WRONGFUL TRADING DURING DE FACTO INSOLVENCY

BY

REHANA ZAMAN KHAN
192-FSL/LLMCL/S08

A dissertation submitted in partial fulfillment
of the requirements for the degree of
MASTER OF LAWS (CORPORATE LAW)
(Faculty of Shariah and Law)
in the International Islamic University, Islamabad
1430 A.H /2009 C.E.

Supervisor: Mr. Misbah ul Mustafa

Faculty of Shariah & Law
International Islamic University Islamabad

2009

WRONGFUL TRADING DURING DE FACTO INSOLVENCY

Thesis Statement

In most of jurisdictions today wrongful trading by directors of a company heading for insolvency is being given serious attention, but in Pakistan we continue to follow that is obsolete, if not inadequate, a law that is badly in need of improvement.

BY

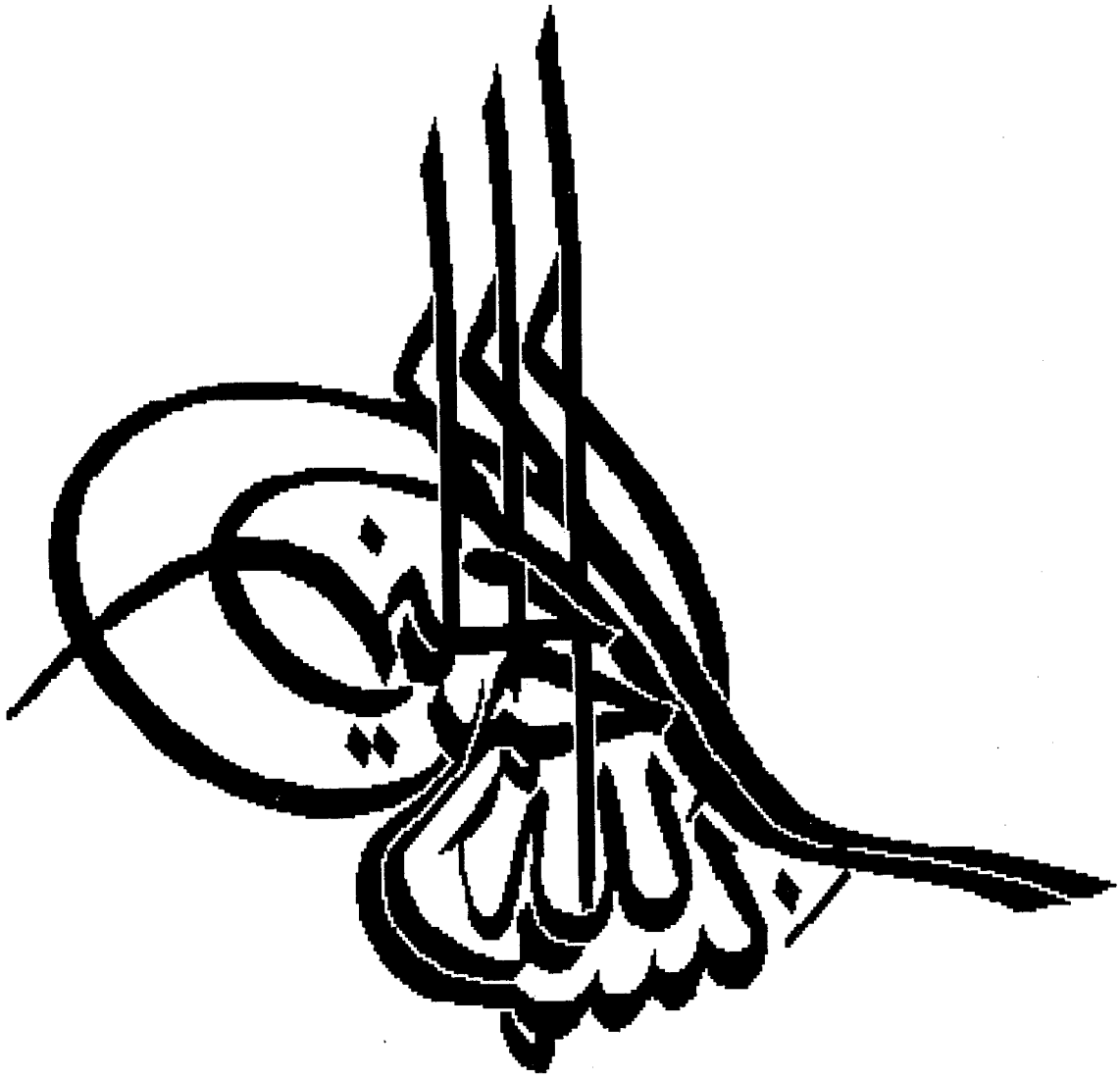
REHANA ZAMAN KHAN
192-FSL/LLMCL/S08

A dissertation submitted in partial fulfillment
of the requirements for the degree of
MASTER OF LAWS (CORPORATE LAW)
(Faculty of Shariah and Law)
in the International Islamic University, Islamabad
1430 A.H /2009 C.E.

Supervisor: Mr. Misbah ul Mustafa

Faculty of Shariah & Law
International Islamic University Islamabad

2009



APPROVAL SHEET

WRONGFUL TRADING DURING DE FACTO INSOLVENCY

BY

REHANA ZAMAN KHAN

192-FSL/LLMCL/S08

Accepted by the Faculty of Shariah and Law, International Islamic University Islamabad, in the partial fulfillment of the requirement for the award of degree of "Master of Law".

Supervisor: _____

Mr. Misbah ul Mustafa

Internal Examiner: _____

Mr. Mohammed Mushtaq Ahmed

External Examiner: _____

Mr. Usman Karim

Date: 17 December, 2009.

Deputy Dean,	Dean,
Faculty of Sharia and Law,	Faculty of Shariah and Law,
International Islamic University,	International Islamic University,
Islamabad.	Islamabad.

ABSTRACT

In simple term, wrongful trading occurs where the directors of a company continue to trade when they know or should have realized that there was no reasonable prospect of the company avoiding insolvent liquidation and the company then goes into liquidation.

Wrongful trading is a principle of UK insolvency law. We trace its origin from 1928 when UK parliament limited the fraudulent trading statute to its criminal side and passed a new wrongful trading provision as a civil remedy. The aim of the introduction of wrongful trading was to reduce the burden of proof required in the fraudulent trading. In UK the separate law is available to deal with wrongful trading. Section 214 of the Insolvency Act 1986 directly deals with wrongful trading.

In United States, Malaysia and, in Pakistan no direct law is available to deal with wrongful trading. In USA there is the concept of deepening insolvency theory in contrast with wrongful trading in UK. Deepening insolvency is a claim that directors or officers take actions that prolonged the life of the corporation outside of bankruptcy and that such action or inaction ultimately harmed the corporations and its stakeholders. In wrongful trading the directors of the company are liable to pay the debts of the company while in deepening insolvency managers and other officers of the company are also personally liable for the deepening insolvency. The concept of deepening insolvency has same meaning as wrongful trading in UK.

In Malaysia there is also not separate law available to deal with wrongful trading. The objects of the insolvency law of the Malaysia achieve the almost same purpose as the Insolvency Act 1986 in UK. Malaysian legislation relating to companies has always been vibrant and progressive. They recently passed the Companies (Amendments) Act 2007 which introduced significant and far reaching changes for Malaysian companies. In particular, important changes were made to the law relating to the directors statutory and common law duties. They amended their Companies Act 1965 more than seventeen times. This is a major milestone in the history of company law legislation in Malaysia.

In Pakistan like in USA and Malaysia no direct law is available to deal with wrongful trading. Section 412 of the Companies Ordinance 1984 fulfills the same purpose but is not sufficient to control the wrongful trading and make the culprits personally liable to pay the debts of the company. Punishment available in this section is not sufficient to deter the director not to repeat this offence in the future.

In Pakistan companies are governed under Companies Ordinance 1984 and regulated by Securities and Exchange Commission of Pakistan. Section 17 of the Securities and Exchange Commission of Pakistan indirectly deals with wrongful trading. Laws available in Pakistan to deal with wrongful trading are insufficient to control this offence. For the development of the corporations and to enhance the economy of the country available laws are badly in need of reforms.

TABLE OF CONTENTS

LIST OF ABBRIVATION.....iii

LIST OF CASES iv

DEDICATION v

ACKNOWLEDGMENTS vii

CHAPTER 1

1. Introduction: History and Origin of wrongful Trading.....1

1.1 What is Wrongful Trading.....4
1.2 What is Fraudulent Trading.....8
1.3 Difference between Wrongful Trading and Fraudulent Trading.....11
1.4 How Wrongful Trading Occurs.....13

CHAPTER 2

2. Legislative Framework dealing with Wrongful Trading in Pakistan.....17

2.1 1History of the Companies Ordinance 1984.....19
2.1.1Objectives of the Companies Ordinance, 1984.....20
2.2 Provisions of Companies Ordinance regarding Wrongful Trading.....22
2.2.Section 412 of the Companies Ordinance 1984 deals with Wrongful Trading.23
2.2.2 Fraudulent Trading deal under Companies Ordinance 1984.....25
2.2.3 Penalty for Fraud by officers and Directors of the Company.....27
2.2.4 Powers of the Directors.....27
2.2.5 Duties of the Directors.....30
2.3 Securities and Exchange Commission of Pakistan as a Regulator.....31
2.3.1 Laws available in Securities and Exchange Commission of Pakistan to prevent the Wrongful Trading.....33

2.3.2 Auditing System Available in the Rules of Securities and Exchange...35
2.3.3 Report by an Auditor.....39
2.3.4 Penalty for the False Auditor Report.....40
2.4 What Amendments have been made in the Corporate Sector of Pakistan to Control the Wrongful Trading.....41

CHAPTER 3

3. Legislation Regarding Wrongful Trading in UK, USA and Malaysia?.....45

3.1 UK laws dealing with Wrongful Trading.....47
3.1.1 Insolvency Act 1986.....49
3.1.2 Company Directors Disqualification Act 1986.....53
3.2 USA laws related to Wrongful Trading.....55
3.2.1 What is Deepening Insolvency?.....55
3.2.2 Difference between Wrongful Trading and Deepening Insolvency.....56
3.2.3 Similarities between Wrongful Trading in UK and Deepening Insolvency in USA.....57
3.2.4 Laws in USA that deals with Wrongful Trading.....58
3.3 Malaysian Laws Regarding Wrongful Trading. 60
2. 3.1 Object of the Corporate Insolvency Law of Malaysia.....62
2. 3.2 Code of Corporate Governance in Malaysia.....64
2.3.3Amendments in the Companies laws of Malaysia to control the Wrongful Trading.....66
2.3.4 Procedure of the liquidation of the Companies in Malaysia in case of Corporate Insolvency.....67

CHAPTER 4

4. Liabilities of the Directors for Wrongful Trading.....69
4.1Who is Director.....70
4.2Liabilities of the Directors for Wrongful Trading.....71
4.2.1 Civil liability.....72
4.2.2 Contractual Liability.....73
4.2.3 Criminal Liability..... 75
4.3 What Should Directors do to Avoid Personal Liability for Wrongful/Fraudulent Trading.....76
4.4 What Director should do if he comes to the Conclusion that there is no Prospect of avoiding Insolvent Liquidation?.....77
4.5 Penalty for the Wrongful Trading.....80

4.5.1 Disqualification of the Directors for wrongful Trading.....81
1.9 How Wrongful Trading can be avoided?.....84

CHAPTER 5

5. Conclusion and Proposal for Reforms
5.1 Conclusion.....88
5.2 Proposal for Reforms in the Companies Law.....91

Bibliography.....93

LIST OF ABBRIVATIONS

AGM	Annual General Meeting
ADB	Asian Development Bank
CCG	Code of Corporate Governance
CMAA	Cost and Management Account Act
CLRC	Corporate Law Reform Committee
CAO	Charted Account Ordinance
CDDA	Companies Directors Disqualification Act
CRA	Corporate Rehabilitation Act
DTI	Department of Trade and Industry
EAD	Economic Affairs Division
HLFC	High Level Finance Committee
KSE	Karachi Stock Exchange
MSC	Malaysian Securities Commission
MICCG	Malaysian Institute of Corporate Governance
PICG	Pakistan Institute of Corporate Governance
SECP	Securities and Exchange Commission of Pakistan
SBP	State Bank of Pakistan
UNDP	United Nation Development Program

LIST OF CASES

kitty v. Atlantic bank of New York (In re Global Service Group, LLC), 316 B.R.451,456 (bankr. S.D.N.Y.2004). p. 56.

Messrs Shaheen Foundation v Messrs Capital F.M (PVT) Limited 2002 & nbsp CLD 188 KARACHI-HIGH-COURT-SINDH. p. 24.

Muhammad Yousuf v Taj Company 1994 CLC 403 LAHORE-HIGH-COURT-LAHORE. P. 26

Official Committee of Unsecured Creditors v. r. e Lafferty & co., Inc., 276 f. 3d 340 (3d cir. 2001). P.58.

Re Brain D Pierson (Contractors) Ltd [2001] 1 BCLC 275. P.51.

Re Continental Assurance Co of London plc (Singer v Beckett) [2001] BPIR 733, Ch D, [2007] 2, pp.49.52, 53.

Re Hydroden (Corby) Ltd [1996] 2 BCLC_180. P. 15,70.

Salomon v Salomon & Co LTD [1897] AC 22 (HL) [2.01), PP.2,47.

Schacht v. Brown, 711 f.2d 1343, 1350 (7th Cir. 1983). P.56

Trenwick America Litigation Trust v..Ernst & Young, L.L.P., No. 157-N, (De.Ch. Aug. 10, 2006). P.58.

DEDICATION TO

MY PARENTS

"Who have been a beacon for me in the darkness of life".

AND

MY TEACHERS

"The ones who groom me and teach me the way to live".

ACKNOWLEDGMENT

Above all is Allah Almighty who I want thank, it is His blessings that, I have been able to come this far. I am indebted to His blessings that He has showered upon me and has guided me throughout my journey to learn more and more.

After Allah Almighty I would like to acknowledge my mother's prayers. I would like to acknowledge the special support of my supervisors, Misbah ul Mustafa, Only because of his supervision, I completed this thesis. After the acknowledgement of my supervisor I would like to acknowledge the support of my brothers and sisters. I would like to acknowledge the special help and support of my sister in law (Bhabi) who always helped me at the time of stress and depression. It will be unjust here if do not acknowledge the support and encouragement of my room mates in the hostel. I would like to acknowledge the help of all of my friends. At the end again, I would like to acknowledge the help of Allah Almighty who gave me courage to complete this work

PREFACE

This thesis is an attempt to introduce the laws related to the wrongful trading in the UK, USA, Pakistan and, Malaysia. It also elaborates the origin and history of the wrongful trading. This research paper is divided into four chapters. Chapter 1 comprises on the detail definition of the wrongful trading, fraudulent trading and how wrongful trading occurs. Chapter 2 overview the legislative framework in Pakistan to deal with wrongful trading. This chapter discusses the law that indirectly deals with wrongful trading. Chapter 3 focuses on the law available in UK, USA and Malaysia to deal with wrongful trading. Chapter 4 is about the liabilities of the directors for wrongful trading and punishment for them who are responsible in the mismanagement of the company. Chapter 5 is the conclusion of this research paper and recommendations for the reforms in the corporate law of Pakistan.

CHAPTER 1

THE HISTORY AND ORIGIN OF WRONGFUL TRADING

In the first chapter the introduction of the wrongful trading, its origin and history have been discussed in a detail. The exoression wrongful trading is not a new phenomenon for the world. We trace its origin from 1928 when United Kingdom parliament limited the fraudulent trading statute to its criminal side and passed a new wrongful trading provision as a civil remedy. Common law theories and rules have been made a significant contribution related to the fraud. "In simple term, wrongful trading occurs where the directors of a company continue to trade when they knew or should have realized that there was no reasonable prospect of the company avoiding insolvent liquidation and the company then goes into liquidation."[1]

The origin of the fraudulent trading statute was found in the section 75(1) of the Companies Act 1929 of UK. This provision was superseded by the section 332 of the Companies Act 1948. Fraudulent trading provision after the recommendation of the Cork Report was included in the section 213 of the Insolvency Act 1986. This section simply states that when directors of a company who were knowingly parties to the carrying on company business with intent to defraud the company and its creditors or for any fraudulent purpose will be personally liable on the obligation. English courts were

---

[1]Hewitsons, *Directors Duties in a Deteriorating Trading Position*, Available at: http://www.hewitsons.com (accessed 20 June, 2009).

uncomfortable because the statute supported both civil and criminal penalties construed its provisions narrowing as they required very high standard of proof. Due to high standard of proof liquidator stopped applying to courts for relief. Therefore, English parliament limited the fraudulent trading statute to its criminal side and passed a new wrongful trading provision as a civil remedy. Now wrongful trading is dealt under section 214 of the Insolvency Act 1986.

In Pakistan section 412 of the Companies Ordinance 1984 indirectly deal with wrongful trading. The world wrongful trading has not been used in the section 412 of the Companies Ordinance 1984 but to the some extent text of the section 214 of the Insolvency Act 1986 and section 412 of the Companies Ordinance 1984 is same.

Wrongful trading provision was introduced to enable contributions to be obtained for the benefit of the creditors from those responsible for the mismanagement of the insolvent company. Many times directors use the rule laid down in the Salomon v Salomon & Co LTD [1897] AC 22 (HL) [2.01) case by the House of Lords that company is a legal entity separate from its members. Unlike fraudulent trading, wrongful trading needs no finding of intent to defraud. Wrongful trading therefore is a less serious and more common offence than fraudulent trading. Only proof for the wrongful trading is that directors ran the business of the company at the time when company was in financial difficulty.

The basic aim to introduce the wrongful trading provision was to reduce burden of proving fraud in such cases. Under this provision the directors of the company are personally liable to pay the debts of the company when they continued its business at the time of financial difficulties. That the directors of the companies are not personally liable

to pay the debts of the company was one of the fundamental principle of the English Company's Law. However, under Insolvency Act 1986 directors of the company will be personally liable to pay the debts of the company if it appears that they were at fault.

UK Insolvency Act 1986 which is now replaced by the Enterprise Act 2002 is a major source to lay down the provisions for the liabilities of the directors in wrongful trading. These provisions envisage clearly that directors will be personally liable to pay the debts of the company if it appears that they were at fault. Similarly Section 413 of the Companies Ordinance 1984 also envisages the liability on the directors if it appears that they carried on company business with intent to defraud the company and its creditors. United States also adopted some new provisions and amended old one to deal with wrongful trading. However, in USA there is the concept of deepening insolvency theory in contrast with wrongful trading in UK. Deepening insolvency is a claim that directors or officers took actions that prolonged the life of the corporation outside of bankruptcy and that such action or inaction ultimately harmed the corporations and its stakeholders. After the collapse of the biggest companies of the world it became very necessary to make new laws that deal with corporate fraud. The case of Enron in United States was the biggest dollar fraud in the world. On Enron alone those losses were more than two times the aggregate losses suffered when the stock market crashed in 1929. After the Enron case United States passed the Sarbanes Oxley Act 2002. They also adopted the Code of Corporate Governance to make the corporation system more efficient, effective and transparent. It was suggested that Enron and other cases happened only due to the poor application of the Corporate Governance. Malaysian legislation relating to companies has always been vibrant and progressive. They recently passed the Companies

(Amendments) Act 2007 which introduced significant and far reaching changes for Malaysian companies. In particular, important changes were made to the law relating to the directors statutory and common law duties. They amended their Companies Act 1965 more than seventeen times. This is a major milestone in the history of company law legislation in Malaysia. The detail of the amendments in the above mentioned jurisdictions have been discussed in this research paper.

