

# Up to speed

The Asian nation is intent on changing its corporate law framework to bring it in line with modern practices

After years of international economic isolation mainly caused by unrest in neighbouring Afghanistan, Pakistan is now poised to take full advantage of its two distinct advantages – a population of over 200 million and an attractive geographical location.

Pakistan's Gawadar seaport is located on the mouth of the Straits of Hormuz through which 20% of world's petroleum passes. The governments of Pakistan and China have signed numerous agreements under the China Pakistan Economic Corridor (CPEC) in which China is investing more than \$46 billion. CPEC is part of China's One Belt, One Road project – a land and sea based economic corridor that connects China to Europe and the Middle East through Pakistan, central Asia and Russia. The new route from Gaward in Pakistan to the Xinjiang province in China would be a shortcut for trade between Europe and China, and will shorten the route for China's energy imports from the Middle East.

The CPEC is proving to be a catalyst for attracting foreign investment (FDI) into Pakistan from other parts of the world. But the country can only fully benefit from the massive FDI inflow if the necessary legal and regulatory regime is in place allowing local and international businesses to grow, and which would also ensure safety and security to local and foreign investors.

As such, the government is aiming to revamp its corporate law framework to bring it in line with modern trends and requirements. In 2015, it enacted a brand new Securities Act, which consolidated and updated the law that governed the securities market in Pakistan. Prior to the enactment of Act, the securities market in Pakistan was regulated pursuant to the Securities and Exchange Ordinance, 1969. In addition, certain provisions of the Companies Ordinance, 1984, also applied to the securities market. The Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002, separately dealt with M&A of listed companies.

In November 2016, the government hurriedly promulgated through an ordinance the long-awaited Companies Ordinance 2016 (CO 2016) which repealed and substituted the main legislation in Pakistan on company law in place since 1984. Unexpectedly, CO 2016 was disapproved by the Senate, and lapsed on December 15 2016. On

## 1 MINUTE READ

Pakistan has recently amended its corporate law framework in a bid to bring it line with global standards, and attract international investment. The new Companies Act, which was approved in May, is expected to provide more transparency when it comes to company law and make doing business easier. It complements the Securities Act, which was implemented in 2015.

Significant changes brought by the Companies Act include new disclosure requirements for foreign companies and for local companies and their officers and certain shareholders of their investments in overseas companies, for issuances and transfers of shares, and for mediation and arbitration proceedings. The appointment of independent company directors is also an issue that will be reviewed.

May 30 2017, the government enacted the Companies Act 2017 (CA 2017) after getting it duly passed by the parliament. CA 2017 essentially follows the pattern of the repealed CO 2016 and is expected to make company law more transparent and simplify doing business in Pakistan.

The main features of these pieces of legislation are discussed below.

## The Securities Act 2015

### Regulation of stock exchanges, clearing houses etc

The Securities Act prohibits the establishment and operation of stock exchanges, clearing houses and central depository companies without obtaining a licence from the Securities and Exchanges Commission of Pakistan (SECP). Only a limited liability public company with specified paid-up capital can apply for a licence to establish or operate a stock exchange, a clearing house or a central depository company. The law lays down certain restrictions on the ownership of a licensee to include the prior approval of SECP for transfer of shares of a licensee. Majority shareholders, directors and senior management of a licensee must fulfil the fit and proper criteria prescribed by SECP.

### Other regulated activities

The business of a securities broker, advisor, or manager, share registrar, credit rating company, balloter, underwriter or debt securities trustee now requires a licence from the SECP under the Securities Act. These licences, except in case of a securities advisor, may only be issued to public or private limited companies. The Act prohibits the short selling of securities.

### Public offer of securities

Part VIII of the Act deals with public offer of securities. A public offer of securities without the issuance of a prospectus approved by the SECP is not permitted. Making an incorrect, misleading or deceptive statement or omitting to include any relevant information in a prospectus is now a criminal offence. The offeror, issuer, their directors and all persons who sign a false or misleading prospectus could be liable to pay compensation to any

person who has suffered a loss by acquiring any securities in reliance upon such prospectus.

### Takeovers of listed companies

Part IX of the Act deals with the acquisition of voting shares of listed companies. It is not applicable to certain transactions where only a disclosure in a prescribed manner suffices. A person who acquires voting shares of a listed company when taken together with any voting shares of such a listed company already held by the acquirer would entitle the acquirer to more than 10% of the voting shares of such a listed company, should disclose his aggregate

purchase of securities and the making of false or misleading statements to induce sale or purchase of securities now constitute criminal offences. Each of these offences is punishable by imprisonment and heavy fines.

The Act also obligates every listed company to disclose any price sensitive information to the public. Such information: (i) is necessary to enable the public to appraise the position of the listed company and its subsidiaries; (ii) is necessary to avoid the creation or continuation of a false market in the securities of such listed company, and (iii) might reasonably be expected to materially affect the market activity and price of its securities.

