Pakistan

AKHUND FORBES

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"Pakistan needs a separate statute for corporate insolvency with unified and enhanced administration and recovery procedures and detailed rules and guidance in relation to the application of the Corporate Rehabilitation Act."

RABEL Z. AKHUND, AKHUND FORBES

Overview of Pakistani procedures

NAME	TYPE	CONTROL	MORATORIUM	INITIATION
Administration	Reorganisation	External administrator	On court application, narrow	Creditor
Scheme of arrangement	Reorganisation	Debtor in possession	On court application, narrow	Creditor, member, director
Receivership	Receivership	External administration	None	Secured creditor
Liquidation	Liquidation	External administration	Automatic, narrow	Company, members, creditor, Securities and Exchange Commission of Pakistan

World Bank key insolvency indicators	Recovery Rate (cents on dollar)	Time (Years)	Strength of insolvency framework (0-16)
	42.8	2.6	11.5

Cross-border insolvency	UNCITRAL Model Law	JIN Guidelines
	-	-

Need to know

- Focus on formal liquidation
- Creditor interests generally safeguarded
- Delays in legal system may however hamper restructuring efforts

Key Legislation

Companies Act, 2017

Most Recent Law Reform

Repeal of Companies Ordinance, 1984

Enactment of the Companies Act, 2017

Enactment of the Corporate Restructuring Companies Act, 2016

Coming into force of the Financial Institutions (Secured Transactions) Act, 2016

Enactment of the Corporate Rehabilitation Act, 2018

Overview

In Pakistan, corporate reconstruction, reorganisation and insolvency is largely governed by the Companies Act, 2017 (“**Companies Act”**). The Companies Act, came into force in mid-2017 and replaced the long standing Companies Ordinance, 1984 (“**Companies Ordinance”**). The Companies Act and related legislation provide for a relatively broad range of corporate restructuring, recovery and liquidation procedures. However, insolvency laws in Pakistan remain undeveloped in practice and their effectiveness is hampered by a court system that is over-burdened with cases, resulting in delays that can defeat the effectiveness of the remedies sought by corporate stakeholders.

Pakistani companies may be subject to formal winding up (liquidation) proceedings, which may be initiated by order of the court or voluntarily by members or creditors. There is also an administration procedure available under the Companies Act, but it is rarely used and will require further enhancement and development if insolvent businesses are to be effectively restructured without going into liquidation. In 2018, Pakistan also enacted the Corporate Rehabilitation Act, 2018 (the “**CRA**”), which is based on Chapter 11 of the US Bankruptcy Code. It allows certain companies to file a petition in the High Court for an order of mediation that is supported by a plan of rehabilitation. As part of the amendments made to the Corporate Restructuring Act in December 2021, a temporary moratorium is also applicable in relation to an obligor where a restructuring scheme has been presented by a corporate restructuring company (see paragraph 25 below) holding at least two-thirds in value of the principal amount payable to secured financial institution by a company in distress.

In addition to formal insolvency procedures, the Companies Act also provides for a distressed company to enter into a scheme of arrangement with its creditors and/or members. Previously, the power to sanction a scheme of arrangement vested in the courts, but under the Companies Act such power has been granted to the Securities and Exchange Commission of Pakistan (“**Commission”**), primarily because of the delays companies were experiencing in Pakistani courts. The Commission has wide powers to give any directions to assist the implementation of a scheme of arrangement as it deems fit. It is yet to be seen how the Commission will enforce such powers and whether this will result in fast and efficient restructurings.

Corporate reorganisation procedures

1. What are the main corporate reorganisation or rescue procedures?

The main corporate reorganisation procedures in Pakistan are:

- management by an administrator under the Companies Act;
- scheme of arrangement; and
- mediation, rehabilitation and appointment of an administrator under the CRA.

Management by Administrator

Overview

Management by Administrator under the Companies Act is a mechanism whereby an external administrator, on the application of creditors who have an interest equivalent to at least 60% of the paid up capital of the company, takes control of the company (“**Administrator”**). The purpose of an Administrator's appointment is to resolve issues regarding the operations of the company such as fraudulent activities, losses and non-operation of industrial units.

This mechanism is seldom used in Pakistan.

The Administrator takes control of the company and its business with the objective of maximising the chances of the company or its business continuing in existence, or if that is not possible, to obtain a better return for the company's creditors and members than would otherwise be the case in the winding up of the company.

A company which is in administration may also, through its Administrator, apply to the Commission to reorganise the company through a compromise or arrangement with its creditors or members.

Initiation

A creditor having an interest equivalent to at least 60% of the paid up capital of the company may make a representation to the Commission and request that an Administrator be appointed to the company. Creditors may make such a representation if, among other things:

- the affairs or business of the company are being or have been conducted or managed in a manner likely to prejudice the interests of the company, its members or creditors;

- any director of the company or person concerned with the management of the company is or has been guilty of breach of trust, misfeasance or other misconduct towards the company or towards any of its members or creditors or directors;
- the affairs or business of the company are being or have been conducted or managed with intent to defraud its members or creditors or any other person or for a fraudulent or unlawful purpose, or in a manner oppressive of any such persons;
- the affairs of the company have been conducted or managed so as to deprive its members of a reasonable return; or
- the accumulated losses of the company exceed 60% of its paid up capital.

The Commission, upon receiving such representation, may appoint an Administrator within 60 days from the date of receipt of the representation. An Administrator is chosen from a panel maintained by the Commission on the recommendation of the State Bank of Pakistan ("**SBP"**).

Supervision and control

From the date of appointment, the Administrator is in charge of the management of the affairs of the company and exercises all the powers of the board or other persons in whom management control is vested. All directors or other such persons are divested of their management powers and cease to hold office.

The appointment of the Administrator may be challenged by an aggrieved party within 60 days of the order of appointment by the Commission. Such challenge may be brought before the concerned Minister-in-Charge of the Federal Government.

The Commission may issue directions to the Administrator concerning its powers and duties, as it deems desirable in the circumstances of the case, and the Administrator may also apply to the Commission at any time for instructions as to the manner in which the Administrator should conduct the management of the company.

Stages and timing

After appointment, an Administrator takes control of the affairs of the company until such time that the Commission deems fit. There is no time limit for the administration and the appointment will continue at the discretion of the Commission.

However, any person aggrieved by an order of the Commission for the appointment of an Administrator may appeal to the relevant Minister-in-Charge of the Federal Government to challenge such appointment of an Administrator.

Moratorium

There is no automatic moratorium or stay on creditors, lenders or counterparties taking any action against the company during an administration. The Administrator may, on his or her own, apply for the staying of legal proceedings in the normal course without any preferential treatment being granted by the courts.

Ipso Facto Stay

There is no equivalent of ipso facto stay which is applicable to the administration process in Pakistan.

Operation of the business

After appointment, the Administrator takes control of the affairs and management of the company and assumes the role of the board and other officers of the company. The Administrator may review any purchase or sales contracts entered into by the company, or any employment given, that may have benefited any director of the company or was against the interests of the members of the company and the Administrator may, with the approval of the Commission, terminate such contracts.

New money funding

There is no provision for new money funding under this mechanism of reorganisation. However, the Commission may issue directions to the Administrator and/or the Administrator may seek approval from the Commission for injecting funds into the company.

Business and asset sales

The Administrator does not have any express powers to dispose of assets. However, as stated under "Supervision and control" above, the Administrator will have all the powers vested in the board of directors and, with the approval of the Commission, the Administrator may take any action that is beneficial for the company.

Implementation of a reorganisation or restructuring plan

The Administrator does not have any express powers to reorganise or restructure the company. However, if deemed necessary, the Administrator may apply to the Commission and give a recommendation that the company requires a reorganisation or restructuring. The procedure for this would be the same as the procedure for schemes of arrangement, which is described below.

Effect on stakeholders

The powers of the directors and officers are suspended upon the appointment of an Administrator. Employees continue in employment unless terminated by the Administrator, in accordance with the law. There is no provision in Pakistani law with regard to the effect of the appointment of an Administrator on the rights of members, and such rights will remain subject to the directions of the Commission.

End of procedure

When it appears to the Commission that the purpose of the order appointing the Administrator has been fulfilled, it may permit the company to appoint directors, and on the appointment of directors, the Administrator shall cease to hold office.