In Pakistan provisions are available to deal with wrongful trading but not sufficient to control this offence. As we said above that section 412 of the Companies Ordinance 1984 indirectly deal with wrongful trading. Section 17 of the Securities and Exchange Commission of Pakistan Ordinance 1969 also indirectly deals with wrongful trading.

In Malaysia and USA also no direct law is available to deal with wrongful trading but they amended their company's laws with the passage of time for the promotion of the corporations that have an integral part to enhance the economy of the country. Insolvency laws have been made in Pakistan but corporate bodies are exempted from the application of the insolvency law.

In Pakistan corporations are governed by the Companies Ordinance 1984 and regulated by the Securities and Exchange Commission of Pakistan. In UK provisions related to the wrongful trading have been introduced in Insolvency Act 1986 and in Pakistan Companies Ordinance 1984 keep the provisions regarding the wrongful trading. Section 412 of the Companies Ordinance, 1984 to the some extent fulfills the same purpose as the section 214 of the UK Insolvency Act 1986.

The aim of this thesis is the analyses of the existing laws of the Pakistan that indirectly deal with wrongful trading. It is essential to pay attention towards the amendments of the corporate laws for the promotion of the corporations in the Pakistan.

1.1 WHAT IS WRONGFUL TRADING?

In simple term, wrongful trading occurs when the directors of the company continue its business when they know or should have realized that there was no reasonable prospect of the company avoiding insolvent liquidation and then company goes in to liquidation. It also occurs when directors of the company know that company is not in good financial position instead of that they continued it business.[2]

Under UK insolvency law wrongful trading occurs when the directors of a company have continued to trade a company past the point when they:

i. knew, or ought to have concluded that there was no reasonable prospect of avoiding insolvent liquidation and
ii. They did not take every step with view to minimizing the potential loss to the company creditors.

It also means that, where the directors of the company know that the company has no assets to pay its debts and incur further debts.[3] Always the directors of the company after

---

[2] Thomson Snell & Passmore, *Directors Responsibilities avoiding the Wrongful Trap*, Jan 2009. Available at: http://www.ts-p.co.uk/.....directors,%20responsibilities%20avoiding%20the%20wrongfull%2---- (accessed 5 June, 2009).

[3] Viswiki Solicitor, *Wrongful Trading*, Available at: http://www.viswiki.co/en/Insolvency-Act-1986 (accessed 20 June, 2009).

committing the wrongful trading use the concept of limited liability.[4] Wrongful trading is a type of civil wrong found in the UK insolvency law under section 214 of Insolvency Act, 1986 and, in section 412 of the Companies Ordinance 1984.[5]

Section 214 of Insolvency Act 1986 was introduced to enable contributions to be obtained for the benefit of creditors from those responsible for mismanagement of the insolvent company.[6]

The separate legal entity doctrine in corporate law means that directors are not personally liable to pay the debts of the company. However, courts and governments took action to make directors liable in certain cases. In United Kingdom law has been made to make the directors liable in case of wrongful trading.[7] The concept of limited liability always provides the protection to the directors for the wrongful trading that the director of the company will not be personally liable to pay the debts of the company but Insolvency Act 1986 contains the provisions for the personal liabilities of the directors. Now director's duties have been codified in the Companies Act 2006.[8]

Like fraudulent trading, wrongful trading needs no finding of intent to defraud. Wrongful trading is therefore less serious and more common offence than fraudulent trading.[9]

---

[4]In Salomon v Salomon case the concept of the limited liability was introduced, that company is legal entity to different from its members. In this case Salomon and his family members were the shareholders of the company and, when company went in to liquidation they said that company has no assets to pay the debts of the creditors. For detail see the Salomon V Salomon case quoted in, Lean Sealy, *Cases and Material of the Company Law*, (Sara Worthington, New Zealand 2005), 32-33.

[5]For detail, See S. 214 of Insolvency Act 1986 and, section 412 of the Companies Ordinance 1984.

[6]Shean Solicitor, *Directors Duties and Responsibilities.*

[7]Andrew Keay and Michael Murry, *Making Company Directors Liable: A Comparative Analysis of wrongful Trading in United Kingdom and Insolvent Trading in Australia,* revised vol, 14th (Online Wiley inter science 2005) Available at: http://www.interscicncc.wilcy.com (accessed 27 August, 2009).

[8]Companies Act 2006. Available at: http://www.opsi.gov.uk/acts2006/ukpga-20060046-en-1- (accessed 9 September, 2009).

[9]Babbe, Fraudulent Trading and Wrongful Trading-a legal guide, available at: http://www.babbelegal.com/images/site-files/11.pdf (accessed 23 June, 2009).

Section 214 of the Insolvency Act 1986 is imperative legislation of the UK government. It contains the penalties for the people who misuse their powers in the management of the company. The provision does not explain what constitutes wrongful trading. The provision does not set out that what will lead to an action under section 214 of the Insolvency Act 1986. Wrongful trading has not been defined by the law but **Marion Simmons QC** has noted the definition of "wrongful" from Oxford Dictionary that is the full of wrong, injuries, injustice, unfairness or violation of equity. After this definition it seems to suggest that there is need to established blame something that the Cork Committee never envisaged.[10]

Section 214 of the Insolvency Act 1986 also lays down the procedure to make the directors liable to pay the debts of the company. For this purpose the liquidator of the company that is insolvent may commence a proceeding against any of the company directors and these proceedings may seek an order from the court to make such contribution to the company assets as the court thinks proper.[11] In order to establish liability on the directors the liquidator needs to prove that the directors of the company continued its business at the time of financial difficulties.[12]

The facts that director ought to have known were those which a reasonable diligent person having both the skill and experience possessed by a reasonable director together with the skill and experience actually possessed by that individual. This means that there is two fold of test for knowledge. There is a general level of skill and experience required

---

[10]Viswiki Solicitor, *Wrongful Trading*, Available at: http://www.viswiki.co/en/Insolvency-Act-1986 (accessed 20 June, 2009).

[11]Jenny Payne, Dan Prentice, *Civil Liability of Directors for Company debts under English Law*, chap 8 (University of Melbourne 2002), 200.

[12]Ibid.,

for all directors under the first part of the test. Under the second, a higher standard of knowledge is required by those with specialist skills.[13]

In the English law, it is the common rule that no one is liable to pay the debts of the company except the company itself. Neither the directors nor the shareholders are responsible to pay the debts of the company after its insolvency.[14]

Manager and director is the top decisions maker officer of the company. It is usually mentioned in the article of association of the company that they cannot manage the listed companies except the board delegate its power on fulltime executives.[15]

Wrongful trading is dealt under section 214 of the Insolvency Act 1986. This section empowers the court to make a declaration like under section 213[16] but only in one specific set of circumstances. This section will be active only when the company has gone into insolvent liquidation. The directors of the company are responsible only when the company goes in to insolvent liquidation.[17] The declaration can be made against a person who before the winding up of the company was a director of that company. The court will not pass any order if it is satisfied that the directors of the insolvent company

---

[13]Ibid.,

[14] In Salomon v Salomon case the concept of the limited liability was introduced, that company is legal entity to different from its members. In this case Salomon and his family members were the shareholders of the company and, when company went in to liquidation they said that company has no assets to pay the debts of the creditors. For detail see the Salomon V Salomon case quoted in, Lean Sealy, *Cases and Material of the Company Law*, (Sara Worthington, New Zealand 2005), 32-33.

[15]Rizwaan J. Mokal, *An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors,* The Cambridge Law Journal, Vol.59. No.2 July, 2000, Cambridge University Press) pp335-369. Available at: http://www.jstor.org/stable/4508678 (accessed 27 May, 2009).

[16]Section 213 of the Insolvency Act 1986 lays down that, if in the course of the winding up of the company it appears that any business of the company has been run with intent to defraud the company and its creditors of any other person, or for any fraudulent purpose, the following has effect. The court in case of fraudulent trading will pass an order on the application of the liquidator against a person who was knowingly parties to the carrying on of the business in the manner above-mentioned are to be liable to make such contributions to the company assts as the court thinks proper. For detail see also, 213 (1) of Insolvency Act 1986.

[17]When company assets are less then its liabilities and, it has no prospect to paying the debts of the creditors and the expenses of the winding up of the company. For detail see also, Ibid., s.214 (6)

took every step to save the company from going in to liquidation. It is difficult to assess that what directors knew before the insolvency of the company, what their results were and what steps they took to save the company from going in to liquidation. They are considered that they had every kind of knowledge and experience regarding the company business. Therefore, they are responsible to pay the debts of the company.

1.2 WHAT IS FRAUDULENT TRADING?

"Fraudulent trading will normally be established where the directors of a company, knowing that it has no prospect of ever paying its debts, incur further debts. It also means that if in the winding up of a company it appears that any of the company business has been carried on with intent to defraud the company and its creditors or for any other fraudulent purpose."[18] To constitute the fraudulent trading the dishonest intention of the directors must be proved. In other words the person who has committed the fraud would be obliged to pay the debts of the company to the creditors through liquidator. It is also necessary that in order to fall foul of the fraudulent trading provisions the behavior in question must constitute "fraud". The Courts have not defined the fraud but, simply restricted themselves to saying that it denotes dishonest behavior.[19] There are some signs for the fraudulent trading like wrongful trading. These signs are as follows:-

i. "Large unexplained profits/losses.,

---

[18]Babbe, Fraudulent Trading and Wrongful Trading -a Legal Guide. Available at: http://www.babelegal.com/images/site-files/11.pdf (accessed 17 May, 2009).

[19]Ibid.,

ii. Actions and transactions by officers of the company when they know there are insufficient funds,

iii. Taking orders and deposits when they cannot be fulfilled,

iv. Playing one bank off with another,

v. Large variation between balance sheet and actual figures"[20]

If all these signs are proved against the directors they will face punishment including compensation and fines that is limitless as the court thinks proper. Directors in the case of fraudulent trading will also face the imprisonment possible for up to 7 years.[21] Under section 413 of the Companies Ordinance 1984 punishment for the wrongful trading is twenty thousand rupees and two years imprisonment that is not sufficient to control this offence.[22]

Therefore, it is required in the case of fraudulent trading that the dishonest intention of the directors must be proved. Fraudulent trading is dealt under section 213 of Insolvency Act 1986 and section 413 of the Companies ordinance 1984. [23] The fraudulent trading provisions as we said above were first available in the section 75(1) of the Companies Act 1928 and 332 of the Companies Act, 1948. The Insolvency Law Review Committee, in its report in 1982 was of the opinion that the fraudulent trading provision as set out in section 332 of the Companies Act, 1948 possessed significance inadequacies in dealing with irresponsible trading. These inadequacies included the very strict proof for the

[20]Director's Responsibilities. Available at: http://www.insolvencyhelpline.co.uk/itd-companies/directors-responsibilities.php#wrongful-trading (accessed 23 June, 2009).

[21]Ibid.,

[22] Section 413, Companies Ordinance 1984.

[23] Thomson Snell & Passmore, *Directors Responsibilities avoiding the Wrongful Trap*, Jan 2009.

fraudulent trading.[24] The Cork Committee recommended that a new provision be included to allow for civil action for unreasonable trading. The civil liability provision was finally enacted in the form of Section 214 of the Insolvency Act 1986. Now the fraudulent trading provision is available in section 213 of the Insolvency Act 1986.[25] Section 213 of the Insolvency Act 1986 provides the definition of the fraudulent trading that if in the winding up of a company it appears that any of the company business has been carried on with intent to defraud the company and its creditors or for any fraudulent purpose, the court on application of the company liquidator, declare that any person who were knowingly parties to the fraudulent trading are liable to make contribution to company assets.[26] Fraudulent trading is considered criminal offence. It is more serious offence then wrongful trading. After the legislative reforms of 1985-1986- the criminal offences became under section 458 of the Companies Act and the civil sanction became the part of the sections 213 and 215 of the Insolvency Act 1986. These provisions give procedure to recognize the persons who always use the concept of limited liability. They run the company business with intent to defraud the company and its creditors and then escape to use the concept of corporate personality.[27]

---

[24] Ian M Ramsay, *Company Directors Liability for Insolvent Trading*, (University of Melbourne 2000), 25.

[25] See the, The Insolvency Law Review Committee Report in 1982, *Insolvency Law and Practice* (Generally referred to as "Cork Report". Available at: Andrew Keay and Michael Murry, *Making Company Directors Liable: A Comparative Analysis of wrongful Trading in United Kingdom and Insolvent Trading in Australia,* rev vol. 14th (Online Wiley inter science 2005) Available at: http://www.interscience.wiley.com (accessed 27 August, 2009). Available also at: http://www.insolvency.gov.uk:8765/ (accessed 12 September, 2009).

[26] Directors Responsibilities. Available at: http://www.insolvencyhelplinc.co.uk/itd-companies/directors-responsibilities.php#wrongful-trading (accessed 23 June, 2009).

[27] Gower, *Principle of Company Law*, (Sweet & Maxwell, London 2003), 194.

1.3 DIFFERENCE BETWEEN WRONGFUL TRADING AND FRAUDULENT TRADING.

The first and most important difference between fraudulent trading and wrongful trading is that fraudulent trading was came to be known for many years before the introduction of wrongful trading. First fraudulent trading provision was available in the section 75(1) of the Companies Act 1928 and in section 332 of the Companies Act 1948. For wrongful trading section 214 of the Insolvency Act 1986 was first time introduced to control the unfair corporate practices. Wrongful trading was not most popular like fraudulent trading.[28]

Fraudulent trading will normally be established where the directors of a company will run its business with dishonest intention to defraud the company and its creditors. For fraudulent trading the dishonest intention of the directors must be proved.[29]

The wrongful trading occurs when the directors of the company knowing that it has no assets to pay its debt incur further debts. This definition applies also on fraudulent trading. Only difference is that in wrongful trading the intention of the directors is not required whereas in fraudulent trading it is necessary to prove that directors of the company ran the business with dishonest intention to defraud the company and its creditors.[30]

---

[28] Ibid.,

[29] Ibid.,

[30] Rizwaan J. Mokal, *An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors,* The Cambridge Law Journal, Vol. 59. No. 2. (Cambridge University Press July, 2000) 335-369. Available at: http://www.jstor.org/stable/4508678 (accessed 27 May, 2009).

There will not normally be a case of fraudulent trading and wrongful trading where a company ceases trading but, before it goes in to liquidation, the directors sell its assets and use the proceeds to pay off only some of its creditors. However, this type of behavior would almost certainly constitute the giving of unlawful preference to creditors which could be set aside at the instance of a liquidator, and might also constitute wrongful trading, rather than fraudulent trading. Directors of the company will be liable for the wrongful trading at the time when it appears that the directors did not cease the business even when they knew that company is not in good financial position and cannot avoid from going in to liquidation.[31] Directors will be liable for wrongful trading in certain conditions that are as follows:

1. Company has gone in to insolvent liquidation. This is very important condition for the liability of the wrongful trading on the directors. Without the liquidation of the company liability cannot be imposed on the directors,
2. At some time before the commencement of the winding up of that company that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation, and
3. That person was a director of the company at that time,[32]

If all these conditions are met, the court may on the application of the liquidator of the company declare that the person is to be liable to make such contribution to the company assets as the court thinks proper. The defense is also available to the company director in case of wrongful trading if they satisfy the court that after he knew or ought to have

---

[31]Ibid.,
[32]Ibid.,

concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation he took every step with a view to minimizing the potential loss to the company creditors. The danger which imposes the potential liability on the directors not only when they knew that things were going wrong but where they ought to have known that they were going wrong. In these situations they must cease the company business otherwise are personal liable to pay the debts of the company.

1.4 HOW WRONGFUL TRADING OCCURS?

Wrongful trading always occurs due to the negligent act of the directors when they continue the company business at the time of financial difficulty.[33] When directors come to know that company is not in good financial position they should stop the business before the company goes in to insolvent liquidation. Otherwise, they are personally liable to pay the debts of the company whole or any part of it.[34] Director's good steps can avoid the company from going into liquidation. They also must seek advice from the licensed practitioner. Section 214 of the Insolvency Act, 1986 provides to the director that he will not liable for the debts of the company if he can show that he took every step with a view to minimize loss to the creditors after he came to be known that company cannot avoid

---

[33]Ibid.,

[34]Company can not be run without directors. They are the trustee of the company. Directors always should work for the interest of the company not for their own interest. For detail see also, Shean Solicitor, *Director's Responsibilities on Insolvency*, Available at: http://sheansolicitor.com/index.php?ption=com-content&view=article&id=11&itemid=16 (accessed 29 May, 2009).

liquidation.[35] Therefore, a director of a company must take reasonable steps to avoid the company from going into liquidation.

Wrongful trading does not occur suddenly. There are some signs which show that if reasonable steps would not be taken by the directors, then company would go in to liquidation. For example the balance sheet of the company is the basic source to know about the real financial position of the company. Balance sheet shows the real financial position of the company. Sometimes its assets are less than its liabilities. When the balance sheet of the any company shows this situation they must cease the company business to save the company from further loss.[36]

In the current economic climate, it is more important than ever that company directors are aware about their duties in relation to running of the company, so that they do not run the risk of committing an offence or incurring personal liability. Directors act as trustee for the company and its property.[37] A director is accountable for his actions and therefore owes certain duties to the company. Over the years these duties have evolved through the courts, but these have now been largely codified in the Companies Act 2006.[38] Such duties include the duty to act within powers, to promote the success of the company, to exercise independent judgment, to exercise reasonable skill, care and diligence, to avoid conflicts of interest, and not to accept benefits from third parties.[39] Where a company is solvent, the directors owe their duties to the company and it is the company acting by its

---

[35] Jenny Payne, Dan Prentice, *Civil Liability of Directors for Company debts under English Law.*

[36] Ibid.,

[37] Hewitsons, *Directors Duties in a Deteriorating Trading Position.* Available at: http://www.hewitsons.com (accessed 20 June, 2009).

[38] Companies Act, 2006. Available at: http://www.braconlinc.eu/liabrary/directors Dutics UK Companies Act.pdf (accessed 12 September, 2009).

[39] Lean Sealy, *Cases and Material of the Company Law*, (Sara Worthington, New Zealand 2005), 294.

shareholders which has the right to enforce these duties. Although the duties are still owed to the company and the interest of the creditors become paramount and the company should be managed in order to protect their interest.

Section 214 does not apply only on the de facto directors but also impose liability on the shadow directors. Shadow directors according to whose instructions the board of directors accustomed to act.[40] Millett J held in *Re Hydroden (Corby) Ltd [1996] 2 BCLC 180* that the terms "de facto" and "de jure" are mutually exclusive.[41] In the case of many companies limited by guarantee the directors may be known with the name of council members or governors. It means only the de facto and shadow directors are not responsible for wrongful trading but the others members will also be responsible to pay the debts of the company.[42] In such circumstance, the court can require the directors involved to make a personal contribution to the company's assets. Control of wrongful trading became a great challenge for the world. It happens due to the negligent act of the company directors. When it appears that company assets are less than its liabilities, so at this stage directors must ceased the company business to save the company from further losses.

---

[40] Gower, *Principle of Company Law*, (Sweet & Maxwell, London 2003), 194

[41] Section 214 imposes liability not only on de facto directors but also on the shadow director. In case of wrongful trading not only the de facto and shadow directors but any person who was party to carrying on the business at the time of financial difficulty will be personally liable to pay the debts of the company. For detail see also the decision of the J Millett in *Re Hydroden (Corby) Ltd [1996] 2 BCLC 180.*

[42] *The Law and Directors Responsibilities*. Available at: http://www.freelance.co.uk/legal/directorresponsibility.shtm/#toppcr (accessed 12 September, 2009).

