



**RESEARCH PAPER**

**Pakistan's New Corporate Rehabilitation Act 2018: A Critical Assessment**

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**ABSTRACT**

This paper is designed to throw an insight into the legal frame work of corporate rescue prevailing in Pakistan for the companies which are at the brink of insolvency. While doing so this paper not only traces the roots of existing legal frame work of corporate rescue but also examine the relevant provisions of the law dealing with corporate rescue in our jurisdiction i.e Corporate Rehabilitation Act 2018. This paper apprised that, despite the fact that Corporate Rehabilitation Act 2018 is a result of continuous efforts of more than a decade, this Act is not entirely in accordance with the need of a financially distress company as well as with the socio economic condition of our jurisdiction rather it possess certain lacunas. By this analytical overview the paper aims to provide the reader with the instigation of thought for making possible improvements in our present law in order to make the same aligned with the need to protect the viable companies from collapse. It is concludes by proposing certain recommendations to overcome the shortcomings reflected by the existing legal framework for corporate rescue in Pakistan.

**Introduction**

In the realm of corporate insolvency law the term corporate rescue in not uncommon. This concept was introduced at international level by the publication of cork report in England in year 1982. Subsequently, this concept was endorsed by several countries. Corporate rescue is basically a component of corporate insolvency law. In the beginning the corporate insolvency law of each country provided the only possible solution for a company facing final difficulty in shape of its dissolution. However, with the passage of time the term corporate rescue was added as a component of corporate insolvency law with the aim to protect the company striving for financial assistance. In the realm of corporate world the existence of companies facing financial difficulties is not unusual however, in absence of any stringent policy to avert their failure the frequent collapse of such companies can set

back the economy of any country. As a matter of fact there may be several reasons for financial distress of a company like weakness in management, lack of effective corporate planning, production issues, obsolete technology, lack of finance and human resource problems. However, the main focus of this paper is to appraise the possible solutions available to a distress company facing any of such issue. Whenever a company is in financial distress, legally it has certain options aiming to protect the interest of creditors and that of the company itself. As an outline currently the corporate insolvency law of each country includes the provisions geared to rescue a company where possible and in case the rescue is not possible to dissolve the company.

In Pakistan the corporate insolvency law was initially embodied in Companies' Ordinance 1984 however, the same did not entail a comprehensive procedure for corporate rescue. To overcome this deficiency, like many other countries, Pakistan also underwent through a process of legislative reforms and development in relation to corporate rescue legislation. In the beginning, besides other temporary arrangements in shape of different amnesty schemes and waiver of taxes on long standing unpaid loans, efforts to create a full-fledge law for facilitating the rehabilitation of financially sick companies were also in progress.

Legislature in Pakistan introduced the first draft on Corporate Rehabilitation Act ("CRA") while considering the suitability of corporate rescue regime of US initially in year 2002 and thereafter in 2004. The 'DCRA, 2004' incorporated many of the feature of rescue model of US, like it provided for both voluntary filing on behalf of the company and involuntary filing by any of the interested parties (DCRA 2004, Section 11 & 12). The DCRA 2004 not only gave the concept of debtor in possession but also provided for the administration in case administrator is appointed by the court to manage the day to day business of debtor (DCRA 2004, Section 22 & 24). Like chapter 11 rescue model of US the concept of moratorium was also incorporated in DCRA of 2004 (DCRA 2004, section 15). Though, the pressure to bring a corporate rescue law in line with US model of corporate rescue appeared to come from industrialists, who manifestly have substantial influence (Jamal, 2015). However, the draft was strongly resisted by the financial sector for more than a decade who presumed it as a complex rescue model that would anticipate their efforts for recovery of outstanding debts.

Thereafter, in year 2009, again the government machinery was put into motion to bring the law for stability of companies and for recovery of outstanding debts by revising the DCRA of 2004 but no successful results came out.

Thereafter in year 2011 another draft on corporate rehabilitation law was prepared which was also in line with the U.S Corporate rescue model but with certain modifications as compared to previous drafts. However, this draft of 2011 like previous one also met the same fate and was also criticized by the stake holders especially by the financial institutions (Zuberi, 2012).