Scheme of arrangement

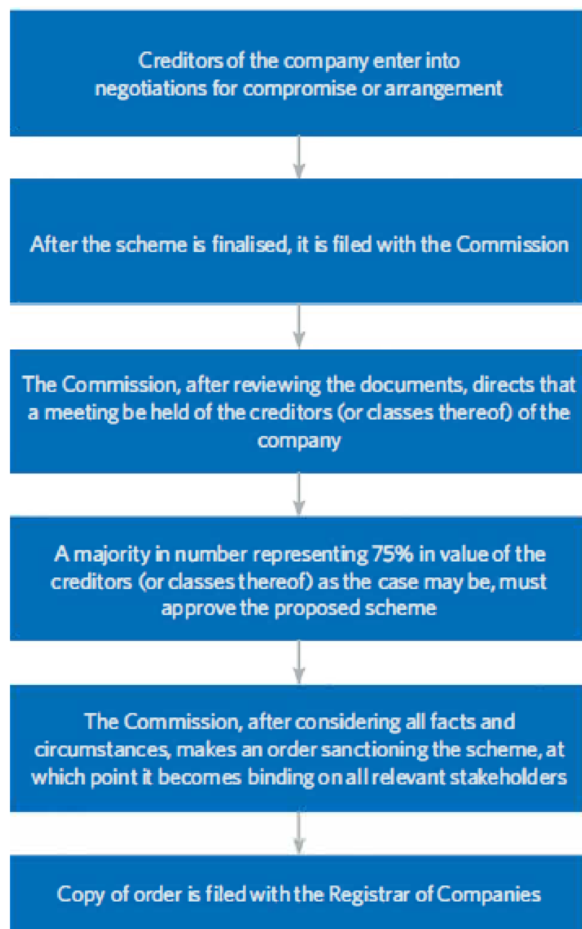
Overview

Schemes of arrangement in Pakistan may be: (i) creditors' schemes, that is, schemes affecting the rights of creditors of a company; or (ii) members' schemes, that is, schemes affecting the rights of members (shareholders) of a company. In this chapter, we only discuss creditors' schemes (and "**scheme**" and "**scheme of arrangement**" refer to a creditors' scheme of arrangement).

This is a common method of reconstruction and reorganisation in Pakistan. A scheme of arrangement may be filed before the Commission, either in the context of winding up proceedings or otherwise (eg upon a merger of companies). The power to approve such arrangements was previously vested in the High Courts of Pakistan only. After the enactment of the Companies Act, and the repeal of the Companies Ordinance, and certain amendments to the Companies Act, such powers were vested in the Commission. The scope of the Commission's power, however, was curtailed by subsequent notifications issued by the Federal Minister-in-Charge (pursuant to section 285(8) of the Companies Act), which transferred the power of the Commission to sanction schemes of arrangement in respect of all companies (other than small sized companies and companies that are wholly owned by the Federal Government) to the Company Bench of the relevant High Court of Pakistan. The Federal Government is expected to issue further notifications regarding the division of power between the Commission and the High Court of Pakistan to sanction schemes of arrangement. For the purposes of this section, the term Commission is used interchangeably with High Court depending on the nature of the company that is the subject of the scheme of arrangement.

Schemes of arrangement may be divided into two categories:

- applications for compromise or arrangement under section 279 of the Companies Act that do not involve a reconstruction of the company or merger with another company. This type of application normally deals with arrangements and compromises relating to winding up, liquidation or with reorganisation and division of share capital of the company ("**section 279 Application"**); and
- applications for compromise or arrangement under section 279 of the Companies Act that are proposed for the purpose of the reconstruction of a company and/or the merger or acquisition of a company. The Commission has a separate power to facilitate and sanction this type of compromise or arrangement under section 282 of the Companies Act ("**section 282 Application**").



Initiation

Both a section 279 Application and a section 282 Application can be filed by the company or creditors. Where a company is in the process of being wound up, a section 279 Application can be filed by the liquidator.

In the case of a section 279 Application, the Commission must be satisfied that all material facts relating to the company, such as the financial position of the company, the auditor's report on the latest accounts of the company and the pendency of any investigation, have been disclosed.

Supervision and control

While either a section 279 Application or a section 282 Application is pending, the control of the company remains with the board of directors and the existing management of the company and there is no interference by the Commission. However, the Commission has the authority to approve the respective applications and supervise the arrangement that is being carried out.

Stages and timing

After the filing of a section 279 Application, the Commission may make an order for a meeting of the creditors of the company, depending on the nature of the compromise or reorganisation.

If the majority in number representing 75% in value of the creditors (or classes thereof) agree to the compromise or arrangement and the Commission approves it, the compromise or arrangement becomes binding on the company, its creditors (or classes thereof), its members, its liquidator and other contributories.

In relation to a section 282 Application, if it is shown that:

- a compromise or arrangement proposed under section 279 is proposed for the purposes of, or in connection with, a scheme for the reconstruction of any company or companies, or the amalgamation of any two or more companies or division of a company into one or more companies;
- under the scheme the whole or any part of the undertaking or property or liabilities of any company concerned in the scheme (a **"transferor company"**) is to be transferred to another company (the **"transferee company"**) or is proposed to be divided among and transferred to two or more companies; and
- a copy of the scheme drawn up by the applicants has been filed with the Registrar,

the Commission may order a meeting of the creditors or class of creditors to be called to approve the compromise or arrangement as directed by the Commission. The same voting thresholds for creditor approval as for a section 279 Application applies as a Section 282 Application is a particular type of section 279 Application. Section 282 Applications also typically require member consent by the same thresholds.

The Commission may, in sanctioning a compromise or arrangement under section 282, make orders regarding any of the following matters:

- the transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of any transferor company;
- the allotment or appropriation by the transferee company of any shares, debentures, policies or other like interests in that company which under the compromise or arrangement are to be allotted or appropriated by that company to or for any person;
- the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company;
- the dissolution, without winding up, of any transferor company;
- provision to be made for any persons who, within such time and in such manner as the Commission directs, dissent from the compromise or arrangement; and
- such incidental, consequential and supplemental matters as are necessary to ensure that the reconstruction, amalgamation or bifurcation is fully and effectively carried out.

If an order under section 282 provides for the transfer of property or liabilities:

- the property is, by virtue of the order, transferred to, and vests in, the transferee company; and
- the liabilities are, by virtue of the order, transferred to and become liabilities of that company.

A copy of the order passed in connection with a section 279 Application or a section 282 Application, sanctioning the reconstruction, the amalgamation or division, duly certified by an authorised officer of the Commission, must be filed with the Registrar of the Commission within seven days from the date of the order.

Depending on the complexity of the scheme of arrangement, the entire process may take six to 18 months.

Moratorium

There is no automatic moratorium. After submission of either a section 279 Application or a section 282 Application, any related party to the compromise or arrangement may apply to the court for a stay of commencement or continuation of any suit or proceedings until final disposal of the respective application.

Ipso Facto Stay

There is no equivalent of ipso facto stay which is applicable to schemes of arrangement in Pakistan.

Operation of business

During the pendency of a section 279 Application or a section 282 Application, the directors of the company continue to have control over the company.

New money funding

During the pendency of a section 282 Application, the company can continue to borrow money and grant security in the normal course of its business. However, the Commission will not sanction a scheme of arrangement in the presence of any objection by substantial creditors or where the scheme of arrangement may be prejudicial to the interests of creditors as a whole. Where specific creditors object to the scheme of arrangement, the Commission may seek assurances from the applicants regarding the manner in which the concerned creditors will be protected and may make any orders it deems fit.

If the section 279 Application does not involve a winding up of a company then the company may continue to borrow money and grant security in the normal course of its business. However, in the event that the section 279 Application has been made by a liquidator and involves a winding up, then the liquidator will need to apply to the court for directions if it requires additional funding. See Question 2 below.

Business and asset sales

Assets subject to security may be sold with the consent of the secured creditors unless the Commission orders otherwise. The Commission has wide powers to give effect to schemes of arrangement; therefore, it is possible for the purchaser to even acquire assets free and clear of encumbrances if, for example, the creditor consents or if the Commission deems it appropriate. Usually, the Commission will not interfere with or prejudice creditor rights. The scheme of arrangement is designed in consultation with the relevant stakeholders, therefore, it almost acts as a pre-negotiated arrangement.

Effect on stakeholders

The terms of the scheme of arrangement will dictate the treatment of directors, creditors and other stakeholders subject to the approval of the Commission. The Commission has wide powers to give any directions or pass any orders for the effectiveness of the scheme of arrangement.

End of procedure

Once the Commission has approved a section 279 Application or a section 282 Application, the scheme of arrangement shall take effect in accordance with the terms of the Commission's orders from the date the order is passed and, if necessary, the Commission may monitor the implementation of the scheme of arrangement.