CHAPTER 2

LEGISLATIVE FRAMEWORK DEALING WITH WRONGFUL TRADING IN PAKISTAN

In a modern economy, an efficient and effective system is essential to facilitate economic transactions, specialization in production and establish investors-friendly institutions and competitive markets. A stable and efficient system not only reduces the uncertainty and cost of transactions but also improves the overall economic efficiency through efficient allocation of recourses. To compete in international markets and meet with 21st century challenges it is essential to introduce new provisions to control the unfair corporate practices in Pakistan. The main issue that has been discussed in this thesis is that what laws are available to deal with wrongful trading and, what are essential to be adopted to fulfill this purpose?

Wrongful trading is not a new term in Pakistan but with an alternate name. Here no direct law is available to deal with wrongful trading. Section 412 of the Companies Ordinance 1984 to the some extent fulfills the same purpose like, 214 of the Insolvency Act 1986 in UK. Like in USA and Malaysia in Pakistan also no direct provision is available to deal with wrongful trading. In other jurisdictions amendments have been made in their company law but in Pakistan still we are following the law that is badly in need of reforms. The most important issue that has been discussed is that, in Pakistan we make the laws related to every filed but forget about their proper implementation. In 2002 SECP adopted the Code of Corporate Governance to make the corporations system fair, effective and transparent. This

Code, along with the Companies Ordinance 1984, forms the legal basis for Corporate Governance in the country. The main objective of the Code of Corporate Governance is to stimulate the performance of the companies and limit insider's abuse of powers. Pakistan Institute of Corporate Governance was established in 2004. This institute is also performing its functions for the proper implementation of the Corporate Governance in the corporations. For the future practices of the Corporate Governance in Pakistan the support of the donor agencies ADB and UNDP is required. The detail of all these laws, rules and SECP guides lines have been discussed in this chapter.

Section 17 of the Securities and Exchange Commission of Pakistan Ordinance 1969 describes the procedure for fraudulent activities. Corporate Rehabilitation Act 2004 is about the reorganization of the corporations at the time of financial difficulty. Under the Corporate Rehabilitation Act, the judiciary will approve plans filed by the debtors or creditors on how to revive a troubled company. This law was modeled on the US Chapter 11 of the Bankruptcy Code 1996 procedure and Mexico's Insolvency Law 2000.

Stock exchanges of the any country play very vital role to enhance the economy of the country. In Pakistan history of the stock market is not very old. It came in to existence in 1949. Karachi Stock Exchange of the Pakistan has been declared as the best performing stock market for the year of 2002. Due to the fraudulent act of the managing officers of the stock exchange we have faced the stock market crashes three times. In Pakistan amendments are required in the company's laws to make the directors personally liable to pay the debts of the company. Concept of limited liability should be buried forever that nobody could use it for his personal interest. Section 214 of the Companies Ordinance 1984 deals with the

director's duties. This provision does not contain the sufficient duties of the directors that bound them not to go beyond their limit. Section 214 of the Companies Ordinance 1984 envisages that the directors of the companies must disclose their interest in contracts before the shareholders. Same text is available in the section 317 of the Company Act 1985 of the UK. Duties available in the Companies Ordinance 1984 are not sufficient to eliminate this evil from the society. Amendments and reformations are required to make the corporations system more efficient, effective and transparent.

2.1 HISTORY OF THE COMPANIES ORDINANCE 1984.

The Companies Ordinance 1984 governs the corporate sector in Pakistan. It was promulgated on 8th October, 1984 and, repealed the Companies Act 1913 of India. This Act was issued in 1913 which was adopted in Pakistan after independence. The company's law was administered by the provinces until 1973 when the new Constitution of Islamic Republic of Pakistan placed the company's law in concurrent list and therefore, was taken over by the Federal Government except that the companies operating within the provinces could be regulated by the Provincial Government.[1]

The objective of this ordinance was to amend and consolidate the law according to the needs of the day. Its other aim was to provide protection to the creditors, investors, and to develop the economy of the country. There were amendments in these laws with the passage of time

[1]Nazir Ahmed Shaheen, *Practical Approach to the Companies Ordinance, 1984,* (Federal Law House: Pakistan 2004).

to strong the corporate sector of the Pakistan.[2] In 1993, a committee headed by Mian Mumtaz Abdullah, Chairman erstwhile Corporate Law authority was formed who furnished its report and some of its recommendations were implanted through an Ordinance by caretaker government but the Ordinance lapsed without placing the recommendations before the parliament. 1n 1996, a commission headed by Mr. Justice (Rtd) Shafi ur Rehman was constituted who reviewed the Ordinance and furnished its report to the Federal Government.[3]

2.1.1 Objectives of the Companies Ordinance, 1984.

Companies Ordinance, 1984 was established with the following objects.

1. Healthy growth of the corporate enterprises,
2. Protection of investors and creditors,
3. Promotion of investment, and
4. Development of economy.

The above objects have very integral part to enhance the economy of the country. Industries play very imperative role to augment the economy of the country so these must be protected from the people who misuse the concept of limited liability take the company into insolvent liquidation. The role of the investment also can not be denied. Companies Ordinance 1984 has been amended many times to accomplish the real objective of the creation of the corporations. The major amendments in the Act, 1984 were made through the Finance Act 1995, in 1999, and Companies (Amendments) Ordinance 2002. Finance Act 1995 repealed

[2] Companies Ordinance 1984, (Amendments) February 2009. Available at: http://www.secp.gov.pk/corporatelaw/pdf/co1984-%20feb09.pdf (accessed 4 September, 2009).

[3] Nazir Ahmed Shaheen, *Practical Approach to the Companies Ordinance, 1984.*

the Companies Issues Act, 1947, which gave the discretionary power to the federal government to control the issue of share capital by companies made several amendments in the Companies Ordinance 1984. In 2002, the concept of single member company was introduced in the Companies Ordinance 1984, through the Companies (Amendments Ordinance), 2002. This Act facilitates the sole proprietorship to obtain the corporate status and has given them the privileges of limiting the liability of their proprietors. This amendment was also to encourage the documentation of the economy. According to this ordinance the listed companies' members will be three rather then seven. It was also included in this ordinance that directors of the listed companies will prepare the annual accounts of the company. The time of the meeting was also reduced from six months to four months.[4]

As we discussed above that there is no direct law to deal with wrongful trading, but the laws hat have been made to the some extent fulfill the same purpose as the Insolvency Act 1986 in the UK.[5] Companies Ordinance 1984 provides the detail procedure regarding the insolvent trading. Section 412 of the Companies Ordinance 1984 is almost same with the section 214 of the Insolvency Act 1986 in UK. The important thing that has been discussed is that the laws that are available to deal with wrongful trading have same purpose but not according to the need of the day. Securities and Exchange Commission of Pakistan is the regulator of the corporate sector in Pakistan. Section 17 of the Securities and Exchange Commission of Pakistan Ordinance 1969 envisages the provision to prevent the fraudulent activities. SECP

---

[4]Ibid.,

[5]S.196-214 of the Companies Ordinance, 1984.

also adopted the Code of Corporate Governance in 2002.[6] That was a major step towards this was a joint project by the Securities and Exchange Commission of Pakistan and the United Nation Developing Programs (SECP-UNDP) in collaboration with the Economic Affairs Division (EAD) of the Ministry of Finance. The project was lunched in August, 2002 with the objective to design, develop and implement the Code of Corporate Governance. Though this project had some discussion on Corporate Governance for banks but its main focus was the corporate sector in Pakistan. To address the problems of the banking sector, the State Bank of Pakistan (SBP) issued a Hand Book of Corporate Governance in 2003. The objective of this was to provide the guidelines for the Board of Directors, managers and shareholders.[7] The basic aim of this Code of Corporate Governance was to provide protection to the shareholders and the investors. The available laws that indirectly deal with wrongful trading have been discussed in a detail.

2.2 PROVISIONS OF COMPANIES ORDINANCE REGARDING WRONGFUL TRADING?

As we know that in Pakistan companies are governed by the Companies Ordinance 1984 and regulated by the Securities and Exchange Commission Pakistan. In Companies Ordinance

---

[6]Security and Exchange Commission of Pakistan adopted the Code of Corporate Governance to make the companies system transparent and fair. Corporate Governance is a system by which companies run their business. For detail see also, Code of Corporate Governance 2002, available at: http://www.secp.gov.pk/cl/pdf/codeco-g.pdf (accessed 5 September, 2009).

[7]Ahmed M. Khalid, Mohammed Nadeem Hanif, Corporate Governance of Banks in Pakistan, May, 2004. Available at: http://www.ravi.lums.edu.pk/fcg/images/AhmedKhalid%20and%20nadeemhanif.pdf (accessed 10 October, 2009).

1984 no direct provision is available to deal with wrongful trading.[8] The important thing about the control of the wrongful trading is that there must be extension in the duties of the directors.[9] Companies Ordinance 1984 provides only the provisions for the winding up of the insolvent company, arrangements and reconstruction, management by administrator and rehabilitation of companies' owning sick industrial units.[10] Powers and duties of the directors are also available in Companies Ordinance 1984 but are not sufficient for the personal liability of the directors in case of wrongful trading. For the control of wrongful trading there must be fiduciary and statutory duties of the directors like in other Jurisdictions of the world.[11] Some sections are essential to be discussed that indirectly deal with wrongful trading.

2.2.1 Section 412 of the Companies Ordinance 1984 deals with Wrongful Trading.

412. Power of the Court to assess Damages against Delinquent Directors

"- (1) If in the occurs of the winding up of the company it appears that any person who has taken part in the promotion or formation of the company, or any past or present director, liquidator or officer of the company-

a) Has misapplied or retained or become liable or accountable for any money or property of the company; or
b) Has been guilty of any misfeasance or breach of trust in relation to the company".

---

[8]Insolvency Law Reform Report on Pakistan, S.1 by, Maudood A. Khan & Aly Shahorr, Available at: http://www.Insolvencyasia.com/Insolvency-law...../Pakistan (accessed 3 September, 2009).

[9]UK Companies Acts 2006. Available at: http://www.opsi.gov.uk/acts2006/ukpga-20060046-en-1- (accessed 9 September, 2009).

[10]Insolvency Law Reform Report on Pakistan, Available at: http://www.adb.org/documents/.../insolvency/local-study-pak-khan-i.pdf- (accessed 23 June, 2009).

[11]Section 196-214 of the Companies Ordinance 1984.

When we analyzed the Section 412 of the Companies Ordinance 1984 it has been cleared that in Pakistan section 412 of the Companies Ordinance 1984 fulfils the same purpose as the section 214 of the Insolvency Act 1986. The issue is that laws are available in Pakistan to deal with this offence are not according to the need of the hour. Section 412 envisages that if in the course of the winding up of the company if it appears that any person who took part in the formation or promotion of the company or any other officer or directors who have misapplied and misuse the money and the property of the company shall be liable to pay the damages to the company. The court on the application of the official liquidator or creditors examines the conduct of the person, officer, liquidator and directors. After examination of the application if court is satisfied that directors and other officers of the company are at fault the court pass an order against these persons to repay or restore the money or property to the company and its creditors.[12] Every day there are cases of the wrongful trading in Pakistan. These cases show that how the high authority of the corporation with fraudulent destroy the whole business of the company and deceive investors and the creditors. Due to their attitude peoples are sacred to invest this money. The *Messrs Shaheen Foundation v Messrs Capital F.M (PVT) Limited 2002 & nbsp CLD 188 KARACHI-HIGH-COURT-SINDH* was filed against the company directors for the mismanagement of the company business. Petitioner alleged that the conduct of the business affairs of the company in an unlawful, fraudulent mala fide manner, which oppressive to the petitioner. Neither books of the accounts have been made nor the accounts have been audited, approved or filled with authorities nor the Annual General Meeting have been held as required by law. Directors have repeatedly

[12]Zaka Ali, Companies Ordinance, 1984, (The Ideal Publisher Karachi, 2007).

committed and continuing to commit act and omissions in violation of Article of Association. Respondents denied all the allegations raised by the petitioner. J Shabbir Ahmed held that petitioner failed to provide the record that shows the mismanagement of the company business by the directors therefore, the petition dismissed by the honorable court. This petition was filed under section 410 to 415 of the Companies Ordinance 1984 that provide for determination of liability, civil and criminal of the directors etc.[13] The purpose of the section 412 is same with section 214 of the Insolvency Act 1986. The only difference is that the sub sections of the 214 of Insolvency Act 1986 provide the detail procedure for the wrongful trading that is not available in section 412 of the Companies Ordinance 1984.

2.2.2 Fraudulent Trading deal under Companies Ordinance 1984.

> **413. Liability for Fraudulent Conduct of Business.** – "(1) If in the course of the winding up of the company it appears that any business of the company has been carried on with intent to defraud creditors of the company or any other person, or for any fraudulent purpose, the Court, on the application of the official liquidator or the liquidator or any creditor or contributory of the company, may, if it thinks fit, declare that any persons who were knowingly parties to the carrying on of the business in the manner aforesaid shall be personally liable responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct."

Section 413 of the Companies Ordinance 1984 deals with fraudulent conduct of business by the directors. According to section 413 of the Companies Ordinance 1984, if in the course of the winding up of the company it appears that any business of the company has been carried on with intent to defraud the company and its creditors or for any other fraudulent purpose

---

[13] *Messrs Shaheen Foundation v Messrs Capital F.M (PVT) Limited 2002 & nbsp CLD 188 KARACHI-HIGH-COURT-SINDH.* Available at: www.http://www.pakistanlawsite.com/LawOnline/law/contents3.asp?Detailes=2002K5010 (accessed 1 November, 2009).

the court on the application of the creditor or official liquidator will declare that the persons who were knowingly party to this act shall be personally liable to pay whole or any part of the company debts. Court has wide discretion to pass an order against the directors and other officers of the company who ran the company business with intent to defraud the company and its creditors. The person who carried on company business with intent to defraud the company and its creditors shall also be liable for imprisonment which may extend to two years, or with fine which may extend to twenty thousand rupees, or with both.[14] Section 413 indirectly deals with fraudulent trading and section 412 deals with wrongful trading because in section 413 the word intent has been used that is required for the poof of fraudulent trading. This section fulfills the same purpose as the section 213 of the Insolvency Act of the UK. *Muhammad Yousuf v Taj Company 1994 & nbsp CLC& nbsp 403 LAHORE-HIGH-COURT-LAHORE* was filed against the directors of the company for their fraudulent act under section 410-415. In this case directors of the Taj Company prepared the false financial statement to show that the company is earning profit with intention to defraud the investors and its creditors. They defrauded the public intentionally. Directors and managing directors of the company who were party to knowing the real position of the company has been held personally liable to pay the debts of the company individually.[15]

Under sections 412-413 the court has power to pass an order not only against the officer of the company and, also against the person who was partner of that firm and the director of that company. All these persons of the company are personally liable to pay the debts or

[14]S. 413, Companies Ordinance, 1984.

[15] Muhammad Yousuf v Taj Company 1994 CLC 403 LAHORE-HIGH-COURT-LAHORE. Available at: http://www.pakistanlawsite.com/LawOnline/law/contents3.asp?Detaileds=1994L281 (accessed 1 November, 2009).

repay the money and the property of the company if it appears that they knew the financial position of the company instead of that did not cease the business of the company.[16]

2.2.3 Penalty for Fraud by officers and Directors of the Company.

Section 415 of the Companies Ordinance 1984 contains the penalty for the directors and officers of the company who misuse their powers and company goes in to liquidation. Any officer or director of the company who commit fraud or induce to give the debts of the company or ran the company business with intent to defraud the company and its creditors or concealed or removed the property of the company shall be punished with imprisonment for a term which may extend to two years and shall also be liable for fine.[17] This punishment is not sufficient to prevent the fraudulent activities in the Pakistan. However, Disqualification of the directors that is available in the Companies Directors Disqualification Act 1986 is the lesson for the rest of the company directors.

2.2.4 Powers of the Directors.

Section 196 of the Companies Ordinance 1984 lays down the powers of the directors. They are responsible to control and manage the business of the company and exercise their powers within their limits. They shall also use their powers to promote the business of the company. All these powers shall be exercised on behalf of the company. As a director of the company they shall be bound to work only for the interest of the company rather then for their

[16]Section 413-414 of the Companies Ordinance 1984.
[17]Section 215, Companies Ordinance 1984.

personal interest. They can exercise their powers by passing the resolution in the general meeting of the company. Which shall include:-

1. Directors have a power to call the shareholders in respect of moneys unpaid their shares,
2. They issue the shares,
3. Directors issue the debentures in the nature of redeemable shares.
4. They make loan,
5. They borrow the money,
6. They invest the funds of the company,
7. They enter into a contract for sale or purchase on the behalf of the company.
8. Directors of the company have also power to prepare the annual or half-year periodically accounts as required circulated among the members,
9. To approve bonus to employees, and
10. To incur capital expenditures or any single item or dispose of a fixed asset in accordance with the limits as prescribed by Commission from time to time..[18]

Section 196 of the Companies Ordinance contains the provisions regarding the powers of the directors. Directors of the company are not the ordinary persons. They hold the all affairs of the company. They should excise their powers for the promotion of the corporations not for their personal interest. In the presence of these powers directors of the company cannot say that they were not aware from the financial apposition of the company therefore did not cease it business. All these powers of the directors show that if they exercise these powers with due care and diligence they can avoid the company from going in to insolvent liquidation because they have full control on the every matter of the company.

---

[18]Ibid., S.196.

In Companies Ordinance 1984 even the word wrongful trading is not available therefore, the peoples do not know the worst impact of this offence on the corporations. The directors are not allowed to sell, lease or otherwise dispose of the undertaking or a sizeable part thereof, unless the company business comprises of such selling or leasing. They are also not authorized to remit the loan of the any creditors without the permission of the company.[19] Directors of the company shall be punished if they contravene these provisions. Punishments that are available for the misuse of these powers by the directors are not adequate to control the unfair corporate practices. Only to impose one hundred thousand rupees on the directors for the misuse of their powers is not sufficient to control the wrongful trading by the directors. When wrongful trading occurs it destroys the whole business of the company. Only to make liable the directors to pay the one hundred thousand fines is not sufficient to control the wrongful trading. There must be provisions according to which directors must be personally liable to pay the debts of the company.

They can save the company from going in to insolvent liquidation if they use these powers only for the development of the companies. All the powers of the directors mentioned above describe clearly that directors are fully aware about the affairs of the company. If they use these powers only for the interest of the company and its creditors, they can save the company from going in to insolvent liquidation.

---

[19]Ibid., 196 (3) (a) (b).

2 .2.5 Duties of the Directors.

Duties of the directors have become a hot issue in the world. In the UK duties of the directors have been codified in the Companies Act 2006. Over the years these duties have evolved through the courts those now available in Companies Act 2006. A director is accountable for his actions and therefore owes certain duties to the company. [20] In Pakistan section 214 of the Companies Ordinance 1984 deals with the duties of the directors in a company. This section does not keep sufficient duties on the directors that can save the company from the offences like wrongful trading. This provision of the Companies Ordinance, 1984 is not sufficient to save the corporations from the great losses. The importance of the corporations cannot be denied to enhance the economy of the country. Therefore, there must be sufficient laws to save these corporations from the past fraud experiences. The punishments for the violation of these duties are also not satisfactory to deter the directors not to repeat this offence in the future.

Section 214(1) of the Companies Ordinance 1984 only lays down the duty on the directors of the company that they are responsible to disclose any contract in which they directly or indirectly interested. Director duties that every director of a company who is in any way directly or indirectly concerned with the contract or arrangement entered in to on behalf of the company shall disclose the nature of his interest at a meeting of the directors. Directors are not allowed to enter in to a contract for their personal interest.[21]

---

[20]Companies Act 2006. Available at: http://www.braconline.eu/liabrary/directors Duties UK Companies Act.pdf (accessed 12 September, 2009).

