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ISSUES AND CHALLENGES IN THE ENFORCEMENT OF ISLAMIC FINANCE JUDGMENT WITHIN THE MALAYSIAN BANKRUPTCY FRAMEWORK[1]

by

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INTRODUCTION

Bankruptcy proceeding is one of the modes available to judgment creditor to enforce the terms of judgment and to recover the judgment debt due and payable by a judgment debtor. Unlike other execution proceedings, bankruptcy proceeding is regarded as quasi penal proceeding whereby strict adherence to the bankruptcy rules is required.[3] The strict compliance with the bankruptcy rules is commonly imposed by the court due to the fact that the bankruptcy order shall have the effect of depriving the financial freedom and personal liberty of a judgment debtor which is guaranteed under the Federal Constitution.[4] Once a person is adjudged a bankrupt, that person shall be subjected to certain disabilities and disqualifications in order to prevent him from incurring further debts.[5] In addition, all his assets shall vest with the Insolvency Department (formerly known as official assignee) and be divisible among his creditors.[6]

The main objectives of bankruptcy laws are threefold:[7]

(a) to secure fair and equitable distribution of the asset of a debtor among

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1 This paper forms part of the author's ongoing research on the inadequacies of the Malaysian litigation framework to cater for dispute resolution in Islamic banking and finance.

2 The author wishes to record his special thanks to his research supervisor, Dr Md Anowar Zahid (Senior Lecturer, Faculty of Law, Universiti Kebangsaan Malaysia) and his partners at Messrs Akram Hizri & Azad, Advocates & Solicitors for giving their valuable comments, advice and encouragement.

3 *Sobri bin Arshad v Associated Tractors Sdn Bhd* [1991] 3 MLJ 32.

4 Article 5(1) of the Federal Constitution provides 'No person shall be deprived of his life or personal liberty save in accordance with law'.

5 *Re Ong Thim Kuang; Ex p Public Bank Bhd and other cases* [2000] 5 MLJ 442 at p 444H.

6 Section 24 of the Bankruptcy Act 1967.

7 JH Thompson, *The Principles of Bankruptcy Law*, 1975, London, HFL (Publishers) Ltd at p 1.

his creditors in accordance with their respective rights against him;

(b) to relieve the debtor of his financial liability and enable him to make a fresh start free from the burden of his debts and obligations; and

(c) to protect the interest of the creditors and the public by providing a mechanism for investigation of the conduct of the debtor in his affairs and imposition of punishment where there has been fraud or misconduct on the debtor's part.

In this country, the bankruptcy jurisdiction is developed under the conventional legal framework which is primarily based on interest-bearing transaction. All judgments under conventional commercial transactions shall carry pre-judgment interest and post judgment interest.[8] This research identifies that there is no amendment made to the bankruptcy laws to suit the need of the Islamic banking and finance industry. For the time being, all Islamic financial institutions are required to comply with the existing bankruptcy legislations. Hence in this paper, the research will analyse the inadequacies and lacuna in the bankruptcy framework in relation to the enforcement of Islamic finance judgment. This research defines the term 'Islamic finance judgment' as 'judgment pronounced by the court of competent jurisdiction on claim arising from Islamic financial transaction as duly approved by Shariah'.

THE CONVENTIONAL BANKRUPTCY FRAMEWORK

Origin of bankruptcy

The word 'bankruptcy' has its origin in the commercial practices among the medieval Italian merchants and bankers.[9] When a merchant or banker was unable to pay his debts, it was common practice for his creditors to break his bench as a symbol of financial failure.[10] This practice led to the phrase 'banca rotta' which is derived from the Italian banca (bench) and rotta (break).[11] English merchants later changed the term 'banca rotta' to 'bankrupt' while the French merchants called it as 'banqueroute'.[12]

8 Section 11 of the Civil Law Act 1956 and O 42 r 12 of the Rules of Court 2012.

9 Martin A Frey et al, *An Introduction to Bankruptcy Law* (4th Ed, 2005), New York. Thompson Delmar Learning at p 1.

10 *Ibid.*

11 *Ibid.*

12 *Ibid.*

Definition of bankruptcy

The term 'bankruptcy' is legally defined in the *Black's Law Dictionary* as 'the statutory procedure usually triggered by insolvency, by which a person is relieved of most debts and undergoes a judicially supervised reorganisation or liquidation for the benefit of that person's creditors'.[13] This research, however, prefers the legal definition of 'bankruptcy' as provided by Catherine Tay Swee Kian (1984) as follows:

> Bankruptcy is a proceeding by which the State takes possession of the debtor's property by an officer appointed for the purpose, and such property is then realised and, subject to certain priorities, distributed amongst the persons to whom the debtor owes money or has incurred pecuniary liability.[14]

At this juncture, the term 'bankruptcy' must be distinguished from the word 'insolvency'. Insolvency is merely the factual state of a person's inability to pay his debts when they become due, but who is not yet adjudicated bankrupt.[15] By contrast, 'bankruptcy' refers to a legal recognition of that state of affairs.[16] An insolvent person will only become bankrupt after he has been so adjudged by a court. Hence, it may be summarised that a bankrupt is usually an insolvent person but an insolvent person is not necessarily a bankrupt.

Adoption of English bankruptcy framework by Malaysia

The first bankruptcy legislation in England began with a statute enacted in the year 1542 in the reign of Henry VIII, namely the *Statute of Bankrupts or An Acte againste suche persones as doo make Bankrupte*.[17] This statute was initially applicable to traders and later in the year 1861, the application of the bankruptcy statute was extended to private debts.[18] Modern bankruptcy law was formulated in a series of English Bankruptcy Acts in 1869, 1883 and 1890 and in the English Bankruptcy and Deed of Arrangements Act 1913 and was subsequently consolidated in the English Bankruptcy Act 1914.[19] The English

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13 *Black's Law Dictionary* (7th Ed), 1999. West Group at p 141.

14 Catherine Tay Swee Kian, *Bankruptcy: The Law and Practice*, 184, Butterworths & Co Publishers Ltd at p 1.

15 *Ibid.*

16 *Ibid.*

17 Stephen J Lubben, *A New Understanding of Bankruptcy Clause*, Case Western Reserve Law Review, Vol 64, Winter 2013, Issue 2 at p 328 at http://law.case.edu/journals/lawreview/Documents/DigitalPrint.2.Lubben.V64.Issue2.pdf.

18 JH Thompson, *The Principles of Bankruptcy Law*, 1975, London, HFL (Publishers) Ltd at p 1.

19 *Ibid.*

Bankruptcy Act 1914 was then repealed and replaced by the Insolvency Act 1986, which was later amended by the English Insolvency Act 2000. In Malaysia, the Bankruptcy Act 1967 was modelled after the English Bankruptcy Act 1914.

