Options for Corporate Restructuring in Pakistan

By ALTAF QURESHI

PAKISTAN'S CORPORATE INSOLVENCY FRAMEWORK has its conceptual roots in English law and is governed by the Companies Ordinance, 1984 (the "**Ordinance**"). The primary objective of the relevant legal provisions is to protect the interest of creditors, balanced against shareholders, through a transparent winding up process.

Investors, sponsors and similar interested third parties are primarily concerned with understanding a Pakistani court's approach to winding up a company, for fear that this process may be outside of their control or does not offer commercial opportunities relating to distressed enterprises. The following article summarizes the main options available for corporate restructuring in Pakistan.

Winding Up

Under section 297 of the Ordinance, a company incorporated in Pakistan may be wound up either by a court, voluntarily through a petition, or by a combination of the two, in each case through a process supervised by the High Court, which is appealable to the Supreme Court in Pakistan.

There are five High Courts in Pakistan, one for each of the four provinces and an additional one for the federal capital Islamabad.

The grounds on which a company in Pakistan may be wound up include, among others, the company being unable to pay its debts (which may include contingent and prospective liabilities). The purpose of winding up proceedings is essentially for the court to determine the solvency of a Pakistani company in the face of all its creditors as a class. Therefore, the ground of "inability to pay debts" is based on the lack of available company assets to do so, rather than a mere unwillingness to pay.[1]

While the Ordinance lays out the procedure and grounds for a corporate insolvency, general principles of insolvency, obtained from bankruptcy laws for individuals in Pakistan, are deemed to apply to corporate entities pursuant to section 404 of the Ordinance. The Ordinance also provides procedures for winding up a foreign company that "goes into liquidation in the country of its incorporation" and that has an established place of business in Pakistan.

The court's powers for adjudicating the merits of a winding up petition are outlined in section 314 of the Ordinance. Such powers are broad enough to enable the dismissal of frivolous petitions and to regulate the conduct and affairs of the company, with the purpose of preventing prejudice against certain shareholders and creditors of the company. Different shareholders and creditors may be categorized into different classes if sufficient justification exists to connect them (e.g. a class of preferential shareholders). A winding up petition may therefore be denied by the court on the grounds that it is prejudicial to a particular class of shareholders or creditors.

The court also has the ability to provide alternative relief when it is justified and a genuine insolvency situation does not exist. For example, when the underlying motive for filing a winding up petition is not insolvency-related but rather

related to a creditor wanting to take an unfair advantage over other creditors (when the company itself is not insolvent) or to apply pressure on the company to pay a debt that is genuinely contested, the court would seek to recognise those underlying motives and deny the winding up petition using its powers under section 314 of the Ordinance.[2]

As in English law, in the interim period before a winding up order is passed, a provisional manager may be appointed for the company. In cases where a winding up order is entered, an official liquidator is appointed in order to conclude the winding up and dissolution of a company. The liquidator, through the powers granted by section 333 of the Ordinance, aims to achieve the maximum recovery and realization of value from the assets of the company for the petitioners, the creditors whose debts have been recognized by the official liquidator and the registered shareholders.

Reorganisation

Pakistani insolvency law also affords opportunities for corporate reorganization. In terms of the legal approach, a distinction is made between companies, where restructuring is approved by the courts versus banks or non-banking financial institutions, where the Securities and Exchange Commission of Pakistan and the State Bank of Pakistan, respectively, must approve any restructuring proposal.

In the case of a company restructuring, a proposed "scheme of arrangement," in accordance with section 284 of the Ordinance, is filed with the court either in the context of a winding up proceeding or outside of a winding up proceeding (for example, in the case of a merger or acquisition where both companies are going concerns).

If a scheme of arrangement is to be filed during a winding up proceeding, an application would first be submitted for an interim injunction under section 319 of the Ordinance, which injunction the court may grant upon "proof to the satisfaction...that all proceedings in relation to the winding up ought to be stayed."