[21]S. 214 (1) Companies Ordinance, 1984.

The provisions of the Companies Ordinance 1984 bound the directors not to go beyond their limits otherwise they shall face punishment. These duties are most important for the promotion of the industries. If only we say that the directors of the companies have only duty to disclose their interest before company or shareholders or that interested directors not to participate in the proceeding of the vote or they are not permitted to contribute in the political affairs are not sufficient according to the need of the hour.

Rules of the SECP and some guides are also on the bases of the provisions of the Companies Ordinance 1984. Insolvency Law Report also describes the procedure under the provisions of the Companies Ordinance 1984. SECP is a regulator of the corporate sector in Pakistan. Along with the provisions of the Companies Ordinance 1984 sections of Securities and Exchange Commission of Pakistan that indirectly deal with wrongful trading have been discussed in a detail.

2.3 SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN AS A REGULATOR.

Securities and Exchange Commission of Pakistan 1997 Act established Securities and Exchange Commission of Pakistan as the regulator of the capital markets and the controller of corporate entities. The Securities and Exchange Commission of Pakistan aspires to develop a contemporary but efficient corporate sector and capital markets.[22] It provides thrust for economic growth and encourages collective harmony in the country as the apex

[22]Code of Corporate Governance. Available at: http://www.findarticles/mi-m1309/is-2-40/ai-105657565/ (accessed 10 October, 2009).

regulator of the capital markets, corporate sector, and financial sector and in insurance sector in Pakistan.[23] SECP came in to operation on Jan 1, 1999 as a successor to former Corporate Law Authority, as a statutory body created under the Securities and Exchange Commission of Pakistan Act, 1997. The foremost function of the SECP is to regulate, monitor and enforce laws pertinent to the corporate sectors in Pakistan. It provides the transparency, accountability and good Corporate Governance.[24] With the passage of time, they did amendments in their rules to fulfill the need of the industries. In Jun, 2007 they amended its rules regarding the filing of documents. According to new law each company shall be required to file the documents through electronic procedure.

The aim of this amendment is to make the whole system electronic. In this way the companies are not required to go physically to the Securities and Exchange Commission of Pakistan for filing the documents. They can easily file the documents through required procedure. This is a good step by the SECP but have to see that how long it will be in practice because unluckily in Pakistan rules and regulation are for the time being and then disappear from the surface.[25]

Securities and Exchange Commission of Pakistan did not introduce the separate laws to deal with the wrongful trading and fraudulent trading. Securities and Exchange Commission

---

[23]Official Newsletter of SECP December, 2008, winter edition, vol viii, issue v. Available at: http://www.secp.org.com.pk (accessed 25 August, 2009).

[24]Ibid.,

[25]Securities and Exchange Commission of Pakistan did amendments in its rules regarding the filing of the documents in 5 Jan, 2007. The aim of this amendment in the rules of the Securities and Exchange Commission of Pakistan to seek the facility in filing the documents. According to this amendment in the laws each company shall be required to send its documents by electronic system prescribed by the Securities and Exchange Commission of Pakistan. Available at: http://www.secp.gov.pk/cl/pdf/Jan05Amendments (accessed 1 September, 2009).

Pakistan adopted the Code of Corporate Governance in March, 2002. It was applicable on the three Stock Exchanges and on all the public companies. Its aim was to make the companies system fair and transparent.[26] But this code also criticized by the corporations and the commentators. They are of the view that the complying of the code is very expensive. The other point for the criticism is that there are various difficulties to enforcing and implementing the code. Very important point raised by the commentators is that there is the lack of the relevant expertise in the Pakistan to implementing this code. In addition it was also pointed out that this code is defective, outdated, and had no advantage to the stakeholders.[27] What provisions are available in the rules and guides of Securities and Exchange Commission of Pakistan for the wrongful trading and fraudulent activities are essential to be discussed?

2.3.1 Laws available in Securities and Exchange Commission of Pakistan to prevent the Wrongful Trading.

Section 17 of the Securities and Exchange Commission 1997 provides as under;

> **"17. Prohibition of Fraudulent acts, etc.** No person shall, for the purpose of inducing, dissuading, effecting, preventing or in any manner influencing or turning to his advantage, the sale or purchase of any security, directly or indirectly,-
>
> a) employ any device, scheme or artifice, or engage in any act, practice or course of business, which operates or is intended or calculated to operate as a fraud or deceit upon any person; or

---

[26]Code of Corporate Governance Practices in Pakistan, Monday 24 August, 2009. Available at: http://www.finance.kalpoint.com/economic-updates/exclusive/corportae-practices-in-Pakistan.html (accessed 3 September, 2009).

[27]Ali Adnan Ibrahim, *Corporate Governance in Pakistan: analysis of Currant Challenges and Recommendations for Future Reforms,* Available at: http://www.law.wustl.edu/wugs/r/issues/volume52/p323ibrahim.pdf (accessed 3 September, 2009).

b) make any suggestion or statement as a fact of that which he does not believe to be true; or
c) omit to state or actively conceal a material fact having knowledge or belief such fact; or
d) do any act or practice or engage in a course of business, or omit to do any act which operates or would operate as a fraud, deceit or manipulation upon any person, in particular-"[28]

The above section does not directly deals with wrongful trading but this section achieves the almost same purpose like, Rule 10b-5 of the SEC Act 1934 of the United States of America. This section of the Securities and Exchange Commission Pakistan Ordinance 1969, clearly envisages that if any person that is involve in the management and the operation of the company run the company business to commit fraud or deceive the business of the company shall be charged guilty under section 17 of the Securities and Exchange Commission of Pakistan Ordinance 1969 and will face punishment under the section 24 of the said Ordinance.

Section 24 of the same Act provides a penalty for Indulging in Fraudulent Acts:

24. Penalty. (1) "Whoever contravenes the provisions of section 17 shall be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to five thousand rupees, or with both." The penalty available in section 24 of the Securities and Exchange Commission of Pakistan Ordinance 1969 are not sufficient to prevent the corporate failure. If a person swells the whole assets of the company he should not be only liable to pay the fine which may not extend to five thousand rupees and two years imprisonment but they must be personally liable to pay the debts of the company and damages that caused due to their negligence act. They must also be disqualified from the

[28]S. 17, Securities and Exchange Commission of Pakistan Ordinance, 1969. Available at: http://www.secp.gov.pk/corportae law/pdf/secord1969sep08.pdf (accessed 23 September, 2009).

company like in UK. This is a best lesson for other directors of the companies. What system is available in the rules of Securities and Exchange Commission of Pakistan regarding the auditing system in the companies is essential to be discussed because the main reason of the insolvency of the corporations is false auditing by the auditors. As we discussed in previous chapters that after the collapse of the world biggest companies auditing system become very hot issue. Almost every jurisdiction made laws to make the auditing system fair, efficient and transparent.

2.3.2 Auditing System Available in the Rules of Securities and Exchange Commission of Pakistan.

Auditing system of the corporations in Pakistan is not fair and efficient like in other jurisdictions of the world. To avoid the corporate failure it is essential to make the company auditing system more efficient and transparent. The laws that deal with auditing system of the companies are almost same but not sufficient to meet the 21st century challenges. Securities and Exchange Commission of Pakistan guidelines and Companies (Audit and Cost Account) Rules, 1998 provide the procedure of fair auditing and appointment of the auditors in the corporations.[29] Each company is bound to prepare its financial statement that shows the true financial position of the company. Directors of the company will come to be known about the assets and liabilities of the company. This is the best way to save the company

[29]Securities and Exchange Commission of Pakistan, a Guide for Appointment of Statutory Auditors and Ancillary Matters. Available at: http://www.secp.gov.pk/Guide/auditors guide.pdf (accessed 10 October, 2009).

from going in to liquidation. Always after the liquidation of the company director's escape from their liabilities with pretending that they were not aware about the financial position of the company.[30] The account book shows that how much money company has to pay and how and from where has to receive the money. All sales and purchases will also be included in the account book.[31]

It is also necessary that if the company is engaged in the manufacturing of any goods, mining activities, and such particulars relating to utilization of the material will also be mentioned in the account book. In this way directors of the company will come to know about the income of the company. The detail of the labours and other item are also necessary to be included in the account book if required by the commission in the general or by especial order. The best advantage of this information is that if company keeps the proper record of all these things then directors cannot continue its business to defraud the company and its creditors. All these information are in record in the office of the commission.[32]

Directors of the company are responsible to keep this record also in another branch of the company office. It is upon the willingness of the directors that in which branch they can keep the company record. When directors decide, the company will file this record with the registrar with a notice within seven days with full address of that place. The registrar will be required to keep this record with due care and diligence.

Directors of the company are also bound to keep the proper record of book account that gives the true view of the company financial situation. They do not disclose the true assets and

---

[30]Ibid.,
[31]Ibid., s 230 (a) (b) (c) (d) (e).
[32]Ibid., (e).

liabilities of the company. This is the reason that takes the company at the stage of liquidation. The company directors are responsible to inspect all these books and papers of the company during the business hours.[33]

The directors of the company from time to time shall make a plan to inspect the company account books and papers. They shall decide to what extent and at what place they should inspect the company account record. They have right to specify the reasonable time to inspect the company record. Without directors and other authorized officer, nobody is allowed to inspect the said documents.[34]

Directors of the company are required to keep all this record in a proper form. These rules of the Securities and Exchange Commission of Pakistan and sections of the Companies Ordinance 1984 are same with the laws of UK, and USA. They also provide that directors of the company are responsible to keep the proper record of the company account. The aim of this law was to avoid the wrongful trading.[35]

Securities and Exchange Commission of Pakistan made rules for the companies regarding the account book of the companies. These rules called the Companies (Audit of Cost Account) Rules, 1998.[36]

According to the rules of this Act the directors are bound to follow these rules and make the fair and transparent account book of the company otherwise will have to face punishment prescribed by the Commission.

---

[33]Ibid., (3).

[34]Ibid., (4).

[35]Mace & Jones, *Wrongful Trading a Risk not Worth Taking Warns as Christmas Sales Slump,* (29 December 2008). Available at: http://www.maceandjones.co.uk/contact (accessed 12 Jun, 2009).

[36]See, Companies (Audit and Cost Accounts) Rules, 1998.

The section 1(ii) of the Companies (Audit of Cost Account) Rules, 1998 envisages that these rules shall apply to the companies and the class of the companies required by the Securities and Exchange Commission of Pakistan through a general or special order issued under clause (e) sub-section (1) of section 230 of the Companies Ordinance 1984. The Commission mentions it in the rules that each company will provide the information relating to utilization of the material, labour and other inputs or item of cost order.[37]

Every company shall be required to appoint its cost auditor to keep and prepare the cost report of the company. Director of the company shall appoint the auditors with the prior approval from the Securities Exchange Commission of Pakistan. The condition for appointing of the auditor is that he or she must be with the qualification of charted accountant under the meaning of the Charted Accountant Ordinance 1961, (X of 1991).[38] If he or she is not charted accountant he must be cost and management accountant within the meaning of the Cost and Management Accountant Act, 1996 (XIV of 1996).[39] The approval from the Securities and Exchange Commission of Pakistan for the appointment of the cost auditor shall be required to be taken before the sixty days of the financial year of the company.[40]

---

[37]Section 1 (ii) Companies (Audit and Cost Accounts) Rules, 1998. Available at: http://www.secp.gov.pk/cl/pdf/1998.pdf (accessed 2 September, 2009).

[38]Charted Accountant Ordinance 1961, (X of 1961).

[39]For the qualification of the Auditor or Cost Accountant see, Cost and Management Accountant 1996, (XIV of 1996).

[40]Ibid., s.3 (ii).

Directors of the company shall apply to the Securities and Exchange Commission of Pakistan for appointing the auditor thirty days before on the date on which the auditor appointed.[41]

To promote the industries and to meet the 21st century challenges it is essential to make its financial system fair and transparent. There are some conditions for the disqualification of the peoples to become an auditor of the companies.

The present and past directors, officers, employees of the company cannot become the auditor because there can be some personal interest for them. Spouses of the directors, minor children's, and a body corporate also cannot become the auditor of the company. A person who is disqualified for appointment as auditor of the company subsidiary or holding company or subsidiary of that holding company. All these peoples cannot become the auditor of the company. These peoples for their personal interest can prepare the false financial statement of the company. For the fair effective, efficient and transparent system there must be an independent auditor in the company.

2.3.3 Report by an Auditor.

The auditor of a holding company is also required to report on consolidated financial statements in accordance with section 237 of the Companies ordinance 1984. Cost auditor will prepare an audit report according to the order of the Securities and Exchange

[41]Ibid., s.3 (iii).

Commission of Pakistan.[42] This report will be prepared under section 230 (1) of the Companies Ordinance 1984. In this report the cost auditor will disclose the actual position of the company that how much it has assets and liabilities, the raw material of the company and other machines will also be mentioned in the report. The report must show each and every thing of the company. The report will show some specific things that are as follows:-

I. Raw material of the company

II. Stock of work in process

III. Stock of finished products: and

IV. Other Stock.[43]

If all these things are included in the account report then how the directors of the company can commit the wrongful trading because everything will be in front of their eyes. After the clean and clear report of the auditor they cannot escape from the liabilities of the wrongful trading to pretending that they were not aware about the financial position of the company. All these laws indirectly define the procedure to avoid the wrongful trading.

2.3.4 Penalty for the False Auditor Report

If auditors of the company fail to provide the true and fair financial report of the company, they shall be punished with fine which may not to extend twenty thousand rupees and, if the

[42]Ibid.,
[43]Ibid., 4 (a) (b).

failures continues with a fine of hundred rupees each day till the final submission of the repot.[44]

2.4 WHAT AMENDMENTS HAVE BEEN MADE IN THE CORPORATE SECTOR OF PAKISTAN TO CONTROL THE WRONGFUL TRADING?

When we analyze the amendments that have been made in the corporate sector of Pakistan we find no particular amendment in the law regarding the control of the wrongful trading. The provisions that indirectly deal with wrongful trading are available in the Companies Ordinance 1984 and in the Securities and Exchange Commission of Pakistan Ordinance 1969. Still the fraudulent activities are conducting under section 17 of the Securities and Exchange Commission of Pakistan Ordinance 1969. Sections 412 and 413 of the Companies Ordinance 1984 have not been changed to extend the more duties under they will be liable for the wrongful and fraudulent trading. After the enactment of the Companies Ordinance 1984 still we are following these sections without any amendment. The amendments and reformations in the laws of the Companies Ordinance and in SECP rules and guide are not sufficient to deal with wrongful trading. Available provisions in the Companies Ordinance 1984 to the some extent fulfill the same purpose like in the other jurisdictions of the world but not as a whole. Duties of the directors are not provided in law in detail. Reformations

[44]Ibid., s. 5.

that have been made are not directly related to the business of the companies and the control and awareness of the wrongful trading.[45]

In Pakistan amendments have been made in the Insolvency Laws but corporate bodies are exempted from the application of the Insolvency Laws. For this reason, insolvent companies are wound up under Companies Ordinance 1984. Only Companies Ordinance 1984 provisions are not sufficient to deal with the wrongful trading and fraudulent trading. The reports that are available regarding Insolvency Law Reform in Pakistan or Insolvency Law Regime are also based on the Companies Ordinance 1984. Insolvency Laws are applicable in the case of winding up of insolvent company relating to the rights of the secured and unsecured creditors.[46]

Under the Companies Ordinance 1984, detailed procedure is available to deal with the companies for either matter. Every section of the Companies Ordinance 1984 is related to the company matters like if there is problem of winding up (Insolvency) of the companies sections 305 to 449 are relevant sections for that matter. Companies Arrangements and Reconstruction shall be dealt under sections 284 to 289 of Companies Ordinance 1984. Management by the administrator and Companies Rehabilitation shall be dealt with under sections 295 and section 295. Section 296 deals with the matter of management by the administrator and Rehabilitation of the Companies owing sick industrial units. Corporate Rehabilitation Act 2004 has been reviewed and notified on January, 2009 in the chairmanship of the Salman Ali Sheikh (Chairman of the Securities and Exchange

---

[45]Ibid.,

[46]Insolvency Law Reform Report on Pakistan, S.1 by, Maudood A. Khan & Aly Shahorr, Available at: http://www.Insolvencyasia.com/Insolvency-law...../Pakistan (accessed 3 September, 2009).

Commission of Pakistan).[47] Only to review the Act are not sufficient to fulfill the business need of the 21st century.

Companies, like people, are normally worth more alive then dead. That is simple undisputable fact. Given the approaching financial storm Pakistan can no longer afford to ignore the lessons learnt by the rest of the world. Now it becomes issue of the hour that there must be legislation and amendments in the old laws to solve these problems without execution. If in the whole world there are amendments in their companies' laws, why not in Pakistan?[48]

The affair of the winding up of the company goes on for a long time and no significant is to returns the assets to the stakeholders by the directors. It takes years to obtain statement of affairs, book of account, realization of debts and sales of assets, distribution of assets to creditors, before the company is finally dissolved by the sanction of the court. All affairs of the liquidated company remain unresolved.[49]

Amendments and reforms have been made in the banking sector but no attention has been paid towards this serious offence. Corporate Rehabilitation Act has been promulgated in 2004 but still this Act is not in practices in the corporations.

---

[47]Salman Ali Sheikh, Feisal Naqvi, *A permanent solution for the sick industries: Corporate Rehabilitation - I* Available at: http://www.defence.pk/forums/economy-development/12191-permanent-solution-sick-industries-corporate-rehabilitation.html (accessed 4 September, 2009).

[48]Ibid.,

[49]Sumant Batra, *Insolvency Laws inSsouth Asia: Recent Trend and Development,* This document reproduces a report by Mr. Sumant Batra written after the Fifth Forum for Asian Insolvency Reform (FAIR) which was held on 27-28 April 2006 in Beijing, China. It will form part of the forthcoming publication "Legal & Institutional Reforms of Asian Insolvency Systems". Available at: http://www.oecd.org/dataoecd/42/14/3818412.pdf (accesses 3 September, 2009).

Securities and Exchange Commission Pakistan adopted the Code of Corporate Governance in March, 2002 and developed the Non-banking Finance Companies in 2003 but no attention has been given towards the making of separate laws to control the wrongful trading and make them personally liable to pay the debts of the company who abuse the concept of limited liability. We have the laws but not sufficient to meet the 21st century challenges. Separate law is required to control this offence and make them personally liable who are involved in the mismanagement of the company.

CHAPTER 3

LEGISLATION REGARDING WRONGFUL TRADING IN UK, USA AND MALAYSIA

As we discussed in chapter one that wrongful trading is not new phenomenon for the world. Its concept was first introduced in the United Kingdom. Fraudulent trading provisions were first available in section 75 (1) of the Companies Act 1928. It attracted both civil and criminal penalties. For fraudulent trading very high standard of proof was required. The reason for introducing the wrongful trading was to reduce the burden of proof. Liquidators of the insolvent companies stopped applying to courts for relief because of strict burden of proof imposed upon the prosecution. Therefore, UK Parliament introduced new offence with the name of wrongful trading. Wrongful trading can be proved without high standard of proof. The only thing required to be proved the offence of wrongful trading is that directors of the company continued its business at the time of financial difficulty.

Wrongful trading is dealt with under section 214 of the Insolvency Act 1986. It arose out of the frustration at the perceived failure of the rules against fraudulent trading. The Cork Committee reported that the existing laws that deal with fraudulent trading did not provide sufficient incentive to directors of insolvent companies to take steps to prevent further loss to the creditors. As released Cork Committee recommendations that any person who continues the company business at the time of financial difficulty will be personally liable to pay the debts of the company. A claim will be available to the

company creditors, liquidators, receivers and administrators. These proposals were watered down by the Department of Trade and Industry before being enacted as what is now section 214 of the Insolvency Act 1986. Section 214 of the Insolvency Act 1986 defined clearly the wrongful trading. Section 212 of the Insolvency Act, is about the remedy available for the wrongful trading.