Every director, executive officer and

---

## It is recommended that investors review their shareholder agreements to determine how CA 2017 may affect them

---

shareholding to such listed company, the relevant stock exchange and SECP.

The acquisition of control or of voting shares in a listed company when taken together with any voting shares held by the acquirer in that company entitle the acquirer to more than 30% voting shares of the listed company, and requires a public offer to all shareholders of the company in a prescribed manner. A public offer may be conditional upon the minimum level of acceptance, and once made cannot be withdrawn except where a competitive bid for the same number of shares has been made by another person.

### Prevention of fraudulent market practices

The Securities Act requires listed companies to maintain a list of persons employed by them who have access to insider information. The lists will need to be regularly updated and sent to the SECP.

Insider trading, false trading, market rigging and market manipulation constitute separate offences under the Securities Act. Certain acts such as fraudulently inducing trading in securities, employment of fraudulent or deceptive means in connection with a transaction involving the sale or

substantial shareholder of a listed company is obliged under the Act to disclose to the listed company and the SECP beneficial ownership in equity securities of the listed company. Any gain made through trading of such equity securities within a period of less than six months should be tendered to the SECP.

## CA 2017

### Jurisdiction of the court

A high court has been designated as the competent court to hear all matters falling within the remit of CA 2017. The jurisdiction of all other courts including the civil courts is expressly barred.

New provisions are incorporated to ensure the expeditious disposal of matters falling under CA 2017. A high court has to decide the case within 120 days of institution. An adjournment is allowed only after imposing heavy costs and in certain exceptional circumstances. The matters under CA 2017 are to be normally decided on the basis of affidavits. In a bid to achieve expeditious disposal the provisions of the *Qanun-e-Shahadat* order, 1984 (the law of evidence) and the code of civil procedure, 1908, are made inapplicable to proceedings under CO

2017 unless the high court decides otherwise. Generally, legal provisions that seek expedited decisions remain unenforceable in Pakistan as the courts are already overburdened with work.

## Types of companies

CA 2017 prohibits the formation and carrying out of any business by an association, partnership or entity consisting of more than 20 people unless registered as a company. This requirement does not apply to certain entities including partnerships formed to carry out legal or accounting practices, or any other profession where practice as a limited liability company is not permitted.

CA 2017 allows the formation of: (i) a public company; (ii) a private company; and (iii) a single member company. A company may be: (i) a company limited by shares; (ii) a company limited by guarantee; or (iii) an unlimited company.

## Issuance and transfer of shares

A company with share capital could issue only fully paid shares which may be of different kinds and classes as provided in its memorandum and articles of association. The variation of rights of shareholders of a class could be affected only if a majority of at least three-quarters of the shareholders of such class exercised the option for such an alteration.

Shares or other securities of any members in a company are considered movable property transferable in the manner laid down in the articles of association of the company. Certain restrictions are, however, imposed on the transfer of shares in a private company.

CA 2017 prohibits a subsidiary company from holding any shares in its holding company – any such allotment or transfer of shares is declared void. Private companies and public unlisted companies are not allowed to purchase their own shares.

Where a loan is obtained by a public sector company from the government, CA 2017 empowers the latter to direct the company to convert the loan or a part thereof into shares on such terms and conditions as the government may determine.

CA 2017 prohibits the invitation, acceptance or renewal of deposits of money by a company from the public. This prohibition does not extend to banking companies or class of companies or deposits

to be notified by the SECP. Likewise, this prohibition does not extend to a loan raised by a company by issue of debentures or a loan obtained from a banking company.

## Appointment and removal of directors

Under CA 2017, only a natural person can be appointed a director. Assignment of office by a director is prohibited and declared void *ab initio*. A director must act in good faith to promote the objects of the company for the benefit of its members as a whole, and in the best interest of the company, its employees, shareholders, community and for the protection of environment.

As a new development, a person who does not hold a national tax number under the Income Tax Ordinance, 2001, is ineligible for appointment as a director. This requirement may cause considerable inconvenience to foreign investors as foreign directors nominated to the boards of their local subsidiaries by foreign parent companies are generally averse to such tax registrations.

CO 1984 required that to be appointed the director of a company a person must be a member of such a company and hold at least one share in it. This provision is now abandoned where such a person represents a member which is not a natural person. This change would be welcomed by foreign companies who were previously required to transfer certain shares in local companies to their nominee directors to sit on the boards of local companies. This process was fraught

he had acted diligently.

A director who has an interest in a contract or arrangement to be entered into by or on behalf of the company must not take part in any discussion of, or vote on, any such arrangement or contract. In the case of a listed company, a director with material personal interest should not attend the board meeting in which the matter is being considered.

All related party transactions are to be entered into in accordance with the policy approved by the board and subject to such conditions as may be specified by the SECP. Where a majority of directors are interested in a related party transaction, the matter is to be placed before the general meeting for approval.