In the case of a section 279 Application made in circumstances where the company is being wound up, after disposal of all its assets, the company may be wound up in accordance with the order of the court appointing the liquidator.

Other key features

In cases of mergers and acquisitions an exemption may also be required from the Competition Commission of Pakistan. Pursuant to the Securities Act, 2015 ("**Securities Act"**), if a scheme of arrangement relates to a merger of or with a listed company, a number of additional notices, undertakings and disclosures are required to be made to the Commission.

Mediation, Rehabilitation and Appointment of an Administrator under the CRA

Overview

The CRA is based on Chapter 11 of the US Bankruptcy Code. It allows certain companies to file a petition in the High Court for an order of mediation that is supported by a plan of rehabilitation, which, if confirmed by the High Court, can result in rehabilitation of the company and the restructuring of its debts. The CRA and rehabilitation of distressed companies under the CRA remains untested so far. The CRA's interaction with other insolvency procedures is also not well delineated in Pakistani law. Further regulations and guidance needs to be issued by the Commission to clarify the practical details of implementing the CRA.

Initiation

A company may file a petition in the High Court for an order of mediation supported by a plan of rehabilitation, statement of affairs and a special resolution of the shareholders of the company approving the plan of rehabilitation.

Qualifying creditors may file a petition in the High Court for an order of mediation against a debtor company. In this context, qualifying creditors means one or more creditors holding unpaid and overdue claims for an aggregate amount of not less than two-thirds of the value of the assets of the company as per the company's latest balance sheet.

Supervision and control

The supervision and control of the company remains with the directors and shareholders of the company subject to any orders made by the court or any powers vested by the court in the mediators appointed by it for the purposes of conducting mediation between different stakeholders of the company in respect of the rehabilitation plan,

Stages and timing

There is no time limit for the insolvency expert appointed as a mediator to conduct the mediation or for the court to approve a plan of rehabilitation.

Where qualifying creditors have filed a petition for an order of mediation and if the court is convinced that a *prima facie* case for mediation has been made out, the court may make an order directing the company to submit a statement of affairs to it within 15 days and the qualifying creditors to submit a plan of rehabilitation within 30 days of submission of the statement of affairs by the company. Thereafter, the court may appoint insolvency expert(s) to act as mediators in relation to the plan for rehabilitation filed in court.

The plan of rehabilitation shall specify the following matters in relation to a company:

- claims and classes of claims against the company;

- interests and classes of interests in the company;
- claims and interests belonging to the company;
- claims or interests that will not be impaired under the plan of rehabilitation;
- claims or interests that will be impaired under the plan of rehabilitation;
- places of business of the company, details of its assets and any security interests created over such assets;
- particulars of shareholders, directors and key management of the company; and
- scheme of implementation of the plan for rehabilitation of the company.

The plan of rehabilitation may also include the following:

- the settlement, restructuring or rescheduling of any claims or interests or classes of claims of interests;
- the change of ownership and management of the company;
- the sale of all or any assets of the company and the distribution of proceeds of such sale among holders of claims or interests;
- the assumption, rejection or assignment of any executory contract or unexpired lease of the company;
- the enforcement of any claims or interests belonging to the company; and
- any other matter concerning rehabilitation of the company or distribution of proceeds of sale of property of the company.

The statement of affairs of a company shall be verified by an affidavit of the chief executive officer or a director of the company and must contain the following:

- the assets, debts and liabilities of the company;
- the particulars of the creditors, stating separately the amount of secured debts and unsecured debts along with particular of any securities given;
- the debts due to the company and the particulars of the company's debtors;
- details of any person who has possession of the company's property;
- addresses of the places of business of the company;
- details of any pending litigation;
- latest publicly disclosed accounts and the last audited accounts; and
- such other particulars as may be prescribed by regulations or as the court may order.

A class of creditors shall be deemed to have accepted the plan of rehabilitation if such plan is accepted by the creditors holding at least two-thirds in value of such class.

A class of interest of the company shall be deemed to have accepted the plan of rehabilitation if such plan is accepted by holders of at least two-thirds in value of interests of such class. In this context, interests or class of interests means persons or a class of persons who are liable to contribute to the assets of a company in the event of it being wound up and includes the holder of any shares which are fully paid up.

A class that is not impaired under a plan of rehabilitation and each holder of a claim or interest of such class are conclusively deemed to have accepted and approved the plan and solicitation of their acceptance or approval is not required.

The court may confirm a plan of rehabilitation if the plan is in accordance with the provisions of the CRA and has been approved or is deemed approved by a class of claims or interests in accordance with the CRA as outlined above.

The provisions of a plan of rehabilitation confirmed by the court shall bind the company, any entity issuing securities under the plan, any entity acquiring property under the plan and any creditor or shareholder of the company, whether or not the claim or interest of such creditor or shareholder is impaired under the plan and whether or not such creditor or shareholder has accepted the plan.

The court will refuse to confirm a plan if the principal purpose of the plan is to avoid taxes, duties or fiscal charges.

The court may pass such directions as are necessary for the implementation of the plan upon application by the company or the qualifying creditors.

Moratorium

There is no automatic moratorium or stay on creditors, lenders or counterparties taking any action against the company.

Ipso Facto Stay

There is no equivalent of ipso facto stay which is applicable under the CRA in Pakistan.

However, the court may, on application of the company or any other interested person, pass an order for:

- preservation of assets of the company in such manner as the court may deem fit in the circumstances of the case; and
- protection of the company or its shareholders, directors and guarantors,

against any imminent adverse action, measure, process or proceeding commenced to recover a claim against the company or its shareholders, directors, and guarantors through sale, transfer, repossession or mortgage of assets of the company or its shareholders, directors and guarantors, or by creating any rights or interests in relation to such assets.

The stay mentioned above shall continue until confirmation of the rehabilitation plan by the court or dismissal of the case by the court.

Operation of the business

The CRA gives the qualifying creditors a right to appoint an Administrator pursuant to the CRA (the "**CRA Administrator**"). Until the appointment of a CRA Administrator upon an application made by qualifying creditors, the directors of the company shall have control over the operation of the company's business.

The court may, on petition of qualifying creditors and after notice and a hearing, appoint an insolvency expert as administrator of the company at any time before confirmation of a plan of rehabilitation for one or more of the following reasons:

- the affairs or business of the company have been conducted or managed in a manner likely to be prejudicial to the interests of the company or the qualifying creditors;
- any director of the company or person concerned with the management of the company has been guilty of breach of trust, misfeasance or other misconduct towards the company or the qualifying creditors;
- the affairs of the company have been so conducted or managed with intent to defraud its shareholders or qualifying creditors or for a fraudulent or unlawful purpose or in a manner oppressive to shareholders or qualifying creditors;
- the affairs of the company have been so conducted or managed as to deprive the qualifying creditors of their claims against the company in full or in party;
- any project owned by the company is not in operation for over a period of two years or has been in operation intermittently or partially during the preceding two years;
- the accumulated losses of the company exceed 60% of its paid up share capital; or
- any project set up by the company has not commenced operations or has not been operating smoothly or its production or performance has deteriorated to the extent that:
  - the market value of its shares as quoted on the stock exchange or the net worth of such shares has fallen by more than 75% of its par value;
  - its debt to equity ratio has deteriorated beyond 9:1; or
  - its current ratio has deteriorated beyond 5:1

Upon the appointment of a CRA Administrator:

- all the powers of the directors, chief executive officer, and other officers of the company shall cease to have effect; and
- all the powers of a receiver appointed prior to the commencement of a case shall cease in relation to the property of the company.

A CRA Administrator shall, among other things:

- operate the company's business;
- prepare and submit in the court the statement of affairs, where the company has not done so;
- investigate the acts, conducts, assets, liabilities and financial condition of the company, the operation of the company's business and the desirability of the continuance of such business and any other matter relevant to rehabilitation of the company;
- adopt the plan of rehabilitation, seek modification of the plan or recommend winding up of the company;
- institute, defend or settle legal proceedings;
- subject to approval of administration committees, make any compromise or arrangement with creditors; and
- be accountable for all property of the company and have the power to enter into transactions concerning the business and property of the company including the sale or lease of the property of the company.

A CRA Administrator shall have wide powers to do anything incidental to exercising the powers vested in it pursuant to the CRA.

New money funding

There is no specific provision for new money funding under this mechanism of reorganisation. However, the court may issue directions for injecting funds into the company although this is unlikely to be the case. Furthermore, a CRA Administrator may, to the extent allowed by administration committees (of creditors and shareholders), obtain credit and incur debt (both secured and unsecured but subject to certain conditions in case of secured credit and debt) in the course of the company's business which shall be treated as an administration expense.

