right of a secured creditor. At present, the rights of secured creditors are protected under the common law. The common law gives the secured creditors priority over the unsecured creditors in the case of liquidation. Under the common law, the asset which is subject to a charge will not be available for distribution amongst the general creditors. The CLRC believes that the rights of secured creditors *vis-à-vis* the charged asset should be clearly stated in the corporate legislation.
- 7.3 The CLRC noted that UK and Singapore do not have an express provision for the right of a secured creditor.
- 7.4 The New Zealand Companies Act 1993 provides for a specific statutory provision on the rights and duties of secured creditors under section 305(1) to (11). Section 305(1) allows a secured creditor to:
- realise property subject to a charge; or
  - value the property subject to a charge and claim in the liquidation as an unsecured creditor for the balance due, if any; or
  - surrender the charge to the liquidator for the general benefit of creditors and claim in the liquidation as an unsecured creditor for the whole debt.
- 7.5 The New Zealand Companies Act 1993 also provides for the avenue on how a secured creditor may realise or value or surrender the secured property. Section 305(3) states that a secured creditor who realizes its property subject to a charge:

(a) may, unless the liquidator has accepted a valuation and a claim by the secured creditor, claim as an unsecured creditor for any balance due after deducting the net amount realised.

(b) must account to the liquidator for any surplus remaining from the net amount realised after the satisfaction of the debt.

7.6 Section 305(4) of the New Zealand Companies Act 1993 states that if a secured creditor values the security and claims as an unsecured creditor for the balance due, the valuation and any claim must be made in a prescribed form and shall contain the full particulars of the valuation, any claim and the charge including the date on which it was given and shall be substantiated with any supporting documents.

7.7 Section 305(10) of the New Zealand Companies Act 1993 states that a secured creditor who has surrendered a charge under subsection (1)(c) or who is taken to have surrendered a charge to the liquidator after notice has been given to him and he fails to comply with such notice, he may with the leave of the court or the liquidator withdraw the surrender and rely on the charge or submit a new claim under this section.

7.8 The Australian Corporations Act 2001 has a specific provision for the right of a secured creditor which secures the right of a secured creditor to realise and deal with a security in the event of the winding up of a company.<sup>39</sup>

<sup>39</sup> Section 471C of the Australian Corporations Act 2001 states: 'nothing in section 471A or 471B affects a secured creditor's right to realize or otherwise deal with the security'.

- 7.9 Subdivision C of the Australian Corporations Act 2001 is a provision relating to secured creditors in insolvent companies. Section 554E of the Australian Corporations Act 2001 deals with the proof of debt by a secured creditor. Section 554E(1) states that in the winding up of an insolvent company, a secured creditor is not entitled to prove the whole or any part of the secured debt otherwise than in accordance with this section and with any other provision of the Act or the regulations which are applicable to proving debt.
- 7.10 Based on the comparative jurisdictional study, the CLRC is of the view that the provision found under the New Zealand Companies Act 1993 is the most comprehensive and caters for the rights of a secured creditor in dealing with secured property in the event of liquidation. As such, the CLRC proposes to provide for the rights of secured creditors in the Companies Act 1965 similar to those found under section 305 of the New Zealand Companies Act 1993.

## RECOMMENDATIONS

- 7.11 The CLRC recommends the codification of the rights of secured creditors in the Companies Act 1965 (similar to section 305 of the New Zealand Companies Act 1993).

## Question for Consultation

### Question 22:

Do you agree that the rights of the secured creditors should be expressly provided in the Companies Act 1965? If yes, should section 305 of the New Zealand Companies Act 1993 be used as a model for such a codification?

## 8. RIGHT OF CREDITORS IN RELATION TO MUTUAL CREDIT AND SET-OFF

8.1 A set-off of mutual debts occurs when creditors of the company owes money to the company. In this situation, they must set-off the debts and can only prove the balance. Section 245 of the Companies Act 1965 allows for set-off in relation to mutual debts existing between the company and its contributories. The word 'contributory' is defined under sections 4 and 214 of the Companies Act 1965 as present and past members and in some cases the director of a company. The Companies Act 1965 does not contain an express provision conferring the same right to a creditor of the company. However, when a company is wound up and creditors are required to prove their debts under section 291 of the Companies Act 1965, the provisions of the Bankruptcy Act 1967 in relation to proof of debts are applicable.<sup>40</sup> Because of the application of the provisions of the Bankruptcy Act 1967, where there are mutual dealings and debts between the creditor and the company, the creditor is required to set-off any mutual debts and to prove only for the balance.

8.2 Although the Bankruptcy Act 1967 is applicable to the winding up of an insolvent company, the CLRC believes that in line with the concept of simplifying the law to remove any confusing cross-references to other statutes (as far as this is practicable),

<sup>40</sup> Sections 41 and 42 of the Bankruptcy Act 1967.



the right to set off mutual debts should be expressly provided for in the company law statute itself.