Bankruptcy legislation in Malaysia

The Bankruptcy Act 1967 sets out the substantive laws of bankruptcy[20] and is divided into eight parts, namely (1) proceedings from the act of bankruptcy to the discharge of bankruptcy;[21] (2) disqualification and disabilities of bankrupt;[22] (3) administration of property;[23] (4) Director General of Insolvency;[24] (5) constitution, procedure and powers of court;[25] (6) small bankruptcies;[26] (7) fraudulent debtors and creditors;[27] and (8) supplemental provisions.[28] In addition to the substantive provisions, the Bankruptcy Act 1967 also contains schedules prescribing the procedure for the meeting of creditors, registration of deeds of arrangements and the proof of debts.[29] In terms of detailed procedure of the bankruptcy, the Bankruptcy Act 1967 is supplemented with the Bankruptcy Rules 1969. Since bankruptcy proceeding is governed by its own rules, the Rules of Court 2012 cannot be applied to the bankruptcy proceedings except in a situation where there is a lacuna in the Bankruptcy Rules 1969.[30] The Bankruptcy Rules 1969 provides various forms which are used in bankruptcy proceedings.

Exclusive jurisdiction of the High Court over bankruptcy proceedings

In this country, the bankruptcy matter falls under the special jurisdiction of the High Court.[31] Under art 121(1) of the Federal Constitution, here are two High Courts, namely the High Court of Malaya and the High Court of Sabah and Sarawak. The two High Courts are of co-ordinate jurisdiction and status and shall have exclusive territorial jurisdiction over disputes that arise within their

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20 *Halsbury's Laws of Malaysia*, Volume 6, at p 5, Lexis Nexis Malaysia Sdn Bhd.
21 Part I (ss 3–35) of the Bankruptcy Act 1967.
22 Part II (ss 36–39) of the Bankruptcy Act 1967.
23 Part III (ss 40–69) of the Bankruptcy Act 1967.
24 Part IV (ss 70–87) of the Bankruptcy Act 1967.
25 Part V (ss 88–105) of the Bankruptcy Act 1967.
26 Part VI (ss 106–108) of the Bankruptcy Act 1967.
27 Part VII (ss 109–119) of the Bankruptcy Act 1967.
28 Part VIII (ss 120–139) of the Bankruptcy Act 1967.
29 Schedules A, B and C of the Bankruptcy Act 1967 .
30 Appendix C Rules of the Court 2012 and r 276 of the Bankruptcy Rules 1969.
31 Section 24 of the Courts of Judicature Act 1964 and s 88 of the Bankruptcy Act 1967.

territories. In exercising its bankruptcy jurisdiction, the court shall have full power to decide on all legal and factual questions which arise in the bankruptcy case.[32] The bankruptcy case may be heard either in open court or in chambers by the High Court judge.[33] Nevertheless, some applications under the bankruptcy action may be heard by the registrar of the High Court.[34] In the event that any party is not satisfied with the decision of the registrar, they may always file appeal to the judge in chambers. On appeal, the judge may review, rescind or vary any order made under the bankruptcy jurisdiction[35] or affirm the decision of the registrar. Regardless of the wide power given to the High Court in exercising its bankruptcy jurisdiction, the High Court (or commonly called Bankruptcy Court) is not allowed to go behind the judgment to enquire the validity of the judgment debt except where there is sufficient evidence of fraud or collusion or miscarriage of justice.[36]

Persons subject to the bankruptcy jurisdiction

Under the Bankruptcy Act 1967, no person can be subjected to the jurisdiction of the bankruptcy court unless he is a 'debtor' within the definition of the Act. Section 3(3) of the Bankruptcy Act 1967 defines 'debtor' as any person who at the time when the act of bankruptcy was done or suffered by him:

(a) was personally present in Malaysia; or

(b) ordinarily resided or had place of residence in Malaysia; or

(c) was carrying business in Malaysia either personally or by means of any agent; or

(d) was a member of a firm or partnership which carried on business in Malaysia.

The statutory definition above clearly demonstrates that a debtor need not be Malaysian citizen and may include a foreign citizen or permanent resident provided that any one of the four criteria above is met. However, where a debtor is subject to the bankruptcy jurisdiction, no creditor can file petition against such debtor unless the conditions set out in s 5(1) of the Bankruptcy Act 1967 have been fulfilled.

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32 *Re Wong Chong Siong, ex parte Arab Malaysian Finance Bhd* [1998] 7 MLJ 208; [1999] 1 CLJ 222 (per Abdul Malik Ishak J); s 91(1) of the Bankruptcy Act 1967.

33 Section 89 of the Bankruptcy Act 1967.

34 Section 90 of the Bankruptcy Act 1967 and Practice Direction No 3 of 1993.

35 Section 92 of the Bankruptcy Act 1967.

36 *Sovereign General Insurance Sdn Bhd v Koh Tian Bee* [1988] 1 MLJ 304 (SC).

The conditions[37] on which creditor may present petition for bankruptcy are as follows:

(a) the debt owing by the debtor to the petitioning creditor, or if two or more creditors join in the petition the aggregate amount of debts owing to the several petitioning creditors, amounts to thirty thousand ringgit (RM30,000);

(b) the debt is a liquidated sum payable either immediately or at some certain future time;

(c) the act of bankruptcy on which the petition is grounded has occurred within six months before the presentation of the petition; and

(d) the debtor is domiciled in Malaysia or in any State or within one year before the date of the presentation of the petition has ordinarily resided or had a dwelling house or place of business in Malaysia or has carried on business in Malaysia personally or by means of an agent or is or has been within the same period a member of a firm or partnership which has carried on business in Malaysia by means of a partner or partners or an agent or manager.

Further, prior to presenting a bankruptcy petition, a creditor must verify whether or not the debtor is a social guarantor. A creditor is not entitled to commence bankruptcy action against a 'social guarantor'[38] unless he proves to the court that he has exhausted all avenues to recover debts owed by the principal debtor. In addition, bankruptcy proceedings cannot be instituted against any corporation or companies registered under the Companies Act 1965 since the corresponding procedure to distribute assets of an insolvent company is by way of winding up proceedings.[39] A bankruptcy proceedings may however be instituted against the estate of a deceased by a special petition to appoint the Director General of Insolvency to take over the administration of deceased's estate from the appointed administrator or executor.[40]

Acts of bankruptcy

37 Section 5(1) of the Bankruptcy Act 1967.

38 Section 2 of the Bankruptcy Act 1967 defines 'social guarantor' as 'a person who provides, not for the purpose of making profit, the following guarantees:
(a) a guarantee for a loan, scholarship or grant for educational or research purposes;
(b) a guarantee for a hire-purchase transaction of a vehicle for personal or non-business use; and
(c) a guarantee for a housing loan transaction solely for personal dwelling'.

39 Section 218 of the Companies Act 1965 .

40 Section 122 of the Bankruptcy Act 1967.

An act of bankruptcy refers to the occurrence of an event in connection with the conduct of a debtor or his financial status which entitles an adjudication order to be made against him.[41] The commission of an act of bankruptcy is sine quo non to the presentation of bankruptcy petition under the provision of the Bankruptcy Act 1967. There are ten acts of bankruptcy which may be used as grounds for creditor to present bankruptcy petition against a debtor.[42] However, the most common basis for commission of act of bankruptcy is on the non-compliance of bankruptcy notice. Where a bankruptcy notice has been served on a debtor, and the debtor fails to comply with the requirements of such notice by paying the demanded sum stated therein within seven days after service (in case the service is effected in Malaysia), the debtor is deemed to have committed an act of bankruptcy[43] which entitles his creditor to present petition to court to adjudicate the debtor as a bankrupt.

