

Pakistan has a comprehensive debt recovery and corporate restructuring and insolvency legislative framework. Debt recovery is governed largely by the Code of Civil Procedure 1908. Banking companies are covered by special legislation, the Banking Companies (Recovery of Loans, Advances, Credits and Finances) Act 1997. Corporate restructuring and insolvency laws are based almost entirely on the equivalent English laws and are found in the Companies Ordinance 1984. In an attempt to keep pace with developments in other jurisdictions, the legislature has promulgated other new laws including the Corporate and Industrial Restructuring Ordinance 2000 (concerning the restructuring and management of the non-performing assets of certain banks and financial institutions) and the Companies (Rehabilitation of Sick Industrial Units) Rules 1999.

The issue in Pakistan is not the lack of an adequate and comprehensive legislative framework, but rather the lack of a speedy and efficient implementation process. Legal proceedings are generally protracted, partly due to the caseload.

1 Describe the nature and the effectiveness of the following processes:

a) Civil unsecured debt collection remedies.

Legal proceedings may be instituted against the debtor by the creditor. These will be governed by the provisions of the Code of Civil Procedure 1908 ("the Code"). After hearing the suit in accordance with the Code, the court passes judgment. The creditor must then commence execution proceedings to obtain enforcement. Legal proceedings, however, are generally slow. There is a backlog of approximately 20 years on the original jurisdiction side of the High Court of Sindh and the appeal process can take up to five years.

b) Secured property enforcement remedies.

A secured debt may also be recovered by initiating a suit for damages against the debtor as discussed in Section 1a. In addition, legal proceedings may be commenced against the person providing the security. The nature of the enforcement proceedings will differ according to the nature of the security.

If the debt is secured by a mortgage, then the mortgagee may (at any time after the debt becomes due) institute a suit for foreclosure or sale of the mortgaged property against the mortgagor. Both suits give the mortgagor an opportunity to pay the creditor the amount due to him. If payment is not made within the prescribed time period, then, in the case of a suit for foreclosure, the mortgagor is debarred from redeeming the mortgaged property and is required to give possession of the mortgaged property to the creditor (where necessary). In the case of a suit for sale, if payment is not made within the prescribed time period then the mortgaged property may be sold and the proceeds applied for the repayment of the debt. If the proceeds of sale are insufficient, then the court may pass a decree for the recovery of the balance amount from the mortgagor. The creditor may also institute a suit for the recovery of the amount secured by the mortgage against the mortgagor in a number of different circumstances.

If the debt is secured by a pledge or hypothecation of goods and the debtor makes a default in the payment of the debt, or in the performance of the promise for which the goods were pledged, then the creditor may either initiate a suit against the debtor upon the debt or promise and retain the goods pledged as collateral security, or sell the pledged goods (having given the debtor reasonable notice of the sale). If the proceeds of the sale are insufficient, the debtor is liable to pay the balance amount due and any proceeds in excess of the amount due must be paid by the creditor to the debtor.

The comments in Section 1a above on the protracted nature of legal proceedings are equally applicable here.

c) Any special debt collection or secured property remedies that are available to banking sector creditors.

Banks seeking to recover debts benefit from special legislation in Pakistan. The banking company may institute an action in a banking court if a borrower or customer (including a surety or indemnifier) defaults on a loan or finance provided by a banking company. The advantage of proceedings before banking courts (as opposed to the ordinary courts) is that the banking courts are specialized and follow procedures

geared to the expeditious disposal of debt recovery suits. If the debt is secured by a mortgage and the suit filed before the banking court is for its enforcement, the mortgagor is not given the opportunity to pay the creditor the amount due to him – rather, the court will pass a decree for foreclosure or sale at the first instance. If the banking company is seeking to recover the debt through the sale of any property pledged, mortgaged, hypothecated, assigned or otherwise charged as security for the debt, the banking court may at any stage of the proceedings do one of the following:

- ▲ Restrain or injunct the sale, creation or transfer of an interest or charge or lease or disposal of the property.
- ▲ Attach the property or appoint a receiver for the property.

Also, a banking company may, having obtained a decree in its favor, sell pledged or mortgaged property with or without the intervention of the banking court, either by public auction or by inviting sealed tenders. The proceeds can then be appropriated towards satisfaction of the decree. If the banking company sells or seeks to sell such property, but is unable to obtain voluntary possession for this purpose, the banking court will give possession of such property to the purchaser, or to the banking company, as the case may be.

