

DOING BUSINESS (2018) – PAKISTAN

Karachi and Lahore

Protecting Minority Investors

Introduction

1. This preliminary briefing paper considers the current position of the DB topic of ‘Protecting Minority Investors’ in Pakistan.
2. The laws regulating the field of insolvency include Companies Act 2017 (‘the 2017 Act’), Securities Act 2015, Pakistan Stock Exchange Regulations (PSX Regulations) and Code of Civil Procedure 1908. The 2017 Act was assented to by the president on May 30, 2017 and published in the Official Gazette on May 31, 2017. The 2017 Act has repealed the Companies Ordinance, 1984.
3. Since the law related to incorporated entities is a federal subject, the DB indicator is regulated mostly by the federal laws. However, the civil procedure applicable to derivative/shareholder suits is governed by provincial legislation/code.¹ At present, even the Codes of Civil Procedure enforced in Sindh and Punjab are identical. Nonetheless, if any changes are suggested in the procedure, the competent forum to effectuate those changes would be relevant provincial legislature.
4. In 2017, Pakistan scored 6.7 out of 10 for the indicator of strength of minority investor protection index and Distance to Frontier (DTF) of Pakistan is 66.67%.² Due to similar laws and regulations of the indicator, there is no difference between the scores of Lahore and Karachi for this index.
5. The 2017 Act has at least made three changes which are not reflected in index scores or DTF. First, the Companies Ordinance 1984 allowed the shareholders with at least 20% voting power to file derivative suits. The 2017 Act has amended the threshold to 10% voting power. Second, unlike the repealed law, the Act requires disclosure of compensation of directors. Third, it mandates a company to hold annual general meeting every calendar year.

Indicator	Companies Act 2017 Changes
Can shareholders representing 10% of Buyer's share capital sue directly or derivatively for the damage the transaction caused to Buyer? (0-1)	The shareholders having 10% voting power can file a suit (Section 286).

¹ Reference is made to entry 31 of the Federal Legislative List (Part I) of the Constitution of Pakistan, 1973.

² Data provided by the Doing Business team.

Must Buyer disclose the compensation of individual managers?	Every public listed company is required to maintain record of contract/terms of employment of directors which would be available for inspection by all shareholders. The CEO is deemed a director of a company (Section 210).
Assuming that Buyer is a limited company, must members meet at least once a year?	The 2017 Act requires annual general meeting to be held every calendar year (Section 132 (1)).

6. Owing to enforcement of provisions of 2017 Act, the score of ‘extent of director liability index’ would increase from the existing six to seven points. Likewise, for ‘extent of corporate transparency index’ the score of Pakistan is expected to increase two more points i.e. from five to seven points.
7. It is necessary to first identify the reasons for Pakistan’s low performance on index of protection of minority investors, which are as follows:
 - i. low standards of corporate accountability
 - ii. procedural problems of shareholder/derivative suits
 - iii. insufficient corporate transparency laws
8. Most, if not all, the changes are required in the applicable legal framework. Therefore, reforms suggested for improving the strength/index score are legislative and policy-oriented.
9. A few reforms can be implemented in the short-term requiring changes in the secondary legislations such as rules or regulations. The regulator i.e. the Securities and Exchange Commission (SECP) or Pakistan Stock Exchange can make these changes in less than a year by providing special regulations or amending the existing rules. Other reforms can be planned and implemented over a long-term (>1 year) which typically necessitate changes in primary legislations i.e. parliamentary or provincial enactments.
10. The following table identifies the indicators in need of reform and accordingly lays out a reform plan for it:

<u>Indicator</u>	<u>Measures</u> (Short-Term -ST, Long-Term - LT)
Which corporate body is legally sufficient to approve the Buyer-Seller transaction?	To secure the interest of minority investors, the Companies Act (Sections 207 & 208) may be amended to require approval of the members/shareholders in the general meeting in case of related party transactions. The rule should be specifically applicable where

	an interested director owns majority interest or majority voting power of the company. (LT)
Must Buyer immediately disclose the transaction to the public and/or shareholders?	<p>The PSX Regulations (Regulation 5.19.13) and the Securities Act 2015 (Section 96) already entail immediate/forthwith disclosure of a material contract or price-sensitive information. In this regard two important changes are suggested in regulations. First, the description of information disclosure should not be left to the company/Buyer. Instead the statutory regulations must specify the nature of information to be disclosed in a specific format to allow adequate public disclosure.</p> <p>Pursuant to Section 96, SECP may consider prescribing specific form(s) for disclosure of price-sensitive information which may include the deal valuation, the description of assets purchased, any material changes in the ownership of the company etc. In the same way PSX Regulations can also be redrafted to provide more details.</p> <p>Second, both the PSX Regulations and supporting regulations of the Securities Act 2015 may include a definite timeline for disclosure (e.g. within 72 hours or three working days), instead of using generalized expression such as immediate or forthwith disclosure. (ST)</p>
Must an external body review the terms of the transaction before it takes place?	<p>Pakistan Stock Exchange may introduce regulations regarding prior review of transactions where 10% or more assets of a listed company are involved. For this purpose, the expression ‘material information’ as used in Regulation 5.6 of PSX Regulations may include any transaction involving 10% or more of the paid-up share capital of the company.</p> <p>Similarly, SECP may introduce regulations pursuant to Section 208 of the 2017 Act and require prior review of commission in case of related party transactions exceeding a certain monetary value. (ST)</p>
<p>Can shareholders hold the interested director liable for the damage the transaction caused to Buyer?</p> <p>Can shareholders hold the other directors liable for the damage the transaction caused to Buyer?</p>	<p>The test as prescribed in the 2017 Act (Sections 286) may be reconsidered to impose liability on the directors as long as it can be shown that the terms of the approved transaction were unfair or there was a conflict of interest which resulted in damages to the company. (LT)</p>
Can a court make void the transaction upon a successful claim by	Section 286 and 287 of the 2017 Act may be amended to allow court to make the transaction void. (LT)

shareholders?	
Can the plaintiff request categories of documents from the defendant without identifying specific ones?	Provincial legislatures may consider a change in Order 11 of the Code of Civil Procedure 1908 to allow a general discovery of relevant documents, especially in case of company matters. (LT)
Can the plaintiff directly question the defendant and witnesses at a trial?	Provincial legislatures may consider a change in the Code of Civil Procedure 1908 in the context of company cases whereby plaintiffs may be allowed to directly question the defendants. (LT)
Can shareholder plaintiffs recover their legal expenses from the company?	Provincial legislatures may amend the Code of Civil Procedure 1908 (Section 35) where a shareholder suit is successfully brought, the company may be liable to pay the legal expenses. (LT)
Must Buyer obtain shareholders' approval every time it issues new shares?	An amendment to Section 83 of the 2017 Act is required to include shareholder approval for increasing paid-up share capital. (LT)
Assuming that Buyer is a limited company, must all members consent to add a new member?	Section 83 of the 2017 Act may be amended to include consent of all members for adding a new member. The proposed rule can be qualified by a proviso which prohibits existing members to unreasonably withhold such consent. (LT)
Assuming that Buyer is a limited company, must a potential acquirer make a tender offer to all shareholders upon acquiring 50% of Buyer?	There are no such restrictions placed on new acquirers of private limited company. The law may be amended to make it mandatory for a 50% acquirer to make tender offer to all shareholders. The 2017 Act and the Companies (General Provisions and Forms) Rules, 1985 would be amended to reflect this change. (LT)
Must a detailed notice of general meeting be sent 21 days before the meeting?	An amendment to Sections 133 and 140 of the 2017 Act may prescribe a notice period of 21 days for all general meetings. (LT)

<p>Can shareholders representing 5% of Buyer's share capital put items on the agenda for the general meeting?</p> <p>Assuming that Buyer is a limited company, can members representing 5% put items on the meeting agenda?</p>	<p>At present, shareholders representing 10% of the Buyer's share capital can request a general meeting. Section 133 and 140 of the Companies Act 2017 can be amended to allow shareholders representing 5% voting power to place items on the agenda. (LT)</p>