Leave to execute judgment after the expiry of a six year period

The Federal Court in the case of *AmBank (M) Bhd (formerly known as AmFinance Bhd) v Tan Tem Son and another appeal*[44] had once held that:

> Since a bankruptcy proceeding is an action upon a judgment within the meaning of s 6(3) of the Limitation Act, and limitation for bringing the action is 12 years, a judgment creditor is entitled to enforce a final judgment by instituting bankruptcy proceeding without the leave of the court within that period of 12 years.
>
> ... The phrase 'any person who is for the time being entitled to enforce a final judgment' in the proviso to s 3(1)(i) of the Bankruptcy Act does not require a judgment creditor to obtain leave pursuant to O 46 r 2(1)(a) of the RHC 1980 prior to initiating a bankruptcy proceeding based on a final judgment which had been obtained more than six years ago.

However, the said decision has been overruled by another panel of Federal Court in the recent landmark case of *Dr Shamsul Bahar bin Abdul Kadir v RHB Bank Bhd and another appeal*,[45] whereby it was held that a judgment creditor who commences bankruptcy proceedings after more than six years had lapsed from the date of judgment must obtain the prior leave of the court pursuant to

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41 Khoo Kay Ping, *Khoo's Law and Practice of Bankruptcy in Malaysia*, (2003 Lexis Nexis) at p 15.

42 Section 3(1) of the Bankruptcy Act 1967.

43 Section 3(1)(i) of the Bankruptcy Act 1967.

44 [2013] 3 MLJ 179; [2013] 3 CLJ 317.

45 [2015] 4 MLJ 1; [2015] 4 CLJ 561.

O 46 r 2 of the Rules of the High Court 1980. The reasoning of the Federal Court in *Dr Shamsul Bahar's* case is as follows:

> The meaning of the words 'execution thereon not having been stayed' should be construed in the context of s 3(1)(i) of the Bankruptcy Act 1967 and not from the perspective of s 6(3) of the Limitation Act 1953 . Section 6(3) should not be read to nullify O 46 r 2 of the Rules of the High Court 1980. Further, any person who is for the time being entitled to enforce a final judgment in the proviso to s 3(1)(i) must be a person who is entitled to enforce a final judgment without prior leave of court.

Based on the foregoing, it is now trite for judgment creditor to apply for leave from court prior to commencement of bankruptcy proceedings in the event that the judgment is more than six years. In addition, even if leave is granted, the law also restricts the judgment creditor from claiming post judgment interest after the six year period from the date of judgment.[46] Section 6(3) of the Limitation Act 1953 provides:

> An action upon any judgment shall not be brought after the expiration of twelve years from the date on which the judgment became enforceable and *no arrears of interest in respect of any judgment debt shall be recovered after the expiration of six years from the date on which the interest became due.* (Emphasis added.)

Receiving order and adjudication order

At the hearing of the creditor's petition, the court may record receiving order and adjudication order (commonly known as 'ROAO') if it is satisfied that the debtor has committed an act of bankruptcy and that the judgment creditor has proved the requirements stated in s 6(2) of the Bankruptcy Act 1967. The receiving order (RO) does not render the debtor a bankrupt and instead its effect is to appoint the Director General of Insolvency as receiver of the debtor's property and to restrict the rights of other creditors against the estate of the debtor.[47] The unsecured creditors are unable to commence legal action against the debtor after receiving order is made except with the leave of the court. At the time making a receiving order, the court shall also make adjudication order (AO) to adjudge the debtor bankrupt unless the debtor can show to the satisfaction of court that he is in position to offer composition or make a

46 *Captain Ho Fooi v Standard Chartered Bank Malaysia Bhd* [2009] 4 MLJ 511; [2009] 5 CLJ 501 (CA).

47 Section 8(1) of the Bankruptcy Act 1967.

scheme of arrangement satisfactory to his creditors.[48] When a debtor is adjudged a bankrupt, his property shall become divisible among his creditors and shall vest in the Director General of Insolvency.[49]

Disqualifications and disabilities of an undischarged bankrupt

Upon adjudication made by the court, a bankrupt shall be disqualified from:

(a) holding the office of a Member of Parliament;[50]

(b) being appointed as sessions court judge or magistrate;[51]

(c) holding certain positions in statutory bodies and registered societies;

(d) practicing in certain professions;

(e) carrying business under either alone, in partnership or by way of company;[52]

(f) becoming a director of any company;[53]

(g) working in a business of relatives;[54]

(h) maintaining legal action unless with sanction from Insolvency Department;[55]

(i) leaving Malaysia without prior permission from the Insolvency Department or the court;[56]

(j) receiving pension and gratuity; and

(k) enforcing his rights under certain legislations.

Notwithstanding the aforesaid disqualifications and disabilities, a bankrupt is still competent to negotiate any settlement of his debt with his creditor provided that any agreement that is reached pursuant to that negotiation is brought to the attention of the Director General of Insolvency for his approval, and such an agreement is perfectly valid.[57]

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48 Section 24(1) of the Bankruptcy Act 1967.
49 Section 24(4) of the Bankruptcy Act 1967.
50 Article 48(1)(b) of the Federal Constitution.
51 Section 36 of the Bankruptcy Act 1967.
52 Section 38(1)(c) of the Bankruptcy Act 1967.
53 *Ibid.*
54 Section 38(1)(e) of the Bankruptcy Act 1967.
55 Section 38(1)(a) of the Bankruptcy Act 1967.
56 Section 38(1)(c) of the Bankruptcy Act 1967.
57 *Re Hashbudin bin Hashim; Ex parte Citic Ka Wah Bank Ltd* [2009] 5 MLJ 135.

Discharge and annulment of bankruptcy orders

Pursuant to the amendment to the Bankruptcy Act in year 1998,[58] which came into effect on 1 January 1999, a bankrupt may apply for discharge either from court or the Director General of Insolvency. The application for discharge to the court can be made at any time after the bankrupt has been adjudged bankrupt[59] by filing Form 48 together with a certificate from the Director General of Insolvency specifying the number of creditors who have submitted proof of debts.

At the hearing of the application, the court shall consider the report prepared by the Director General of Insolvency and such report is regarded as prima facie evidence of statements stated therein.[60] However, in the case *Lim Hun Swee v Malaysia British Assurance Bhd (currently known as Allianz General Insurance Malaysia Bhd) & Ors (judgment creditors)*,[61] the Court of Appeal held that:

> In an application for discharge, the court shall take into consideration a report of the DGI as to the bankrupt's conduct and affair, including a report as to the bankrupt's conduct during the proceedings under his bankruptcy. This is a mandatory requirement. *However, the court is not bound to accept it if the court is satisfied that the report is incomplete and unreliable or made based on incomplete investigation into the conduct and affairs of the bankrupt.* Without a proper or complete report by the DGI, the court cannot decide on the issue of discharge. The purpose of the DGI report is to secure a full and complete investigation and disclosure of all the material facts or information relating to the bankruptcy particularly on issues stipulated under s 33(4) and (6) of the Act. (Emphasis added.)