- 8.3 The CLRC noted that a set-off is beneficial to creditors since they are able to set off the debts they owe to the company and claim for the balance instead of risking not being paid at all. However, there are limitations where the dealings which gave rise to the set-off must have arisen prior to the winding up. If the creditor knew of the winding up at the time the debt arose, he cannot claim to set-off the debt. This is specified under section 41 of the Bankruptcy Act 1967.
- 8.4 The current application of section 41 of the Bankruptcy Act 1967 in proving debts by creditors under section 291 of the Companies Act 1965 following the winding up of the company is confusing because it is not clear from section 291 of the Companies Act 1965 itself how a creditor should prove his debts when the company goes into liquidation without having to make an extensive cross reference to sections 41 and 42 of the Bankruptcy Act 1967. These provisions of the Bankruptcy Act 1967 deal comprehensively with the rights of the mutual credit and set-off of individual debtors and his creditors and the rules as to proof of debts.
- 8.5 The CLRC compared section 245 of the Companies Act 1965 with section 553C of the Australian Corporations Act 2001 and section 310 of the New Zealand Companies Act 1993 and noted that in both the Australian Corporations Act 2001 and the New Zealand Companies Act 1993, the right to set-off is given to both contributories and creditors to set-off their mutual debts to the company.<sup>42</sup>

<sup>41</sup> The CLRC notes that amendments will have to be made to other sections as well for example section 291 of the Companies Act 1965.

<sup>42</sup> This is because section 310 of the New Zealand Companies Act 1993 uses the phrase 'a person who seeks, or would seek to have a claim admitted in liquidation of the company' while section 553C of the Australian Corporations Act 2001 uses the phrase 'a person who wants to have a debt or claim admitted against the company'.

- 8.6 The right to set-off under section 553C(1) of the Australian Corporations Act 2001 applies to persons who have mutual dealings with an insolvent company in liquidation and persons who want to have such debts or claims admitted against that company. However, section 553C(2) of the Australian Corporations Act 2001 states that a person is not entitled under this section to claim the benefit of a set-off if, at the time of giving credit to the company, or at the time of receiving credit from the company, the person had notice of the fact that the company was insolvent.
- 8.7 Section 310(2) of the New Zealand Companies Act 1993 states that a related person is allowed to claim the benefit of a set-off if the transaction was made within 6 months before the commencement of the liquidation. A related person has been defined under section 310(5) of the New Zealand Companies Act 1993 as a related company and includes a director of a company in liquidation.
- 8.8 However, section 310(3) of the New Zealand Companies Act 1993 prohibits a related person from claiming the benefit of a set-off if the transaction was made within the 'restricted period'. The 'restricted period' has been defined in section 310(7) of the New Zealand Companies Act 1993 as a transaction entered into within the period of 2 years before the commencement of the liquidation<sup>43</sup> and in the case of a company that was put into liquidation by the court, the period of 2 years should be calculated from before the making of the application to the court. Nevertheless, if the related person is able to prove that it did not have reason to suspect the company was unable to pay its debts at the time of the transaction, the related person is still entitled to claim the benefit of a set-off.

<sup>43</sup> Commencement of a winding up occurs when the liquidator is appointed.



8.9 The CLRC noted the following differences and similarity between the provisions of set-off in the New Zealand Companies Act 1993 and the Australian Corporations Act 2001:

- The Australian Corporations Act 2001 provision applies only in the insolvent liquidation of a company whilst the New Zealand Companies Act 1993 does not specify so as the New Zealand Companies Act 1993 states in general that this provision applies to *'a person who seeks or...would seek to have a claim admitted in the liquidation of the company'*.
- The New Zealand Companies Act 1993 provides that a set-off is not available for a transaction entered into by a person or 'related person' within a 'restricted period' unless the person can prove that the company is solvent. The Australian Corporations Act 2001 does not have this criterion.
- Both the New Zealand Companies Act 1993 and the Australian Corporations Act 2001 provide that a set-off is not available to a person who knows or has notice that the company is unable to pay its debts.

8.10 The CLRC also noted that section 149(2) of the Insolvency Act 1986, section 212 of the Hong Kong Companies Ordinance (Cap 32) and section 281 of the Singapore Companies Act (Cap 50) are similar to section 245 of the Companies Act 1965 which allows the court to order the contributory of the company to set-off any mutual debts owed between the company and the contributories and *vice versa*. In these jurisdictions, the same provision on the set-off of mutual debts as found in the respective countries' bankruptcy or insolvency laws<sup>44</sup> are also applicable.

<sup>44</sup> See the Insolvency Rules 1986, r. 4.90; section 88 of the Bankruptcy Act (Cap 20) (Singapore); Hong Kong Companies Ordinance.

8.11 Based on the comparative jurisdictional study, the CLRC is of the view that the right to set-off should not be limited to contributories only as required by the existing law but such a right should also be extended to creditors in the company's liquidation. However, the right should not apply to persons (both creditors and contributories) who have reason to believe that the company is unable to pay its debts. For these purposes, the CLRC recommends that section 310(1) and (2) of the New Zealand Companies Act 1993 and section 553C(1) and (2) of the Australian Corporations Act 2001 should be adopted and modified to reflect the above recommendations.