In year 2013, SECP again took the initiative to propose a corporate rehabilitation law which supposedly maintains a balance between debtor-creditor relationship instead of giving priority to the company at the stake of interested party, and for this purpose public consultation was also carried out. The representative of financial as well as business sector appreciated that model law should follow the principle that “a company as a going concern is worth more than the sum of its assets” yet the disagreement regarding the feature and procedure of CRA subsisted more than a decade and finally the ‘Corporate Rehabilitation Act 2018’ has been promulgated in March 2018, which attempted to mark a shift in direction of corporate rescue culture in the country. Although the main theme of this paper is to critically evaluate the new law regarding rehabilitation of financially sick companies however, it seems indispensable that before critically examining the prescribed law its core features should be looked into.

### **Core Features of CRA 2018**

An overview of the Corporate Rehabilitation Act 2018 evinces that it provides a court driven model for rehabilitation of financially constrained companies, a procedure similar to what is provided under the US Code. According to this Act where a company is having financial debts of 100 million rupees or upward it can apply to the court for its rehabilitation.

Corporate Rehabilitation Act, 2018 also provides for stay of action in order to secure the assets of the distressed company (Corporate Rehabilitation Act 2018, section 12). Unlike previous drafts on the subject referred above this Act did not provide for any entity like corporate rehabilitation board though this Act gives the concept of mediator who shall be insolvency expert in the prescribed field and will be hired by the court in relation to the plan of rehabilitation filed in court (Corporate Rehabilitation Act 2018, section 5 &10). Under this Act of 2018 power to confirm a rehabilitation plan rests with the court (Corporate Rehabilitation Act 2018, section 14). Moreover, the court is also given the power to get the confirmed rehabilitation plan implemented (Corporate Rehabilitation Act 2018, section 15). According to corporate rehabilitation Act 2018, revocation of confirmed rehabilitation plan can only be done by the court and that too on the basis of fraud only (Corporate Rehabilitation Act 2018, section 16). Furthermore, the concept of corporate restructuring companies, which was incorporated in earlier drafts on the subject, has also been ousted from this Act. However, regarding corporate restructuring companies a separate Act has been enacted with the purpose to create and establish the corporate restructuring companies to carry on the business of restructuring or reorganizing the non performing assets as well as the distressed companies (Corporate Restructuring Companies Act, 2016). Besides, the above mentioned salient features the Corporate Rehabilitation Act 2018 provides a step by step procedure for rehabilitation of financially sick companies which is briefly discussed as under.

## **Commencement of Case**

According to this newly promulgated Act, the case is commenced by filing a petition under this Act which may be filed either voluntary or involuntary. In voluntary case, a petition is filed by a debtor (sick company) itself while an involuntary case under this Act commences on filing of petition by the qualifying creditor before the court. The term qualifying creditor has also been defined under this Act. According to the provisions of this Act, "qualifying creditors" means "one or more creditors holding unpaid and overdue claims for an aggregate amount of not less than 2/3<sup>rd</sup> of the value of the assets of debtor as per its latest balance sheet" (Corporate Rehabilitation Act, 2018, Section 2(q)). However, the original jurisdiction under this Act to deal with the matters arises therein rests with high court (Corporate Rehabilitation Act, 2018, Section 2(e)).

According to this Act after filing of petition before the designated court the next step would be passing of order of mediation by the concerned court.

## **Order for Mediation**

According to the provisions of CRA 2018 after notice and hearing of a petition filed under this Act, the court shall through written order appoint a sole or joint mediator regarding the plan of rehabilitation filed under this Act (Corporate Rehabilitation Act, 2018, Section 10). The CRA 2018 also entails the qualification of a mediator appointed under this Act according to which the mediator is required to be the insolvency expert referred to in section 5 of CRA 2018. (Corporate Rehabilitation Act, 2018, Section 10). The basic purpose of mediation is to achieve the acceptance of plan of rehabilitation either by the creditors where the plan of rehabilitation is proposed or in other words filed in Court by the debtor or by the debtor where the plan of rehabilitation is filed in court by the qualifying creditors (Corporate Rehabilitation Act, 2018, Section 5(2)).

