THE COMPANIES ACT, 2017

Introduction

The Pakistan Companies Act 2017 (the "**New Companies Act**") received Presidential assent on 30 May 2017 and came into force on 31 May 2017, the date of its publication in the official gazette. The New Companies Act repeals the Companies Ordinance 1984 (the "**Old Companies Ordinance**"), except certain provisions which continue to apply to Non-Banking Finance Companies (NBFCs).[1]

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The New Companies Act is the latest in a series of new laws passed by the current government which seek to update the country's laws in light of changes and developments in the corporate sector, both domestic and international.

Some of the important provisions and key changes introduced under this law are summarized below.

Corporate Governance

The New Companies Act has sought to improve corporate governance by imposing additional duties and obligations on the board and senior management. In addition, certain requirements which were previously only applicable to publicly listed companies have now been extended to unlisted (public or private) companies.

From a corporate governance perspective, one significant change is the inclusion of a positive duty

[1] Part VIIIA of the Old Companies Ordinance, consisting of sections 282A to 282N, continues to apply to NBFCs.

of care and duty of loyalty on directors. The new law sets out specific duties for directors to act in the best interests of the company, and to discharge their duties with reasonable care, diligence and skill, and to exercise independent judgement. Independent and non-executive directors will be liable for acts which occur with their knowledge, connivance or where the director has failed to act diligently. The inclusion of these positive duties means that directors are now at greater risk of potential liability should they fail to discharge their duties diligently or act in accordance with applicable laws.

A director is also required to avoid any direct or indirect conflict of interest, which would include carrying out any competing business with that of the company. Similarly, the chief executive officer (CEO) is prohibited from carrying on any business which competes with the business of the company, or a subsidiary of such company. A director is required to pay back to the company any undue gain or advantage which accrues to such director or his/her relatives, partners or associates. Undue gain is not defined but would presumably include any financial benefit from unlawful use of insider information or from carrying on any competing business to the detriment of the company.

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The eligibility criteria for directors have been amended so that only individuals holding a valid national tax number (NTN) may now act as directors. This requirement applies both to private and public companies.

The company's officers now have a positive duty to endeavour to prevent fraud or money laundering in the company's affairs, and to put in place adequate measures to achieve this. Failure to comply can attract a penalty of up Rs. 100 million and a custodial sentence of up to three years. Officers may avoid liability only if they have taken "reasonable measures" to prevent the commission of the offense. One would normally expect company officers to be liable if they were themselves involved in fraud or other wrongdoing. The provisions of the New Companies Act arguably place a more onerous duty on officers by requiring them to take positive steps to prevent the offense, thereby exposing managers to liability even if they were not themselves involved in the fraudulent acts. In order to avoid personal liability, company officers may potentially have a duty to take active steps to prevent the offense, including reporting such offenses to the authorities.

A person may not serve as a director of more than seven (7) companies. This is a positive step which will enable directors to discharge their duties effectively and avoid conflicts of interest. The Old Companies Ordinance did not contain any such restriction, although the SECP's mandatory code of corporate governance for listed companies does impose a similar restriction on directors of listed companies.

Independent directors are generally seen as playing a key role in good governance and efficient functioning of the board. The New Companies Act

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not only defines who would qualify as an independent director, but also requires that such directors be chosen from amongst a list or databank maintained by an institute or body authorized by the SECP. One can foresee such requirement being potentially restrictive and perhaps unnecessary. However, if implemented properly, the inclusion of qualified independent directors will encourage more responsible corporate governance.

The Old Companies Ordinance required every director to be a member. The justification was the need to align the economic interests of the directors with the interests of the company. Consequently, nominee directors would usually hold a nominal single share in the company on whose board he or she served. This resulted in a nominee director having to transfer its shares to a successor every time there was a change in director, making the process unnecessarily cumbersome. Matters were further complicated if the director died without nominating a successor under the Old Companies Ordinance. The New Companies Act exempts nominee directors of corporate shareholders from this requirement. In addition, executive directors, nominees of creditors or other special interests and directors who are employees have also been exempted from this requirement. Corporate shareholders would be well advised to require their nominee directors to transfer the shares back to them, especially as directors can no longer nominate a successor (and the relevant laws of inheritance would apply resulting in the share being transferred to the nominee director's legal heirs).