Following the grant of the interim injunction, the court must be presented with a "compromise or arrangement" among the company, its creditors, shareholders and the official liquidator (if any). Upon receipt of the scheme of arrangement, the court will consider if the scheme is *bona fide* and workable, although a court would not generally refuse to sanction a scheme that is unanimously agreed to among the relevant parties. The court leaves the merits of the scheme to be decided by a meeting, which it orders to be convened, among the creditors and the shareholders to consider the proposed scheme of arrangement.

The court retains discretion to sanction the scheme (following the decision of the meeting) to ensure that the procedure was accurately followed and that the meeting was convened in a *bona fide* manner that is fair and reasonable to all interests.

Both draft bills sought to introduce a Chapter-11 style regime in Pakistan but also took inspiration from Mexico's insolvency law to better account for the context of a developing country.

During a meeting of the creditors and shareholders, a scheme of arrangement must be approved by a majority in number "representing three-fourths in value of the creditors or class of creditors or members, as the case may be, present and voting either in person or, where proxies are allowed, by proxy...". In practice, this means that the voting pool for the scheme will entirely consist of those creditors or shareholders (or their proxies) who are *present* and *vote* at the meeting. Each shareholder would ultimately receive one vote per share while a creditor would receive votes corresponding with the value of their debt. The majority vote for the scheme is achieved once 75% of the value of the creditors and votes of shareholders, who are present at the meeting, have voted in favour of the scheme.

In the case of *Dewan Salman Fibre Limited vs. Dhan Fibres Limited* (PLD 2001 Lahore), the court recognised, in the context of a voluntary winding up, that the informed view of the majority to a compromise falls within the realm of "corporate and commercial wisdom" which the court does not have the necessary expertise but would act as an umpire. Similarly in *Nova Leathers (Private) Limited vs The Registrar, Joint Stock Companies* (PLD 2001 Karachi), where a scheme of arrangement had proposed a merger, the court recognised that the objective of the merger was to achieve economies of scale and to carry on the business in a more economically efficient manner.

Restructuring Loan Agreements

The corporate insolvency framework described above should be distinguished from the framework for restructuring loan agreements, including loan agreements entered into pursuant to Loan Market Association documentation, which are recognised in Pakistan. Loan agreements in Pakistan are governed by principles of contract law, which provides parties with the freedom to contract (within statutory boundaries, if any) and choose their proposed restructuring arrangements for the relevant debt obligation. In this regard, Pakistan's approach

to restructuring facility agreements and bond issuances is similar to the practice under English law; however, Pakistani law additionally permits the restructuring of contractual debt obligations through a scheme of arrangement filed with the court. This latter approach is particularly useful in the event that not all parties to a contractual debt obligation agree to a proposed restructuring and prevent the execution of amendment agreements.

Recent Developments

Recognizing the need for more detailed and commercially appealing restructuring and corporate rehabilitation legislation, the Securities and Exchange Commission of Pakistan has undertaken an extensive review and consultation process to amend the corporate insolvency laws in Pakistan as a first step in bringing about the necessary changes to Pakistan's insolvency legal and regulatory landscape.

In this regard, there had been some initial successes when the restructuring of bank portfolios of non-performing assets was addressed by the adoption of the Corporate and Industrial Restructuring Corporation Ordinance of 2000 and the Non-performing Assets and Rehabilitation of Industrial Undertakings (Legal Proceedings) Ordinance of 2000. The combined pieces of legislation established a fast track method at the High Court for the acquisition, restructuring or disposition of non-performing loans and other assets of banks in the public interest. Consequently, a statutory framework enabling distressed debt investments had been in place in Pakistan; however, both ordinances have now expired and are no longer in effect.