## RECOMMENDATIONS

8.12 The CLRC recommends:

- (a) to amend the provision in relation to proving debts by creditors upon the winding up of a company under section 291 of the Companies Act 1965 in the following manner:
  - (i) to delete any cross references to provisions of the Bankruptcy Act 1967;
  - (ii) to expressly state that the creditors are entitled to the right to set-off any mutual debts between the company and the creditors and to prove only for the balance; and
  - (iii) to expressly limit that the right to set-off by creditors is not applicable to creditors who have prior knowledge of the winding up of the company at the time the debt arose.
- (b) to expressly provide in the Companies Act that the rights to set-off should not be limited to contributories only but should be extended to creditors of the company in the case of mutual debts for both solvent and insolvent liquidations.
- (c) that the rights to set-off should not apply to the creditors who have reason to believe that the company is unable to pay its debts.

## Questions for Consultation

### Question 23:

Do you agree that any cross references to the Bankruptcy Act 1967 in relation to proving debts by creditors under section 291 of the Companies Act 1965 be deleted?

### Question 24:

Do you agree that the right to set-off should be expressly provided in the Companies Act and that the rights be made available not only to contributories but also to creditors in general subject to the existence of mutual debts between the concerned parties?

### Question 25:

Do you agree that the rights to set-off should not apply to the creditors who have reason to believe that the company is unable to pay its debts?

## 9. PREFERENTIAL DEBTS

9.1 Basically, debts, under the company law, fall under the following categories:

- secured debts - debts secured by a security which enables a creditor to obtain satisfaction under the common law and not under the winding up provisions. Secured creditors need not prove his debt in a winding up and are generally paid ahead of unsecured creditors. However, secured creditors may prove their debts where the debts exceed the value of the property secured of which they may prove as unsecured creditors for the balance.
- preferential debts – unsecured debts under sections 191 and 292 of the Companies Act 1965 and listed in their order of priority.

- ordinary unsecured debts – all other unsecured debts whose debts are admissible against the company in accordance with section 291 of the Companies Act 1965.

This part specifically deals with the treatment of preferential debts under section 292 of the Companies Act 1965 and the comparative study in other jurisdictions on this issue.

9.2 Section 292 of the Companies Act 1965 governs the payment of certain debts in priority to all other unsecured debts. Although the scheme of preferential debts applies to all types of winding up, the usefulness of the scheme will be evident if the company is insolvent and there are insufficient funds to pay all unsecured creditors in full. The fundamental principle of section 292 is that each class of debt is paid in full in accordance to the list of priorities under subsection (1). Thus, the Companies Act 1965 provides a measure of protection for unsecured preferential creditors. However, when it becomes impossible to pay a class in full, those creditors' debts will abate in equal proportions between themselves as provided for under subsection (2). If this is the case, there is a possibility that the subsequent class of creditors will not be paid at all.

9.3 The CLRC noted that the UK Enterprise Act 2002 has inserted section 176A into the Insolvency Act 1986 which has the effect of ensuring that a proportion of the company's net floating charge proceeds are to be made available to the company's unsecured creditors.<sup>45</sup> This part is not to be distributed to the holder of the floating charge. This applies for a company that grants a floating charge and subsequently enters into an insolvency procedure.<sup>46</sup>

<sup>45</sup> See *Report of the Review Committee on Insolvency Law & Practice* (Cork Committee Report), proposal to keep a 10 per centum fund for unsecured creditors).

<sup>46</sup> In the UK these are liquidation, provisional liquidation, administration and receivership.



9.4 The CLRC is aware that unsecured creditors may not have adequate protection. However, the CLRC is of the view that the holder of the floating charge should not be made responsible for the debts that the company incurred in its day-to-day operations. The trade creditors should be able to ascertain the business risk of carrying on business with a company that has charged its assets. Nonetheless, whilst the purpose of section 292 is to ensure that the unsecured creditors are provided some measure of protection amongst the unsecured creditors, the CLRC is of the view that employees are those who are the least protected. Thus, the CLRC's recommendation is in relation to measures which can protect employees of the company. In addition, the CLRC is also aware of competing priority claims in other statutes that may affect the order of priority as specified under the Companies Act 1965.<sup>47</sup> The CLRC is of the view that the existence of different priority regimes in different legislations involving companies will cause confusion and inconsistencies in the application of law and is of the view that where there is competing priority claims in such situations, the order of priority as stated in the Companies Act 1965 should prevail.

## RECOMMENDATIONS

9.5 The CLRC recommends amending section 292 of the Companies Act 1965 in the following manner:

- (a) to amend section 292(1)(b) of the Companies Act 1965 by increasing the present quantum of RM1,500 for wages and salary of each employee entitled to priority to the sum of RM15,000;

<sup>47</sup> It is noted that it is the practice of a liquidator or a receiver to seek directions from the court before distributing the proceeds of sale to the respective claimants in the case where there are competing claims between the debenture holder and the employees of the charger. See *Ban Hin Lee Bank Berhad v Applied Magnetics (M) Sdn Bhd (In Liquidation)* (2003) 5 CLJ 1.