Interestingly, 'public interest companies' are now required to have female representation on the board. A public sector company includes a broad swathe of companies including listed companies, banks, insurance companies, pension funds etc., unlisted companies whose shareholding or assets exceed a certain size (as may be notified by the SECP), as well as public utility companies or those carrying on an essential public service. Whether female quotas will translate into better economic performance remains to be seen, this is nonetheless a welcome development which will promote gender equality and hopefully encourage diverse opinions to be voiced in the corporate boardroom.

It is now easier for companies to give loans to directors and their relatives as many of the restrictions under the Old Companies Ordinance have been removed. Loans to directors (including loans to his/her minor children and spouse) can now be granted subject to shareholder approval. For listed companies, director loans require, in addition to shareholder approval, prior approval of the SECP.

Amalgamation and Reconstruction

The new Companies Act transfers powers relating to the amalgamation and reconstruction of companies from the courts to the SECP. Given that court procedures in Pakistan tend to be marred by delays and lack of capacity, the transfer of such functions to the SECP will considerably speed up such procedures.

Any merger of a company with its wholly owned subsidiary or the merger of wholly owned subsidiaries of the same holding company no longer requires approval of SECP or the courts. In such event, the merger must be approved by the board of each company and it must not involve the payment of consideration other than cancelling the shares of transferor company. The board (presumably of the transferee company) must certify that merger will not result in the transferee company becoming unable to pay its debts in the following one (1) year period.

Incorporation and Subscription

Companies are now required to establish that subscription moneys have been fully paid within 30 days from the date of incorporation, and receipt of payment must be certified by a practicing chartered accountant. A return to this effect must be filed with the SECP within 45 days of the date of incorporation. Failure to pay the subscription moneys within the 30-day period will result in the shares being cancelled.

Companies have also been required to specify their "principal line of business" in the first line of their memorandum of association. Where a company's memorandum does not comply with this requirement, it must amend its memorandum appropriately.

Issuance of Shares at a Discount

Issuance of shares at a discount does not require approval of the SECP where the discounted price is not less than 90% of the par value for listed companies. Issuance at a discount has been disallowed where the price is below 90% of the volume weighted average daily closing price for the previous ninety-days for listed companies, or the break-up value based on discounted cash flows for unlisted companies.

Change of Directors Following Acquisition

The New Companies Act has made it easier for an acquirer to elect its nominee directors by requiring the target company to hold fresh elections within 30 days from the date requested by the acquirer.

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Under the Old Companies Ordinance, only listed companies could hold interim elections to enable an acquirer to nominate its directors to the target company's board. The was permissible provided the acquirer had purchased at least 12.5% of the target company's voting shares, and even then, fresh elections could only be held in the next annual general meeting. This could cause considerable delay in the acquirer gaining seats on the board.

Dispute Resolution Provisions

The New Companies Act has introduced significant changes to court procedures to facilitate timely resolution of disputes under the new law. The High Court having jurisdiction over the place where the company is incorporated continues to have jurisdiction, under a separate Companies Bench constituted for such purpose.

To enable timely hearing of cases, the new law establishes a separate office of the "Registrar of the Companies Bench", which is to perform all ministerial and administrative functions on behalf of the Companies Bench. The Companies Bench is allowed a longer period of up to 120 days, from the previous 90 days under the Old Companies Ordinance, to decide petitions filed before it. The High Courts have also been given the power to impose costs up to Rs. 100,000 per day against any party causing a delay.