The Corporate and Industrial Restructuring Corporation has been entrusted with the acquisition, restructuring, rehabilitation, management, disposition and realization of the “non-performing asset(s)” of certain banks and financial institutions in which the Federal Government holds 85 percent or more of the shares. Any financial asset (such as a loan) which is held as an asset in the books of the relevant bank or financial institution and with respect to which the obligor has been in arrears on any payment obligation for a period of more than 365 days, and with respect to which the obligor’s outstanding payment obligation exceeds PRs10 million, is a “non-performing asset”. The corporation may proceed in respect of the non-performing assets of certain banks and financial institutions in which the federal government holds 85 percent or more of the shares. The corporation is empowered, amongst other things, to acquire, manage, restructure, rehabilitate, sell and dispose of non-performing assets and to initiate actions for the recovery of non-performing assets including filing suits and appeals, entering into settlements through the courts or outside.

The corporation also has, for the purposes of the rehabilitation, management and restructuring of the obligor in respect of whom any non-performing assets and collateral are held by it or on its behalf, been empowered to do the following:

- ▲ Request the relevant regulatory body to appoint an administrator to manage the obligor’s affairs.
- ▲ Apply to the relevant regulatory body to initiate the sick industrial companies process.

d) Corporate bankruptcy/liquidation processes that are available to corporate debtors and creditors.

Where a company is unable to pay its debts, any creditor or creditors of the company may apply to the court for its winding-up by submitting a winding-up petition. A company is deemed to be unable to pay its debts when, for instance, a creditor to whom the company is indebted for an amount exceeding 1 percent of its paid up capital, or PRs50,000, whichever is less, has made a written demand for its payment and the company has not paid or secured or compounded it to the creditors’ satisfaction within 30 days. If the court makes a winding-up order, it will appoint an official liquidator to effect the liquidation.

In addition, if a company is being voluntarily wound-up by its shareholders, its directors are required to make a declaration to the effect that, in their opinion, the company has no debts or that it will be able to pay all its debts within a specified period. If, at any time, the liquidator responsible for the voluntarily winding-up of a company by its shareholders is of the opinion that the company will be unable to pay its debts within the period specified in the declaration, or if that period has expired and the debts have not been paid, then the liquidator is required to summon a meeting of the company’s creditors. The creditors may appoint a different liquidator at that meeting. Further, a company that is insolvent and is proposed to be voluntarily wound-up by its shareholders is required to summon a meeting of its creditors. At that meeting, if the creditors nominate a different person from the person nominated by the company as liquidator, then the person nominated by the creditors will be the liquidator responsible for the winding-up.

e) Formal corporate rescue processes that are available to corporate debtors and creditors.

If a compromise or arrangement is proposed between a company and its creditors, or any class of them, the court may, on an application by the company or any creditor or (in the case of a company which is being wound-up) the liquidator, order a meeting of the creditors or a class of creditors to be called and conducted in such a manner as the court directs. If at least 75 percent of the creditors or class of creditors present and voting at such meeting agree to a compromise or arrangement and such compromise or arrangement is sanctioned by the court, then it will be binding on the creditors or class of creditors and the company, or in the case of a company which is being wound-up, the liquidator and the shareholders of the company. If the court is satisfied that a sanctioned compromise or arrangement cannot be worked satisfactorily with or without modifications it may, either on its own motion or upon an application being made by the registrar or any person interested in the affairs of the company, order the winding-up of the company.

A creditor(s) having an interest equivalent in amount to at least 60 percent of the paid up capital of a company may in certain circumstances request the relevant regulatory body to appoint an administrator to manage the affairs of the company. These circumstances can include, for instance, when the affairs of the company are being conducted with an intent to defraud its creditors, or when the accumulated losses of the company exceed 60 percent of its paid-up capital, or when the company has defaulted on the repayment of a debt of PR\$1 million or more, as adjudicated by a court.

f) Informal corporate rescue processes.

There is no developed practice regarding such processes in Pakistan.

g) Any other corporate insolvency, or insolvency-related, processes that are available under special legislation.

