Of Mixing Water and Oil: *Erinford* Injunctions and s 366 Scheme of Arrangements

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On 24 November 2023, the High Court of Kuala Lumpur delivered its decision on whether a court could grant an injunction to preserve the status quo between parties pending an appeal, otherwise known as an Erinford injunction, after dismissing KNM and KNMG's (collectively, 'the Applicants') application for a scheme of arrangement under s 366 of the Companies Act 2016 ('s 366 SOA')

The High Court's decision above was pursuant to the Applicants' application for an Erinford injunction on 10 November 2024, made after the High Court's striking off of the Applicants' s 366 SOA and pending the Applicants' appeal to the Court of Appeal against the High Court's decision to strike out its s 366 SOA.

After affirming the analysis of the counsel for the 1st and 2nd Respondent and the 3rd Respondent respectively, the High Court held that the Applicants' application for an Erinford injunction was an endeavour to 'extend the shelf life of a restraining order' as obtained under s 368 of the Act. 'Being a creature of statute with a definitive life span', a restraining order would collapse upon a s 366 SOA being set aside. As such, a restraining order under s 368 could not be treated as a normal injunction and normal injunction principles were inapplicable. The High Court also upheld the notion that a court, having heard a dismissed s 366 SOA, is functus officio.

The Law

The doctrinal basis of the power of a superior court to grant an *Erinford* injunction by drawing on its inherent jurisdiction is to temporarily preserve the subject matter in dispute between parties pending an appeal. The question therefore arises as to whether a court is vested with the same inherent jurisdiction to grant an *Erinford* injunction where an applicant has faltered in securing a s 366 SOA – a statutory remedy for companies seeking to reach compromises with their creditors or members.

As will be elucidated in this brief article, 5 principal reasons exist as to why there is no rational or sensible legal foundation to grant an *Erinford* injunction to an applicant whose attempt at a s 366 SOA has failed.

In short, an attempt to try invoking the inherent jurisdiction of a court to grant an *Erinford* injunction against the backdrop of an applicant who has previously obtained a now-defunct s 368 restraining order ancillary to a s 366 SOA is akin to an attempt to mix water with oil. Though the practical result of an *Erinford* injunction and a s 368 restraining order ultimately preserves the status quo between an applicant company and its creditors, the two are entirely distinguishable and separable by their respective origins.

1. A s 366 SOA is merely a statutory mechanism that is bestowed the force of law once a SOA passes judicial filtering, i.e., the convening stage

The statutory provisions governing schemes of arrangements (‘SOA’) do not empower financially distressed companies to alter their contractual obligations owing to creditors or to alter creditors’ rights. Rather, its purpose is merely to supply a statutory mechanism to alter rights and obligations by force of law if the SOA is sanctioned by the Court. If the proposal of a SOA at the judicial filtering or convening stage is held to be unfit for consideration by creditors, it spells the statutory demise of the proposal. There is no tangible commercial interest for preservation: the answer does not lie in an appeal.

At common law, a proposed SOA requires 100% consensus by individual creditors, a feat of near impossibility. Legislative intervention introduced the statutory SOA, to overcome the need for 100% consensus: *In re Anglo-Continental Supply Company Limited* [1922] 2 Ch 723; *Norfolk Island v Byron Bay Whaling Co Ltd and Companies Act* [1970] 1 NSWR 221; *Australian Securities Commission v Marlborough Gold Mines Ltd* (1992-1993) 9 ACSR 531.

At the judicial filtering or convening stage, either the statutory requirements governing proposals (including the rules relating to explanatory circulars) are fulfilled or they are not. If fulfilled, the statutory consequence is the creditors' meeting. Otherwise, the natural statutory consequence is that the proposal comes to an end. Compliance triggers a creditors' meeting, while non-compliance leads to the proposal's demise.

At the judicial filtering or convening stage, the materials *ex parte* before the Court are nothing more than a proposal., At this stage, the role of the Court is supervisory in nature. The Court is to only ascertain whether the SOA 'seems' fit for consideration: *Re Foundation Healthcare Ltd* [2002] 42 ACSR 252.

If the SOA seems fit for consideration, the concomitant consequence is to restrain proceedings by creditors under s 3 68 to facilitate consideration of the SOA. A s 368 restraining order ('RO') is not freestanding as that compliance with the conditions of an RO is spelt out as mandatory: s 368(2) of the Act.

If the Court acts under s 366 by granting leave to summon a creditors' meeting and s 368 by granting a RO, the Court does so without giving its imprimatur to the proposal: *Re Foundation Healthcare Ltd* (supra). The Court retains its supervisory discretionary power to set aside its orders *ex parte*.

The setting aside of a s 368 SOA effectively spells out that an applicant's proposal was not fit for consideration by the creditors. In the circumstances, there is no tangible commercial interest or justification for preservation pending an appeal in such circumstances. The

statutory framework ensures that only viable proposals proceed, aligning with the court's supervisory role in the SOA process.