Control of the wrongful trading and the other related offences have become the great challenge for the corporate world. The legislative history of the UK shows the amendments that have been made to control the wrongful trading. Insolvency Act, 1986 was particularly passed to control the unfair corporate practices. Companies Directors Disqualification Act, 1986 envisages the provisions regarding the disqualification of directors in case of wrongful trading. They also adopted the Code of Corporate Governance in UK. We have witnessed corporate scandals like, Enron, WorldCom, Paramalt and other in many countries.

After the Enron case corporate failure became a great political issue for the Bush administration. In United States there is no similar section like section 214 in UK but available laws have same purpose. Bankruptcy Code 1996 lays down the provisions regarding the corporate insolvency in the United States. Rule 10b-5 of the SEC 1934 is about the fiduciary duties of the directors.[1] They are not allowed to defraud the company and its creditors. This rule deals with the fraudulent activities. To control these unfair

[1]Rule 10b-5 of the SEC of 1934 envisages that, "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, (a) To employ any device, scheme, or artifice to defraud, (b) To make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statement made, in light of the circumstances under which they were made, not misleading, or (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security." For the detail of Rule 10b-5 see, Duke Law Journal, Fiduciary Suits under Rule 10b-5, Vol. 1968, No. 4 (August, 1968), pp.791-815. Available at: http://www.jstor.org/stable/1371557 (accessed 1 July, 2009).

corporate practices United States also passed the Sarbanes Oxley Act 2002. Corporate personality is still unresolved issue in the United States and in the rest of the world as well. People always use the concept of limited liability for committing the wrongful trading.

In Malaysia like, United States also no separate section as section 214 of the Insolvency Act 1986. But available laws fulfill the same purpose. Malaysian Insolvency Regime describes the liabilities of the directors for wrongful trading. Malaysian legislature recently passed the Companies Act 1965 (Amendments) 2007. This amendment is a major milestone in the history of company legislation in Malaysia. This Act introduced significant and far- reaching changes for Malaysian companies. The important changes were about the directors statutory and common law duties. What amendments and reformations have been made regarding the wrongful trading in the different jurisdictions of the world will be discussed in a detail.

3.1 UNITED KINGDOM LAWS DEALING WITH WRONGFUL TRADING

Wrongful trading is a type of civil wrong found in UK insolvency law. It was introduced to enable contributions to be obtained for the benefit of creditors from those responsible for the mismanagement of the company.[2] The legislative history of the present law is instructive in demonstrating what issues have been discarded, and adopted in seeking to

[2]Viswiki Solicitors, *Wrongful Trading*, Available at: http://www.viswiki.com/en/wrongful-trading (accessed 1July, 2009).

implement insolvency law policy.[3] Wrongful trading provision was introduced after the recommendations of the Cork Committee. In 1977 the government commissioned a major review of the law relating to insolvency, bankruptcy, liquidation and receivership. The Cork Report[4], published in 1982.[5] Section 214 of the Insolvency Act 1986 directly deals with wrongful trading. It arose out of frustration at the perceived failure of the rules against fraudulent trading. The law that was available for fraudulent trading did not provide sufficient incentive to directors of insolvent company to take steps to prevent further loss to their company's creditors. The Cork Committee in its report in 1982 recommended that any person involved with the management of the company be made personally liable to pay the debts of the company.[6] The fraudulent trading provision that was available in section 332 of the Companies Act 1948 possessed significance inadequacies in dealing with irresponsible trading. These inadequacies included the fact that the criminal burden of proof to civil action and the applicants for the orders against directors were required to establish actual dishonesty.[7] The principle of wrongful trading was introduced in the UK Insolvency Act 1986, to introduce the wrongful trading.

---

[3]Andrew Keay and Michael Murry, *Making Company Directors Liable: A Comparative Analysis of wrongful Trading in United Kingdom and Insolvent Trading in Australia, rev* vol 14th (Online Wiley inters science 2005) Available at: http://www.interscience.wiley.com (accessed 27 August, 2009).

[4]In 1977 then the government commissioned a major review of the law relating to insolvency, bankruptcy, liquidations and receivership. The Cork Report, published in 1982, was comprehensive in its scope and seen as for as for reaching for recommendations. The cork committee was chaired by the Sir Kenneth Cork, therefore, the name of this report is Cork Report. The basic objective of this report was to discuss the social and financial implications of insolvency, drawing a distinction between the consumer insolvent and the commercial insolvent, observing that the insolvency of a businessperson had much wider implications. The Cork Committee recommended that a new provision be introduced to allow for civil action for fraudulent trading where only the civil burden of proof would apply. For more detail see also, Bankruptcy: A Fresh Start. Available at: http://www.insolvency.gov.uk:8765 (accessed 12 September, 2009).

[5]Legislative History of UK. Available at: http://www.insolvency.go.uk:8765 (accessed 12 September, 2009).

[6] Rizwaan J. Mokal, *An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors,* The Cambridge Law Journal, Vol. 59. No.2. (Cambridge University Press July, 2000), 335-369. Available at: http://www.jstor.org/stable/4508678 (accessed 27 May, 2009).

[7]Visviki Solicitor, *Wrongful Trading.*

Wrongful trading is dealt with under section 214 and fraudulent trading with under section 213 of Insolvency Act 1986. Wrongful trading is less serious offence then fraudulent trading. In wrongful trading it is not necessary that it must be proved that directors ran the company business with intent to defraud the company and its creditors but, in fraudulent trading it is necessary that directors must defraud the company intentionally. For proving the offence of wrongful trading only thing required to prove is that directors continued the company business at the time of financial difficulty.[8] Directors who commit the fraudulent trading will be punished like for other criminal offences.[9] The laws that directly deal with wrongful trading in UK are as follows:

3.1.1 Insolvency Act 1986

Section 214 of the Insolvency Act 1986 directly deals with wrongful trading. This section was introduced to enable contributions to be obtained for the benefit of the creditors from those responsible for the mismanagement of the insolvent company. Section 214 of the Insolvency Act 1986 is the basic source to make the directors liable to pay the debts of the company if it appeared that they were at fault. They will be liable to pay the debts of the company in case of wrongful trading under section 214 (2) in three situations:

a) The company is in insolvent liquidation.

b) At some time before winding up of the company it appears that the directors of the company knew that the company cannot avoid liquidation despite of that they did not stop its business.

c) The person was at that time a director of the company.

---

[8]Rule 10-b5 of the SEC Act 1934.
[9]Ibid.,

Section 214 provides that the liquidator of the company that is in insolvent liquidation may commence proceeding against any of the company director and this proceeding may seek an order that the director against whom proceedings are brought make such contribution to the company assets as the court thinks proper.[10]

Section 214 (3) provides a defense to the directors that the court shall not make a declaration against a person if it appears that after knowing the difficult financial position of the insolvent company they took every step to minimize the loss to the company and its creditors.

The separate legal entity doctrine in corporate law means that directors are not generally liable for their company's liabilities. This concept was first introduced in the case of Salomon v Salomon.

In a case of wrongful trading all persons involved in the mismanagement of the company will be personally liable to contribute towards the debts of the company.[11] The application of the section 214 of the Insolvency Act 1986 is very wide. It does not apply only to de jure director but also on the shadow directors. De jure directors (who are formally appointed and their appointment are registered with companies House). It also applies on de facto (that is a person who assumed the role of director or a company without being appointed) directors. It also applies on the shadow directors (according to whom instructions and directions others directors are accustomed to act). Shadow directors have been defined in section 214 (7).[12]

---

[10]Thomson Snell & Passmore, *Directors Responsibilities Avoiding Wrongful Trap,* Jan 2009. Available at: http://www.ts-p.co.uk/....dircctors%20rcsponsibilitics%20avoiding20th%20wrongfull%2------- (accessed 5 June, 2009).

[11]Ibid.,

[12]S. 214 (7) Insolvency Act 1986.

The normal approach to prove the wrongful trading on the directors is that the liquidators of the company will try to establish a date at which the balance sheet showed that the company assts are less then it s liabilities. In UK it is not an offence to trade at the time of financial difficulty with the hope that the financial position will turn down. The offence is constituted in case where the directors continue the company business even when it is clear that the company can not avoid liquidation.[13]

Section 214 (3) provides a defense to directors that the court shall not make a deceleration under this section with respect to any person if it appears that after the condition specified in subsection (2) (b) was first satisfied in relation to him that person took every step with view to minimizing the potential loss to the company creditors as he ought to have taken. The *Blue Sky defense* provides the same defense to the directors. The *Blue Sky Defense* provision is available in the law of UK and many other jurisdictions of the world.[14] Section 215 of the Insolvency Act 1986 applies both on the fraudulent trading and wrongful trading.

The order passed by the court against the directors is compensatory not punitive. It is difficult stage for the court to asses the appropriate amount of award against the directors. One solution is that the court will see the assets of the company at the time when directors continued its business and at the time of liquidation. Whatever court will think proper will award an amount against the directors. In case of *Re Brain D Pierson*

---

[13]Ibid.,

[14]Blue Sky Defense is being used in many legal systems like in England. It is an exception for the directors in the case of wrongful trading that they continued the business with intentions that the financial situation of the company will improve, then they will not be liable to pay the debts of the company and will not charge for the wrongful trading. Available at: http://www.viswiki.com.cn/blueskydefence (accessed 26 August, 2009).

(Contractor) limited [1999] BCC903,[15] the court awarded 70% of drop net assets. Judge in this case said 70% of the drop in net assets caused due to the action of the directors and 30% could be attributed to irrelevant causes.[16]

Prior to 1997 it was common rule that the amount paid by the directors in case of wrongful trading will be paid to the liquidators. It was an easy and simple way for the liquidators to swell the assets of the company. In 1998 court of appeal changed this law and said if liquidators of the company fail to prove the charge against the directors for wrongful trading then they will not be entitled to take the defendant cost from company assets. The court also gave an exception that they can take the defendant cost if the company has reasonable fund.[17]

It was held that the cost of the wrongful trading action will not be paid from the company assets. All these things have now been clarified by the *Enterprise Act 2002.*[18]

Liquidators will be responsible to pay the defendant cost when they bring the case against the directors for wrongful trading. Now this rule has been changed after the case of *Re-Continental Assurance Company of London plc(Singer v Beckett)* [2001] BPIR 733, Ch D, [2007] 2.[19] In this case liquidators sued many directors of the company. Court of

---

[15]Re Brain D Pierson (Contractor) limited [1999] BCC903. Court has wide discretion to award the appropriate amount in case of to pass an order against the directors to pay the debts of the company. This order is compensatory no punitive. Available at: http://www.viswiki.com.en/Re Brain D piersonltd (accessed 26 July, 2009).

[16] Viswiki Solicitors, *Wrongful Trading*, Available at: http://www.viswiki.com/en/wrongful-trading (accessed 1July, 2009).

[17] Thomson Snell & Passmore, Directors Responsibilities Avoiding Wrongful Trap.

[18]First time in the United Kingdom the Insolvency Act 1986 was introduced to deal with the corporate Insolvency. With the need of the day it was necessary to include some others section in the Act. Insolvency Act 1986 was amended with the name of Enterprise Act 2002. For more detail see also Enterprise Act 2002. Available at: http://www.ukparliment.gov/Enterprise Act2002 (accessed 8 August, 2009).

[19] In Re-Continental Assurance Company V London Plc and Leyland Daf judge gave decision that in case of the wrongful trading proceeding the liquidators will not be entitled to take the defendants cost from the company assets if they fail to prove the charge against the directors. This decision was unattractive for the liquidators. Available at: http://www.viswiki.com/cn/Rc-continantalassurancCompany (accessed 15 July, 2009).

appeal gave an order that the liquidators will not take the defendant cost from the company assets. It was a strange rule that company even though it can not pay its debts but amount is available for liquidator to spend in proceeding of wrongful trading against the directors.[20]

In 2004 House of Lords changed the above rule and said that the liquidators can take the defendant cost from company assets after paying to preferential creditors and the debenture holders.[21] The decisions in *Continental Assurance* (Singer v Beckett) [2001] BPIR 733, Ch D, [2007] 2 *and Ley Daf* made wrongful trading action unattractive to liquidators.[22]

3.1.2 Companies Directors Disqualification Act, 1986

The Insolvency Act 1986 and the Companies' Directors Disqualification 1986 (came in to force on 29 December, 1986) are the consolidation of the Insolvency Act 1985 with over 200 sections of the Companies Act 1985 relating to receivership and companies winding up. The Insolvency Act 1985 represented the most comprehensive revision of corporate and individual insolvency law in more then a century. Provisions of the personal liabilities of the directors were the only substantive provisions of the 1985 Act ever to come in to force on 28 April. However, the Insolvency Act 1985 was superseded

[20]Ibid.,

[21]A company may raise debt finance by large numbers of ways. Thus with a share the company has an incentive to arrange for its debts securities to be traded on a public market, which provides an alternative route by which a lender to the company can liquidate its investment. In Britain such debt securities are traditionally called 'debentures' and the persons by whom company take debt is called debentures holder.

[22]

by the 1986 statutes. These statutes provided clear provisions relating to the personal liabilities of the directors in case of fraudulent and wrongful trading.[23]

Section 1 of the Company Directors Disqualification Act 1986 provides as under;

> "1(1) **[Disqualification order]** In the circumstances specified below in this Act a court many and under section 6 shall, make against a person a disqualification order, that is to say and order that he shall not, without leave of the court-
> a. be a director of a company, or
> b. be a liquidator of a company, or
> c. be a receiver or manager of a company's, property, or
> d. in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of a company, for a specified period beginning with the date of the order."

Disqualification of the directors dealt under Section 1 of the Companies Directors Disqualification Act 1986.[24] The court under sections 1 and 6 shall make a disqualification order against a person that without the leave of the court he or she cannot become the director, liquidator, receiver and manager of the company. They also cannot take part in the formation of the company.[25]

> "1(2) **[Maximum, minimum periods]** In each section of this Act which gives to a court power or, as the case may be, imposes on it the duty to make a disqualification order there is specific the maximum (and, in section 6, the minimum) period of disqualification which may or (as it case may be) must be imposed by means of the order."

Section 1 (2) describes the disqualification period of the directors in case of wrongful trading. The directors of the companies against whom the court passed the

---

[23]Lean Sealy, *Cases and Material of the Company Law,* (Sara Worthington, New Zealand 2005), 3.
[24]S. 1. Companies Directors Disqualification Act 1986.
[25]Ibid.,

disqualification order cannot become directors of the company for minimum two years and maximum for 15 years.

The Department of Trade and Industry brings the cases to court. Only the DTI has power to make an application to the court for disqualification of directors. The above two laws directly deals with wrongful trading.[26]

3.2 USA LAW RELATED TO WRONGFUL TRADING

Like United Kingdom, United States of America also made laws to control the unfair corporate practices. The main legislation in the USA was to impose ethical behavior and control the unfair corporate practices. Before going to discuss it was necessary to first define the deepening insolvency in the USA.[27]

3.2.1 What is Deepening Insolvency?

In USA like in Pakistan no direct law is available to deal with wrongful trading. In USA there is the concept of deepening insolvency theory in contrast with wrongful trading in UK. Deepening insolvency is a claim that directors or officers took actions that prolonged the life of the corporation outside of bankruptcy and that such action or inaction ultimately harmed the corporations and its stakeholders.[28]

---

[26] What to Investigate and How Wrongful and Fraudulent Trading can be proved. Available at: http://www.hrmc.gov.uk/business (accessed 23 June, 2009.

[27] Howard Rockness and Joanne Rockness, *Legislated Ethics: From Enron to Sarbanes-Oxley, the Impact on Corporate America,* Journal of Business Ethics, vol. 57.1 (Springer March, 2005) 31- 54. Available at: http://www.jstor.org/stable/25123452 (accessed 1 July, 2009).

[28] Kirk Land & Ellis LLP, Delaware Chancery Court Rejects Deepening Insolvency" as an Independent Cause of Action. Alert September 2006. Available at: http://www.kirkland.com/sitesfiles/----deepning-insolvency%20.pdf (accessed 28 October, 2009).

The theory of deepening insolvency was first articulated 25 years ago by the United States Court of appeal for the seventh Circuit in Schacht v. Brown, 711 f.2d 1343, 1350 (7th Cir. 1983).[29]

Wrongful trading and deepening insolvency have same purpose. Both apply to control the unfair corporate practices. Third similarity is that, neither principle imposes absolute duty on the managers of the insolvent corporation to shut down and liquidate the corporation as soon as there is an insolvency risk. The New York Bankruptcy Court in kitty v. Atlantic bank of New York (In re Global Service Group, LLC), 316 B.R.451,456 (banker. S.D.N.Y.2004) completely misunderstood the English wrongful trading regime.[30] Fourth, the measure of damages under either principle may be based on the corporation increase in net deficit during the period of unjustified trading.[31]

3.2.2 Difference between Wrongful Trading and Deepening Insolvency

Word wrongful trading is not specifically mentioned in the company law of USA. Deepening insolvency procedure is almost same. The only differences are that wrongful trading claim can be brought only by the liquidator while deepening insolvency may be invoked outside the strict confines of liquidation proceeding. The realm of application of the deepening insolvency principle is potentially very wide. It applies on the managers

---

[29]Schacht v. Brown, 711 f.2d 1343, 1350 (7th Cir. 1983). For detail of the case visit the website, http://www.paulweiss.com/files/publications/f69b5c.../8-21-06.pdf (accessed 8 October, 2009).

[30] Kitty v. Atlantic bank of New York (In re Global Service Group, LLC), 316 B.R.451,456 (bankr. S.D.N.Y.2004).

[31] Ho, Look Chan, On Deepening Insolvency and Wrongful Trading, *International Banking Law Journal and Regulation,* vol.20, August 2005. Available at: http://ssrn.com/abstract=741024 (accessed 28 July, 2009).

and officers of the company, whereas the wrongful trading provision applies only to directors.[32]

Corporate insolvency law has a significant impact on the structure of the commercial and financial markets. Corporate failure affects a wide range of interests of creditors, employees and shareholders. The aim of the insolvency laws in America and in England is same because they provide the same procedure for the insolvent company.[33]

3.3.3 Similarities between Wrongful Trading in UK and Deepening Insolvency in USA

Many things are different in the wrongful trading principles in UK and deepening insolvency theory in USA but two principles share many similarities.

1. First, both principles recognize that undue prolongation of an insolvent corporation's life harms their corporation interest and that when risk insolvency looms. The directors have perverse incentive to continue trading as long as possible. Thus the laws of UK and USA impose same liabilities on the shoulders of directors in case of insolvency of the company.
2. Second, both principles can apply to outsiders who exercise domination and control of debtors.[34]

Wrongful trading in UK and deepening insolvency in USA have many things similar. Wrongful trading is wrongful conduct of the directors at the time of financial difficult position of the company. By contrast, court examining the deepening insolvency theory

---

[32] Ibid.,

[33] Deepening Insolvency: Director Liability. Available at: http://www.thefreelibrary.com/Deepning+An+Insolvency:+Director+Liability-a020329858 (accessed 8 October, 2009).