Besides giving due considerations to statutory requirements and the accurate report of the Director General of Insolvency, the court may also exercise discretion to allow or reject the application for discharge by taking into account the following factors:

(a) age of the bankrupt;

(b) the conduct of the bankrupt;

(c) the extent of the debt settled; and

(d) public interest.

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58 Bankruptcy (Amendment) Act 1998 (Act A1035) — PU(B) 459/1998.
59 Section 33(1) of the Bankruptcy Act 1967.
60 Section 33(8) of the Bankruptcy Act 1967.
61 [2011] 2 MLJ 218; [2010] 8 CLJ 680.

In the case of *Re Ang Ah Kang*,[62] since the bankrupt was 60 years of age, the court held that it is against public policy to chain a person to bankruptcy for the rest of his life. Hence, in the said case, the court has conditionally allowed the bankrupt's application for discharge.

As an alternative, a bankrupt may also apply for discharge directly from the Director General of Insolvency provided that such application is made after five years from the date of the receiving order and adjudication order.[63] An order or certificate of discharge shall have the effect of releasing all the debts of the bankrupt except the debts mentioned in s 35(2) of the Bankruptcy Act 1967.

While the effect of discharge is to release the debtor from his debts after serving the bankruptcy period, the effect of annulment order is slightly different. The Federal Court in the case of *Sardar Mohd Roshan Khan v Perwira Affin Bank Bhd* stated that the effect of annulment order under s 105 of the Bankruptcy Act 1967 is as if the debtor was never adjudged a bankrupt. Tun Zaki Azmi CJ (as he then was) held:

> Section 105 of the Bankruptcy Act 1967 is to be strictly construed, not only based on the wording of that section but also how the section came into being. Once the bankruptcy is annulled, the effect of that annulment is as Sterling LJ had said in *Re Keet*: 'that is to say, wipe out the bankruptcy altogether, and put the bankrupt in the same position as if there had been no adjudication'. The effect of the annulment to the appellant was as if he was never a bankrupt.

Rights of a secured creditor

Under the conventional bankruptcy framework, there is different treatment as to the rights of a secured creditor and unsecured creditor. The secured creditor enjoys priority over the asset of the bankrupt which has been pledged or charged to him prior to the adjudication order. Section 8(2A) of the Bankruptcy Act 1967 expressly provides that a secured creditor is entitled to deal with his security notwithstanding the receiving order recorded by the court. The Federal Court in the case of *K Balasubramaniam, liquidator for Kosmopolitan Credit & Leasing Sdn Bhd (in liquidation) v MBF Finance Bhd & Anor*[64] also stated that the secured creditor has options in dealing with this security:

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62 [1994] 2 CLJ 738.

63 Section 32A(2) of the Bankruptcy Act 1967.

64 [2005] 2 MLJ 201 at p 212.

> 45 The combined effect of sub-ss 291(1) and (2) of the Act and s 42 of the Bankruptcy Act 1967, and Schedule C thereto is that there is no mandatory requirement for a secured creditor to come under the liquidation. He has the option of either relying entirely on his security for which he is not obliged to submit a proof of debt. If he however decides to come under the liquidation, he submits proof of his debt and will be entitled to a dividend in respect of the unsecured portion. If he does not submit proof of his debt, then pursuant to para 16 of Schedule C, he shall be excluded from participating in a dividend.

While a secured creditor is legally entitled to enforce and realise its security, the bankruptcy law has been amended whereby s 8(2A) of the Bankruptcy Act 1967 has been introduced to restrict the claim on interest by a secured creditor. Pursuant to this subsection, a secured creditor cannot claim interest after the date of the receiving order if he fails to realise its asset or security within six months from the date of receiving order.

The rationale behind introduction of s 8(2A) of the Bankruptcy Act 1967 is that the section predetermines the maximum interest that can be claimed by a secured creditor from whatever source.[65] This was to prevent the secured creditors from claiming unlimited interest on the debt either from the security or from the guarantors or sureties. In the case of *United Overseas Bank (M) Bhd v Mok Hue Huan & Anor*,[66] Mohamad Zawawi J considered s 8(2A) of the Bankruptcy Act 1967 as a 'statutory clamp' on secured creditors prohibiting them from claiming any further interest on the debt after the statutory period. This statutory clamp is meant to prevent injustice to the rights and entitlements of the unsecured creditors as was mentioned in the Hansard of Parliament dated 14 May 1992 and 2 June 1992 where the debate of the proposed amendments to the s 8(2A) of the Bankruptcy Act 1967 was reported in Malay language as follows:

> ... dibuat kepada seksyen 8 bagi memperuntukkan bahawa tiada apa-apa bunga boleh dibayar kepada pemiutang bercagar jika sekiranya pemiutang tersebut gagal menghasilkan cagarannya dalam tempoh 6 bulan dari tarikh perintah penerimaan dibuat. Rasionalnya ialah pada amalan biasa dan berdasarkan peruntukan yang sedia ada, didapati segolongan pemiutang bercagar mengambil masa yang terlalu lama untuk menghasilkan harta tersebut. Manakala, bunga

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65 *Wong Goe Chuan v Resolution Alliance Sdn Bhd* [2012] 10 MLJ 84; [2013] 1 CLJ 596 (per Hasnah Hashim J).

66 [2010] 7 MLJ 293; [2010] 9 CLJ 764.

> yang perlu dibayar oleh penghutang berterusan sehinggalah jualan dilaksanakan. Perbuatan sedemikian adalah tidak adil kepada pemiutang yang tidak bercagar dan juga kepada penghutang.[67]

Nonetheless, s 8(2A) of the Bankruptcy Act 1967 which came into force on 17 July 1992 shall have no retrospective effect.[68] The Court of Appeal in the case of *RHB Bank Bhd v Ya'akob bin Mohd Khalib @ Abdul Ghani bin Muhammad*[69] held that:

> Subsection (2A) which was introduced by the Bankruptcy (Amendment) Act (Act A827) and which came into force on 17 July 1992 could not, therefore, take away the plaintiff's accrued right under s 8(2) as the amending Act did not clearly and specifically provide that that sub-s (2A) would have a retrospective effect. It was therefore not intended to have a retrospective effect. To read otherwise it would produce an unjust result as that subsection (2A) deals with a substantive right.

THE CONCEPT OF BANKRUPTCY FROM SHARIAH PERSPECTIVE

In this research, it is discovered that there are several literatures which discuss the bankruptcy concept from the Shariah perspective. According to Asyraf Wajdi et al (2012), there are two concepts closely similar to the conventional bankruptcy which are recognised by the Shariah namely '*al-Hajr*' and '*Taflis*'.[70]

Concepts of *Al-Hajr* and *Taflis*

Al-Hajr (limitation of a person's legal competence) stands as an interdiction to prevent an individual from dealing with his or her property while '*Taflis*' (adjudication order) is a declaration from the judge or court that an individual is a *muflis* (bankrupt).[71] The Maliki school of law categorised the concept of *al-Hajr* to be applicable to four types of people, inter alia, young children, the

67 Hansard of Parliament dated 14 May 1992 and 2 June 1992 as referred to in *United Overseas Bank (M) Bhd v Mok Hue Huan & Anor* [2010] 7 MLJ 293; [2010] 9 CLJ 764.