Business and asset sales

The court may, on the application of the company or qualifying creditors and after notice and a hearing, pass such directions, including the sale of assets of the company, as it deems fit for the purposes of implementation of the plan of rehabilitation and any person responsible for carrying out the plan or any part thereof shall comply with such directions. The court may also direct the company and any other necessary party to execute any instrument required to effect a transfer of property dealt with by the plan of rehabilitation confirmed by the court.

The CRA Administrator may enter into transactions concerning the business and property of the company including the use, sale or lease of the assets of the company, in the ordinary course of business.

Effect on stakeholders

The powers of the directors and officers are suspended upon the appointment of a CRA Administrator. Employees continue in employment unless terminated by the CRA Administrator. There is no provision in Pakistani law with regard to the effect of the appointment of a CRA Administrator on the rights of members, and such rights will remain subject to the directions of the court. However, a CRA Administrator can reject or assume any unexpired lease of an immoveable property.

End of procedure

The court may, upon an application made by an aggrieved person, at any time within 12 months of the date of confirmation of the rehabilitation plan, and after notice and a hearing, make an order on such terms that it thinks fit declaring the confirmation to have been void.

Otherwise, the rehabilitation process shall complete upon implementation of the plan of rehabilitation confirmed by the court.

If the plan of rehabilitation is not confirmed by court within 12 months from the appointment of the CRA Administrator, the company, qualifying creditors or the CRA Administrator may petition the court to convert the proceedings into compulsory winding up proceedings of the company.

Corporate liquidation procedures

2. What are the main (insolvent) corporate liquidation procedures?

Overview

Winding up is the process of putting an end to the life of the company. During this process, the assets of the company are disposed of, the debts of the company are paid from the proceeds of the realised assets and if any surplus remains, it is distributed among the members in proportion to their shareholding in the company. The process of winding up begins either after the court passes an order for winding up, or shareholders of the company pass a special resolution for a voluntary winding up. The company is dissolved after completion of the winding up proceedings. On dissolution, the company ceases to exist.

A person appointed to carry out the winding up of a company is called a liquidator. If the winding up is ordered by the court, the term used for such person is Official Liquidator. The duties of a liquidator include, among other things, to realise the property of the company, to pay its debts, and to distribute the surplus (if any) among the members. An Official Liquidator acts under the supervision of the court, through a recognized reporting system.

The winding up of a company may be: (i) by the court; (ii) voluntary (without supervision by the court); or (iii) initially commenced as a voluntary winding up but subsequently becomes subject to the supervision of the court.

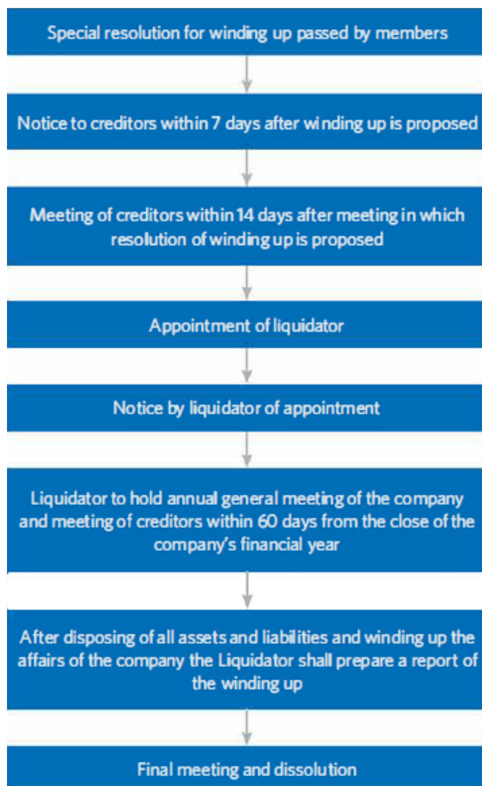
Initiation

Winding up by the court (compulsory winding up)

An application for compulsory winding up may be presented by: (i) the company itself by passing a special resolution; (ii) creditors; (iii) any contributory or contributories; (iv) the registrar of companies; or (v) the Commission or by a person authorised by the Commission.

Compulsory winding up may be commenced upon the occurrence of a number of events listed in the Companies Act including when the company is unable to pay its debts. A company is deemed unable to pay its debts when: (i) the company neglects to pay a creditor an amount of at least PKR 100,000 that is due 30 days after receiving a written demand from that creditor; (ii) if the company is unable to oblige with any execution passed against it by a court; or (iii) if it is proved to the satisfaction of a court that the company is unable to pay its debts keeping in view its contingent and prospective liabilities.

Voluntary winding up



A company can be wound up voluntarily: (a) on expiration of the period fixed for the duration of the company by its constitutive documents or on occurrence of events leading to dissolution of the company as provided in its constitutive documents; or (b) on passing of the special resolution that the company be wound up voluntarily.

Members' voluntary winding up

A members' voluntary winding up is deemed to commence at the time of passing of the resolution for the voluntary winding up. The company ceases to carry out business upon commencement of a winding up. However, it can carry on its activities and business for the beneficial winding up of the company. Although this is a method of solvent winding up (requiring a declaration of solvency from the directors) if the liquidator so appointed by the members determines that the assets of the company are not sufficient to pay off all its creditors, a meeting of the creditors must be called and the creditors may choose to appoint another as liquidator of the company.

Creditors' voluntary winding up

A company can also be voluntarily wound up under the Companies Act by way of a creditors' voluntary winding up. In this case, a meeting of creditors must be called no later than 14 days after the date on which the members of the company pass a resolution for the winding up of the company. The difference between a members' voluntary winding up and a creditors' voluntary winding up is that in a creditors' voluntary winding up, no declaration of solvency is made by the directors of the company. The choice of the creditors in the appointment of a liquidator will prevail in the event of a conflict with the choice initially made by the company's members.

Winding up by supervision of the court

When a company has passed a special resolution for a voluntary winding up, the court, may on its own motion or on the application of any person entitled to apply to the court for winding up, make an order that the voluntary winding up will continue but subject to the supervision of the court.

Supervision and control

A liquidator is appointed to carry out the winding up of a company. If the winding up is initiated by a court order, the person is called an Official Liquidator. The Official Liquidator acts under the supervision of the Court, through a recognised reporting system. A liquidator has control of all the company's assets and liabilities, and has supervisory control over all the officers of the company.

The following are the general powers of a liquidator:

- to institute or defend any suit, action, prosecution or other legal proceeding, civil or criminal, on behalf of the company;
- to carry on the business of the company so far as may be necessary for the benefit of the company;
- to pay creditors;
- to make any compromise or arrangement with creditors;
- to compromise all calls and liabilities to calls, debts and liabilities capable of resulting in debts;
- to sell the movable and immovable property and things in action of the company by public auction or private contract, with the power to transfer to any person or to sell the same in parcels;
- to do all acts and to execute all deeds, receipts and other documents in the name and on behalf of the company;
- to prove, rank and claim in the bankruptcy, insolvency or sequestration of any contributory for any balance against his or her estate and to receive dividends as a separate debt due from the bankrupt or insolvent in the bankruptcy;
- to draw, accept, make and endorse any bill of exchange or promissory note in the name and on behalf of the company; and
- to do all other things necessary for the winding up of the company with the approval or as per the directions of the court.

Stages and timing

The length of a liquidation procedure will depend on the nature of the company, its current financial status and the complexities arising therefrom. After the appointment of a liquidator, all of the company's books and records are handed over to the liquidator who is tasked to look into and investigate the affairs of the company and to evaluate all assets and liabilities of the company in order to deal with the company's debts.

Within 60 days of a winding up order being passed, the liquidator must submit a report to the court containing details of the financial position of the company, including list of assets, bank accounts, capital, liabilities etc.

Moratorium

When a winding up order has been made, no suit or other legal proceeding shall be proceeded with or commenced against the company except by leave of the court. Prior to the passing of a winding up order but upon making of an application for winding up, the company, its creditors or its contributories may apply to the court to restrain further proceedings in any suit or proceedings against the company, upon such terms as the court thinks fit.

Proceedings against the company being wound up that were filed before commencement of the winding up may be transferred to the court that is dealing with the winding up process.

Ipso Facto Stay

There is no equivalent of ipso facto stay which is applicable to the winding up process in Pakistan.

Operation of the business

Once the winding up order has been made, the company continues to maintain its status as a corporate entity. However, the management and administration of the company is carried out by the liquidator until final dissolution of the company. All powers of the directors, chief executive and other officers cease, except for purposes of giving notice of a resolution to wind up and consenting to the appointment of a liquidator.