- (b) to introduce a new definition on 'wages and salary of employees' which shall include wages in lieu of notice of termination of employment, amount of gratuity on termination of employment;
- (c) to abolish any preferences given to all federal taxes; and
- (d) where there are competing priority claims between the Companies Act 1965 and other statutes involving employees, the order of priority as stated in the Companies Act 1965 should prevail.

**A. COSTS AND EXPENSES OF WINDING UP**

- 9.6 Costs and expenses properly incurred in the process of winding up are given first priority under section 292(1)(a) of the Companies Act 1965 and must be paid first in the event of a winding up of the company. Costs and expenses of a winding up include the liquidator's remuneration in carrying out the liquidation process, audit expenses, and any costs of the applicant who petitioned for the winding up.
- 9.7 The CLRC noted that, with the exception of section 386 of the Insolvency Act 1986, other jurisdictions like Singapore, New Zealand, Australia and Hong Kong give the highest priority to costs and expenses incurred in the winding up process.
- 9.8 Section 328(5) of the Singapore Companies Act (Cap 50) as amended by the Companies (Amendment) Act 1993 gives priority to costs and expenses of winding up over floating charges.<sup>48</sup> Section 265(4) of the Hong Kong Companies Ordinance (Cap 32) states costs and expenses of winding up shall take priority over other preferred debts.

<sup>48</sup> See the Committee Report on the Companies (Amendment) Bill 1992.



9.9 Section 312 of the New Zealand Companies Act 1993 states that a liquidator must pay out of the assets of the company the expenses, fees and claims in the order of priority as set out in Schedule 7. Clause 1 of Schedule 7 states that the liquidator's remuneration, costs and expenses for the winding up includes out-of-pocket expenses incurred by the liquidation committee. The Ministry of Economic Development of New Zealand in its Discussion Document on the Draft Insolvency Law Reform Bill (April 2004) recommended retaining costs of winding up as the highest priority for the following reasons:

- these costs cover managing and co-ordinating the liquidation;
- these costs are incurred on behalf of creditors (i.e. they are not pre-existing debt), the costs should be borne by creditors accordingly; and
- if removed, it will be difficult to engage qualified people to administer the insolvent company.

9.10 Section 556(1) of the Australian Corporations Act 2001 covers the costs and expenses relating to winding up in the following priorities:

- expenses incurred in relation to preserving, realising assets of the company and carrying on the company's business;
- preliminary costs in respect of application of order of winding up;
- administrator's entitlement to indemnity;
- expenses incurred by the official manager in carrying on the company's business during the period of official management;
- costs incurred in preparing reports regarding the company's affairs and audit; and
- expenses incurred by members of the committee of inspection (COI).

9.11 Considering the importance and tedious tasks undertaken by the liquidator in the process of a winding up and the facts that all costs and expenses incurred in the winding up are not pre-existing debts, the CLRC views that this provision should continue to enjoy the top priority amongst the preferred debts. Whilst there are views that there could be abuse of this provisions where the cost and expenses could be inflated at the expense of the company and other unsecured creditors, the CLRC is of the view that the possibility of abuse is greatly minimised by the supervision of the court in the process. In addition, the CLRC is also recommending that all insolvency practitioners be licensed and subject to the supervision of a professional body and this will also ensure that professionalism is maintained within the industry.

#### **B. PREFERENTIAL DEBTS IN FAVOUR OF EMPLOYEES**

9.12 The second priority debt found under section 292(1)(b) of the Companies Act 1965 are the wages and salary of the employees of the company. This is in reference to services rendered by the employees to the company within a period of 4 months prior to the commencement of the winding up of the company and the quantum of salary shall not exceed RM1,500 for each employee. The wages and salary of employees are given priority over floating charges by virtue of section 292(4) of the Companies Act 1965.

9.13 Workers' compensation accrued before the commencement of winding up is ranked third under the class of priority debts listed under section 292(1) of the Companies Act 1965. This gives employees a direct right of action against insurers specifically under section 21 of the Workmen's Compensation Act 1952 (Revised

1982) on issues regarding health and safety at work.<sup>49</sup> An employee who suffered injuries in the course of his employment is entitled to claim a preferred debt under section 292(1)(c) of the Companies Act 1965 which is the equivalent to a worker's compensation under section 21 of the Workmen's Compensation Act 1952.<sup>50</sup>

- 9.14 Vacation leave is ranked fifth under the class of priority debts listed in section 292(1)(d) of the Companies Act 1965. This refers to amounts in respect of vacation leave of the employee which arose before the commencement of the winding up. The amount of vacation leave takes priority over floating charges by virtue of section 292(4) of the Companies Act 1965.
- 9.15 Superannuation, provident fund contributions and retirement benefit schemes are ranked sixth under the order of priority found in section 292(1)(e) of the Companies Act 1965. This refers to any contributions by the company for the benefit of its employees accruing over the past of 12 months prior to the commencement of the winding up. Section 292(4) of the Companies Act 1965 gives priority to contributions to provident funds and retirement of scheme benefits over floating charges. All jurisdictions accord preferential treatment to employee's benefits in the form of contribution to provident funds or any retirement scheme benefits. The Insolvency Act 1986, upon the abolition of Crown preferences to recover unpaid taxes, has accorded the highest preference to contributions to occupational pension schemes. Apart from giving preference to contributions to mandatory provident funds and occupational retirement schemes, Hong Kong makes the company liable to pay for any deducted amounts from the employees' salaries which have not been remitted to these funds and also make the company liable to pay any interest accrued thereon.