[34] Ho, Look Chan, *On Deepening Insolvency and Wrongful Trading.*

seems always to be in search of some wrongful conduct. In the leading case of *Official Committee of Unsecured Creditors v. R. E Lafferty & Co., Inc., 276 F. 3d 340 (3d Cir. 2001),* the court defined deepening insolvency by reference to fraudulent conduct and wrongful concealment of the company troubles condition. The definition of the wrongful trading in UK is same like in USA given by the court in the above case.[35]

3.3.3 Laws in USA that deals with Wrongful Trading.

Chapter 11 of the Bankruptcy Code of America 1996 is about the reorganization of the companies at the time of difficulty. It is also related to the liability of directors in case that they ran the company business at the time of financial difficulty. The case *Trenwick America Litigation Trust v .Ernst & Young,* L.L.P., No. 157-N, (De.Ch. Aug. 10, 2006). is the example of the decision of the court in the deepening insolvency. The complaint was filed against the three directors of the company for the mismanagement of the company.[36] The chancery court held that Delaware law does not recognize the deepening insolvency as a cause of action. This also does not come under the chapter 11 of the Bankruptcy Code of America 1996. It was also held that it has not been proved that the directors of the company breached their fiduciary duties. The decision of the court to reject the deepening insolvency does not absolve the directors from their liabilities. The Court of Chancery stated that the cause of action against fraud, fraudulent conveyance and breach of fiduciary duty was the appropriate means to challenge the action of boards

[35]William A. Brandt, Jr. & Catherine E. Vance, *Deepening Insolvency and the United Kingdom Wrongful Trading Statute:* A comparative Discussion. (2005).

[36]The Delaware Court of Chancery Gives the Deep-Six to Deepening Insolvency. Available at: http://www.paulweiss.com/files/publications/f69b5e.../8-21-06.pdf (accessed 8 October, 2009).

of insolvent corporations.[37] In United States and other jurisdictions there is no specific section for wrongful trading like, section 214 in UK. But these jurisdictions have some other sections that achieve the same purpose.[38] In United States the Bankruptcy Code 1996 deals with the matters of the company as section 214 deals with wrongful trading in UK. The Bankruptcy Code allows avoidance of transfer as fraudulent both where there is actual fraud and in the far more benign circumstances of insolvency and a lack of reasonably equivalent value for the suspect transfer.[39]

Chapter 7, of the Bankruptcy Code envisages the provisions that the insolvent company should stop its business if it is proved that the company cannot avoid liquidation. Assets must be used to pay the debts of the company. This chapter provides the same procedure as section 214 of the Insolvency Act 1986. The assets of the insolvent company will be distributed among the creditors and the investors.[40] Chapter 11 provides the procedure for the reorganization of the company business and the appointment of the liquidators for the protection of the investors and the creditors.[41]

The American Bankruptcy Code 1996 regulates both reorganization and the liquidation. Liquidation of the insolvent company is dealt under this Code. US Bankruptcy Cod has been criticized by many experts because the other jurisdictions use it as model law like Sweden.[42]

---

[37]Ibid.,

[38]Andrew Keay, *Wrongful Trading and the Liability of Company Directors: A theoretical Perspective*, 2005. Available at: http://www.insolvency.gov.uk/.../wrongfultradingandliabilityofcompanydirectors.doc- (accessed 23 June, 2009).

[39]William A. Brandt, Jr. & Catherine E. Vance, *Deepening Insolvency and the United Kingdom Wrongful Trading Statute: A Comparative Discussion,* (Vance 2005).

[40]Chapter 7. Bankruptcy Code 1996. Available at: http://www.sec.gov/investors/pubs/bankrupt.htm (accessed 12 October, 2009).

[41]Chapter 11. Bankruptcy Code 1996. Available at: http://www.sec.gov/investors/pubs/bankrupt.htm (accessed 12 October, 2009).

[42]Ibid.,

"Enron, World Com, Health South and Adelphia are the leading corporate failures in corporate history of the world.[43] After collapsed of these world largest companies US congress passed the Sarbanes Oxley Act in July, 2002.[44] The aim of this legislation was to control the corporate insolvency. Now this act has been amended by the Enterprise Act 2003. In Sarbanes Oxley Act 2002 primary focus was on regulating corporate conduct in an attempt to promote ethical behavior and prevent fraudulent financial reporting failure of the past decade.[45]

3.3 MALAYSIAN LAW REGARDING WRONGFUL TRADING

The severe economic turmoil in the global financial markets has resulted in many companies tethering on the brink of insolvency. In this gloomy backdrop, the rise of Corporate Governance transgressions, incidents of market manipulation, insider trading and fraud have exacerbated the risk of personal liability for directors of companies. To control the wrongful trading it is necessary to make them liable who always misuse their powers and take the company in to liquidation.[46] Like, United Kingdom and United States Malaysia also adopted some new laws and amended old ones to control the corporate failure.

---

[43]Ibid.,

[44]Oxley Act was passed by the US congress after the collapsed of Enron, Paramalat, and World Com. Laws were available but not according to the need of the time. Before passing the Oxley Act the Securities Exchange Commission of USA rules deal these practices. The 1933 and 1934 Acts were available but after the corporate scandal in USA it was necessary to pass the new Act to control these practices. The main aim of this Act was the independent auditors in the companies who will be responsible to keep check and balance on the companies. Text of the Oxley Act is available on website: http://www.jstor.org/stable/25123452 (accessed 1 July, 2009).

[45] Andrew Keay and Michael Murry, *Making Company Directors Liable: A Comparative Analysis of wrongful Trading in United Kingdom and Insolvent Trading in Australia,* (14th rev vol online Wiley inter science 2005) Available at: http://www.interscicncc.wiley.com (Accessed 27 august, 2009).

[46]Brain Chia, Stephanie Phua at Wrong & Prtners, *the Fading Appeal of Independent Directorship needs to be Addressed*, February 2009. Available at: http://law.hkh.hk/aiiff/events/symposin/papers/aiman20 Sulaiman.ppt (accessed 10 October, 2009).

Malaysia has always shown eagerness towards raising the standard and efficiency of the corporate laws and Corporate Governance. The various amendments to the principal Acts, the establishment of the High Level Finance Committee in 1999, the Companies Commission in 2001, and the Corporate Law Reform Committee in 2003 indicate Malaysian enthusiasm to achieve these noble and desirable purposes.[47] Malaysian government is always very efficient to pass and amend the laws to make the corporate system transparent. Important changes were made to the law relating to directors statutory and common law duties. The central theme of these amendments appears to be the implementation of a strong and effective Corporate Governance Regime in Malaysia.[48]

Malaysian legislation is always very animated and progressive to amend their company's laws. Companies Act 1965 has been amended not less than seventeen times. This amended Act came in to effect on 15 August, 2007. This amendment is the major milestone in the history of company law legislation in Malaysia.[49]

In Malaysia like United States the laws do not specifically use the expression wrongful trading but its company's laws and insolvency regime proposed laws to deal with directors duties. To avoid the wrongful trading the extension in the directors duties is very important, because wrongful trading always occurs due to the negligent act of the directors. Malaysian Insolvency Regime introduced some new things to facilitate the

---

[47] Sujata Balan, *Reform of the Law Relating to Directors Duties in Malaysia,* (2007). Available at: http://www.insolvencyasia.com/insolvency-law..../Malaysia/pdf/scction-i-pdf (accessed 28 august, 2009).

[48] Ibid.,

[49] Ibid.,

insolvent companies to get back on their earlier position. What is the object of the insolvency law of Malaysia is necessary to be discussed.[50]

3.3.1 Object of the Corporate Insolvency Law of Malaysia?

There is a discernable trend in various jurisdictions to move towards corporate rescue mechanism as a part and parcel of the corporate insolvency regime. Malaysian Corporate Law Reform Committee in 2003 indicated Malaysian enthusiasm to achieve these noble and desirable purposes. The purpose of this law is as follows:-

1. The facilitation of recovery of companies which are in financial difficulties. The foremost object of the Corporate Insolvency Law of the Malaysia is the facilitation to the insolvent companies to get back their earlier position. This section indirectly deals with wrongful trading because wrongful trading always occurs when company's assets are less than its liabilities. The Corporate Insolvency Laws of the Malaysia contains some provisions about the mechanism for the companies to avoid Corporate Insolvency.[51]
2. The suspension of legal actions by individual creditors through the creation of a moratorium. It is also the object of the Corporate Insolvency Law of the Malaysia to remove the person from its present position who ran the company business with dishonest intention. Directors of the company are always responsible for company failure because they are the senior decisions making officers of the company.[52]

---

[50]Corporate Law Reform Committee (CLRC) of the Companies Commission of Malaysia, *Reforming the Corporate Insolvency Regime,* Available at: http://www.abd.org/documents/others/Insolvency/local-atudy-mal-i-pdf (accessed 28 August, 2009).

[51]Ibid.,

[52]Ibid.,

3. Malaysian Company Act 1965 was amended in 2007. The main focus was on the directors statutory and common law duties and liabilities for the company failure.[53]
4. Making provisions for the investigation of the company failures and the imposition of liability of those responsible for the failure. The object of Corporate Insolvency Law of the Malaysia was also to provide the proper way of investigation to know the cause of the company failure. It also provides that directors will be responsible for the breach of their fiduciary and common law duties.[54] After investigation if it proved that the directors of the companies or other member's negligence caused the company failure such persons will be charged for it. Punishment to these people can save the companies from going in to liquidation.
5. The protection of the public from directors who might in future engage in improper trading. It was also the aim of the corporate insolvency law that there must be punishment for the directors to save the company from the loss in the future.[55] Corporate Insolvency Law of the Malaysia also covers the ethical standard. As we discussed in the USA law that ethical behavior is also important for the promotion of the companies.[56]

These are the main objectives of the Corporate Insolvency Law of the Malaysia. Corporate Insolvency Regime is seen to be one that should be able to provide a system to enable the winding up of the companies where there is no future prospect of the business

[53]Malaysia Companies Acts 1965 (Amendments) 2007.
[54] Corporate Law Reform Committee (CLRC) of the Companies Commission of Malaysia, *Reforming the Corporate Insolvency Regime.*
[55]Ibid.,
[56]Ibid.,

becoming profitable. At this stage the business of the company must be ceased. The rules to avoid the wrongful trading in Malaysia are same in the UK.

3.3.2 Code of Corporate Governance in Malaysia

Malaysia also adopted the Code of Corporate Governance like the other jurisdictions of the world including Pakistan to make the companies system transparent, effective and efficient. First time it was issued in 2002. It was issued for the development of the domestic and international markets. The aim of the Corporate Governance in Malaysia has same purpose as in USA and in UK. It was prepared by the Working Group on Best Practices in Corporate Governance and was approved by the High Level Finance Committee of Malaysia.[57] Corporate Governance defined by the Finance Committee in these words that

> "Corporate Governance is the process and structure used to direct and manage the business and affairs of the company towards enhancing business prosperity and corporate accountability with the object of ultimate realizing long term shareholders value, while taking account of the interest of the stakeholders."[58]

The Finance Committee focused on the duties of the directors and the transparency of the auditing system. It was also included in the report of Corporate Governance that directors of the company will be personally liable to pay the debts of the company if it is proved that they ran the company business at the time of financial difficulty.[59] The recommendations of the committee have to some extent been implemented with the

---

[57]Malaysian Code of Corporate Governance. Available: http://www.sc.com.my/eng/htm/cg/cg2007 (accessed 10 October, 2009).

[58]Abdul Hadi bin Zulkafli, M. Fazilahbt Abdul Samad Md Ishak, *Code of Corporate Governance in Malaysia,* Available at: http://www.micg.net/.../CORPORATE%20GOVERNANCE%20IN%20MALAYSIA%20-%2... (accessed 10 October, 2009).

[59]Ibid.,

enactment of new provisions substituting the existing provisions in ss132 (1) and 132(2).[60] The Corporate Governance in Malaysia has same objectives as in the USA and UK. In the fraud survey of Malaysia it was concluded that the only 17% people are aware about the object of Corporate Governance in the corporations. Corporate Governance is very important in the development of the corporations.[61] It was set out in the Code of Corporate Governance that each listed company will be responsible to make its financial statement. The financial statement will show the actual position of the company by which the investors will come to know with the performance and financial position of the company.[62]

The Malaysian Securities Commission has released a new Code on Corporate Governance. It came in to effect on 1st October, 2007. The 2007 Code superseded the existing regulations of the 2002 Code. Its revision has been made to strength the role and responsibilities of the directors and the audit committee. The revised Code received support from the stakeholders and the Malaysian Institution of Corporate Governance and minority shareholders also appreciate it.[63] Revised Code of Corporate Governance provides the protection to the minority shareholders. It suggests the highly regulated business environment in Malaysia. The Code of Corporate Governance also envisages

---

[60] S. 132(1) 132(2) Malaysian Companies Act 1965(Amendments), 2007.

[61] Fraud Survey 2005 report in Malaysia. Available at: http://www.kpmg.com.my/kpmg/publications/fas/fsurvey_2004.pdf (accessed 8 October, 2009). Revised Code on Corporate Governance Introduced in Malaysia. Available at: http://www.csr-malaysia.org/.../Malaysia/revised-corortae-governance-code-20071013124/- (accessed 9 October, 2009).

[62] Finance Committee on Corporate Governance. Available at: www.curojournals.com/cjcfas_13_02.pdf (accessed 12 October, 2009).

[63] Revised Code on Corporate Governance Introduced in Malaysia. Available at; http://www.csr-malaysia.org/../malaysia/revised-corportae-governance-code-2007101324/- (accessed 9 October, 2009).

some principles that restore the confidence of the investors. Investment in any country play very important role for advancing the economy of the country.[64]

.

3.3.3 Amendments in the Companies Laws of Malaysia to Control the Corporate Failure.

Like other jurisdictions corporate fraud is also a debatable issue in Malaysia. In Malaysia like, USA there is no specific section to deal with wrongful trading. To develop the economy of the country and restore the confidence of the shareholders it is necessary to make the culprits personally liable for corporate fraud.[65] Malaysian government is quick to make new law and amend its old company's law to promote its corporations. Companies Act 1965 has been amended not less than seventeen times. This is the major milestone in the history of company legislation in Malaysia. Companies Act 1965 (Amendments) came in to effect on 15 October, 2007.[66] The amendments of the Companies Act 2007 mainly focus on the duties and liabilities of the directors. This amendment also aimed at the implementation of the strong Corporate Governance in the companies.[67] The High Level finance Committee Report on Corporate Governance was published in 1999. Malaysian Insolvency Act 1967 has been also amended in 2003.

---

[64]Corporate Governance Code: a Comparison between Malaysia and the UK. Corporate governance: An International Review, vol. 8, Issue 2, April 2000. Available at: http://www.ssrn.com/abstract=236069 (accessed 10 October, 2009).

[65]Swayer, Tom, Corporate Fraud in Malaysia, Available at: http://www.ezinearticles.com/?Corportae-Fraud-in-Malaysia&id=2861035 (accessed 27 September, 2009).

[66]Ibid.,

[67]S. 132 (2) Companies Act 1965 (Amendments) 2007.

Pengurusan Danaharta National Berhad Act 1998 legislation aimed to help the companies at the time of financial difficulty.[68]

3.3.4 Procedure of the Liquidation of the Companies in Malaysia in case of Wrongful Trading

Business of the companies fails due to many factors. In many cases it was caused due to the mismanagement of directors. In some cases business may fail not because of mismanagement but because of external factors that are not in the control of the company. Where the failure of the company occurs due to the mismanagement by the persons in control of company affairs the important concern is making them responsible for such mismanagement. This is very important step to avoid the wrongful trading.[69]

In Malaysia High Court of the Malaysia has an authority to appoint the liquidators for the Insolvent Company. Section 217 and 218 of the Companies Act 1965 clearly envisage the procedure that the creditors of the insolvent company will make an application to the court for the liquidation of the company. Court has a power to fix a date for the hearing of the case. In hearing of the case any creditor of the company can appear before the court on behalf of the others. It is also the requirement of the Malaysian Companies Law for the liquidation of the corporate insolvent company that the petition of the creditors will be advertised in the two or more national news paper. After advertising the creditors' petition in the news paper case will be fix for the hearing.[70] Section 176 of the Malaysian

---

[68]S. 1 Malaysia Insolvency Law Regime. Available at: http://www.Insolvencyasia.com/insolvency-law.....Malaysia/Pdf/section-i-Pdf (Accessed 29 August, 2009).

[69]Ibid.,

[70]S. 1 Malaysia Insolvency Law Regime. Available at: http://www.Insolvencyasia.com/insolvency-law.....Malaysia/Pdf/section-i-Pdf (accessed 29 August, 2009).

Companies Act 1965 states the conditions for the sanction pass by the court for the company liquidation that, 70% of the creditors will give their consent for the company liquidation. High Court after inquiry if finds that a company cannot continue its business any more pass an order for its liquidation and also award punishment to the directors for the breach of their fiduciary duties. These duties are codified in the Malaysian Companies Act 1965. A director who breaches these statutory and fiduciary duties under the Act shall not only be liable to account for any profit made or any damages suffered by the company but may also be liable to imprisonment for five years or a fine of RM 30,000 (US$8,400).[71]

The procedure and the laws of the Malaysian companies are almost the same as of UK and USA in case of wrongful trading. In UK separate section 214 of Insolvency Act 1986 directly deals with wrongful trading. In Malaysia and USA and, in Pakistan no such separate section is available but purpose of the available laws in these jurisdictions is same.

[71]Ibid.,

CHAPTER 4

LIABILITIES OF THE DIRECTORS FOR WRONGFUL TRADING

A company is in law a legal person separate from its members. However, a company can not take its decisions regarding the company affairs without natural person. These real persons are the directors and the shareholders.[1] From the registration of the corporation everybody knows that, no company is able to manage itself. It requires someone to undertake for it. This is the key role of directors.[2]

Liabilities of the directors are available in section 413 of the Companies Ordinance 1984 but insufficient to control the wrongful trading and make them personally liable to pay the debts of the company who always misuse the concept of corporate personality.

Directors act as a trustee for the company. A director is accountable for his actions and therefore owes certain duties to the company. Over the years these duties have evolved through the courts but now have been codified in the Companies Act 2006 in UK and in Pakistan and in Malaysia these duties are included in the Companies Act, 1984 in Pakistan and, in Companies Act 1965 in Malaysia.[3] They are bound to be complying with the

---

[1]Thomson Snell & Passmore, *Directors Responsibilities Avoiding the Wrongful Trap*, Jan 2009. Available at: http://www.ts-p.co.uk/.....dirctors,%20responsibilities%20avoiding%20the%20wrongfull%2----- (accessed 5 June, 2009).

[2]Hewitsons, *Directors Duties in a Deteriorating Trading Position*, Available at: http://www.hewitsons.com (accessed 20 June, 2009).

[3]Companies Act 2006. Available at: http://www.opsi.gov.uk/acts2006/ukpga-200646-en-1- (accessed 5 September, 2009).

Company Law and Insolvency Act 1986. Directors of the company have some liabilities for the wrongful trading. As we said that directors of the company always misuse the concept of limited liability. Before going to discuss the liabilities of directors it was crucial to first define the directors that who is director? And to what extent they are liable for the wrongful trading?

4.1 WHO IS DIRCETOR?

Who in law is a director? Section 251 of the Insolvency Act 1986 defines a director in two ways. The first is any person who works in the company as a director. Second the Insolvency Act 1986 introduced the concept of a **shadow director.** A shadow director is a person under whose directions and instructions directors are accustomed to act.[4]

Section 175 of the Companies Ordinance 1984 envisages that only natural person can become the directors of the company and no director shall be variable representative of the body corporate.[5]

Case law also refers to the concept of a **de facto director** who is defined as anyone who acts as director but, not dully appointed as such. They are also liable for wrongful trading because they also have some duties towards company and its creditors.[6] Millett J in *Re Hydroden*

---

[4]Ibid.,

[5]Section 175, Companies Ordinance 1984.