The Federal Government of Pakistan has set up a Task Force for Revival of Sick Industrial Units which is required to identify sick industrial companies. If the Bankers' Committee is of the opinion that a company owning an industrial unit is facing financial or operational problems, it must report this to the Task Force. If, after considering the Bankers' Committee's report and other evidence, the Task Force is of the opinion that the company is a sick company, it is required to make a reference to the Federal Government. The Federal Government may declare it to be a sick company having considered the Bankers' Committee's report and the Task Force's reference. If the Federal Government declares a company to be a sick company it will ask the Task Force to prepare a plan for its rehabilitation. This must be submitted to the Federal Government for approval. The Federal Government will cause the plan to be published in the official Gazette to ascertain the views of the shareholders, creditors and other concerned persons within a specified period of time. Having considered these views, the Federal Government may approve the rehabilitation plan. Once a rehabilitation plan is approved by the Federal Government it becomes valid, binding and enforceable in all respects notwithstanding anything to the contrary contained elsewhere. The Federal Government may vary or rescind a rehabilitation plan from time to time and may issue directions for its implementation. Implementation will be supervised by the Federal Government or any authority or person authorized by the Federal Government in this regard.

2 What is the effect upon debt enforcement and secured property enforcement processes of:

a) An adjudication of corporate bankruptcy/liquidation?

Once a winding-up order for a company has been passed, no suit or other legal proceedings may be proceeded with or commenced by or against that company except with the leave of, and subject to any terms imposed by, the court responsible for the winding-up. The court may entertain or dispose of any suit or proceeding by or against the company.

b) The commencement of formal corporate rescue process?

The court may, at any time after application for a compromise or arrangement between a company and its creditors or any class of them is made to it, stay the commencement or continuation of any suit or proceeding against the company on such terms as it sees fit until the application is finally disposed.

c) The initiation of an informal corporate rescue process?

There is no experience of such processes in Pakistan.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

There is no specific effect under the Sick Industrial legislation mentioned earlier.

3 What is the effect on the management of a corporation of:

a) An adjudication of corporate bankruptcy/litigation?

The court will appoint an official liquidator and the management of such company will, in effect, vest in the official liquidator. In any voluntary winding-up, upon the appointment of a liquidator, all the powers of the directors, chief executive and other officers cease and management, in effect, vests in the liquidator.

b) The commencement of a formal corporate rescue process?

Where an application is made to the court for sanctioning a compromise or arrangement between a company and its creditors (or any class of them) and the compromise or agreement is for the purposes of a scheme of reconstruction or amalgamation of a company, then the court may make orders to facilitate the transfer of the whole or any part of the undertaking of a company, which may effect the management of the company.

c) The initiation of an informal corporate rescue process?

There is no experience of such processes in Pakistan.

d) The initiation of an insolvency, or insolvency-related, process under any special legislation?

The rehabilitation plan prepared by the Task Force and approved by the Federal Government in respect of a sick industrial company may contain such provisions as are deemed appropriate by the Task Force/Federal Government for the rehabilitation, reconstruction and re-organization of the company, including the removal and appointment of directors and other officers of the company. Essentially, a sick industrial company must be managed in accordance with the provisions of its rehabilitation plan.

4 Who is responsible for “case management” control and administration:

a) A corporate bankruptcy/liquidation?

The “case management” control and administration for a compromise or arrangement for the winding-up of a company by the court vests in the court and the official liquidator, and in the event of a voluntary winding-up, it vests in the company, the creditors and the liquidator.

b) A formal rescue?

The “case management” control and administration for a compromise or arrangement between a company and its creditors or any class of them vests in the court and any person appointed by the court to effect the compromise or arrangement.

c) An informal rescue?

There is no experience of this process in Pakistan.

d) A case of corporate insolvency under special legislation?

The “case management” control and administration in respect of a sick industrial company vests in the Task Force and the Federal Government.

5 Who has the responsibility for the preparation of the plan of rescue under:

a) A formal rescue?

In the event of an application for a compromise or arrangement between a company and its creditors or a class of them the court will, most likely, require the applicant to prepare the plan of rescue.

b) An informal rescue?

There is no experience of this process in Pakistan.

c) A case of corporate insolvency under any special legislation?

Where a sick industrial company is concerned, the rescue plan will be prepared by the Task Force and may be amended prior to approval and thereafter by the Federal Government.

6 How are the different classes of creditors treated in relation to:

a) A corporate bankruptcy/liquidation?