68 Bankruptcy (Amendment) Act (Act A827).

69 [2008] 1 MLJ 157.

70 Asyraf Wajdi Dusuki et al, *Insolvency Law in Malaysia and the Adjudication Order (Taflis) on a Bankrupt in Islamic Finance: Similarities and Differences*, (2012) ISRA International Journal of Islamic Finance, Vol 4, Issue 2 at pp 145–148.

71 Dr Hakimah Yaacob, *Al-Hajr (Interdiction) and Taflis Bankruptcy from Shariah Perspective*, [2014] 1 LNS(A) lvi, Current Law Journal.

mentally incompetent, the insane and the bankrupt.[72] Those of the Shafie and Hanbali schools of law defined interdiction as prevention of engaging in financial transaction dealings.[73] The one figure who opposed to interdicting debtors was Imam Abu Hanifa, the founder of the Hanafi School, as he opined that interdicting sane adults on the grounds of asset mismanagement would essentially constitute a violation of human rights.[74] However, Abu Hanifah's two disciples namely Abu Yusuf and Muhammad shares the view of Maliki, Shafie and Hanbali's school and they opined that two conditions must be satisfied in order to interdict a debtor ie:

(a) the debtor's debt must be equal or exceed the value of the debtor's assets; and

(b) the creditors must request for the interdiction.[75]

At to the procedure for bankruptcy under the Shariah law, Jason J Kilborn (2011)[76] observed as follows:

> Islamic law has no procedure of 'bankruptcy' per se. Rather, bankruptcy in Islamic law is a concept (called generically *falas*), reflected in several different but closely related Arabic words commonly encountered in *fiqh* discussions. Bankruptcy might describe either the condition (called *iflas*) of a distressed debtor (called a *muflis*), or the official act (called *taflis*) of declaring the debtor to be in one of two distressed conditions. The condition called 'bankruptcy' might describe either simple balance-sheet insolvency (ie, that the debtor's debts equal or exceed his assets), or that the debtor has almost no property at all, just a few fils (the smallest denomination of currency) ...

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72 Al-Ansari, Z (nd) Asna al-Matalib. Cairo: Dar al-Kitabi al-Islami as referred to in Asyraf Wajdi Dusuki et al, *Insolvency Law in Malaysia and the Adjudication Order (Taflis) on a Bankrupt in Islamic Finance: Similarities and Differences*, (2012) ISRA International Journal of Islamic Finance, Vol 4, Issue 2 at pp 145–148.

73 Asyraf Wajdi Dusuki et al, *Insolvency Law in Malaysia and the Adjudication Order (Taflis) on a Bankrupt in Islamic Finance: Similarities and Differences*, (2012) ISRA International Journal of Islamic Finance, Vol 4, Issue 2 at pp 145–148.

74 Jason J Kilborn, *Foundations of Forgiveness in Islamic Bankruptcy Law: Sources, Methodology, Diversity*, 2011, Retrieved from Social Science Research Network (SSRN) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1908896.

75 Dr Hakimah Yaacob, *Al-Hajr (Interdiction) and Taflis Bankruptcy from Shariah Perspective*, [2014] 1 LNS(A) lvi, Current Law Journal.

76 Jason J Kilborn, *Foundations of Forgiveness in Islamic Bankruptcy Law: Sources, Methodology, Diversity*, 2011, Retrieved from Social Science Research Network (SSRN) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1908896.

Further, Umar A Oseni (2014)[77] viewed that though there are different of opinions among the Muslim jurists on some of the issues pertaining to Islamic bankruptcy, the general Shariah principles on bankruptcy can be summarised as follows:

(1) A debtor may be deemed bankrupt if he has no wealth or he has wealth but it will not cover the debt that is currently due. With regard to debts that are not yet due, the one who owes them cannot be deemed bankrupt.

(2) The bankrupt individual may have his assets frozen if his creditors or some of them request that, so that he will not harm them by that.

(3) If his assets are frozen, then any transaction he does, whether buying or selling, establishing a *waqf* or giving a gift, is not valid.

(4) The ruler or *qadi* (judge) may sell his property in order to pay off his debts and leave him nothing except what is necessary for him, such as his dwelling, his books, his clothing, the tools of his trade, and the capital of his business; he may sell everything apart from that (*Al-Munajjid*, 2013).

Discharge of debts under Islamic law

In Islam, non-payment of debt is not only viewed as mere breach of legal or contractual obligation but also regarded as a sin. In the Holy Quran, Allah SWT has commanded the believers to fulfil their obligations, which include the settlement of debts:

> O you who have believed, fulfill (all your) covenants[78]

In a *hadith* narrated by Abu Hurairah, a man demanded his debts from Prophet Muhammad pbuh in such a rude manner that the companions of the Prophet intended to harm him, but the Prophet said, 'Leave him, no doubt, for he (the creditor) has the right to demand it (harshly). Buy a camel and give it to him'. They said, 'The camel that is available is older than the camel he demands'. Then, the Prophet said, 'Buy it and give it to him, for the best among you are those who repay their debts handsomely'.[79]

77 Dr Umar A Oseni, *Insolvency And Debt Restructuring In Islamic Finance: The Need For A Comprehensive Model Law*, [2014] 1 SHR lxxxv.

78 Surah al-Maidah, Chapter 5, verse 1, *The Holy Quran*, English translation by Abdullah Yusuf Ali, Kuala Lumpur, Saba Islamic Media.

79 Bukhari 41:575. Similar stories are recounted in Bukhari 41:577, 578, 586; 47:777 and Muslim 10:3896-3900.

Even though Islamic law gives great emphasis on the debtor's obligation to repay his debt, there is also verse in the Holy Quran which encourages the creditor to discharge the debt as a matter of charity especially to the debtor who suffers hardship. Allah SWT said:

> If the debtor is in a difficulty, grant him time till it is easy for him to repay. But if ye remit it by way of charity, that is the best for you if ye only knew[80]

In addition, there are several reported hadiths which seem to suggest that creditors might be compelled to forgive and discharge at least part of their debts,[81] inter alia, as follows:

> Abu Sa'id al-Khudri (Allah be pleased with him) reported that in the time of Allah's Messenger (may peace be upon him) a man suffered loss in fruits he had bought and his debt increased; so Allah's Messenger (may peace be upon him) told (the people) to give him charity and they gave him charity, but that was not enough to pay the debt in full, whereupon Allah's Messenger (may peace be upon him) said to his creditors: 'Take what you find, you will have nothing but alms'. (Sahih Muslim)[82]

> 'Ka'b bin Malik reported that he made a demand for the payment of the debt that Ibn Abu Hadrad owed to him. This hadith is narrated through another chain of transmitters and (the words are):' He had to get the loan from Abdullah b Hadrad al-Aslami. He met him and pressed him for payment. There was an altercation between them, until their voices became loud. There happened to pass by them Allah's Messenger (may peace be upon him) and he said: O Ka'b, and pointed out with his hand in such a way as he meant half. So he got half of what he (Ibn Abu Hadrad) owed to him and remitted the half. (Sahih Muslim)[83]

The above Quranic verses and hadiths demonstrate the existence of concept of discharge of debts in Islamic law particularly when a debtor is insolvent and in great financial difficulty. This is quite similar to the discharge of debt under the conventional bankruptcy framework.