The evidentiary requirements have been simplified by allowing the court to treat affidavits and other documents as evidence and to issue summary orders. The provisions of the Qanun-e-Shahadat and Civil Procedure Code have been excluded, except to the extent the court may determine. The court is also entitled to impose a penalty of Rs. 100,000, or to award costs in case a party makes serious misstatements or fails to disclose material facts to the court.

Minority Protection

The new Companies Act has introduced a number of minority shareholder protections. The threshold for exercising these minority shareholder rights is set at ten percent. Any member or members holding not less than ten per cent of the issued share capital:

(a) are entitled to petition the court for relief in case of oppression and mismanagement of a company. Under the Old Companies Ordinance, this threshold was set at twenty per cent. In addition, a company may be wound up by the court in case of oppression of the minority (which is defined as shareholders holding ten per cent of the company's shares);

(b) are entitled to propose the company auditor in the annual general meeting;

(c) may apply to the court to declare an election of directors invalid in case of any material irregularity therein;

(d) may petition the court to hold the proceedings of a general meeting invalid due to a material defect or omission in the notice or irregularity in the proceedings of the meeting, which prevented members from using effectively their rights; and to call a fresh meeting;

(e) for listed companies, may demand that the company set up a video-link facility to enable them to attend any meeting.

Use of Technology

The New Companies Act has sought to recognize and encourage the use of electronic means of communication and the use of information technology for service of notices, meetings, exchange of information, conduct of voting or issuance of shares.
Service of documents or information on a company or its officers may be made by electronic means (in addition to post or courier). Documents or information may be served on the SECP, the company registrar or the shareholders via electronic means.

Going forward, all shares will be issued in paperless or book entry form. Following a date to be notified by the SECP, all newly incorporated companies will be required to issue shares electronically. All existing companies must ensure that physical share certificates are replaced by electronic shares within four years from the date of the New Companies Act, which date the SECP may extend by another two years.

A director may participate in a board meeting via video conference. Similarly, shareholders may participate in general meetings through a video link. As noted above, listed companies are required to provide a video link facility to enable shareholders (residing in a different city who hold at least 10% of the shares) to participate in the company's annual general meeting, provided they have given the company at least seven days prior written notice.

Registration of Charges

Any charge over moveable or immoveable assets of the company must be registered with the company registrar within 30 days from the date of creation of the charge. Such charges include a charge on book debts, floating charges, charges over aircraft, vessels, intellectual property or charges arising due to conditional sale arrangements, hire purchase agreements, retention of title etc. The register of charges will be open for inspection, and is deemed notice to the general public from the date of registration of the charge.

This will make it easier for creditors to search the company's records for pre-existing charges since all types of security over the company's assets will now be registered with the registrar of companies.

Provisions Extended to Private Companies

Shareholders of private limited companies have now been given a statutory pre-emption right to purchase the shares offered for sale by another shareholder. Previously, such rights of first refusal had to be included in the company's articles or in a separate shareholder's agreement. Pre-emption rights on further issuance of shares continue to apply to both private and public limited companies.

A director or CEO is required to give written consent to act as director or CEO, and to file a return with the SECP. Under the New Companies Act, this requirement now extends to private companies, which were exempt under the Old Companies Ordinance.

The board of a private company is now prohibited from disposing off a sizeable part of an enterprise without a shareholder resolution authorizing such disposal. Under the Old Companies Ordinance, this restriction only applied to public companies.

Security Clearance

The New Companies Act now specifically authorizes the SECP to require the security clearance of any shareholder or director. In practice, foreign directors and shareholders were already routinely subject to security clearance and companies were required to provide a written undertaking to remove the nominee director or incoming shareholder should the security clearance be refused. This practice has now been given legal cover, but the process lacks transparency. A concept of deemed approval in case a negative response is not received within a certain timeframe would have provided greater time certainty to investors.

Foreign Companies and Global Register of Beneficial Interests

Under the New Companies Act, the SECP may require a foreign company to provide details of its beneficial ownership or any other details or documents required for inspection, inquiry or investigation. Failure to provide the required information is an offense attracting a level 3 penalty on the standard scale. A foreign company is also required to file with the registrar of companies, within 30 days of the change, any alteration to; (i) its constitutional documents; (ii) its principal place of business outside or within Pakistan; (iii) its directors, CEO, secretary or principal officer in Pakistan; or (iv) name and address of persons authorized to accept service of process.