More recent efforts by the Securities and Exchange Commission of Pakistan to reach industry and stakeholder consensus for restructuring legislation reform led to the Corporate Rehabilitation Bill of 2011 and, subsequently, the Corporate Restructuring Companies Bill of 2015. Both draft bills sought to introduce a Chapter-11 style regime in Pakistan but also took inspiration from Mexico's insolvency law to better account for the context of a developing country. Pakistani regulators have a long history of studying other jurisdictions for market development and reform; however, the use of Mexican insolvency laws in itself demonstrates an evolution in such market studies, where previously advanced markets were reviewed, but where such legal transplants may not have provided the expected benefits. While these corporate restructuring bills have not been passed, it continues to be the stated and official aim of the Securities and Exchange Commission of Pakistan to introduce legislative reforms to Pakistan's corporate insolvency laws. It remains unclear what the timeline for adopting such reforms will be and what the eventual bill would contain.

In the meantime, avenues for corporate or debt restructuring of a distressed company exist through the filing of schemes of arrangement before a court. Such schemes may be used in the context of winding up petitions or in the absence of any insolvency proceedings relating to the relevant company. In the context of contractual debt obligations, such as Loan Market Association loan documentation, restructuring in Pakistan is handled as it is under English law, through appropriate structural or contractual amendments, but may also involve schemes of arrangement in the event that minority creditors are entrenched and preventing the restructuring. ■

1. Examples of other grounds under which a company in Pakistan may be wound up are for carrying on unlawful or fraudulent activities; for carrying on business in a manner oppressive to any of its shareholders (including minority); or if it is "just and equitable" to do so. This last ground is seen as a question of fact and depends on the circumstances of each case and therefore cannot be summarised as a general rule.
2. In *Khursheed Ismail vs. Unichem Corporation (Private) Limited* (1996 CLC 1863), the petitioner shareholders alleged irregular increase of capital and issuance of new shares in the respondent company. The courts held in this case, alongside a series of cases, that there are three broad categories of cases where there exists "just and equitable" grounds for winding up a company. The first is the exclusion of a director from management; the second is where there is a complete state of deadlock and third is when there is a justifiable lack of confidence in the management of the company. However, in each case, the court seeks to find a balance with the interests of shareholders. The courts have rejected arguments in the past relating to dishonest directors or directors that have entered into *ultra vires* transactions, as being insufficient bases to argue for just and equitable winding up of a company.
3. In the case of Integrated Technologies & Systems Limited vs. Interconnect Pakistan (Private) Limited (2001 CLC 2019), the petitioner was a BVI incorporated company that held shares in the respondent company, which the petitioner sought to wind up alleging that the respondent company had acted unlawfully and in a manner that was oppressive to its interests as a shareholder (as they were being excluded from the affairs of the company and company funds were being diverted). The court passed a winding up order in this case but had it suspended until the sooner of a fixed date or when an agreement is met between the petitioner and another large shareholder for a buy-out of shares in the respondent company. The court allowed the parties to agree to a price among themselves for their shares (subject to a minimum) and restricted the respondent company from raising finance or debt during this period.
4. The reason for such an order was to enable the respondent company to continue functioning as a viable entity. This was due to the fact that the company was fully operational and had undertaken substantial projects which were being executed using significant sums, by way of direct foreign investment, and that consequently an immediate winding up order was likely to prejudice the shareholders, creditors and interested third parties.

▼ **Altaf Qureshi** is a partner at the law firm Ijaz Ahmed & Associates based in Karachi, Pakistan. Mr Qureshi's geographic focus is Pakistan and Middle East, covering Pakistani and English law. His areas of practice are Corporate, Commercial, Banking, Finance, Trade, Investment, Securities and Capital Markets. The firm most recently advised on the amalgamation of the Karachi, Lahore and Islamabad stock exchanges into the Pakistan Stock Exchange and the London offices of a global investment bank in respect of a futures, options and derivatives transaction in Pakistan. Mr Qureshi received an LL.B (London) and an LL.M (Columbia) degree, is a Barrister and Solicitor (England and Wales) and Advocate High Courts (Pakistan).