## **Moratorium**

The term moratorium is not an innovative concept within the ambit of insolvency laws rather it is among the important feature of rescue model of almost each jurisdiction. The literal meaning of moratorium is "An authorized postponement, in the deadline for paying a debt or performing an obligation" (Black's Law Dictionary). The purpose of moratorium in corporate rescue proceedings is similar all around the world i.e. to stops all litigation pending against the debtor and its property including creditor's enforcement of lien and acquisition of possession by lessors, and other creditor action, whether such actions have been taken through the medium of court or otherwise (Spiro, Westermann & Cruz, n.d).

The CRA 2018 also provides for moratorium or stay of action against the debtor i.e. the sick company, in case the matter is being proceeded before the court under this Act, in order to preserve not only the assets of the debtor but also the

debtor itself its shareholders, directors and guarantors (Corporate Rehabilitation Act, 2018, Section 12).

### **Lifting the Stay**

A thorough perusal of CRA 2018 evinces that this Act not only provided the benefit of moratorium but also entails three different stages where a stay or moratorium could be lifted (Corporate Rehabilitation Act, 2018, Section 12(2)). Firstly, according to this Act a stay could be lifted at any time before the confirmation of plan of rehabilitation. Secondly, as per provisions of CRA 2018 where a moratorium granted under section 12 if not vacated earlier shall cease to have effect upon the confirmation of plan of rehabilitation (Corporate Rehabilitation Act, 2018, Section 14). Thirdly, the stay granted under this Act would be lifted upon dismissal of case under this Act (Corporate Rehabilitation Act, 2018, Section 17).

### **Acceptance of Plan of Rehabilitation**

According to this Act the acceptance of plan of rehabilitation rests with the class of creditors, holding two third of the value of such class, and with that of holders of class of interests of the debtor with the majority of two third in value of interests of such class (Corporate Rehabilitation Act, 2018, Section 13). Since the rehabilitation plan provide a way forward for resolving the financial constraints of debtor entity therefore, its scope may be wider and it may provide for a number of changes, including changes in the amounts, interest rates or date of maturity of outstanding debts, reinstatement of favorable existing contracts irrespective of defaults, satisfaction or modification of liens, and issuance of new debt or equity securities for cash, property, existing securities, or in exchange for old debt or equity interests etc (Bracewell &Giuliani, 2012). More or less similar contents of plan of rehabilitation have been enlisted under CRA 2018 (Corporate Rehabilitation Act, 2018, Section 7).

### **Confirmation as well as Implementation of Plan of Rehabilitation**

Once the proposed rehabilitation plan is accepted, the next step would be its confirmation. According to this Act the power to confirm a plan of rehabilitation rests with the court and the court may after notice and hearing confirm a plan of rehabilitation already proposed and accepted in prescribed manner (Corporate Rehabilitation Act, 2018, Section 14). This law mandates that the provisions of a confirmed plan of rehabilitation are binding upon the debtor as well as upon all the interested parties. As per this law the court is also empowered to refuse confirmation of rehabilitation plan in case it appears to the court that the basic intent to propose a plan is to avoid taxes, duties or other fiscal charges levied under the law (Corporate Rehabilitation Act, 2018, Section 14).

As per CRA 2018 the court is empowered not only to confirm the plan but also to get it implemented, and to achieve this purpose the court can pass appropriate directions.

### **Revocation of Confirmation of Plan of Rehabilitation**

The court, under this Act, is empowered not only to refuse to confirm a plan of rehabilitation but even at a later stage, i.e. within a period of twelve months from the date of confirmation of plan of rehabilitation, the court can revoke the confirmation of plan, already granted. As per the CRA 2018 upon application of any aggrieved party wherein it has been alleged that the order for confirmation of plan of rehabilitation was procured through fraud, the court may revoke the order of confirmation of plan of rehabilitation (Corporate Rehabilitation Act, 2018, Section 16).

### **Control of the Debtor**

As per this Act usually the control of the debtor/ sick company rests with the debtor itself unless the administrator is appointed in which case the whole control is shifted at his hands. However, the option to get appointed an administrator for managing the affairs of the debtor rests with the qualifying creditors.