[6] Rizwaan J. Mokal, *An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors,* The Cambridge Law Journal, Vol.59. No. 2. (Cambridge University Press July, 2000) 335-369. Available at: http://www.jstor.org/stable/4508678 (accessed 27 May, 2009).

(Corby) Ltd [1996] 2 BCLC 180 has held that the terms "de facto", "de jure" and "shadow directors" are mutually exclusive.[7]

The important point is that under whose authority and control the company is running its business? Law says that any one who is officially director or not but if he or she takes the commercial and financial decisions of the company are equally liable like shadow directors. These people can be shareholder, assistant of the manager and directors, who under law are responsible for any mismanagement of the company.[8]

4.2 LIABILITIES OF THE DIRCETORS FOR WRONGFUL TRADING

Directors of the company whenever commit the wrongful trading are liable to compensate for the shareholders and the creditors if it appears that they were at fault. In different jurisdictions the liabilities of the directors are different than others. In Pakistan section 413 of the Companies Ordinance 1984 is about the liability of the delinquent director for the fraudulent conduct of business. Fraudulent conduct of business can be defined for the wrongful trading and for the fraudulent trading. Wrongful trading always occurs due to the fraudulent act of the directors.[9]

---

[7] The Law and Directors Responsibilities. Available at: http://www.freelance.co.uk/legal/directorresponsibility.shtm/#topper (accessed 12 September, 2009).

[8] Ibid.

[9] Section 413, Companies Ordinance 1984.

4.2.1 Civil Liability

When directors of the company exercise their duties they must act with due care and diligence that a prudent person can exercise.[10] They must work only for the interest of the company not for their own interest but, now it has become very hot issue that directors of the company sometimes run the business of the company with intent to defraud the company and its creditors and, escape from the liabilities to use the principle of limited liability.[11] They have some fiduciary duties towards the company. Fiduciary duties of the directors were first established by the common law judges, operating without any guidance from the formal written law. In the United States and many other common law jurisdictions, contain no statement at all of the core fiduciary duties of care and loyalty.[12]

Almost every jurisdiction law imposes some liabilities on the directors to avoid the corporate failure. They must avoid conflict of interest in running the affairs of the company. Company is on the mercy of its directors they can take it at the top of success and can take at the stage of lowest to lowest. If they want, they can prevent the insolvent trading.[13] Directors of the company are liable to pay the debts of the company to its creditors at the time of liquidation

---

[10]Companies Act 2006. Available at: http://www.opsi.gov.uk/acts2006/ukpga-200646-en-1- (accessed 5 September, 2009).

[11]In the concept of limited liability the directors of the company will not be personally liable to pay the debts of the company. This concept was first introduced in the case of, Salomon v Salomon & Co Ltd [1897] AC 22, Quoted in book, Lean Sealy, *Cases and Material of the Company Law,* (Sara Worthington, New Zealand 2005), 28-29.

[12]Bernard S. Black, *The Principle Fiduciary Duties of Directors,* presentation at third Asian Roundtable on Corporate Governance, (Singapore, 4 April, 2001). Available at: http://www.oecd.org/dataoecd/50/53/1872746.pdf (accessed 8 September, 2009).

[13]Directors of the company can avoid insolvent trading if they perform their duties only for the interest of the companies. Some necessary steps by them can save it from going into insolvent liquidation. Detail is available at http://www.reelanceuk/legal/directors-responsibilities.htm (accessed 26 June, 2009).

when it proves that they ran the business of the company at the time of financial difficulties.[14]

4.2.2 Contractual Liability

Directors have also contractual liability like civil liability. They will be liable for breach of any contract in which they entered without disclosure on the board of directors. They should enter in each contract only for the interest of the company rather then for their personal interest. All contracts in which directors entered on behalf of the company caused damages, directors shall be held liable to pay that damages to the company. In many cases directors of the company entered in to contracts where they seek to promote only their own interest not the interest of company.[15]

Section 214 of the Companies Ordinance 1984 contains the duties of the directors that they must disclose the interest in the contract before the shareholders in the meeting of the board of directors. If the director fails to comply with the section 214 of the of the Companies Ordinance 1984, shall b liable to a fine which may extend to five thousand rupees. This fine is not sufficient to control the wrongful trading. The big problems in the laws of the Pakistan regarding wrongful trading is that, these provisions contain very less punishment for the directors.[16]

Wrongful trading occurs only due to the negligent act of the directors, when they run the business of the company with dishonest intention to defraud the company and its creditors.

---

[14]S.214 Insolvency Act 1986.
[15]See European Union Action Plan 8 June, 2007.
[16] Section 21(6), Companies Ordinance, 1984.

This became an unresolved issue that directors after the liquidation of company want exemption to their liabilities. In current situation whole world is focusing on the point that how they can save the business of the company from the corporate fraud. Always it happens that the directors of the company are individually liable to pay the debts of the company is one of the basic rule of the common law of England but in United States the applicability of the deepening insolvency will be also on other members.[17]

They could become liable for wrongful trading if it appears that they continued entering into contracts or accepting credit after they knew that there is no chance to save the company from going in to liquidation. The court has a discretionary power to pass an order against the directors to use their personal assets to pay the debts of the company. They are also responsible to treat all the creditors equally. They are not allowed to give the preference to any creditor that the company is threatening to sue them.[18]

Directors of the company are not liable for those acts when they satisfy the court that they took every step to save their company from going in to liquidation.[19] It is the responsibility of directors that when they see that company is not in good financial position, they must inform the company in first general meeting. If directors don not inform the company in first general meeting then they will be liable individually for any breach of contract and, also for damages caused by their negligence. It is the element for the contractual liability for the

---

[17] Directors Responsibilities. Available at: http://www.insolvencyhelpline.co.uk/itd-companies/directors-responsibilities.php#wrongful-trading (accessed 23 June, 2009).

[18] Turber Villes Solicitor, *Batting to Save a Falling Business can put Director at Risk,* spring, 2009. Available at: http://www.turbervilles.co.uk (accessed 15 July, 2009).

[19] Beswicks Solicitor, *Director Personal Liability at Greater Risk under New Company Act.* Available at: http://www.beswicks.com (accessed 14 July, 2009).

directors that they must committed fraud to the company for their own interest. In this situation directors will fail to fulfill the contractual liabilities.[20]

We know that if the directors of the companies enter in to contract not disclosing that they are on behalf of the company then there will be contractual liability on theme. In Companies Act 1985 it is mentioned that if the directors of the company sign or authorize to be signed on behalf of the company any bill of exchange, promissory note, endorsement, cheque or order for money in which company name is not mentioned will be liable for fine and also will be personally liable for that contract. For all damages and loss caused by that contract the person who signed the contract will be liable for them.[21]

4.2.3 Criminal Liability

We know that like the civil and contractual liability the company law also imposes the criminal liability on the directors and the members of the management board. They are the persons who run the business of the company. Many laws have been made to impose criminal liability on the directors in case of fraudulent trading.[22] Section 213 of the Insolvency Act 1986 and section 413 of the Companies Ordinance 1984 contain the criminal liability on the directors for fraudulent trading. Under section 413 of the Companies Ordinance 1984 directors of the company shall be liable to pay the fines and also liable for the imprisonment which mat extend to two years. Under section 213 of the Insolvency Act

---

[20] Rizwaan J. Mokal, *an Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors.*

[21] Ibid.,

[22] Beswicks Solicitor, *Director Personal Liability at Greater Risk under New Company Act.*

1986 directors of the company shall be liable to pay the debts of the company and, and will also liable for the fines that is limitless on the discretion of the court. Under Insolvency Act 1986 directors are also liable for the disqualification if it appears that they were at fault and ran the company business with intent to defraud the company and its creditors. Directors of the company are disqualified minimum for two years and, maximum for seven years. Disqualification of the directors is a lesson for the other directors to avoid the wrongful trading. In contrast with the punishments available in the Insolvency Act 1986 the Companies Ordinance 1984 contains insufficient liability on the directors for the fraudulent conduct of business.

4.3 WHAT SHOULD DIRECTOR DO TO AVOID PERSONAL LIABILITY FOR WRONGFUL/FRAUDULENT TRADING?

When we talk about avoiding the fraudulent trading the answer is simple that do no act dishonestly. We discussed above in a detail that the fraudulent trading occurs when the directors of the company run its business with dishonest intention to defraud the company and its creditors. But when there is question of wrongful trading it become more difficult to answer that in wrongful trading what directors of the company should do?[23]

In order to avoid the fraudulent trading and wrongful trading and to save the company from going in to liquidation they must cease the business of the company when it is in difficult financial position. Directors of the company must keep themselves aware with the financial

[23]International Law Firm, Companies Act 2006 Directors Duties and Liabilities, available at: http://www.braconline.eu/liabrary/directors Duties UK Companies Act.pdf (accessed 12 September, 2009).

position of the company, because in this way they could judge that company is not in good financial position. After knowing that the financial position of the company is not good they must take professional advice from the professional practioners. To know the daily affairs of the company do not apply on the all type of directors. Non executive directors are not responsible to keep themselves up to date with the daily affairs of the company. Director's act can save the fraudulent and wrongful trading and, can avoid the company from going in to liquidation.[24]

The provisions of the Companies Act, 2006 confirm the duties of the directors towards the company itself and not for the individual shareholders. They are responsible to take those steps that are in the best interest of the company not for the individuals. Companies Act 2006 extends the scope of the duties of the directors. Now directors cannot escape from any liability.[25]

4.4 WHAT DIRECTOR SHOULD DO IF HE COMES TO THE CONCLUSION THAT THERE IS NO PROSPECT OF AVOIDING INSOLVENT LIQUIDATION?

The answer of this question is that directors of the company always use to resign from the company when it is at the stage of insolvency. However, this is not probably effective, because if all directors resign from the company in the financial difficulty then company will

---

[24]Thomson Snell and Passmore, *Directors Responsibility Avoiding the Wrongful Trading,*
[25]Ibid.,

obviously become insolvent.[26] This is also an offence to leave the company in difficult situation. This would be considered a worst act by the directors.[27] They should take some steps to avoid their company from going in to liquidation not to run away. If directors of the company come to the know that their company is in financial difficulty and cannot avoid liquidation then they have three options to save their company from going in to liquidation.

1. When they come to know that the company is not in good financial position and, cannot continue its business then they must stop company business. This is an ideal solution to save the company and its creditors from further loss. When directors of the company stop the company business in difficult situation it would also be a defense against them from wrongful trading. After ceasing the company business they must appoint a liquidator to distribute the company assets among the creditors. When they will appoint a liquidator they will also give guarantee to him that liquidator will not be personally liable if company assets are not sufficient to pay the creditors debts. Director's appropriate decision can avoid the company from going in to liquidation. They should not resign when company is not in good financial position but they must take some steps to save the company from further loss.[28]
2. The second option to the directors of the company is that, if directors are not finding the liquidator willing to act, then the best solution is that they must stop the company business completely. And after ceasing the company business they are not required to

---

[26]Ibid.,

[27]Andrew Keay, *Wrongful Trading and the Liability of Company Directors: a Theoretical Perspective,* 2005. Available at: http://www.insolvency.gov.uk/.../wrongfultradingandtheliabilityofcompanydirectors.doc- (accessed 14 July, 2009.

pay the debts to the creditors because this can create discrimination among the creditors that will also create another problem for the directors. Wrongful trading will not occur if they stop the company business. If directors do not appoint the liquidator then there are some tricky problem, as we discussed above if they have problem to appoint the liquidator they must cease the company business. When they stop the company business for a while they can complete their contracts but, if they completely cease the company business then nothing will be achieve from the contracts.

3. The third option to the company directors to avoid the wrongful trading is that they must place the company in to administration. It is an alternate solution to save the company from further loss.[29]

In order to obtain an administrator order the applicant will apply to the court for it. They will produce this information in the court that company cannot be saved from going in to liquidation therefore, it is necessary to appoint an administrator to save the company from further loss.[30]

During the period when application has been moved in the court for administrator no resolution of the company will be passed, neither they can take any decision regarding the company affairs, business and property. No proceeding will be commenced against the company without the consent of the administrator. After reviewing the application for

[29]Ibid
[30]Ibid

administrator by the company court will pass an order for administrator. Administrator will be obliged to take any kind of decision that is necessary to save the company from loss.[31] Administrator will also be bound to take the order from the court before taking any decision relating to the company matters. He will not be allowed to appoint the new director, or remove the old one without the permission of the court. He also cannot call the creditors meeting without the consent of the court.[32]

These are the some important options for directors to avoid the wrongful trading and fraudulent trading. The most important option is that they must cease the company business when company is not in good financial position. Wrongful trading occurs when the company directors carrying on its business in the difficult financial position.[33]

4.4 PENALTY FOR THE WRONGFUL TRADING

Penalty for the wrongful trading is compensatory not punitive. The most important modern statutory exception to the principle of limited liability is based on the notion of wrongful trading by directors in the period preceding the insolvency of their company. The Cork Committee, which recommended this reform in 1982, the aim, was to protect the interest of the creditors and the investors.[34] Directors of the company are responsible to look after the day to day business of the company. Their good act can take the company at the stage of development and if they do not act with due care and diligence can take the company at the

---

[31] Ibid
[32] Ibid
[33] Ibid
[34] Directors Responsibilities. Available at: http://www.insolvencyhelpline.co.uk/itd-companies/directors-responsibilities.php#wrongful-trading (accessed 23 June, 2009).

stage of insolvency. Under the provisions of the Companies Ordinance 1984 directors of the company will be liable to pay the debts of the company for wrongful trading and for fraudulent trading they will also be liable for the imprisonment which may extend to two years. Under UK Insolvency Act 1986 directors of the company are also liable for the disqualification if it appears that they carried on the company business at the time of financial difficulty. This is sufficient punishment to save the company from the wrongful trading in the future.[35]

4.4.1 Disqualification of the Directors for Wrongful Trading

Under the Companies Directors Disqualification Act 1986 the court has the power to make a disqualification order against the directors of a company who committed wrongful trading.[36] Section 1 of the Companies Directors Disqualification Act, 1986 deals with the disqualification of the directors for wrongful trading.[37]

Section 1 of the Companies Directors Disqualification Act, 1986 gives procedure that a court has power to pass an order against the company directors that are involved in the mismanagement of the company. The person against whom the court pass an order of

[35]Shean Solicitor, Directors' Responsibilities on Insolvency. Available at: http://www.sheansolicitor.com/index.php?opyoon=com-contents&view=article&id=11&itemid=14 (accessed 22 June, 2009).

[36] Ibid.,

[37]Section 1 Companies Directors Disqualification Act 1986.

disqualification cannot become the director of the company, neither they can take part in the promotion of the company for the prescribed period.[38]

The disqualification order is passed against the directors under two grounds.

1. Responsibility for wrongful or fraudulent trading and
2. Unfitness to be concerned in the management of a company.[39]

The above conditions are the main conditions for the disqualification of the directors but, directors can also be disqualified if found guilty in offence related to the mismanagement of the company. The Companies Act, 1985 contained sixty-nine indictable offences and fifty separate duties on the directors for the disqualification. Therefore, it is not difficult to prove the offence on directors for the disqualification.[40]

A disqualification order can run minimum for two and maximum for fifteen years.[41]

1. After the disqualification order by the court, he or she cannot become the director without the consent of the court.
2. The second is that he or she cannot take part in the promotion, formation and management of the company without the permission of the court.[42]

Under section 7 of the Companies Directors Disqualification Act, 1986 the Secretary of State for Trade and Industry or the Official Receiver in the case of a company being wound up by the court may apply to the court to have a director or shadow director of an insolvent

---

[38]R.R Durry, *Company Law Directors,* Available at: http://www.law.etetr.uk/staff/clrury/documents/directors (accessed 27 August, 2009).

[39]Ibid.,

[40] Directors Responsibilities. Available at: http://www.insolvencyhelpline.co.uk/itd-companies/directors-responsibilities.php#wrongful-trading (accessed 23 June, 2009).

[41]Section 1(2), Companies Directors Disqualification Act 1986.

[42]The Law and Directors Responsibilities, Available at: http://www.freelanceuk.com/find-a-freelancer/art-dirctors-responsibilities (accessed 26 July, 2009).

company disqualified on the grounds of unfitness.[43] Under the Insolvency Act 1986 action against directors personally for fraudulent and wrongful trading may only be brought by the liquidator of the insolvent company. Prior to the Insolvency Act 1986 an individual creditor or contributory could bring an application for fraudulent trading. However, this was removed as it was thought it may encourage creditors to put improper pressure on directors to settle claims personally.[44]

The power to disqualify on the ground of unfitness has generated a high level of activity. In the years 1997-1998 to 2000-2001 between 1250 and 1500 directors were disqualified each year by court order and in 2001-2002, when disqualification undertaking was introduced, the total orders and undertaking was over 1750.[45]

The recent cases show that the courts are still struggling to develop a logical motivation for the disqualification of directors. After the legislation of 1986 there was a hope that it will fulfill the all requirements regarding the corporate insolvency but it appeared that it's not being fulfilled. The problem is still unresolved.[46] In the first case of *Ipcon fashion Ltd* Hoffman J held that directors use very cunning way at the time of dealing with your suppliers and disposing of the assets of the company." The directors, Mr Haya, had conducted business in the clothing trade through the medium of four companies over a period of nine years. The first company went in to liquidation in 1997. The point is that why

---

[43]Section 7, Companies Directors Disqualification Act 1986.

[44] Rizwaan J. Mokal, *An Agency Cost Analysis of the Wrongful Trading Provisions:* Available at: http://www.jstor.org/stable/4508678 (accessed 27 May, 2009).

[45]Ibid.,

[46] Vanessa Finch, *Disqualification of Directors: A Plea for Competence,* The Modern Law Review, Vol. 53, No. 3 (Blackwell on behalf of the Modern Law Review May, 1990). Available at: http://www.jstor.org/stable/1096480 (accessed 27 May, 2009).

they did not stop the business of the other company if one went in to liquidation? These steps of the directors make them liable for disqualification.[47]

Hoffman J seemed to have no hesitation in finding that Mr Hava's conduct shown in unfit to concern in the management of a company and disqualifying him for five years. They also said in case ***Re Stanford Services Ltd,*** the attitude of the director towards his duties was not good. He has to act with due care ad diligence for the interest of the creditors including crown but he continued the business at the time when he knew that company is not in good financial position that is proof of wrongful trading.[48]

A disqualification order issued by the court may prevent the individual that they are not allowed to become director of the company but also from acting as a receiver, liquidator or manager of the company property. If the directors breach the order of the court shall be liable for imprisonment or fine or both and also be personally liable to pay the debts of the company.[49]

4.5 How WRONGFUL TRADING CAN BE AVOIDED?

Directors of the company are the main pillar to run the business of the company. They are responsible for the management and operation of the company. Wrongful trading that deals under section 214 of the Insolvency Act, 1986 imposes certain duties on the directors in case

---

[47]Ibid.,

[48]Ibid.,

[49]How to Investigate and how Disqualification of Directors: What are the roles of DTI and the Liquidator. Available at: http://www.hrmc.gov.uk/business.com (accessed 14 July, 2009).

the company goes in to liquidation. When they run the company business at the time of financial difficulty they will be personally liable to pay the debts of the company.[50]

Directors have many duties and responsibilities towards the company, particularly under the Companies Act, 2006. Prior to this Act the nature and scope of duties owed by directors were established and developed by the courts through case law and based on common law and fiduciary obligation.[51] If they fail to meet these duties intentionally, negligently or by incompetency can face personal claim to compensate company, or be disqualified in wrongful trading and will face imprisonment in case of fraudulent trading.[52]

The act of the directors can avoid wrongful trading. This is not too difficult but only to be sincere with the business of the company. Necessary steps by the directors that can avoid wrongful trading are as follows:

1. First and most important step of the directors that can avoid the wrongful trading is that, they should not continue the company business at the time of financial difficulty. They will be personally liable to pay the debts of the company whole or in part unless he took every step he ought to have taken to minimize loss to the company creditors. The standard by which he is to be judged is defined by reference both to his actual knowledge, skill and experience, and to the expertise reasonably to

---

[50]S. 214 Insolvency Act 1986.