New money funding

While new money funding was available under the Companies Ordinance, there is no express provision in the Companies Act giving the liquidator the power to raise monies with or without granting security over the company's assets. Therefore, a liquidator will have to apply to the court for directions if it requires additional funding for the company in connection with the winding up process.

Business and asset sales

The liquidator has the power to sell all immovable and movable property and actionable claims of the company. The sale can be made by public auction or private contract, with the power to transfer property to any person. The liquidator can conduct the sale without approval of creditors or the court, however, the liquidator is required to act in the best interest of the winding up process. The liquidator can also sell secured assets, as a winding up order is binding on both secured and unsecured creditors. The Companies Act has also been amended in 2020 to require that unclaimed assets and dividends (which have remained unclaimed for a period of 180 days) must be reported to the court as part of the statement filed by the liquidator and must be handled in such manner as prescribed by the Companies Act.

Effect on stakeholders

After the commencement of liquidation proceedings, directors and officers of the company cease to hold any powers.

Contracts with third parties do not automatically terminate, however, the liquidator has the power to disclaim onerous or unprofitable contracts. Employees are not automatically terminated, however, redundant employment contracts are usually terminated by the liquidator after commencement of winding up proceedings.

End of procedure

When the affairs of a company have been completely wound up, the company will be dissolved.

Corporate receivership procedures

3. Is there a corporate receivership procedure for security enforcement?

Overview

In Pakistan, secured creditors can appoint a receiver and manager in order to enforce security over a company's property.

Receivers are generally appointed in respect of specific assets of the company, as opposed to all assets of the company. If an appropriate application is made then the courts also have the power to appoint a receiver in respect of all or substantially all of the assets of a company. Section 113 of the Companies Act provides for corporate receivership, together with Order 40 of the Code of Civil Procedure, 1908 ("**Code"**) which provides a comprehensive mechanism for the appointment of a Receiver.

Receivership is also provided for in the Transfer of Property Act, 1882 (“**Transfer of Property Act”**) in respect of mortgaged immovable property and in the Financial Institutions (Recovery of Finances) Ordinance, 2001 (“**FIRF Ordinance”**) for protection of a financial institution's secured property.

Appointment

A Receiver may be appointed under particular security instruments which created the security or by order of the court. A Receiver can be anyone who is not a body corporate, a director of the concerned company, a person of unsound mind, a court-disqualified person or an undischarged insolvent.

Supervision and control

A Receiver has complete control of the secured property after appointment. The supervision of the court will depend on the type of appointment. If the Receiver has been appointed by the court, the Receiver will act on the instructions of the court.

Where the Transfer of Property Act governs the receivership, the Receiver will be deemed to be the agent of the company.

The receivership process may be subject to liquidation proceedings filed against the concerned company, and a court application for the appointment of a Receiver may be stayed if the company is being wound up.

Moratorium

The appointment of a Receiver does not automatically create a moratorium and there are no laws concerning the appointment of Receivers that can result in the imposition of a moratorium.

Operation of the business

Under the Transfer of Property Act, a Receiver is the agent of the mortgagor. Since the appointment of a Receiver is for specific secured assets, the Receiver will be responsible for managing the specified assets and may exercise all rights in the property which vested in the owner before appointment. The company will cease to have control of such secured property. If a court appoints a receiver over all assets of the company, then the company will not be able to sell any of its assets or use any of the assets as collateral for financing. If the receivership is for a specified asset, then any limitation to conduct of the business will be limited to that specified asset and the company may continue to use its other assets in the normal course of its business. The Receiver is personally liable for all debts incurred under contracts entered into by the Receiver, but in order to avoid personal liability the Receiver can, at the time of entering into the contract, stipulate that only the estate will be liable for the satisfaction of any claim.

New money funding

A Receiver does not have any express powers under statute to borrow money. However, a Receiver may be given such powers by virtue of the instrument by which the Receiver was appointed or through the directions of the court. As between the Receiver and his or her appointer, the Receiver will be personally liable for all debts incurred by him or her unless the contract for his or her appointment or the underlying security document indemnifies the Receiver against such costs and liabilities.

Business and asset sale

A Receiver has the authority to dispose of the secured property and to collect rents and profits arising out of the secured property. Receivers owe a duty to the secured parties and will have to act in accordance with the best interests of the secured party. The terms and conditions of sale of the secured property, including transfer of existing claims on the secured property, are determined and negotiated between the Receiver and the purchaser. Normally, after disposal of secured property and upon repayment of outstanding debt, all security will be released.

Effect on stakeholders

The appointment of a Receiver does not directly affect any officers and/or employees of the company.

Relationship with other insolvency procedures

The court may order that any property in the control of a Receiver be transferred to the liquidator of the company, following the commencement of winding up proceedings.

Special procedures

4. Are there insolvency procedures specific to particular industries?

There are insolvency procedures specific to insurance companies, banking companies, and non-profit companies

Banking companies are governed by the Banking Companies Ordinance, 1962 and regulated by the SBP. The High Court may order the winding up of a banking company, if the banking company is unable to pay its debts (subject to SBP's consent), or if an application for its winding up has been made by the SBP. The SBP may also be appointed as the Official Liquidator of a banking company.

Insurance companies are primarily governed by the Insurance Ordinance, 2002 ("**Insurance Ordinance"**). The court may order winding up of any insurance company, under the procedure laid down in the Companies Act, read with provisions provided in the Insurance Ordinance. Insurance companies will not be able to enter into new contracts of insurance after winding up proceedings have been filed.

The Companies Act also provides for the 'Rehabilitation of Sick Public Sector Companies'. This is a mechanism through which public sector companies can be reorganised or restructured through intervention of the Government of Pakistan.

In relation to a non-profit company constituted under section 42 of the Companies Act on winding up and after satisfaction of all its debts and liabilities, any remaining assets must be transferred to another non-profit company.

5. What are the main types of security, and what assets can security be taken over?

Types of assets over which security can be taken

In Pakistan, security can be taken over the following types of property:

- immovable property, which includes:
  - land (freehold or leased, however, only the Government has freehold title to land);
  - any buildings or structures standing on land;
  - anything permanently attached to land; and
  - any rights attached to the land such as easements;
- tangible movable property, which includes:
  - plant and machinery;
  - raw materials;
  - trading stock (inventory);
  - cars and other vehicles;
  - furniture and other movable assets;
  - aircraft; and
  - ships and other vessels; and
- intangible movable property, which includes:
  - financial instruments (such as shares, debentures and securities);
  - claims and receivables;
  - bank deposits; and
  - intellectual property.

Immovable property

The main types of security that may be taken over immovable property are:

- an English legal mortgage, where the mortgaged land is transferred to the mortgagee absolutely subject to the right of redemption (that is, the condition that the mortgaged property will be transferred to the mortgagor upon satisfaction of the debt); and
- an equitable mortgage created by the deposit of title deeds.

The formalities required to ensure enforceability of such security are as follows.

Under the Transfer of Property Act, a mortgage (other than an equitable mortgage) must be granted by way of an indenture of mortgage which must be:

- signed by the mortgagor;
- attested by two witnesses; and
- registered with the relevant land registry where the mortgaged immovable property is situated.

For an equitable mortgage, the mortgagor records the creation of equitable mortgage by recording it in a memorandum of deposit of title deeds.

Further formalities in respect of all mortgages are:

- applicable stamp duty on the documents (including mortgage documents) must be paid in accordance with applicable stamp laws. The stamp duty payable varies across provinces;
- registration under the Registration Act, 1908. Any mortgage of immovable property, other than an equitable mortgage, must be registered within four months of the execution of the mortgage deed, failing which the mortgage is rendered invalid;
- filing with the Registrar of Companies ("**ROC**"). The mortgagor must file with the relevant ROC a form recording creation of the security interest (including mortgage) within 30 days of creation of the mortgage and obtain a certificate of charge; and
- if the underlying land has been leased, consent may be required from the relevant lessor.

Tangible movable property

For tangible movable property the main types of security are:

- mortgage (eg, security over ships and other vessels is created by way of a statutory mortgage pursuant to the Pakistan Merchant Shipping Ordinance, 2001); and
- hypothecation (which generally means a charge (fixed or floating) on any tangible movable property, existing or future, created by a security provider in favour of a lender without the delivery of possession of the tangible movable property to that lender).