### **Administration of Debtor**

Although the CRA 2018 is based on the premise of 'debtor in possession'. However, there is no bar to appoint the administrator if the need arises so. As the CRA 2018 provides a court-driven procedure for rehabilitation of sick companies therefore the power to appoint administrator for the debtor also rests with the court. According to this Act the court may on a petition made by the qualifying creditors appoint an insolvency expert as administrator of debtor. While the power to determine fees and expenditure to the administrator rests with the court in accordance with the regulations (Corporate Rehabilitation Act, 2018, Section 20).

### **Exit Routes**

Under CRA 2018 in following situations the rehabilitation process for financially sick company ceases to have effect:

1. If during proceeding of petition under this Act, the court reaches to the conclusion that to proceed further with the case would amount to an abuse of the judicial process the court can dismiss the case (Corporate Rehabilitation Act, 2018, Section 17).
2. The case under this Act also merits dismissal where the petitioner who files the petition has failed to provide necessary funds for mediation despite availing opportunity in this regard. (Corporate Rehabilitation Act, 2018, Section 17).

3. This law further provides that where the mediator could not effectively discharge any of his functions specified in section 10 within the prescribed period of twelve months from the date of his appointment the court may dismiss the case (Corporate Rehabilitation Act, 2018, Section 17).
4. As per this Act the court is empowered to convert the rehabilitation case into winding up on the application of creditor or administrator if the acceptance of a plan of rehabilitation could not be achieved within the period of twelve months from the date of appointment of administrator (Corporate Rehabilitation Act, 2018, Section 18).
5. Additionally, in another eventuality the court can convert the petition for rehabilitation into winding up where it appears to the court that the petition under this Act has been filed by the debtor for fraudulent purposes or to avoid taxes or other liabilities (Corporate Rehabilitation Act, 2018, Section 18).

### **Critical Assessment of the Corporate Rehabilitation Act 2018**

To determine whether a corporate rescue model has been effective, the core values, its intended aim as well as its overall impact should be analyzed. Admittedly this enactment is a result of efforts prolonged over two decades. It is also an admitted fact that too much extent this Act is a reflection of chapter 11 rehabilitation proceedings of US Bankruptcy Code. While considering the chapter 11 proceedings of US Code as best model, legislature of our country was prompted to make an enactment regarding rehabilitation of financially sick companies on the similar lines. There is also no denial of the fact that many commentators have used U.S. bankruptcy legislation as a "yardstick" for analyzing other bankruptcy systems (Rhim, 1994), yet to adopt the same system without considering the socio-legal as well as economic condition of the country is not recommended. No doubt, this Act has covered a gap in the corporate insolvency law of our country which was persisting since the creation of Pakistan yet it contains several drawbacks which need to be overcome in order to make it a piece of healthy legislation. Throughout the history of corporate insolvency law in Pakistan it is for the first time that a specific legislation for rehabilitation of financially sick companies has been introduced in our country via this Act therefore the undersigned is not intended through this critical evaluation to show a rejection of this Act straightaway yet the purpose of this analysis is to highlight the weaknesses which this enactment reflects.

### **Non- coverage of Small Companies**

A critical review of CRA 2018 reveals that unlike the procedure prescribed for rehabilitation of sick companies under Companies Ordinance 1984 (repealed) or Companies Act 2017 this Act is intended to be applicable upon all sorts of companies either public or private and either big or small yet in practical implication the scope of this Act is not extended to cover small enterprises. As the criteria provided under

this Act to consider a company as financially sick is based on its outstanding or unpaid debts to the minimum value of rupees hundred million or upward. While the Companies Act 2017, on the other hand, classified the companies into three categories on the basis of their sizes and share capital. In schedule III appended with Companies Act 2017 small size company (SSC) has been defined as "A private company having paid-up capital up to Rs. 10 million and (ii) turnover not exceeding Rs.100 million while its employees not more than 250". Thus, if a company starts its business with rupees one million then it would not be possible for such a company to raise its loan/debt to the maximum value of rupees 100 million or upward. Hence, it can be said that while setting up the criteria under this Act for considering a company as financially sick and to find it eligible for rehabilitation this very aspect has been ignored or overlooked. However, in practical implications in a developing country like Pakistan there is need to create a legal regime that enables the small businesses to thrive like in the developed countries UK and US.