<sup>49</sup> The Annotated Statutes of Malaysia (Companies Act 1965) by Malayan Law Journal Sdn Bhd.

<sup>50</sup> See the Supreme Court decision in the case of *Indo-Malaya Engineering Bhd v Muniandy* [1990] 3 MLJ 301.



The CLRC noted that with the exception of the Insolvency Act 1986, other jurisdictions rank wages and salary of employees as the second priority in the class of preferred debts.

9.16 Section 328(2) of the Singapore Companies Act (Cap 50) limits the quantum of wages entitled to priority in the sum equivalent to 5 months salary of S\$7,500 whichever is lesser. The Singapore Companies Act (Cap 50) has defined the term of 'employee' in section 328(2B) to include a subcontractor of labour and the term 'wages and salary' includes:

- all arrears of moneys due to a subcontractor of labour;
- wages in lieu of notice of termination of employment before or after the commencement of winding up; and
- any amount of gratuity upon the termination of employment.

9.17 The CLRC noted that the Hong Kong Companies Ordinance (Cap 32) gives adequate protection in respect of the payment of wages and salary of employees where:

- labourers, workmen, clerks or servants are entitled to receive payment of wages from the Insolvency Fund under the Protection of Wages on Insolvency Ordinance if they have made payments to the fund during the period of 4 months before the commencement of the winding up. The quantum of wages shall not exceed \$3000;
- each employee is entitled to any severance payment not exceeding the amount of \$6000 under the Employment Ordinance;
- any long service payment to each employee not exceeding \$8000;
- any amount of compensation due under the Employees' Compensation Ordinance;

- any wages in lieu of notice of termination of employment payable to an employee not exceeding one month's salary or \$2,000 whichever is lesser;
- all accrued holiday remuneration to clerks, servants, workmen or labourers on the termination of his employment before or by reason of the winding up;
- any payment from the Employment Compensation Assistance Fund for the amount due by the company in respect of compensation under the Employment Compensation Assistance Ordinance accrued before the relevant date;
- any amount of unpaid contribution under the Occupational Retirement Scheme Ordinance which should have been paid by the company before the commencement of winding up;
- any amount of salary deducted by the company from its employee's salary for the purposes of making a contribution to the Occupational Retirement Scheme Fund which has not been paid into such account;
- any amount deducted by the company from the income of its employee for the purposes of making a contribution to the approved trustee of a registered scheme under the Mandatory Provident Fund Scheme Ordinance which has not been paid to that approved trustee; and
- sum and interest thereon payable to the Mandatory Provident Fund Scheme Authority.

9.18 Under clause 2 of Schedule 7 of the New Zealand Companies Act 1993 wages and salary of the employee includes:

- commission for services rendered to the company during the 4 months preceding the commencement of liquidation;
- holiday pay;
- any compensation for redundancy owed to an employee accrues before or by reason of the commencement of liquidation;

- any reimbursement provided for under the Employment Relations Act 2000 in respect of wages lost during the 4 months before the commencement of liquidation;
- any amount relating to any compensation under the Workers' Compensation Act 1956 accrued before the commencement of liquidation;
- amounts deducted by the company from the salary of an employee in order to satisfy the obligations of the employee;
- amounts payable to the Inland Revenue in accordance with section 163(1) of the Child Support Act 1991; and
- any amount that forms part of any apprenticeship contract may be ordered to be paid to an apprentice who is deprived of employment by reason of the commencement of liquidation.

The total sum to which priority is to be given to each employee under the above paragraphs shall not exceed \$15,000 or such greater amount prescribed at the commencement of liquidation.

9.19 The Ministry of Economic Development of New Zealand in its Discussion Document on the Draft Insolvency Law Reform Bill dated April 2004 recommended the following:

- to remove priorities for apprentices who will be deprived of employment by reason of the liquidation of the company as apprentices are covered under the Employment Relations Act 2000 and the priority is now redundant; and
- employee priority shall not include damages under the Employment Relations Act 2000. This expressly excludes damages for humiliation, loss of dignity and injury to feelings and loss of any benefit.

9.20 The CLRC noted that prior to the insolvency reform under the Enterprise Act 2002 which came into effect on 15 September 2003 and having the aim of modernising the insolvency law regime, the remuneration of an employee was ranked fifth in the order of priority of the preferred debts under Schedule 6 of section 386 of the Insolvency Act 1986. After the reform, the remuneration of an employee is now ranked second in priority of other preferential debts and the remuneration of an employee covers the following:

- any remuneration in respect of the whole or part of the period of 4 months before the relevant date;
- amount owed by way of accrued holiday remuneration; and
- any amount ordered to be paid by the debtor under the Reserve Forces (Safeguard of Employment) Act 1985.