The formalities required for taking these types of security are as follows:

- ship mortgages have their own formalities stipulated in the Pakistan Merchant Shipping Ordinance, 2001;
- for hypothecations, a deed of hypothecation is executed by the security provider in favour of the lender. The charge created under the deed of hypothecation is governed by the terms of the document, which provides in detail the powers and provisions safeguarding the interest of the lender;
- hypothecation over a motor vehicle must be noted on the registration certificate of the motor vehicle; and
- other formalities for hypothecation include payment of applicable stamp duty and filing with the ROC (see "Immovable property" above).

Intangible movable property

Financial instruments

The main type of security taken over financial instruments is a pledge of the relevant financial instrument.

The formalities required for taking this type of security include:

- a pledge agreement is entered into between the pledgor and the pledgee to create and record the pledge. A power of attorney is also usually issued by the pledgor in favour of the pledgee to deal with the financial instrument on occurrence of a default. One of the essential components of a pledge is the delivery (actual or constructive) of the relevant financial instrument to the pledgee;
- payment of any applicable stamp duty and filing with the ROC;
- where the financial instruments are in dematerialised form, certain forms must be filed with the depository to mark a pledge on the relevant financial instruments;
- for government bonds issued by the Government of Pakistan, the bonds have to be moved into the relevant account of the creditor at SBP;
- if the shares of a listed company are to be pledged by its promoters, certain disclosures (if the prescribed thresholds are met) must be made to the relevant stock exchanges and to the company; and
- SBP's special consent is also required for pledging shares in favour of foreign lenders.

Claims and receivables

The main types of security that can be taken over claims and receivables are:

- hypothecation (see "Tangible movable property" above); and
- assignment by way of security.

The formalities required for taking these types of security include:

- payment of applicable stamp duty and registration with the ROC;
- notice to the account debtor (an account debtor will only be bound by the terms of an assignment by way of security if it has received written notice of such assignment or otherwise consented to it in writing);
- a direction that payments from the account debtor be made into a designated collection account on which the lender has a lien; and
- binding the account debtor to the assignment, so that the account debtor does not receive a valid discharge if the receivables are paid directly to the company and not into the designated collection account.

Cash deposits

The main type of security taken over cash deposits is a lien that gives control to the beneficiary of the security.

The formalities required for this type of security include that the lien is:

- in writing;
- attested by at least two male witnesses;
- stamped in accordance with applicable stamp duty laws; and
- registered with the ROC.

Intellectual property

The main types of security that can be created over intellectual property rights are:

- mortgage;
- assignment by way of security; and
- hypothecation.

The formalities for taking these types of security include:

- under the Patents Ordinance, 2001, a mortgage or other security interest created on a patent must be in writing;
- under the Trademark Ordinance, 2001, a trade mark can be assigned by the owner by executing an assignment agreement in writing between the owner and the assignee. Security over the trade mark can also be created by executing a deed of hypothecation;
- under the Copyright Ordinance, 1962, the owner of a copyright can assign the copyright by executing an assignment agreement in writing between the owner and the assignee;
- under the Registered Designs Ordinance, 2000, a mortgage or any other interest in a registered design can be created by executing an agreement between the parties. That agreement must be filed with the Controller of Patents and Designs in the prescribed form within the stipulated timeline;
- payment of applicable stamp duty and filing with the ROC; and
- the relevant forms of security creation must also be filed with the relevant intellectual property rights office. Registration of assignment or security creation is mandatory for patents, registered trademarks and registered designs (but is not mandatory for copyright).

6. Is it possible to take floating or general security over all of the present and after acquired property of a company (and is this common)?

Yes, floating charges are common in Pakistan.

Security enforcement

7. What are the main methods of enforcing security?

The nature of enforcement proceedings will differ according to the nature of the security and the terms on which it was granted. Security can be enforced through: (i) enforcement without court intervention; or (ii) enforcement with court intervention.

Receivership

Receivership is one of the methods of enforcing security (see Question 3 above).

Enforcement without court intervention

A pledge can be enforced by the pledgee by giving reasonable notice to the pledgor. The pledgee does not need to obtain a court order to sell the pledged assets. If the pledged assets are in the possession of the pledgee, the pledgee can directly dispose of the pledged assets and apply the proceeds against the loan. This position has been strengthened by the coming into force of the Financial Institutions (Secured Transactions) Act, 2016 ("**FIST Act**") in 2020, which expressly provides that a secured creditor may enforce the following security interests without the intervention of the courts:

- a security interest that is perfected by possession;
- an assignment of receivables by way of security;
- a security interest in a negotiable instrument that is perfected by possession;
- a security interest in a right to payment of funds credited in a deposit account that is perfected by control;
- a security interest in a motor vehicle based on a retention of title arrangement; and
- a security interest in a title document that is perfected by possession.

In connection with enforcement of mortgages, the Government has also promulgated subordinate legislation in 2018 under the FIRF Ordinance for sales of mortgaged properties by banks without court intervention. Recently a five member bench of the Lahore High Court has held that financial institutions are not required to obtain a court decree to sell mortgaged property to recover defaulting loans if they follow the prescribed rules and section 15 of the FIRF Ordinance.

Nevertheless, direct sale of mortgaged properties by mortgagees, without involvement of the court, is relatively uncommon in Pakistan. If, however, the Supreme Court of Pakistan affirms the decision of the Lahore High Court, we expect this position to start to change as financial institutions gradually become more comfortable in seeking recourse to this 'self help' remedy.

In the case of security over a right to payment of funds credited to a bank account, the secured creditor may, where such secured creditor is the depository bank, be entitled to appropriate and set off the funds credited in the bank account against the customer's obligation. Where such secured creditor is not the depository bank, the secured creditor may be entitled to instruct the depository bank to pay the funds credited in the deposit account to or for the benefit of the secured creditor, provided that an appropriate control and set-off agreement has been entered into.

Enforcement by the court

Enforcement of security by the court is the more common method of enforcing security.

Legal proceedings are instituted by the creditor, which are governed by the Code, along with any special law that applies to the particular type of creditor. For example, financial institutions can file legal proceedings under the FIRF Ordinance, however, the manner in which the suit will proceed and the technicalities arising in relation to the proceedings will also be governed by the Code.

In the case of creditors that are financial institutions, the FIRF Ordinance provides a summary procedure for the recovery of claims by financial institutions (local and foreign). Recovery suits are filed with the Banking courts, which have exclusive jurisdiction in the first instance. Appeals can be filed in the relevant High Court with jurisdiction on the matter.

On the pronouncement of judgment and decree by a Banking court, the proceedings are generally automatically converted into execution proceedings, without requiring a separate application or fresh notice to be issued to the judgment debtor.

In the event that the creditor is not a financial institution as defined in the FIRF Ordinance, the creditor may institute a suit for recovery and damages in the relevant court having jurisdiction. The proceedings will be governed by the Code. A Receiver may be appointed in this circumstance who will have authority to take control of the property.

8. With respect to share security, is it possible for the secured creditor or an appointee to exercise the voting power of the shares?

Since share security is taken by way of a pledge which normally does not involve the pledgee's name being put on the register of members, there is no automatic right to exercise voting power in respect of the pledged shares in favour of the pledgee. However, the pledgee may seek an irrevocable power of attorney or other voting trust arrangement coupled with proxies from the pledgor to secure its ability to exercise voting powers in respect of the pledged shares.

Trade and unsecured creditors

9. What forms of security or quasi-security are asserted by trade creditors or suppliers?

In Pakistan, trade creditors and suppliers are able to rely on retention of title clauses in sale contracts and liens arising under contract. An unpaid seller of goods has, by implication of law, a lien on the goods for the sale price while the seller is in possession of them and in case of the insolvency of the buyer, a right of stopping the goods in transit after the seller has parted with their possession together with a right of re-sale.

Where possession of goods has not passed to the buyer, the unpaid seller has, in addition to its other remedies, a right of withholding delivery similar to and co-extensive with its rights of lien and stoppage in transit where possession has passed to the buyer.

10. What are the main remedies and enforcement actions available to unsecured creditors for unpaid debts?

Unsecured creditors have the option of instituting proceedings against the company in court. The proceedings will be governed by the Code. If the unsecured creditor is successful in the proceedings and the court passes judgment in favour of the unsecured creditor, the unsecured creditor will then need to file execution proceedings to obtain final decree and enforcement.

Insolvency distributions and priorities

11. When are distributions made to secured and unsecured creditors in reorganisations and liquidations?

In winding up proceedings, the liquidator makes distributions in accordance with the Companies Act. The liquidator is required to distribute funds within 30 days of the sufficient funds coming into the liquidator's hands. Distribution is subject to expenses of winding proceedings and preferential payments.