Every substantial shareholder (defined as any shareholder that holds or controls more than 10% of a company's shares) or officer of a company incorporated in Pakistan, who is a citizen of Pakistan, or a dual national, is required to report to the company its foreign shareholding and any other foreign interests. The company is required to maintain this information in a global register of beneficial ownership, and to report such foreign shareholding and interests to the registrar of companies in its annual return. Failure to report such shareholding constitutes an offense which incurs a penalty of up to five years imprisonment and/or Rs. 500,000. The purpose of requiring shareholders and officers to report their foreign ownership is ostensibly to ensure that any conflicts of interests and related party transactions are disclosed to all shareholders and receive the required approvals. Further, full disclosure will also help curb insider trading. A large amount of portfolio investment into Pakistani listed securities takes place through Mauritian entities, which makes it difficult for the SECP to monitor insider trading.

Procedural and Other Changes

The new Companies Act has also simplified certain processes and filings. For example, a company need not file its annual returns each year if there has been no change in its particulars from the date of its previous filing. It is sufficient for a company to simply confirm that there has been no change from the date of filing of last year's returns. Single member companies and those with paid-up capital of less than Rs. 3 million are exempted from filing even the latter confirmation.

The minimum notice period for holding an extra-ordinary general meeting has been done away with and such meetings can be called at shorter notice, provided all the members entitled to vote and attend agree. Interestingly, in order to pass a special resolution at such meeting, all members entitled to vote and attend must consent to the passing of a special resolution at such meeting. This provision is intended to prevent controlling shareholders from excluding others from the decision-making process by calling meetings at short notice and passing special resolutions therein. Accordingly, unless all shareholders agree, a special resolution cannot be passed unless a minimum 21-day notice is given to all shareholders.

The New Companies Act now expressly permits resolutions of shareholders or the board to be passed by circulation.

Dividends can now be paid in cash or in kind, out of the company's profits, provided that the in-kind dividends may only take the form of shares in a listed company.

The prohibition on financial assistance has been retained, with private limited companies continuing to be exempt. In addition, loans to employees, loans granted by banks in the ordinary course of business and employee stock option schemes are also specifically exempted from the prohibition.

The Companies Act has introduced a concept of inactive companies where a company formed for a future project or to hold an asset or intellectual property, but which does not have significant accounting transactions, may apply to the SECP to be designated as an inactive company. The SECP may by prior written notice enter a company in the register of inactive companies if a company does not file financial statements or annual returns for two consecutive years.

A simplified liquidation procedure has been introduced for companies which cease to operate and have no assets or liabilities. Such companies may apply to the SECP for their name to be struck off the register of companies.

Finally, the new law introduces a standard scale of penalties. The penalties have been enhanced and are divided into three levels, ranging from a fine of Rs. 500 per day to Rs. 500,000 per day, and from Rs. 25,000 to Rs. 100 million.

Conclusion

The New Companies Act is a welcome development and a significant improvement on the Old Companies Ordinance, which had become outdated since its enactment over three decades ago. Despite periodic amendments and updates to Pakistan's corporate laws via issuance of rules and regulations by the SECP, an overhaul of the country's corporate regime was overdue. Other jurisdictions such as the UK, India and UAE, whose previous company laws were enacted roughly the same time as the Old

Companies Ordinance, have already updated their respective laws in 2006, 2013 and 2015. As with any new legislation of this scale, there are areas that require clarification and perhaps amendment, and whose impact will become known with time.

On the whole, the New Companies Act is a much needed and necessary piece of legislation which has brought country's business laws at par with current international best practices. By enhancing the ease of doing business, the new law will play a positive role in making Pakistan an attractive destination for both domestic and foreign investment.