2. There is no *lis* or cause of action in a s 366 SOA

The provisions governing SOAs within the Act do not confer a cause of action upon a company against its creditors. Instead, it provides a statutory mechanism for implementing a SOA. Unlike disputes between parties in ordinary litigation, there is no *lis* or dispute as such in a proposed SOA. The company in financial distress acknowledges its indebtedness, as would be self-evident in the affidavits accompanying a s 368 SOA application.

A SOA applicant under the Act seeks temporal protection from the Court for a finite period from its creditors. Its avowed purpose is to allow the debtor an opportunity to construct a proposal for consideration by its creditors, to decide whether to accept or to reject the debtor's proposal to alter rights and obligations by operation of law.

When an applicant's SOA proposal does not seem fit for consideration at the judicial filtering or convening stage for creditors' consideration, it is not an adjudication of competing legal rights between feuding parties as in an ordinary piece of litigation. In cases dealing with an *Erinford* injunction, a plaintiff and a defendant claim competing interests or rights in the subject matter calling for adjudication by the Court.

3. There is no room for the application of a court's inherent jurisdiction where the statutory rules are exhaustive

The inherent jurisdiction of a court is a procedural tool designed to prevent injustice or abuse, a reserved source of power possessed naturally by a Court to enable it to function as a court of law: The Inherent Jurisdiction of the Court, 1970 Vol 23 Current Legal Problems by I. H. Jacob; The Inherent Jurisdiction of the Court (1983) 57 ALJ 449 by Keith Mason; The Inherent

Jurisdiction to Regulate Civil Proceedings (1997) 113 LQR 120 by M.S.Dockray. It is not available where non-compliance with statutory rules provides for its own consequences.

Order 92 r 4 declares its existence: *R Ramachandran v The Industrial Court of Malaysia* [1997] 1 MLJ 145 (SC). It is a procedural rule, not intending to alter substantive rights.

Whether a subject matter is policed by exhaustive self-contained or self-regulating provisions providing for its own statutory consequence, it is inappropriate to resort to the court's inherent jurisdiction: *Permodalan MBf Sdn Bhd v Tan Sri Dato Sri Hamzah Bin Abu Samah & Ors* [1988] 1 MLJ 178 (SC); *SBSK Plantations Sdn Bhd v Dynasty Rangers (M) Sdn Bhd* [2002] 1 MLJ 326; *The Royal Selangor Golf Club v Pentadbir Tanah Wilayah Persekutuan Kuala Lumpur* [2012] 5 MLJ 364 (CA). See also, *Dato' Seri Anwar bin Ibrahim v Public Prosecutor* [2011] 1 MLJ 158.

The provisions within the Act governing SOAs act as a self-contained and self-regulatory framework. A SOA must cross 3 statutory hurdles and each of these hurdles serve a distinct purpose. Failure at the judicial filter or convening stage, or the creditors' meeting stage, spells the natural statutory demise of the proposal and its accompanying RO.

4. An application for an *Erinford* injunction will prolong the statutory life of a restraining order as envisioned by the Legislature

Although a RO operates similarly to an injunction, surrendering to the temptation of treating the two jurisdictions as synonymous is incorrect: there is a world of a difference between a RO and a common law injunction. In this respect, the metaphor of mixing oil and water to spell out the elemental difference of a RO and a common law injunction is apt.

First, a RO is not granted on the *Cyanamid* principles or principles governing the grant of injunctions, but rather granted in compliance with the statutory rules laid out in the CA 2016. If the statutory rules are not fulfilled, no RO can be granted.

Second, the temporal purpose of a RO is to facilitate an applicant's proposal, at a time when it is uncertain whether such proposal will be accepted at a creditors' meeting. If accepted, the uncertainty of obtaining judicial sanction remains.

Third, a RO is not directed against named defendants like in an action. Instead, the RO operates as a notice to the public at large (including courts of coordinate jurisdiction) that the debtor company is under the temporary protection of the Court acting under ss 366 and 368 of the Act. It is a notice of a public nature emerging from a reading of s 368(5).

Fourth, on the face of the application under consideration, it is to 'restrain' and 'stay' existing actions and/or any new/future actions or proceedings in a Court of coordinate jurisdiction, the winding-up court, an arbitral tribunal, the Industrial Court, an adjudication tribunal under CIPAA or other execution or enforcement proceedings, among others.

Therefore, there is nothing for the creditors to deal with or part away following the setting aside of a SOA. Substituting a RO with an *Erinford* injunction is wrong, given that the Act provides for its own consequences whenever the threshold requirements at the convening stage are not satisfied.

Resorting to a Court's inherent jurisdiction to resuscitate and extend the statutory shelf life of a demised RO contravenes the Act in the guise of an *Erinford* injunction. This is because, unlike an Erinford injunction, a RO has a definite life span.