Distributions in a reorganisation, if any, will be made in accordance with the terms of the scheme of arrangement approved by the Commission.

Receivers have authority only to distribute funds to the secured creditor who appointed the Receiver, upon receipt of the proceeds of enforcement.

12. What is the priority regime for distributions in an insolvency?

In winding up proceedings, the order of priority in distribution is as follows:

- costs and expenses related to the winding up procedure;
- fixed charge holders;
- any preferential payments;
- floating charge holders;
- unsecured creditors; and
- shareholders or members of the company.

The types of preferential payments include:

- all revenues, taxes, cesses (types of taxes) and rates due from the company to the Federal Government, a Provincial Government or to a local authority at the relevant date that have become due and payable within one year before that date on a pari passu basis;
- all wages or salary of any employee in respect of services rendered to the company;
- all accrued holiday remuneration payable to any employee;
- unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, all amounts due in respect of contributions towards insurance payable within one year before the relevant date, by the company as employer of any persons, under any other law for the time being in force; and
- all sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees maintained by the company.

Subject to the retention of such sums as may be necessary for the costs and expenses of the winding up, the preferential debts must be discharged so far as the assets are sufficient to meet them and, in the case of the debts to which priority is given, formal proof is not required except in so far as may be otherwise prescribed.

In the event of a landlord or other person distraining or having distrained on any goods or effects of the company within 90 days before the date of a winding up order, the debts to which priority is given by the Companies Act shall be a first charge on the goods or effects so distrained on, or the proceeds of sale thereof, provided that, in respect of any money paid under any such charge, the landlord or other person shall have the same rights of priority as the person to whom the payment is made.

13. Are there any classes of unsecured creditors that have preferential treatment in a reorganisation or liquidation?

Yes, as mentioned in Question 12 above there are certain classes of unsecured creditors, such as employees, who receive preferential treatment under the Companies Act in a winding up proceeding.

Furthermore, deposit holders of banking companies also receive preferential treatment up to the first PKR 100,000 of their deposit with an insolvent bank.

Setting aside pre-insolvency transactions

14. What transactions can be set aside in a liquidation or reorganisation?

In liquidation proceedings, a court may set aside transactions involving fraudulent preferences. A fraudulent preference occurs in respect of a creditor, surety or guarantor of the company where the company does something, or suffers something to be done, which has the effect of putting that person into a better position in the liquidation than he or she would have been in if that thing had not been done.

Fraudulent preferences can include the transfer of immovable and movable property, delivery of any goods, or payments and execution made, taken or done by or against the company within a period of 180 days prior to commencement of winding up.

Except when an order to the contrary is passed by the court:

- every transfer of shares and alteration in the status of a member made after the commencement of winding up shall, unless approved by the liquidator, be void; and
- any transfer or disposition of property, including actionable claims of the company, not being a transfer or delivery made in the ordinary course of its business or in favour of a purchaser or encumbrancer in good faith and for valuable consideration, if made within one year before the presentation of a petition for winding up by the court or the passing of a resolution for voluntary winding up of the company, shall be void.

Where a company is being wound up, a floating charge on the undertaking or property of the company created within one year immediately preceding the commencement of the winding up shall be invalid, unless it is proved that the company immediately after the creation of the charge was solvent.

Upon the appointment of a CRA Administrator, the CRA Administrator may, with the approval of the court, avoid a transfer of an interest of the company in property in favour of a creditor where such transfer:

- is made on account of an antecedent debt owed by the debtor before such transfer;
- is made within six months before the date of appointment of the CRA Administrator or, if the creditor is an insider, within one year before the date of the appointment of the CRA Administrator; and
- enables such creditor to receive more than what such creditor would have received otherwise.

The CRA Administrator shall not avoid any transfer which is:

- intended by the company and the creditor to be a contemporaneous exchange of new value given to the company;
- made in the payment of a debt incurred in the ordinary course of business and on ordinary course terms; or
- for the benefit of a creditor to the extent that such creditor gives new value to or for the benefit of the company subsequent to the transfer.

Finally, after notice and hearing in court, a CRA Administrator may abandon any property of the company that is burdensome or that is of inconsequential value and benefit to the company.

15. Is there a 'suspect period' prior to formal insolvency during which transactions may be set aside?

Yes, as mentioned in Question 14 above, the 'suspect period' is 180 days or one year in the case of an insider.

Director liability and compulsory filings

16. Are there circumstances where companies are required to commence insolvency proceedings? What are the consequences of failure to do so?

There are no express provisions in the Companies Act which require the company to commence insolvency proceedings, unless the company's articles and memorandum of association stipulate winding up after a certain period of time or after a particular purpose for which the company was established has been fulfilled.

17. Can directors or management be subject to any civil or criminal liability for trading while insolvent or other analogous concepts?

There are no express provisions in the Companies Act which require the company to commence winding up proceedings. The officers of the company may conduct business while the company is insolvent, unless there is an intention to defraud the company's creditors.

However, a director or responsible officer of a company which is ordered to be wound up by the court or which passes a resolution for voluntary winding up can face liability if it is proved that the directors or officers:

- have by false pretences or by means of any other fraud, induced any person to give credit to the company;
- with intent to defraud creditors of the company, have made or caused to be made any gift or transfer of or charge on, or has caused or connived the levying of any execution against, the property of the company; or
- with intent to defraud creditors of the company, have concealed or removed any part of the property of the company after, or within 60 days before, the date of any unsatisfied judgment or order for payment of money obtained against the company.

The director and officers of a company can also face liability if proper books of accounts are not kept. Actions against directors, officers and members can be initiated by the court of its own accord, by the liquidator or on application of any person interested in the winding up.

18. Do directors owe any duties to creditors once a company is insolvent or in financial distress?

Directors owe a duty not to defraud creditors.

Lender liability

19. Is there a concept of 'shadow directorship' that can lead to creditors becoming liable for actions of the company or the directors?

Under Pakistani law, a shadow director is a person who is not formally appointed as a director but who gives directions or instructions that the directors of the company are accustomed to act upon. The concept remains underdeveloped and there is no reported precedent confirming that shadow directors can be liable to creditors of the company for the actions of the company or the formally appointed directors.

20. Are there any other key liability risks for creditors to consider when engaging with companies and directors in pre-insolvency restructuring negotiations?

There are certain risks for creditors that participate in negotiations in respect of an arrangement or compromise under section 279 of the Companies Act, including a risk that disposals of property by the company may subsequently be set aside.

The concept of lenders and creditors becoming liable to other creditors as a result of pre-insolvency restructuring negotiations is under-developed and untested in Pakistan. Specific legal advice should be sought by creditors in these circumstances.

Credit bidding

21. Is credit bidding possible?

Winding up

There is no express statutory provision relating to credit bidding in winding proceedings in Pakistan. In such proceedings, the liquidator has control of the property and the manner in which it is sold is subject to the requirements of the liquidator and/or the court. If a creditor wishes to purchase the secured property and offset the secured debt against the purchase price, it may apply to the liquidator or to the court, as the case may be, and it will be in the discretion of the court and/or liquidator to allow such an arrangement.

Security enforcement

Under the FIRF Ordinance, a financial institution can take part in an auction for the sale of secured property over which it has a mortgage. Financial institutions need to make the highest bid in order to acquire the property and they cannot acquire it without holding an auction. The entire process may be subject to the supervision of the court.

22. Are there any rules regarding 'self-dealing' that restrict the ability to credit bid?

As noted in Question 21 above, self-dealing is not absolutely prohibited so long as safeguards such as the making of the highest bid under supervision of the courts, are followed.

Pre-packaged sales/reorganisations

23. Are pre-pack sales or reorganisations permitted or usual?

Pre-pack sales as part of a reorganisation procedure are permitted (and common) and can be sanctioned through the compromise and arrangement mechanism provided in section 279 of the Companies Act under supervision of the Commission. Once an arrangement, which could include a pre-pack sale, is agreed upon by the management of the company, its members and the creditors, the formal process to enforce the arrangement must be adhered to.

There are no mandatory provisions in the Companies Act which require a company to seek a pre-pack sale of the business before the commencement of winding up proceedings.

24. Is it possible for creditors and the company to pre-agree a restructuring prior to commencing a formal reorganisation process?

As noted in Question 23 above, creditors and the company may agree to terms before commencing formal restructuring, pursuant to section 279 of Companies Act, which envisage that proposed arrangements must be sanctioned by the Commission. Pursuant to section 279, where a compromise or arrangement is proposed, an application may be made by the company or any creditor requesting that the Commission order a meeting of all the creditors or class of creditors for their consent. If a majority representing 75% in value of creditors or class of creditors present and voting in person or by proxy at the meeting agree to any compromise or arrangement, the same may be sanctioned by the Commission and shall become binding on all creditors or class of creditors and also on the company.