The amount of salary referred to in the above is £800.<sup>51</sup> The term 'remuneration' includes the following:

- any wages or salary including commission payable for services rendered by the employee to the company;
- an amount falling under:
  - (i) a guarantee of payment under the Employment Rights Act 1996;
  - (ii) any payment for time off (to look for work or to arrange for training), time off for ante natal care under the Employment Rights Act and time off to carry out trade union duties under the Trade Union and Labour Relations (Consolidation Act) 1992;

<sup>51</sup> See Insolvency Proceedings (Monetary Limits) Order 1986, art. 4.

- (iii) remuneration on suspension on medical or on maternity grounds under the Employment Rights Act; and
- (iv) remuneration for redundancy dismissal with compensation under the Trade Union and Labour Relations (Consolidation Act) 1992.

9.21 The Companies Act 1965, Singapore, Hong Kong and Australia statutorily provide for employees claims to take priority over holders of debentures under any charge created as floating charges by the company and the claims shall be paid accordingly out of any property subject to the charge.

In addition, retrenchment benefits are not given any preferential treatment under the Companies Act 1965. On the other hand, Singapore ranks retrenchment benefits in the third position and includes any *ex-gratia* payments payable before, on or after the commencement of the winding up. The aggregate amount for these payments shall not exceed SD\$7,500.<sup>52</sup> This preference was introduced by the Companies (Amendment) Act 1993. Australia has similar provision for retrenchment benefits for employees of a company facing liquidation.

9.22 Based on the above comparative study, the CLRC noted that the Hong Kong Companies Ordinance (Cap 32), the New Zealand Companies Act 1993 and the Insolvency Act 1986 provide for better protection in terms of social and welfare of employees in the event of the winding up of a company. In this respect, the CLRC sees the necessity to upgrade the social obligation of a company for the benefit and well-being of its employees. The CLRC recommends that the quantum of wages and

<sup>52</sup> See section 328(2) of the Singapore Companies Act (Cap 50).



salary which is entitled to priority shall be increased from the present sum of RM1,500 to RM15,000. In addition, the definition of salary and wages should be extended to include notice in lieu of termination of employment and the amount of gratuity on termination of employment. Payment in relation to the retrenchment of employees should also be included.

### C. FEDERAL TAXES

- 9.23 Federal taxes under section 292(1)(f) of the Companies Act 1965 is ranked seventh in the order of priority. This includes but is not limited to income and sales taxes and excise and customs duties which have been assessed before the time fixed for the proving of debts has expired. The trend in the earlier case shows that judges are more inclined to regard the federal taxes take priority over subsequent debts by reason of section 10 of the Government Proceedings Act 1956 (Revised 1988).<sup>53</sup>
- 9.24 The trend, however, has now changed where the court has ruled that section 10 of the Government Proceedings Act 1956 (Revised 1988) is only a general provision and must be read subject to the special exception contained in section 292(1)(f) of the Companies Act 1965 whereby federal taxes rank seventh in priority amongst preferred creditors in the winding up process of a company.<sup>54</sup>
- 9.25 Section 292(3) of the Companies Act 1965 states that a lender who advances his money for the purposes of paying the wages of employees of a company under liquidation, may prove to recover his loans as a preferential debt if the company

<sup>53</sup> See the case of *Anuarul Aini v Ketua Pengarah Kastam dan Eksais Diraja* [1991] 1 MLJ 360.

<sup>54</sup> See the Supreme Court decision in *Directors of Custom, Federal Territory v Ler Cheng Chye* [1995] 2 MLJ 600.



goes into liquidation, to the extent that the employees would have been able to claim had they not been so paid. This claim is payable out of the assets of the company that is subject to a floating charge.

- 9.26 Singapore ranks taxes in the seventh position, Hong Kong in third position and New Zealand in fifth position. Australia, on the other hand, has no provision on taxes.
- 9.27 In the UK, the scope of the Crown's preferential status was reduced as part of the 1986 reforms. Prior to the insolvency reform under the UK Enterprise Act 2002, income tax and custom and excise duties were ranked first and second respectively in the order of priority of preferential debts under Schedule 6 of the section 386 of the Insolvency Act 1986. However, the Enterprise Act 2002 which came into effect on 15 September 2003 has abolished the Crown's preferential rights to recover unpaid taxes ahead of other creditors. The abolition is aimed at bringing real benefits to unsecured creditors, including many small firms. The category of debts that is no longer considered preferential is amount due to the Inland Revenue in respect of income tax and National Insurance contributions in the 12 months prior to insolvency, and amounts due to the Customs and Excise including value added tax (VAT) in the 6 months prior to insolvency. Other categories of preferential debts remain preferential.
- 9.28 The Consultation Document of the Joint DTI / Treasury Review of Company Rescue and Business Reconstruction Mechanisms, (the Consultation Document),<sup>55</sup> highlighted two principal arguments in favour of the Crown's status as preferential creditor:

<sup>55</sup> The Joint DTI / Treasury Review of Company Rescue and Business Reconstruction Mechanisms.