ISSUES AND CHALLENGES IN THE ENFORCEMENT OF ISLAMIC FINANCE JUDGMENT WITHIN THE MALAYSIAN BANRKUPTCY FRAMEWORK

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80 *Surah al-Baqarah*, Chapter 2: verse 280, The Holy Quran, English translation by Abdullah Yusuf Ali, Kuala Lumpur, Saba Islamic Media.

81 Jason J Kilborn, *Foundations of Forgiveness in Islamic Bankruptcy Law: Sources, Methodology, Diversity*, 2011, Retrieved from Social Science Research Network (SSRN) at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1908896 .)

82 Sahih Muslim 10:3777.

83 Sahih Muslim 10:3780-3781.

In this research, it is observed that the existing bankruptcy procedural framework does not cater for Islamic finance and fails to offer better protection to the consumer, debtor and guarantor under Islamic finance transaction.

No recognition of 'social guarantor' for Islamic finance transaction

In the recent case of *Re Khairulnizam bin Jamaludin; ex-parte Hong Leong Bank Bhd*,[84] the Court of Appeal has explained the rationale of protection of social guarantor under s 5(3) of the Bankruptcy Act 1967 as follows:

> s 5(3) clearly states that a '... petitioning creditor shall not be entitled to commence any bankruptcy action against a social guarantor unless he proves to the satisfaction of the court he has exhausted all avenues to recover debts owed to him by the debtor' ... *the object is to protect social guarantors from unnecessary bankruptcy petitions by requiring the creditor to exhaust all other available avenues to recover the debts before becoming entitled to commence a bankruptcy action.* A social guarantor remains exposed to the very exposure s 5(3) seeks to remedy if the creditor can serve a bankruptcy petition and put the social guarantor into having to incur legal costs, without first proving to the satisfaction of the court he had exhausted all other avenues. In plain language, bankruptcy action against social guarantors is intended to be confined to being the avenue of last resort. (Emphasis added.)

However, this research observes that such protection to social guarantor applies to guarantors under the conventional lending transaction and does not apply to guarantor under Islamic financing. This is due to the fact that the phrase 'social guarantor' has been statutorily defined as:

> a person who provides, not for the purpose of making profit, the following guarantees:
>
> (a) a guarantee for a *loan*, scholarship or grant for educational or research purposes;
>
> (b) a guarantee for a hire-purchase transaction of a vehicle for personal or non-business use; and
>
> (c) a guarantee for a *housing loan transaction* solely for personal dwelling.
>
> (Emphasis added.)

The use of the word 'loan' clearly indicates that such protection may only covers the conventional lending transaction as the only loan in Islamic financing is under the concept of *Qard al-Hasan*, which is hardly used in the

84 [2015] 1 MLJ 745 at para [6].

Islamic financial market. The definition in s 5(3) of the Bankruptcy Act 1967 seems not applicable to guarantors who provide guarantee to secure Islamic financing either under the sale-based financing, lease-based financing and partnership-based financing. Hence, it is the duty of the Legislature to make necessary amendments to the definition of 'social guarantor' so that equal protection is given to social guarantors in Islamic financing facilities.

In the case of *Per: Zamri Naim bin Ismail v Ex-Parte: Bank Muamalat Malaysia Bhd*,[85] it is observed that the judgment debtor to an Islamic financing facility has raised the issue that the respondent bank should have taken execution action against the first, second and third defendants who are the principal debtor and directors of the principal debtor before resorting to him, who he believed to be a social guarantor. However, the court in this case has not dealt with the issue of the applicability of the statutory protection to social guarantor under Islamic financing. This may be due to the fact that the respondent bank has convinced the court that the second and third defendants were already made a bankrupt on 16 January 2008. Nevertheless, this research maintains the view that the issue pertaining to applicability of statutory protection on social guarantor under Islamic financing facilities is still unclear and requires legislative intervention.

Statutory requirement to state interest in the bankruptcy notice

Section 3(1)(i) of the Bankruptcy Act 1967 is the commonly invoked provision to prove an act of bankruptcy when a debtor fails to satisfy the demand made in a bankruptcy notice. This subsection provides:

> A debtor commits an Act of bankruptcy in each of the following cases:
>
> ...
>
> (i) if a creditor has obtained a final judgment or final order against him for any amount and execution thereon not having been stayed has served on him in Malaysia, or by leave of the court elsewhere, *a bankruptcy notice under this Act requiring him to pay the judgment debt or sum ordered to be paid in accordance with the terms of the judgment or order with interest quantified up to the date of issue of the bankruptcy notice*, or to secure or compound for it to the satisfaction of the creditor or the court; and he does not within seven days after service of the notice in case the service is effected in Malaysia, and in case the service is effected elsewhere then within the time limited in that behalf by the order giving leave to effect the service, either comply with the requirements of the notice or satisfy the

85 [2015] 10 MLJ 193.

> court that he has a counter-claim, set off or cross demand which equals or exceeds the amount of the judgment debt or sum ordered to be paid and which he could not set up in the action in which the judgment was obtained or in the proceedings in which the order was obtained: (Emphasis added.)

From the relevant reported case laws, it is observed that this provision created some controversies and uncertainties as to the computation of the outstanding amount in a bankruptcy notice arising from Islamic finance judgment. In the case of *Ong Lian Oeu v Kuwait Finance House (Malaysia) Bhd*,[86] the judgment creditor had obtained a judgment in default of appearance against the judgment debtor for amounts outstanding under the Islamic banking facilities. Based on the judgment, the judgment creditor then filed a bankruptcy notice against the judgment debtor on 11 June 2012. The judgment debtor applied to set aside the bankruptcy on the ground, inter alia, that the amount claimed in the bankruptcy notice was only quantified up to 30 April 2012 and not up to the date of issue of the bankruptcy notice ie on 11 June 2012, which was contrary to s 3(1)(i) of the Bankruptcy Act 1967. In resolving this issue, the High Court has held:

> [7] Having seen the terms of the judgment above, I am of the view that the judgment was granted in relation to the Islamic banking facilities. Thus the judgment does not accord any right to the judgment creditor to claim for interest. In view of this, the judgment creditor is only entitled to claim for 'gantirugi bayaran lewat' (late payment compensation), and not interest. As such, contrary to the assertion of the judgment debtor, the judgment creditor is not claiming for interest.
>
> [8] In my considered view the phrase '*with interest quantified up to the date of issue of bankruptcy notice' under s 3(1)(i) of the Bankruptcy Act 1967 ('the Act') does not apply to the present case on the ground that the judgment creditor is not claiming for interest.* In other words, the judgment creditor is not obliged to quantify the 'gantirugi bayaran lewat' (late payment compensation) up to the date of issue of the bankruptcy notice as the said provision is only applicable in respect of interest and not 'gantirugi bayaran lewat' and *there is nothing in language of s 3(1)(i) to suggest that the said provision is wide enough to encapsulate the late payment compensation ...*
>
> [9] Therefore, to my mind, the word 'interest' in the phrase 'with interest quantified up to the date of issue of the bankruptcy notice' under s. 3(1)(i) of the Act ought to be given a strict construction. As such, the word 'interest' ought not to be interpreted to include late payment compensation vis-a-vis the Islamic Banking facilities.