The Commission's approval is a necessary condition and the law requires all material facts, financial statements, auditor reports and other relevant documents to be disclosed to the Commission. If the Commission remains unsatisfied with the proposed compromise or arrangement it may give directions to modify the proposed compromise or arrangement.

Debt trading

25. Is it common for the debt of distressed companies to be traded?

Loan sell downs are not uncommon in Pakistan.

Pursuant to the Corporate Restructuring Companies Act, 2016 ("**Corporate Restructuring Act**"), corporate restructuring companies may be incorporated for the specific purpose of taking over non-performing assets of financial institutions. A non-performing asset is a financial asset held on the books of a financial institution with respect to which an obligor has been in arrears for more than one year on any payment obligation (or which has been classified as a loss in the books of the financial institution) and includes all security interests with respect thereto.   A corporate restructuring company may also acquire such non-performing assets through trusts created for this purpose by it. Furthermore, a corporate restructuring company holding at least two-third in value of the principal amount payable to a secured financial institution, may present a scheme to the corporate restructuring board (notified by the Federal Government) which may sanction a restructuring scheme in accordance with the Corporate Restructuring Act. The provisions of the Corporate Restructuring Act remain untested.

Over a decade ago, a Corporate and Industrial Restructuring Corporation ("**CIRC**") was set up under a similar law which has since expired. The CIRC law enabled the carrying out of an effective non-performing loan (“**NPL**”) acquisition and recovery programme which resulted in the acquisition of 254 of the most problematic NPLs of around PKR 50 billion, and the revival of almost 140 sick industrial units which were sold to new entrepreneurs.

Early in 2020, a new corporate restructuring company, the Pakistan Corporate Restructuring Company Limited was established by 10 leading Pakistani banks with the support of the SBP. The reported mandate of this company is to acquire, manage, restructure, resolve non-performing assets of financial institutions and reorganise and revive the commercially and financially distressed companies.

26. Are there any legal or process restrictions on who can acquire the debt of corporate borrowers?

Debt trading by financial institutions is regulated by the Commission. Corporate restructuring companies, duly licensed by the Commission, can take over non-performing assets of a financial institution. Pursuant to section 6 of the Corporate Restructuring Act, a financial institution, with the prior approval of its board of directors, may trade its non-performing assets to corporate restructuring companies by entering into a transfer and assignment agreement. Pursuant to the said section, such transfer and assignment agreements result in the transfer of benefits and risks associated with the non-performing assets. The Corporate Restructuring Act pursuant to certain amendments introduced in 2021 also allows financial institutions to appoint a duly licensed corporate restructuring company to act as its agent for recovery of non-performing assets.

Debt for equity swaps

27. What process is required for a debt for equity swap outside a formal reorganisation procedure?

When issuing shares, companies are required to comply with the relevant provisions of the Companies Act, the Securities Act and the memorandum and articles of association of the company. According to section 83 of the Companies Act, upon passing a special resolution and obtaining approval from the Commission, a company may issue shares to its creditors as part of debt for equity swap scheme where it does not conduct a rights issue of shares. Otherwise, a debt for equity swap may be conducted in circumstances where the Company conducts a rights issue and all its existing shareholders refuse to accept such rights issue of shares. In those circumstances the 'rump' may then be offered to the company's creditors as conversion of their debt to equity.

Under the Companies Act, a loan to a public sector company from the government can be converted into equity. In the case of a loan taken from the Federal or Provincial government by a public sector company, the respective government may, by order, direct that the said loan or any part thereof, be converted into shares of that company, even if the terms of such loan do not include the option for such conversion.

28. To what extent can a debt for equity swap be implemented without such processes in a reorganisation procedure?

The Commission has wide ranging powers to effect a reorganisation (including approving debt for equity swaps) as part of a scheme of arrangement provided that the approval of 75% of the members and/or creditors, as the case may be, is in place to give effect to the scheme of arrangement.

29. Are there any foreign ownership restrictions on companies or other assets?

Pursuant to the Investment Policy 2013, all sectors of economy, with the exception of a few strategic industries, are open for foreign investment and there are no minimum or maximum equity requirements. Foreign nationals (natural persons) may not directly acquire immovable property in Pakistan without the consent of the Ministry of Interior. They may acquire property through Pakistani incorporated corporate vehicles.

Informal financial restructurings and work outs

30. Are informal financial restructurings of distressed companies common?

The practice of informal financial restructuring is not common in Pakistan. Because of the wide-ranging powers of the Commission, every scheme aimed at restructuring requires approval and oversight of the Commission in order to protect members, creditors and other stakeholders from business malpractices.

Cross border insolvency

31. Has the UNCITRAL Model Law been adopted? Are there any significant modifications to its application?

No, Pakistan has not adopted the UNCITRAL Model Law on Cross Border Insolvency.

32. Have the courts adopted the JIN cross-border cooperation guidelines?

Pakistani courts have not adopted the JIN cross-border cooperation guidelines. However, as these guidelines aim to strengthen efficient and effective communication between courts in insolvency cases with cross-border effects, the courts may agree to refer to the JIN guidelines while adjudicating matters of cross border insolvency. However, it should be noted that Pakistani courts have limited experience with cross border insolvency.

33. Are there any other grounds upon which assistance or recognition can be granted to foreign insolvency processes?

Under Pakistani law, there are no such grounds upon which assistance or recognition can be granted to foreign insolvency processes.

34. Will courts in your jurisdiction generally recognise the effectiveness of a compromise of debt effected under an insolvency or restructuring process that occurs in the same jurisdiction as the governing law of that debt obligation?

While under Pakistani conflicts of laws principles, Pakistani courts ought to follow the rule in Gibbs and generally recognise the effectiveness of a compromise or discharge of debt effected under an insolvency or restructuring process that occurs in the same jurisdiction as the governing law of that debt obligation, this concept remains untested in Pakistani courts.

Recent trends and developments

35. Describe any recent trends or developments in Pakistan

The Companies Act, which is intended to facilitate modern business practices in an evolving economic environment, has introduced some significant legislative changes and new concepts, although the substantive law of insolvency has not been materially changed.

The Corporate Restructuring Act has reformed the establishment of corporate restructuring (debt trading) companies, but the legislation is currently untested.

Law reform

36. Is there any anticipated insolvency, restructuring or security law reform in Pakistan?

The FIST Act has been enacted and came into force in 2020. The FIST Act provides a comprehensive code for the creation and registration of security interests over movable property to secure the obligations owed by a customer to a financial institution. The FIST Act also clarifies and expands the law relating to the priority of security interests, provides for the establishment of a secured transactions registry and codifies certain laws relating to security interests over movable property. This is a very important codification of securities law in Pakistan and the enforcement of the FIST Act has been eagerly awaited by the banking community. Further changes were introduced to the FIST Act in 2021 to further accommodate common banking and security transactions as they are structured in the context of Islamic finance.

Changes introduced to the Corporate Restructuring Act in 2021 are also designed to make it easier for financial institutions to restructure and recover their non-performing loans and take them off their books to improve their balance sheets.

37. COVID-19 Measures

What temporary or permanent changes to insolvency or restructuring law have been enacted in your jurisdiction to address the COVID-19 crisis?

There have been no specific legislative reforms or measures (at the time of writing) regarding insolvency or restructuring laws in Pakistan, with a view to responding to the special circumstances created by COVID 19 pandemic.

Glossary – Pakistan

Code
Code of Civil Procedure, 1908

Commission
Securities and Exchange Commission of Pakistan

Companies Act
Companies Act, 2017

Companies Ordinance
Companies Ordinance, 1984

CRA
Corporate Rehabilitation Act, 2018

Corporate Restructuring Act
Corporate Restructuring Companies Act, 2016

FIRF Ordinance
Financial Institutions (Recovery of Finances) Ordinance, 2001

FIST Act
Financial Institutions (Secured Transactions) Act, 2016

Insurance Ordinance
Insurance Ordinance. 2002

ROC
Registrar of Companies

SBP
State Bank of Pakistan

Securities Act
Securities Act, 2015

Transfer of Property Act
Transfer of Property Act 1882

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Akhund Forbes is a leading Pakistani full service corporate and commercial law firm which specialises in advising leading financial institutions, corporations and governments on their most challenging transactions, projects and dispute resolution matters. It has one of the larger dedicated corporate transactional team of lawyers in Karachi which is the commercial hub of Pakistan.

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