- firstly, the Crown is an involuntary creditor. It neither chooses its debtors nor has the ability to tailor the terms on which it becomes a creditor; and
- secondly, Crown debts are debts due to the public purse and the benefits to society as a whole of the collection of taxes due to the Crown (and the expenditure of such revenues on public 'goods') outweighs the benefits to or claims of individual creditors except, to a limited extent, employees.

However, the Review pointed out that the Crown is not unique in being an involuntary creditor in that any creditor whose claim against a company or individual arises as a result of a wrongly (tortious) act is also an involuntary one. The Review Group believed that without Crown preference, it is likely that a more realistic or commercial approach would be adopted by the Inland Revenue and Custom and Excise, resulting in more business being saved with consequential benefits for the Treasury and the business community as a whole.

- 9.29 Some of the responses to the Consultation Document see no justification in any of the Crown debts being afforded preferential status. The only justification for the Crown's preferential status that the respondents were aware of is the fact that the various government departments are involuntary creditors. However, the respondents were of the view that this argument was not compelling as the government merely levies taxes, it does not advance funds to assist and develop the business. It was further argued that the Crown has other remedies available to it that the small and unsecured creditors do not have, for instance, the power to levy distress and impose penalties as well as the resources to devote to the efficient collection of tax.

- 9.30 The CLRC noted that other jurisdictions such as Australia have abolished Crown preference. The abolition has, however, been counter-balanced by the establishment of a more stringent process for the collection of tax and the increased personal liabilities for directors.
- 9.31 The CLRC views that the federal taxes should not be accorded preferential treatment among the unsecured creditors simply because the government should require the company to pay all its taxes well before the company is wound up and not after the commencement of winding up of the company. The CLRC is of the opinion that if this practice is allowed to continue, rights of other unsecured creditors especially the employees of the company and petty traders or small firms would be greatly affected as they would be deprived from getting all their entitlements in the event of a winding up. However, the CLRC takes into account that the abolishment of federal taxes may have an impact on the government's policy-decisions as it may in some ways affect government's revenues.
- 9.32 The CLRC also recommends that in the event that there is a surplus after the distribution of the preferred creditors portion under section 292 of the Companies Act 1965 and if federal taxes are to be retained as preferential debts under section 292 of the Companies Act 1965, the surplus should rightfully be given to the employees of the company as their added benefits and to the small creditors such as small firms. The CLRC is concerned with the promotion of the social benefits and well-being of the employees of the company. This is also one way of looking after the interest of the business community especially small firms. In this respect, the CLRC recommends that the employees' benefits and the small unsecured creditors should be paid ahead of the federal taxes.

## Questions for Consultation

### Question 26:

Do you agree that the provision on preferential creditors be retained, but with modifications?

### Question 27:

Do you agree that the quantum for wages and salary entitled to priority shall be increased from the present sum of RM1,500 to RM15,000?

### Question 28:

Do you agree that section 292(1)(d) be amended by introducing a new definition on 'wages and salary of employees' which shall include the payment of notice in lieu of termination of employment and payment for gratuity for termination of employment by reason of the winding up?

### Question 29:

Do you agree with the recommendation to abolish any preference accorded to federal taxes in recovering unpaid taxes of a company?

## 10. THE DEREGISTRATION PROCESS UNDER SECTION 308 OF THE COMPANIES ACT 1965

10.1 Deregistration or removal from the Register is deemed to be the formal demise of a company which terminates the existence of a company. There are several circumstances in which a company may be removed from the Register:

- as a result of a merger or amalgamation of two companies, the court may order the dissolution of one of the Companies after its assets and liabilities have been transferred to the other;<sup>56</sup>
- upon completion of the winding up and the grant of orders of release of the liquidator and dissolution of company made pursuant to section 240 of the Companies Act 1965;
- on the expiration of three months after the lodgement of return to the Regulators (Registrar and Official Receiver) in the case of a voluntary winding up under section 272 of the Companies Act 1965; and
- deregistration initiated by the regulator i.e. the Registrar of Companies under section 308 of the Companies Act 1965.

10.2 Section 308(1) and (3) of the Companies Act 1965 empowers the Registrar to strike-off from the Register the name of a company which is being wound up if the Registrar has reasonable cause to believe that:

- the company is a dormant company by the fact that it is not carrying on business or is not in operation; or
- the company is being wound up and the Registrar has reasonable cause to believe that:
  - (i) no liquidator is acting for it; or
  - (ii) where the affairs of the company are fully wound up and for a period of six months the liquidator has been in default in lodging any returns required to be made by him; or
  - (iii) the affairs of the company have been fully wound up and there is insufficient funds to pay the costs of obtaining order of the court dissolving the company.

<sup>56</sup> See section 178(1)(d) of the Companies Act 1965.