5. <u>A court hearing a s 366 SOA that has failed at the convening stage is *functus officio*; there is nothing to appeal upon a s 366 SOA's failure at such convening stage</u>

Lastly, having decided at the judicial filtering or convening stage that there is no proposal fit for consideration at a creditors' meeting, a Court post-dismissal of a scheme is *functus officio*

in the statutory context as discussed above. This does not imply that an applicant cannot formulate a fresh statutory proposal for consideration.

At risk of repetition, there is no pending trial or *lis* between debtors and creditors in a proposed scheme initiated by debtors with the aim of altering rights and obligations under the auspices of the Act. In the statutory context, the debtors acknowledge the existence of debts and the Court is not asked to adjudicate whether such debts are indeed owing. Rather, the Court is asked to decide whether to '*order a meeting in a summary way*' of creditors under s 366(1) to consider the proposal with respect to admitted debts.

In all cases where an *Erinford* injunction was granted, the *lis* adjudicated upon by the trial Judge was kept 'alive' and continued through the appeal process. When a scheme proposal fails at its convening or creditors' meeting stage, its failure is incapable of generating an adjudicated *lis* for appeal.

To take a hypothetical example, assuming the proposal passes the convening stage but fails to attain 75% majority vote in value at the meeting stage, it cannot be that the trial Judge is not *functus officio* and may grant a common law injunction pending appeal to preserve a rejected proposal at the creditors' meeting. *Mutatis mutandis*, where a trial Judge rules at the convening stage that a proposed scheme is not fit for consideration by creditors at a meeting.

In the second situation above, it is not imaginable that the decision created an adjudicated *lis* between the trial Judge and the proponent of the scheme that invites an appeal. More accurately, the trial Judge is telling the proponent to come up with a proposal that seems fit for consideration by creditors at a meeting. With respect, it is at the third stage, or sanction stage, that something may arguably become a subject matter deserving preservation.

If the High Court says 'yes to sanction' with a majority vote of 75% in value, rights and obligations of scheme creditors are thereby altered to the extent set out in the sanctioned scheme. In this situation, that which needs to be preserved is the non-implementation of a

scheme made binding by operation of law over the heads of the dissentients pending appeal. The basic question on appeal will be whether there is fair alteration of rights belonging to the minority scheme creditors, or whether the trial Judge had wrongly exercised his/her discretion in sanctioning the scheme notwithstanding the majority vote (a relevant but not conclusive factor in considering fairness: *Scottish Lion Insurance Co Ltd v Goodrich Corporation and others* (2010) SC 349 at [29].

Case law examples include *In re Alabama, New Orleans, Texas and Pacific Junction Railway Company* [1891] 1 Ch 213 (appeal against sanction given by North J was dismissed); *Re BTR plc* [2000] 1 BCLC 740 (CA) (leave to appeal against sanction was refused as '*there was no realistic prospect of the Court of Appeal interfering with the exercise of that discretion*').

If a High Court refuses to sanction a scheme despite the scheme attaining a majority vote of 75% in value, that which needs to be preserved pending appeal by the company or the majority creditors or both, is for the minority creditors to hold their hands. Recent case law demonstrating this, where a court of law declined to sanction a scheme and which decision ended at the Federal Court, was reported as *MDSA Resources v Adrian Sia Koon Leng* [2023] 5 MLJ 900.

The basic question on appeal if the High Court declines to sanction a scheme will be whether the debtor's obligations and the rights of all scheme creditors had been fairly altered by the vote of the majority. The matters which an appellate court will consider was eloquently captured by Lindley LJ in *In re Alabama* (supra) at pp 238 to 239:

> *I think that is very likely, but, still, there is the statute, and what the Court has to do is to see, first of all, that the provisions of that statute have been complied with; and, secondly, that the majority has been acting bona fide. The Court also has to see that the minority is not being overridden by a majority having interests of its own clashing with those of the minority whom they seek to coerce. Further than that, the Court has to look at the scheme and see whether it is one as to which persons acting honestly,*

> *and viewing the scheme laid before them in the interests of those whom they represent, take a view which can be reasonably taken by business men. The Court must look at the scheme, and see whether the Act has been complied with, whether the majority are acting bonâ fide, and whether they are coercing the minority in order to promote interests adverse to those of the class whom they purport to represent; and then see whether the scheme is a reasonable one or whether there is any reasonable objection to it, or such an objection to it as that any reasonable man might say that he could not approve it.*

<u>Conclusion</u>

An applicant who has failed to meet the convening requirements of a s 366 SOA ought not be granted an *Erinford* injunction. An unsanctioned s 366 SOA does not create a *lis* between a company seeking a s 366 SOA and its creditors. A judge who presided and dismissed a s 366 SOA is thereafter *functus* to grant an *Erinford* injunction.