## Public sector companies

Provisions are made in CA 2017 that grant certain additional powers to the government in respect of public sector companies. A public sector company is defined as a company which is directly or indirectly controlled, beneficially owned or where not less than 51% of the voting securities or voting power are held by the government or in respect of which the government has otherwise power to elect, nominate or appoint majority of its directors.

Where a loan is obtained by a public sector company from the government, CA 2017 empowers the government to direct the company to convert the loan or a part of it into shares.

CA 2017 grants the government a

---

## Where a loan is obtained by a public sector company from the government, CA 2017 empowers the government to direct the company to convert it into shares

---

with difficulty as executives came and went, while the process of transfer of share to the new executive was slow and tedious.

CA 2017 now lays down how independent directors are selected. They are to be chosen from a data bank maintained by the SECP. The law provides certain protection to an independent director or a non-executive director in respect of an act done without his knowledge, consent or connivance or where

statutory power to appoint the CEOs of public sector companies. It also has the power to appoint CEOs of companies where a majority of directors are appointed by the government. Likewise, the government has the authority to remove CEOs of the companies where it holds more than 75% of the voting rights.

In 1990s, Pakistan launched a major privatisation programme which saw the

## Additional powers granted to the government through CA 2017 may impact the rights of investors previously protected through a shareholder agreement

government sell a minority stake in a state-owned enterprise to an investor along with management rights.

The additional powers granted to the government through CA 2017 may have an impact on the rights of investors previously protected through a shareholders' agreement. It is, therefore, recommended that investors carefully review their shareholder agreements to determine how CA 2017 may affect them. Likewise, the memorandum and articles of association of Pakistani companies need to be revisited to bring them in line with CA 2017.

### Investigations and related matters

CA 2017 grants the SECP very wide powers to investigate the affairs of a company. The regulator can appoint officers or outside professionals with experience in the relevant fields as investigators to investigate serious offences. It can also request the government to form a joint investigation team consisting of SECP senior officers and officers of law enforcement agencies to investigate any such offences.

### Mediation, arbitration, arrangements and reconstructions

CA 2017 requires the SECP to maintain a database of qualified professionals for mediation between the parties. The provisions of the Arbitration Act, 1940, apply to all arbitrations between companies and persons under CA 2017. This change in law may impact the validity and enforceability of certain arbitration agreements that call for international arbitration. It is advisable for the investors to analyse the validity of their existing arbitration agreements as in case of a conflict between a law and a contractual term the law prevails.

CA 2017 has taken away the high court's jurisdiction in respect of the reconstruction and amalgamation of companies. Under CA 2017, the SECP is granted jurisdiction to

sanction and enforce a compromise or an arrangement between a company and its members or creditors, and to facilitate reconstruction and amalgamation of companies. CA 2017 permits amalgamation of wholly-owned subsidiaries with each other or with their parent company without the SECP's approval in certain circumstances.

### Dissolution of companies

CA 2017 provides for three different modes for winding up of companies. In addition, a simplified procedure for the dissolution of companies which have ceased to operate and have no known assets or liabilities is introduced. CA2017 has empowered the registrar of companies to declare a company as inactive under certain circumstances. It seems that the reporting requirements in respect of inactive companies would be less burdensome as compared to active companies.

### Companies established outside Pakistan

Like the previous company law, foreign companies with established places of business in Pakistan are required under CA 2017 to submit certain documents to the registrar of companies. A significant change brought through CA 2017 is to empower the SECP to call upon a foreign company to provide information about the shareholding in the company at any point in time or any other information as directed by the regulator.

### Other significant changes

CA 2017 empowers the SECP to require a security clearance for any shareholder or director or other office bearer of a company (including a foreign company) from any local and foreign agency.

The law imposes an obligation on every officer of a company to endeavour to prevent

the commission of any fraud or offence of money laundering or terrorist financing in their company.

As an important development every substantial shareholder or officer of a company with 10% or more shares in a foreign company or corporate body has to now report that shareholding to the company. The company is obligated to submit this information to the SECP along with its annual return. Likewise, any investment by a locally incorporated company in a foreign company or body corporate has to be reported to the registrar of companies. This provision is introduced to maintain transparency and address issues such as corruption, money laundering and terrorism financing.

CA 2017 exempts companies operating in any export processing zone or a tax-free zone are exempt from its requirements. The law also gives the SECP the power to restrict the disclosure of information regarding foreign promoters, shareholders and directors of such companies without written authorisation. Certain additional obligations are imposed in CA 2017 in respect of real estate companies, agriculture promotion companies and *Shariah*-compliant companies.

In conclusion, both CA 2017 and the Securities Act 2015 are quite well thought-out and timely legislations. But their success largely depends upon their actual implementation. Generally, ambitious goals are set in new legislations which are not followed through by regulators and the courts.



**Mansoor Hassan Khan**  
Partner  
Khan & Associates,  
Attorneys at Law (Islamabad  
and Lahore)

*The author would like to thank senior associate Saqib Majeed for his help in the writing of this article.*