- 10.3 In any of these circumstances, the Registrar may remove the company's name from the Register upon the fulfilment of the following steps:
- upon notification by way of a show cause notice to the company and its liquidator (if any) and its directors giving them one month to come up with a reasonable explanation failing which a notice with a view of striking the company's name off the Register will be published in the Gazette;<sup>57</sup>
  - publish or advertise the proposed deregistration in the Gazette for three months stating that at the expiration of the stipulated period the name of the company will be deregistered from the Register and the company will be dissolved;<sup>58</sup> and
  - after the expiration of time in the notice, the Registrar may strike the company's name off the Register and upon the publication of the notice in the Gazette notifying the deregistration, the company shall demise but the liability of its officers and members of the company shall still subsists and the court has the right to wind up the company which has been removed from the Register.<sup>59</sup>
- 10.4 The effect of deregistration is that the company ceases to exist and if the company has any property left, it shall vest with the Registrar.<sup>60</sup>
- 10.5 Any party aggrieved by the deregistration can apply to the court within 15 years after the name has been struck-off the Register, and the court may grant the order upon its satisfaction that it is just to order such reinstatement of registration of that company and the company is deemed to have continued in existence as if it has never been deregistered. The court may also make an ancillary order if it thinks it is

<sup>57</sup> See section 308(1) of the Companies Act 1965.

<sup>58</sup> See section 308(2) of the Companies Act 1965.

<sup>59</sup> See section 308(4)(a) and (b) of the Companies Act 1965.

<sup>60</sup> See section 310 of the Companies Act 1965.

just by giving directions to place the company and all other persons back in their original position before the company was deregistered.<sup>61</sup>

- 10.6 The CLRC noted that the procedure for deregistration of a company under the Companies Act 1965 is adequate and well in place. However, the CLRC is concerned about the implementation and enforcement of this provision by the Registrar particularly section 308(3) of the Companies Act 1965 concerning a company which is not in operation. The CLRC, therefore, is of the view that a liquidator should be allowed to make an application to the Registrar to strike-off a company that is no longer in operation. In this respect, the CLRC recommends that the Registrar should design a simple form in the Companies Regulations 1966 for the liquidator to fill up which would enable the liquidator to apply to dissolve a company that is no longer in operation.

## RECOMMENDATION

- 10.7 The CLRC recommends that liquidators should be allowed to apply to dissolve a company which is no longer in operation and to facilitate this, there should be a simple form in the Companies Regulations 1966 for the liquidators to fill up and lodge with the Registrar which shall enable them to apply to dissolve the company.

## COMPARATIVE JURISDICTIONAL STUDY

- 10.8 The CLRC noted that section 344 of the Singapore Companies Act (Cap 50) is in similar to section 308 of the Companies Act 1965. The Registry of Companies and

<sup>61</sup> See section 308(5) of the Companies Act 1965. The CLRC noted that Australia is the only jurisdiction that has statutorily provided in its statute that the applicant company must pay all fees and penalties payable under the statute before an application for removal from Register could be made.

Businesses of Singapore (RCB) has issued guidelines on the application for striking-off defunct companies and the guidelines are posted on the RCB' s website.

- 10.9 Section 652(1) and (4) of the UK Companies Act 1985 and section 291(1) and (4) of the Hong Kong Companies Ordinance (Cap 32) have similar provisions authorising the Registrar to deregister dormant and wound up companies which are no longer in operation.
- 10.10 The Australian Corporations Act 2001 in section 601AA allows either the company or its director or member of the company or a liquidator to lodge with the Australian Securities and Investments Commission (ASIC) an application for the voluntary deregistration of a company. A voluntary deregistration of a company may only be available in the following circumstances:
- all the members of the company agree to the deregistration;
  - the company is not carrying on business;
  - the company's assets are worth less than \$1,000;
  - the company has paid all fees and penalties payable under the Act;
  - the company has no outstanding liabilities; and
  - the company is not a party to any legal proceedings.
- 10.11 On the other hand, section 601AB of the Australian Corporations Act 2001, gives the power to ASIC to initiate a compulsory deregistration of a company in the following circumstances:
- (a) the company has not responded to a notice of return of particulars of the company at least after 6 months; and

- (b) the company has not lodged any documents under the Act in the last 18 months; and
- (c) the company is not in operation; and
- (d) the company failed to pay its review fee in respect of a review date at least 12 months after the date for payment was due.
- (e) the company is being wound up and ASIC has reason to believe that:
  - (i) there is no liquidator acting;
  - (ii) the company's affairs have been fully wound up and liquidator has not lodged any return for the last 6 months; and
  - (iii) the company has no property to cover the costs for obtaining a court order to apply to deregister the company.

10.12 The dissolution of a company under section 317 of the New Zealand Companies Act 1993 is by way of removal from the Register either after the liquidation has been completed or as a result of an amalgamation or where the Registrar is otherwise satisfied that the company is defunct, whereby for instance, it has paid off all its creditors, has ceased trading and has distributed all its assets.

### Question for Consultation

#### Question 30:

**Do you agree that a liquidator should be allowed to apply to the Registrar to strike-off the name of a company that is no longer in operation?**