### **No Timely detection of Financially Sick Companies**

It is generally said that a stitch in time saves the nine. The same principle applies to the awful situation of financially sick companies. As it is observed that the existing financial atmosphere in the country has fashioned an indifferent environment for most of the companies to trade without problems. The fiscal move has produced the environment of vulnerability for the companies to finance and operate business ventures easily. In such situation, it has become difficult for the companies to identify, analyze and attempt to counteract fiscal distress. Having recognized the possible alternatives available to a company depends on the conclusions drawn from the scrutiny of the distress it is passing through at that time. This situation makes it urgent to find out at what point a company is in trouble. In other words, this gives a thought for timely detection of the problem. It is internationally admitted fact that Corporate Rehabilitation law of each country is align with the principle of timely detection of financially sick companies. However, the phenomenon of timely detection of distressed company is missing under CRA 2018. Rather the criteria provided under CRA 2018 to determine a company as financially sick seems to be inconsistent with the principle of timely detection as according to Corporate Rehabilitation Act 2018 a company will be considered as financially sick if it has debt of rupees hundred million or upward. However, it might be possible that till reaching the debt of any company to that extent the company become totally fragile and incapable to survive. Thus, while considering this criteria it is quite possible that this law might not be workable even for the companies with large capital as till raising the loan at the stage of rupees hundred million or upward, the stage of financial constraint would might be too late to resolve the issue and to make the company enable to breathe and to prosper again. Hence, it can safely be presumed that the criteria provided under this Act for sickness of a distressed company to seek for its rehabilitation is itself not aligned with the principle of timely detection of financially sick companies.



### **Non Acknowledgment of Losses for Determination of a Company as Financially Sick**

Besides the above referred lacuna in the criteria set up by this law for considering a company as financially sick, the definition of financial sickness of a company is also misconceived as rather than to acknowledge the losses it acknowledges the accumulated debts to be reach at the value of minimum 100 million rupees or upward. Thus, this criterion on one hand narrow down the scope of applicability of this Act upon distressed companies and on the other hand giving weightage to nonpayment of debts only rather than losses. While it might be possible that otherwise financially sound companies just to gain advantage under this Act might raise their debts to the prescribed value. Nonetheless, this Act is totally silent regarding this aspect which might be misused in future while chances of financial scam will also be high in this regard.

### **No Initial Inquiry under this Act regarding Financial Condition of Company/Debtor**

Since this Act has made the criteria for filing a petition for rehabilitation by a financially sick company in terms of its increasing debt value to the minimum of rupees 100 million or upward, therefore, it might be possible that a company otherwise having assets, may raise its loan to the value of rupees 100 million in order to file petition under this Act and to get stay against its creditors just to defraud the creditors. However, this situation can be combat by adding the provision of initial inquiry after filing of petition by the debtor which would not only help to sort out the fake cases at initial stage but also save the precious time of the court from conducting the fraudulent cases till later stage and then to dismiss the same.

### **Missing of word 'Good Faith' for filing a petition under this Act**

Under CRA 2018 a petition for rehabilitation of financially sick company can be filed either by the debtor or by the qualifying creditor yet the word 'good faith' is missing in the relevant section (i.e. Corporate Rehabilitation Act, 2018, section 8) for filing of petition under this Act.

However, by adding the word 'good faith' for moving a petition for reorganization more particularly by the debtor, filing in bad faith can be sort out at initial stage as it would present an opportunity to the court to filter out the 'bad faith filing'. Moreover, the creditors could also apply to the court to challenge any petition filed by the debtor. Universally, the term "good faith" has special significance and central to the commercial law. This subjective idea will make the less chances of fraud and abuse of filing the petitions. The insertion of good faith in section 8 of the Act will aim to protect the mistaken belief of one contracting party and to give effect to the appearances in the true subjective sense. This approach can be found both in the civil law as well as common law countries. This rationalization effort will sufficiently prove as a catalyst to file honest petitions with clean hands of the

debtors, and equally it will dispel the multiple uncertainties surrounding the notion and function of the term. Most of the legal systems such as American, German and Dutch law have attempted from an academic point of view to define good faith so as to provide certain criterion to enable the courts to determine the content of good faith in different factual situations. The American has fully adopted the liberal concept of good faith while filing chapter 11 case. The rehabilitation process for companies in US is quoted in Chapter 11 of the US Code which entails some checks & balances and one of them is that the filing of petitions must be in good faith. The courts in US also duly appreciated the principle of good faith. In a celebrated judgment of Missouri-Kansas Pipe Line Co., the Court held as under:

"In the issue of good faith, there must of course, be fundamentally the honesty of purpose of three petitioning creditors having the required amount of claims. Honesty of purpose ought not in any way to be questioned by the mere fact that their claims represent a small percentage of all claims against the debtor, if the aggregate of their claims is within the statutory requirement for Congress has determined what creditors may invoke relief under the Act and it is not for the courts to adopt any other criterion." (Hanna 1935).