Upon the winding-up of a company, certain debts such as all revenues, taxes, cesses (assessments) and rates payable to the Federal or a Provincial Government and the wages and salaries of, and other payments to, employees are paid in priority to other debts.

b) A formal rescue?

Where an application is made to the court for the sanctioning of a compromise or arrangement between a company and its creditors, or any class of them, and the compromise or arrangement is for the purposes of a scheme of reconstruction of a company, the court may make orders for the purposes of facilitating and effecting the same, which orders may affect the priority of debts.

c) An informal rescue?

There is no experience of this process in Pakistan.

d) A case of corporate insolvency under special legislation?

The rehabilitation plan prepared by the Task Force may reschedule the debts of the company, modify the terms and conditions of any of its outstanding debts and liabilities and vary the rights of any creditors (or class of them), including any relevant security.

7 What is the position of both unsecured and secured creditors who vote against, do not agree with, or do not consent to, a plan of rescue in relation to:

a) A formal rescue?

If a compromise or arrangement is approved by the required majority vote of the creditors (or a class or classes of creditors) and sanctioned by the court, it is binding on all creditors.

b) An informal rescue?

There is no experience of this process in Pakistan.

c) A case of corporate insolvency under any special legislation?

Every rehabilitation plan formulated by the Task Force must be submitted to the Federal Government for approval and the Federal Government will, unless it otherwise decides for reasons to be recorded, publish the plan in the official Gazette to ascertain the views of the shareholders, creditors and other concerned persons before its approval. Creditors should communicate any reservations they might have within the time period specified by the Federal Government. An approved rehabilitation plan is, however, binding on all creditors and the company.

8 In relation to the need for an insolvent corporation to have urgent working capital funding, what difficulties are encountered in the provision of such funding in relation to:

a) A formal rescue?

An insolvent company that wishes to raise working capital urgently by issuing shares at a discount would require approval from its shareholders and the relevant regulatory body.

An insolvent company may face difficulties if it wishes to raise working capital through debt financing. For instance, when providing a financial facility, a bank or other financial institution must ensure, amongst other things, that a certain debt to equity ratio is maintained.

b) An informal rescue?

There is no experience of this process in Pakistan.

c) A case of corporate insolvency under special legislation?

There are no provisions regarding this subject under the Sick Industrial Companies legislation mentioned earlier.

9 Briefly describe the relevant provisions relating to the setting aside of antecedent and fraudulent transactions in relation to:

a) A corporate bankruptcy/liquidation.

A conveyance, mortgage, delivery of goods, payment, execution or other act relating to property made or done by or against a company within six months before the commencement of its winding-up may be deemed a fraudulent preference of its creditors and may, therefore, be invalid. Where a company is being wound-up by the court, any attachment, distress or execution against the estate or effects without the leave of the court or any sale of any of the properties of the company without the leave of the court will be void. A floating charge on the property of the company created within 12 months of its winding-up will, unless the company was solvent immediately after the creation of the charge, be invalid except to the extent of any cash paid at the time of, or subsequent to, the creation of, and in consideration for, the charge.

b) A formal rescue.

The provisions covering attachment, distress or execution against the estate or effects or any sale of any of the properties of the company and with regard to a floating charge are applicable in the case of an application to the court by the creditor(s) for the prevention of mismanagement or oppression as well.

c) A case of corporate insolvency under special legislation.

There are no provisions relating to this subject under the Sick Industrial Companies legislation mentioned earlier.

10 Are there any provisions of a law that might operate to invalidate a secured property transaction in relation to:

a) A corporate bankruptcy/liquidation?

b) A formal rescue?

c) A case of corporate insolvency under special legislation?

Please refer to Section 9 above.

11 Describe the difficulties that are encountered in endeavoring to administer cases of corporate bankruptcy/liquidation and formal corporate rescue that involve property and business interests located in more than one jurisdiction.

If the property of an insolvent company is outside Pakistan, it would need to be dealt with by instituting appropriate proceedings in that jurisdiction. However, if such assets are situated in the United Kingdom, then a decree by a Pakistani court may be able to be executed in the United Kingdom. Under Pakistani law, a decree of any of the superior courts of the United Kingdom can be filed in a Pakistani court and executed in Pakistan as if the decree had in fact been passed there. Reciprocal arrangements in respect of the execution in the United Kingdom of decrees passed by Pakistani courts exist in the United Kingdom.

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