86 [2013] 10 CLJ 526.

...

> [13] I am in full agreement with the submission of the judgment creditor's counsel that in view of foregoing and to avoid any ambiguity on the amount that the judgment debtor has to pay, for the purpose of the bankruptcy notice, the *judgment creditor is deemed to have waived its claim for late payment compensation calculated at the judgment creditor's R-Rate from 1 May 2012 to 11 June 2012.* (Emphasis added.)

The foregoing decision indicates the inadequacies of the bankruptcy framework which does not provide statutory mechanism for calculation of outstanding amount and late payment charges for bankruptcy action pursuant to Islamic finance judgment. Hence, the court has to come out with the aforesaid decision whereby the Islamic bank is deemed to have waived its claim for late payment charges from 1 May 2012 to 11 June 2012. By holding that the claim is waived, the issue lead to another practical issue ie whether the Islamic bank/creditor is estopped from claiming late compensation charge until the date of receiving order at the stage of filing proof of debt.

The similar issue was also raised in the case of *Tan Thean Chooi v Kuwait Finance House (Malaysia) Bhd & Another*[87] whereby Mohd Amin Firdaus JC held that:

> The Bankruptcy Act 1967 does not contain any provision whatsoever in relation to Islamic banking, especially a judgment sum based on Murabahah Tawarruq facility. *Thus, there was a lacuna in the Act. It is for the Legislature to look into the lacuna and not this court.* In consequence of this lacuna, 'interest' in s 3(1)(i) of the Act ought not to be interpreted to include late payment compensation in relation to Islamic banking facilities. In the circumstances, the *JC was not obliged to quantify the late payment compensation up to the date of issue of the bankruptcy notice.* Therefore, the bankruptcy sums which were only quantified up to 30 April 2012 and not up to the date of issue of the bankruptcy notice on 8 June 2012 was valid.

The aforesaid cases clearly demonstrate the existence of lacuna in the provision of the Bankruptcy Act 1967 considering the fact that there is no mechanism provided for computation of outstanding amount and late payment charges in bankruptcy notice arising from Islamic finance judgment.

Absence of statutory period to restrict the claim for late payment charge (*Ta'widh* and *Gharamah*)

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87 [2013] 7 CLJ 404.

Under the conventional bankruptcy framework as discussed earlier, it can be seen that there are several provisions which restrict the rights of creditors in claiming interest when there is delay on the part of the creditor. For instance, s 6(3) of the Limitation Act 1953 restricts the imposition of post judgment interest after six years from the date of judgment. Section 8(2A) of the Bankruptcy Act 1967 also provides restriction on the right of secured creditor to claim interest after expiry of six months period from the date of receiving order should the creditor fails to realise its security. These provisions are meant to give protection to the bankrupt from being burdened with accumulated interest and to balance with the rights of the unsecured creditors.

However, for Islamic banking and finance cases, it is observed that there is no statutory period under the bankruptcy framework restricting the rights of the Islamic finance institutions in claiming late payment charges. With the introduction of O 42 r 12A to the Rules of Court 2012,[88] all judgment creditors in Islamic financing transaction are entitled to claim for late payment charge (either in a form of *ta'widh, gharamah* or combination of both).

The SAC of Bank Negara Malaysia in its 95th meeting held on 28 January 2010 had decided that *ta'widh* (compensation) may be imposed on late payment of financial obligation arising from exchange contracts (such as buy and sell and hire purchase) and *qard* (loan). Nevertheless, *ta'widh* may only be imposed upon the lapse of the repayment period agreed by both contracting

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88 1. Every judgment debt arising from financial transactions in accordance with Shariah shall carry a late payment charge calculated from the date of judgment until the judgment debt is fully satisfied at the rate provided under Order 42, rule 12 and subject to the following conditions:
(a) the judgment creditor shall only be entitled to ta'widh as a result of late payment;
(b) the amount of late payment charge shall not exceed the outstanding principal amount; and
(c) if the amount of ta'widh is less than the amount of late payment charge, the balance shall be channelled to any charitable organizations as determined by the Shariah Advisory Council.
2. For the purpose of this rule —
(a) 'Shariah Advisory Council' means the Shariah Advisory Council established under the Central Bank of Malaysia Act 2009 [Act 701] and the Capital Markets and Services Act 2007 [Act 671]; and
(b) 'ta'widh' means compensation for actual loss and shall be calculated at the rate determined by the Shariah Advisory Council.

parties.[89] In addition, the SAC in its 101st meeting held on 20 May 2010 had arrived at the following decisions on the difference between *ta'widh* and *gharamah*:[90]

> As a deterrent mechanism against cases of default by customers in discharging their financial obligation arising from Islamic contracts, the imposition of late payment charge by Islamic banking institutions that comprises both concepts of *gharamah* (fine or penalty) and *ta'widh* (compensation) is allowable. Gharamah is not allowed to be recognised as income, and it must be channelled to specified charitable bodies. However, Islamic banking institutions may recognise *ta'widh* as income on the basis that it is imposed on the customers as compensation for the actual loss incurred by the Islamic banking institutions.

Further, the SAC, at the 13th Special Meeting on 25 July 2011 and the 115th Meeting on 25 August 2011 had decided that late payment charge on judgment debt could be implemented, inter alia, as follows:[91]

> Late payment charge on judgment debt may be awarded by the court from the date of judgment until the date the judgment is fully satisfied as provided by the Rules of Court. The SAC decides that the rate shall be determined by applying the principles of *ta'widh* and *gharamah*.
>
> *Ta'widh* refers to compensation on actual loss ...
>
> *Gharamah* refers to the penalty imposed as a deterrent measure for the delay in payment by the debtor. In this context, *gharamah* refers to the difference between late payment charge and *ta'widh*, that is the difference if the *ta'widh* is less than the late payment charge. Late payment charge is determined by Rules of Court.
>
> Late payment charge on judgment debt shall not be compounded.
>
> ...
>
> The total amount of late payment charge shall not exceed the outstanding principal amount.

The above Shariah rulings have been subsequently incorporated into the Bank Negara's *Guidelines on Late Payment Charges for Islamic Banking Institutions*[92] which came into force on 1 January 2012. Upon perusing the above Shariah

89 Bank Negara website at http://www.bnm.gov.my/?ch=en_press&pg=en_press_all&ac=2078&lang=en.

90 *Ibid.*

91 Tun Abdul Hamid Mohamad, *Late Payment Charge On Judgment Debts Arising From Financial Transactions In Accordance With Shariah* (O 42 r 12A of the Rules of Court 2012), [2015] 4 CLJ ix.

92 BNM/RH/GL 008-14.

rulings and the Bank Negara's Guidelines, this research identifies that there is no provision to restrict the claim on late payment charge after judgment has been recorded by the court. Paragraph 6.4 of the Bank Negara's Guidelines[93] merely provides monetary limit to the claim of late payment charges but does not prescribe any limitation period. The said para 6.4 reads as follows:

> The accumulated combined late payment *charges shall not exceed 100 percent of the outstanding principal amount.* For example, if the outstanding principal is RM50,000 the total cumulative combined late payment charges amount must not be more than RM50,000. (Emphasis added.)