### **Absence of requirement of Adequate Disclosure**

Though it is said that CRA 2018 of Pakistan is more or less a reflection of chapter 11 of US Bankruptcy Code however, in practical implication the CRA 2018 does not reflect the requirement of adequate disclosure which is an important aspect of chapter 11 of US Bankruptcy Code. The US Bankruptcy Code requires that, before voting on a Plan, holders of claims and equity interests must receive a court-approved disclosure statement containing "adequate information" concerning the debtor and the plan.

### **No Fixed Duration of Moratorium**

A thorough perusal of this Act reveals that there is no fixed duration of moratorium which may be abused by the debtor to gain advantage over the creditors.

This Act provides two grounds for vacation of moratorium, if the same is not vacated earlier i.e. upon confirmation of plan by the court or upon dismissal of the case. However, perusal of this Act reveals that even the time limit within which the plan of rehabilitation must be confirmed by the court is not fixed, which means the duration of stay is not fixed and in turn it reflects that there are high chances that this aspect would be utilized by the debtor to gain undue advantage over the creditor.

### **Non Imposition of Penalties**

A thorough perusal of CRA 2018 evinces that it does not provide a penal clause for imposition of penalties in case of fake and frivolous filing. As a matter of

fact a penal clause served as a deterrence which could prevent the debtor as well as the creditors either from filing a bad faith petition or from presenting an unviable plan.

### **To seek for Financial Assistance for Distressed Companies is optional**

Under this Act a petition for rehabilitation or reorganization of a financially distressed company can be filed either by the debtor itself or by the qualifying creditors yet to apply for rehabilitation of the debtor is optional as the word 'may' has been used for filing a petition under section 08 of 'Corporate Rehabilitation Act, 2018'.

However, as a matter of fact the word may imply a vast power to the management of the debtor either to apply for the reorganization or not. Thus, making the filing of petition optional might resulted into a situation that a viable company may be liquidated instead of reorganization leaving behind several persons unemployed and causing loss to the economy as well as the national exchequer.

### **Non Imposition of Penalty upon Directors/Management of the Debtor to apply for Rehabilitation of company/debtor**

Since, according to this Act filing of petition for rehabilitation or reorganization of a financially distressed company is optional while no mandatory requirement has been imposed upon the debtor or upon its management/ directors to make a reference to the court for rehabilitation of debtor. Even no penalty has been imposed under this Act upon management of the debtor in case of their failure to refer the matter to court by filing a petition for rehabilitation on behalf of the debtor. As a matter of fact imposing of fine or penalty upon the management/directors of debtor to seek remedy under this Act would bind the management of the debtor to be vigilant in this regard. However, in the current scenario it might be possible that the management of a company either ignores to seek help at appropriate stage or seeks for the outside help under this Act at the later stage which not only worsen the condition of the distressed company but further make it practically unfeasible for the company to survive or to reorganize.

### **Conclusion**

In Pakistan since the promulgation of Companies Ordinance 1984, the only law dealt with the corporate rescue was the Companies Ordinance 1984, which contained only few rudimentary provisions in this regard. However, after long efforts the CRA 2018 has been promulgated which is the first law in Pakistan that deals directly with the rehabilitation of the financially sick companies. Although, via this enactment the proper procedure for revival of companies which are at the brink of collapse came into limelight for the first time in the country as Pakistan was in the march of creating a law to facilitate the corporate rescue of distressed corporations

since long. However, thorough perusal of this newly created law unveils that it possessed several lacunas which have bearing upon the practical implication of this law yet by curbing the deficiencies referred above the utility of this Act would definitely be extended to a large extent.

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