The above Bank Negara's Guidelines seems to suggest that judgment creditor under Islamic financing may claim for late payment charge for an infinite period provided that the accumulated late payment charge cannot exceed the judgment sum. For instance, if the judgment sum amounts to RM1m, it means that the accumulated late payment charge may go up even to RM999,999.99 as long as it does not exceed RM1m.

This research views that this situation may bring additional burden to the judgment debtor or bankrupt particularly when the delay is caused by the judgment creditor. It may not be just and equitable for judgment debtor to bear late payment charges when the judgment creditors themselves fail to expedite the execution proceedings. This research proposes that a suitable statutory limitation period should be fixed within the legal framework to bar the judgment creditor from claiming excessive late payment charge. This proposal may be in line with the Quranic verse[94] and several hadiths[95] which compel creditors to discharge part of the debts due to them.

Applicability of restriction under s 8(2A) of the Bankruptcy Act 1967 to Islamic finance cases

Besides the absence of statutory limitation period on the claim for late payment charge on the judgment sum, this research also discovers that the statutory clamp under s 8(2A) of the Bankruptcy Act 1967 does not apply to secured creditors under Islamic financing transaction. Under the conventional bankruptcy framework, the secured creditors are not entitled to claim further interest if they fail to realise or foreclose the secured assets within six months

93 *Ibid.*

94 *Surah al-Baqarah, Chapter 2: verse 280, The Holy Quran,* English translation by Abdullah Yusuf Ali, Kuala Lumpur, Saba Islamic Media.

95 Sahih Muslim 10:3777 and 3780–3781.

from date of receiving order. By having this provision, it will prompt the secured creditor to expedite the foreclosure action since their monetary claim has been capped by law.

However, in Islamic finance transaction, it appears that after the receiving order is recorded by the court, the Islamic secured creditors are entitled to claim the late payment charge and seek recovery of the full unearned profit in a sale-based transaction. There is no statutory provision to compel the bank to expedite the foreclosure proceedings. In the event the foreclosure proceedings are delayed, the sale proceeds from the auction may not be able to settle the outstanding debt and there is possibility that no surplus is available to be distributed to the unsecured creditors. This position will not only deprive the interest of the unsecured creditors but also prolong the suffering faced by the debtor or bankrupt.

In the case of *MK Associates Sdn Bhd v Bank Islam Malaysia Bhd*,[96] it was argued by the plaintiff that the defendant bank should not be allowed to impose any late payment charges whether the same is described as interest or *Ta'widh* beyond the date the plaintiff was ordered to be wound-up. The plaintiff further contended that the imposition of *Ta'widh* for the period between January 2000 until June 2012 contravened s 8(2A) of the Bankruptcy Act 1967.[97] Nevertheless, the defendant argued that the said provision was not applicable as it only applied to a claim for interest and not a claim for *Ta'widh* and hence the defendant had the right to charge *Ta'widh* as it formed part of the 'costs' defined under the term 'indebtedness' in the property sale agreement executed by the plaintiff and the defendant. After hearing the submission of both parties, the learned judge has allowed the declaration that the defendant bank is not entitled to claim *Ta'widh* on the basis that at the time the agreements were entered into in year 1994, *Ta'widh* was not practised by the Islamic financial institutions. *Ta'widh* was only introduced after the SAC's Resolution in year 1998. As such, the said resolution should take effect only on 1 January 1999 to existing and new agreements and shall have no retrospective effects. The learned judge has not given any specific ruling on the issue raised by parties pertaining to applicability of limitation under s 8(2A) of the Bankruptcy Act 1967 since the judge has ruled that the defendant bank has no contractual right to claim the same.

96 [2015] 6 CLJ 97.

97 In the aforesaid reported case, the provision was incorrectly cited as s 8(2) of the Bankruptcy Act 1967.

The lack of procedural mechanism to deal with Shariah issues in bankruptcy proceedings

Another important aspect which will be discussed in this research is on the absence of procedural mechanism to deal with Shariah issues in bankruptcy proceedings. As highlighted earlier, a bankruptcy court has no power to go beyond the judgment to enquire the validity of the judgment debt.[98] In the event that there are some uncertainties as to the terms of the Islamic finance judgment as granted by the civil court, it is discovered that there is no provision under the Bankruptcy Act 1967 and Bankruptcy Rules 1969 which can be invoked to enable the bankruptcy court or Director General of Insolvency to refer the Shariah issues to the SAC. In the event the bankruptcy court makes reference to the SAC under the provisions of the Central Bank of Malaysia Act 2009, is such reference amount to 'going beyond the judgment' as ruled by the Supreme Court in *Sovereign General Insurance Sdn Bhd v Koh Tian Bee*?[99]

On the other hand, s 85(3) and 85(4) of the Bankruptcy Act 1967 provides the discretionary power to the Director General of Insolvency as follows:

> (3) The Director General of Insolvency may apply to the court as prescribed for directions in relation to any particular matter arising under the bankruptcy.
>
> (4) Subject to this Act, the Director General of Insolvency *shall use his own discretion in the administration of the property of the bankrupt.*
>
> (Emphasis added.)

The above provisions seem to suggest that the Director General of Insolvency shall use his own discretion to administer the property of a bankrupt and in some situations, he may refer to court for directions. However, it must be noted that the court is not the authority to give any ruling on Shariah issues. Hence, this research proposes that amendment should be made to s 85 of the Bankruptcy Act 1967 to allow the Director General of Insolvency to directly seek ruling from the SAC on any Shariah issues arising under the bankruptcy.

In addition, it is also observed that at present, there is no special filing code for Islamic bankruptcy proceedings. Both the Islamic and conventional bankruptcy actions are given the similar filing code ie Code 29. Based on the practice direction[100] issued in 2013, special filing codes for Islamic financing

98 *Sovereign General Insurance Sdn Bhd v Koh Tian Bee* [1988] 1 MLJ 304 (SC).

99 *Ibid.*

100 Practice Direction No 4 of 2013 and supplemented by Practice Direction Nos 6 & 7 of 2013.

are only assigned to civil proceedings commenced by writ (Code 22M) and originating summons proceedings (Code 24M). Perhaps, the judiciary may consider issuing supplementary practice direction to cater for bankruptcy proceedings and winding up proceedings arising from Islamic finance judgment.

CONCLUSION

The foregoing discussion in this paper reveals that there are some lacuna and practical legal issues in the existing bankruptcy framework which cannot be resolved in litigation proceedings at court. The court even admitted the existence of the lacuna and held that it is for the Legislature to look into it.[101] Hence, legislative intervention is needed to make necessary amendments to the provisions in the Limitation Act 1953, Bankruptcy Act 1967 and Bankruptcy Rules 1969 to suit the need for enforcement of Islamic finance judgment. It is also hoped that the Law Harmonisation Committee established by Bank Negara Malaysia may review the relevant legislations pertaining to bankruptcy laws with the view to strengthen the Malaysian legal framework for Islamic finance and to position Malaysian law as choice of law.

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101 *Tan Thean Chooi v Kuwait Finance House (Malaysia) Bhd & Another Case* [2013] 7 CLJ 404.