[51] Rizwaan J. Mokal, *An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors,* The Cambridge Law Journal, Vol. 2. (Cambridge University Press July, 2000) 335-369. Available at: http://www.jstor.org/stable/4508678 (accessed 27 May, 2009).

[52]Ibid.,

be expected of a person carrying out the same functions as him in relation to the company.[53]

2. The second step of the directors to avoid the wrongful trading is that do not incur the further debts even company has no reasonable assets to paying its earlier debts. This is also a way that takes the company at the stage of insolvency. Wrongful trading also means that where directors of the company knowing that it has no prospect of paying its debts incur further debts. To avoid the wrongful trading directors of the company are require to stop incur further debts when company is not in good financial position.[54]
3. The third step for the directors of the company to avoid the wrongful trading is that they should seek advice from an insolvency lawyer or licensed insolvency practitioner as soon as possible. This is not only to avoid the wrongful trading but also to reduce the risk of incurring personal liability.[55]
4. The directors of the company are not allowed to pay the debts to those creditors who are threatening to be sued by the company.[56]
5. At the time of selling the company assets make sure about the market value of the assets. This is not in favor of the company business if the market value is known by the directors and even then they sell the company assets cheaper.[57]

---

[53] Babbe , Fraudulent Trading and Wrongful Trading -a legal guide. Available at: http://www.babelegal.com/images/site-files/11.pdf (accessed 17 May, 2009).

[54] Mace & Jones, *Wrongful Trading a Risk not Worth Taking Warns as Christmas Sales Slump,* (29th December, 2008). Available at: http://www.maceandjones.co.uk/contact (accessed 12 Jun, 2009)

[55] Ibid.,

[56] Ibid.,

[57] Ibid.,

6. Examine the company accounts. Failure to keep proper books and records in itself an offence under Companies Act 1985 and can have far reaching effects particularly if the company fails and enters into some form of insolvency. To keep proper account record of the company can avoid the wrongful trading because wrongful trading always occurs when directors continued its business in financial difficulty. In this way directors will come to be known about the financial position of the company. We know that the wrongful trading occurs when the company directors run the business at the time when company is not in good financial position. However, if they have record of everything then they will be aware about the financial position to avoid wrongful trading.[58]
7. They should also pay the tax returns on time.[59]

Company directors are personally liable to pay the debts of the company if they do not take the above mentioned steps to avoid the wrongful trading.[60]

---

[58]Shean Solicitor, *Directors Responsibilities on Insolvency*, Available at: http://www.sheansolicitor.com/index.php?opyin=com-content&view=article&id=11&itemid=14 (accessed 23 June, 2009).

[59]Ibid.,

[60] Andrew keaya, *Directors' Duties towards Company and Creditors,* (routledge-lavenisb 26 Oct, 2006). Available at: http://www.routledgelaw.com/..../co-directors-responsibilities-to-creditors-isbn9781845680084 (accessed 26 August, 2009).

CHAPTER 5

CONCLUSION AND PROPOSAL FOR REFORMS

5.1 CONCLUSION

It is concluded from the study of this thesis that laws in Pakistan to deal with wrongful trading are badly in need of reforms to meet the 21st century challenges. The most important point discussed in this paper is the comparison of the law of UK, USA and Malaysia with Pakistan. Common law theories and rules have been made a significant contribution related to the fraud. We traced the origin of wrongful trading in UK. In UK separate law is available to deal with wrongful trading. It is a principle of UK insolvency law. In USA no separate law is available to deal with wrongful trading but the available laws achieve same purpose. In Malaysia also no separate law is available but the available laws fulfill the same purpose as in the UK. In Pakistan no separate and sufficient law is available to save the company from wrongful trading by the directors. The laws that have been made to get back the companies in case of wrongful trading in their previous position are not practically implemented in the corporations. Only provision that is available in the Companies Ordinance 1984 cannot control this offence.

This paper gives the analysis of the worst impact of the wrongful trading on the business of the corporations. The issue discussed in this thesis is the control of the

wrongful trading that can be only fulfill with the legislation of the new law and in the amendments of the old one. The major issue that was essential to be discussed is that directors of the company should be personally liable to pay the debts of the company and, there is no law that makes directors liable before the insolvency of the company. Directors always use the concept of limited liability after committing the wrongful trading.

The important issue that has been discussed is that the directors can save the company from going into liquidation if they take necessary steps to save the company from further loss. It is concluded that wrongful trading is not this type of offence that could not be controlled. This purpose can be achieved only by the directors. The minor attention can solve this one of the biggest issue of the corporate world. After the collapsed of the world's biggest companies like, Enron, Paramalat, Ahold and World Com it became necessary to adopt some new laws that save the corporations from the fraud. If the directors take the necessary steps they can avoid the wrongful trading in the corporations.

The major issues that discussed in this thesis were to overview the corporate laws of the Pakistan to control the wrongful trading. We concluded that in Pakistan no separate law is available to deal with wrongful trading as in the United Kingdom. Companies Ordinance 1984 is only primary governing law of the corporations. Available provisions incorporated in the Companies Ordinance 1984 are not sufficient to control the unfair corporate practices in Pakistan. The most important issue on which this thesis focuses is

that attention should be given to amend the laws according the need of the hour. There must be reforms and amendments in the Company's Ordinance 1984 and, in the Rules and Acts of the Securities and Exchange Commission of Pakistan.

Securities and Exchange Commission of Pakistan is the regulator of the corporate sector in Pakistan. The punishments in the Rules and Acts of the SECP are also not sufficient to make the culprits of the wrongful trading personally liable to pay the debts of the company and deter them not to repeat this offence in the future.

In the current situation Pakistan is facing many problems that are a big hurdle in the development of the corporations like, political crises, financial crises and terrorism. Recently the main problem that is the big hurdle in the development of the industries is the terrorism. The peoples who have to pay attention on the development of the corporations are busy in the politics. Corporations have an imperative role to enhance the economy of the country. It is essential to be taken necessary steps to promote the corporations for the development of the Pakistan.

The net conclusion of this thesis is that this issue can be solved with the legislation of new laws and amendments in the old one.

5.2 PROPOSAL FOR REFORMS

After the conclusion it has been proved that there must be amendments in the Companies Ordinance 1984 to control the wrongful trading that has become a serious issue in the world. SECP that regulates the corporate sector in Pakistan should adopt new and separate laws to make the directors liable for the wrongful and fraudulent trading. Beside these two major reforms others important proposal for the reformations are as under:-

- We need the laws that directly deal with the wrongful trading and make them personally liable who misuse the concept of limited liability.
- Wrongful trading must be treated as a criminal offence that makes the directors liable for the imprisonment along with the fine.
- Punishment available in the Companies Ordinance 1984, and in the Securities and Exchange Commission of Pakistan Ordinance 1969 are also required to be extended that directors before going to commit wrongful trading think hundred times.
- Directors must be liable not only for fine but they must be personally liable to pay the whole debts of the companies and others damages caused by their negligence.
- Disqualification of the directors must be included in the law to save the corporations from the wrongful trading in the future.
- Corporate Rehabilitation Act 2004 is essential to be practically implanted in the corporations that will be a good step to get back the companies on their previous position.

- Practical implementation of the Code of Corporate Governance should be compulsory in the company's business system. There must be some source for the future practices of Corporate Governance in Pakistan without the support of the donor agencies.
- Through the Code of the Corporate Governance the auditing system of the corporations should be making fair and transparent that is very important step to save the companies from wrongful trading.
- There must be some provisions that make the directors personally liable before the insolvency of the company. After insolvency it becomes difficult to get back the company on its previous position.
- Available laws in Pakistan that indirectly deal with wrongful trading are also not sufficient to deal with wrongful trading.

BIBLIOGRAPHY

ARTICLES

Ali Salman,Saikh. Naqvi Feisal. "A permanent solution for the sick industries: Corporate Rehabilitation", - I Available at: http://www.defence.pk/forums/economy-development/12191-permanent-solution-sick-industries-corporate-rehabilitation.html (Accessed 4 September, 2009)

Balan, Sujata. Reform of the Law relating to Directors Duties in Malaysia. 2007. Available at: http://www.insolvencyasia.com/insolvency-law..../Malaysia/pdf/section-i-pdf (Accessed 28 august, 2009)

Bernard, S Black. The Principle Fiduciary Duties of Directors. Presentation at third Asian Roundtable on Corporate Governance Singapore, 4 April 2001. Available at: http://www.oecd.org/dataoecd/50/53/1872746.pdf (Accessed 8 September 2009)

Babbe, Fraudulent Trading and Wrongful Trading-a legal guide. Available at: http://www.babbelegal.com/images/site-files/11.pdf (Accessed 23 Jun, 2009)

Balan, Sujata. Reform of the Law relating to Directors Duties in Malaysia, 2007. Available at: http://www.insolvencyasia.com/insolvency-law..../Malaysia/pdf/section-i-pdf (accessed 28 august, 2009).

Brandt, A William Jr. & Catherine E. Vance. Deepening Insolvency and the United Kingdom Wrongful Trading Statute: A comparative Discussion. (2005).

Chia, Brain. Stephanie Phua at Wrong & Prtners, the Fading appeal of Independent Directorship needs to be addressed, February 2009. Available at: http://law.hkh.hk/aiiff/events/symposin/papers/aiman20 Sulaiman.ppt (accessed 10 October, 2009).

Crimean War, Available at: http://www.spartacus.school.net.co.uk/warcrimean.htm (Accessed 27 August, 2009)

Corporate Governance in an emerging Market: A perspective on Pakistan, *Journal of Legal Technology Risk Management*. vol.1, No.1, fall 2006. Available at: http://www.ssrn.com/abstract=9764 (Accessed 15 September, 2009)

Durry, R.R. Company Law Directors. Available at: http://law.etetr.uk/staff/clrury/document/directors (Accessed 27 August, 2009)

Fraud Survey 2005 Report in Malaysia. Available at: http://www.kpmg.com.my/kpmg/publications/fas/fsurvey_2004.pdf (accessed 8 October, 2009).

Finch, Vanessa. Disqualification of Directors: A Plea for Competence, The Modern Law Review, Vol. 53, No. 3 (Blackwell on behalf of the Modern Law Review May, 1990). Available at: http://www.jstor.org/stable/1096480 (accessed 27 May, 2009).

Hewitsons. Directors' Duties in a Deteriorating Trading Position. Available at: http://www.hewitsons.com (Accessed 20 Jun, 2009)

Insolvency Law Reform Report on Pakistan, Available at: http://www.adb.org/documents/.../insolvency/local-study-pak-khan-i.pdf- (Accessed 23 Jun, 2009)

Ibrahim, Ali Adnan. Corporate Governance in Pakistan: analysis of Currant Challenges and Recommendations for Future Reforms. Available at: http://www.law.wustl.edu/wugs/r/issues/volume52/p323ibrahim.pdf (Accessed 3 September, 2009)

Jones, Mace. Wrongful Trading a Risk not Worth Taking Warns as Christmas Sales Slump. 29 December 2008. Available at: http://www.maceandjones.co.uk/contact (Accessed 12 Jun, 2009)

Jean du Plessis, and Claus Luttermann. Corporate Governance in the EU, the OECD Principles of Corporate Governance and Corporate Governance in Selected Other Jurisdictions, available at: http://www.OECd.org/dataoecd/20/60/40(823806) (Accessed 29 August, 2009)

Look, Chan Ho. On Deepning Insolvency and Wrongful Trading, *International Banking Law Journal and Regulation,* vol.20, August 2005.

Khan, Maudood A. & Shahorr Aly, Insolvency Law Reform Report on Pakistan. Available at: http://www.Insolvencyasia.com/Insolvency-law...../Pakistan (Accessed 3 September, 2009)

Keay, Andrew and Murry Michael. Making Company Directors Liable: A Comparative Analysis of wrongful trading in United Kingdom and insolvent trading in Australia. 14th rev vol online Wiley inter science 2005. Available at: http://www.interscience.wiley.com (Accessed 27 August, 2009)

Keaya Andrew, Directors' Duties Towards Company and Creditors, routledge-lavenisb, 26 Oct 2006. Available at: http://www.routledgelaw.com/..../co-directors-responsibilities-to-creditors-isbn9781845680084 (Accessed 26 August 2009

Khan, Muhammad Arshad and Khan. Sajawal, Financial Sector Restructuring in Pakistan. August 2007. Available at: http://www.mpra.ub.uni-muenchen.de (accessed 12 September, 2009)

Look, Ho Chan. On Deepening Insolvency and Wrongful Trading. (Journal of International Banking Law and Regulation, vol. 20, August 2005). Available at: http://www.ssrn.com/abstract=741024 (accessed 10 October, 2009).

Mokal, Rizwaan J. An Agency Cost Analysis of the Wrongful Trading Provisions: Redistribution, Perverse Incentives and the Creditors. *The Cambridge Law Journal*, Vol. 2 Jul. 2000, Cambridge University Press. Available at: http://www.jstor.org/stable/4508678 (accessed 27 May, 2009)

Prentice, D.D. Creditors interest and Directors Duties.vol. 10, No.2. http://www.jstor.org/stable/764443 (accessed 23 Jun, 2009)

Passmore Snell, & Thomson. Director's Responsibilities avoiding the Wrongful Trap. Jan 2009. Available at: http://www.tsp.co.uk/...directors%responsibilities%20avoiding%20th%20wrongful%2------- (accessed 5 June, 2009)

Rockness Howard and, Rockness Joanne. Legislated Ethics: From Enron to Sarbanes-Oxley, the Impact on Corporate America. *Journal of Business Ethics*, vol 57.1 Springer

March 2005 Available at: http://www.jstor.org/stable/25123452 (accessed 1 July, 2009)

Revised Code on Corporate Governance introduced in Malaysia. Available at: http://www.csr-malaysia.org/.../Malaysia/revised-corortae-governance-code-20071013124/- (accessed 9 October, 2009).

Solicitor, Viswiki. Wrongful Trading. Available at: http://www.viswiki.co/en/Insolvency-Act-1986 (accessed 20 June, 2009)

Solicitor, Shean. Directors' Duties on Insolvency. Jan 2009, Available at: http://www.sheansolicitors.com/index.php?option=com-content&view==article&id=3&itemid=5 (accessed 25 June, 2009)

Snell Thomson, and Passmore. Directors responsibility avoiding the Wrongful Trading. Available at: http://www.tsp.co.uk/....Directors%20responsibilities%20avoiding%20wrongfultrading%2... (Accessed 2 September, 2009

Tom, Swayer. Corporate Fraud in Malaysia, Available at: http://www.ezinearticles.com/?Corportae-Fraud-in-Malaysia&id=2861035 (accessed 27 September, 2009)

Turber, Villes Solicitor. Batting to save a Falling Business can put Director at Risk. Spring, 2009. Available at: http://www.turbervilles.co.uk (accessed 15 July, 2009)

Vanessa, Finch. Disqualification of Directors: A Plea for Competence. The Modern Law Review, Vol. 53, No. 3 Blackwell on behalf of the Modern Law Review May, 1990. Available at: http://www.jstor.org/stable/1096480 (accessed 27 May, 2009)

BOOKS

Ahmed, Nazir Shaheen. *A practical Approach to the Companies Ordinance, 1984,* Rawalpindi: Federal Law House, 2004

Ali, Zaka. *The Companies Ordinance, 1984,* Karachi: The Ideal Publication, 2007.

Gower, *Principle of Company Law,* London: Sweet & Maxwell, 2003.

Ramsay,M Ian. *Company Directors Liability for Insolvent Trading,* University of Melbourne 2000.

Sealy, Lean. *Cases and Material of the Company Law*. Switzerland: Sara Worthington, 2007.

Saed, Khuwaja Amjad. *Company Law in Pakistan*, Lahore: Khuwaja Publications, 2008.

CASES

Kitty v. Atlantic bank of New York (In re Global Service Group, LLC), 316 B.R.451,456 (bankr. S.D.N.Y.2004).

Messrs Shaheen Foundation v Messrs Capital F.M (PVT) Limited 2002 & nbsp CLD 188 KARACHI-HIGH-COURT-SINDH .Available at: http://www.pakistanlawsite.com (accessed 1 November, 2009).

Muhammad Yousuf v Taj Company 1994 CLC 403 LAHORE-HIGH-COURT-LAHORE.

Re Continental Assurance Company London plc (Singer v Beckett), [2001] BPIR 733, Ch D, [2007] 2, Available at: http://www.viswiki.en/Re-Continental-Assurance-co-of-London-plc (accessed 3 August, 2009)

Re Brain D Pierson (Contractor) limited [1999] BCC903 Available at: http://www.viswiki.com.en/Re Brain D piersonltd (accessed 26 July, 2009)

Re Producing Marketing Consortium Ltd (No 2) [1989] 5 BCC 569.

Re Hydroden (Corby) Ltd [1996] 2 BCLC 180.

Salomon v Salomon & Co Ltd [18977] AC 22 (HL) [2.01].

Schacht v. Brown, 711 f.2d 1343, 1350 (7th Cir. 1983).

Trenwick America Litigation Trust v .Ernst & Young, L.L.P., No. 157-N, (De.Ch. Aug. 10, 2006).

DOCUMENTS

Bankruptcy Code 1996.

Company Directors' Disqualification Act 1986.

Companies Act 2006.

Companies Act 1985.

Companies Ordinance 1984.

Companies Act 1965.

Corporate Rehabilitation Act 2004.

Cost and Management Accountant Act 1996.

Charted Accountant Ordinance 1961.

Companies Act 2006.

Enterprise Act 2003.

Insolvency Act 1986.

Sarbanes Oxley Act 2002.

Securities and Exchange Commission of Pakistan Act 1997.

Securities and Exchange Commission Pakistan Ordinance 1969.

WEBSITES

http://www.secp.gov.pk/corporatelaw/pdf/co1984-%20feb09.pdf

http://www.ssrn.companylaw.com

http://www.ukincorp.co.uk/s-2A-company-directors-responsibilities.html

`http://www.tsp.co.uk/.....dirctors,%20responsibilities%20avoiding%20the%20wrongfull%2-

http://www.viswiki.co/en/Insolvency-Act-1986

http://www.ukparliment.com

http://sheansolicitor.com/index.php?ption=com-content&view=article&id=11&itemid=16

http://www.secp.gov.pk/corporatelaw/pdf/co1984-%20feb09.pdf

http://www.babbelegal.com/images/site-files/11.pdf

http://www.investo.com

http://www.ukparliment.gov/Enterprise Act2002

http://www.hewitsons.com

http://www.interscience.wiley.com

http://www.gethraghguide.com.uk/forum/index

http://www.proberlencyclopedia.co

http://www.secp.gov.pk/cl/pdf/codeco-g.pdf

http://www.adb.org/documents/.../insolvency/local-study-pak-khan-i.pdf-

http://www.Insolvencyasia.com/Insolvency-law...../Pakistan

http://www.findarticles/mi-m1309/is-2-40/ai-105657565/

http://www.finance.kalpoint.com/economic-updates/exclusive/corportae-practices-in-Pakistan.html

http://www.law.wustl.edu/wugs/r/issues/volume52/p323ibrahim.pdf

http://www.pakistanlawsite.com

http://www.secp.gov.pk/Guide/auditors guide.pdf

http://www.oecd.org/daf/corporate-affairs

http://www.hec.digitalliabray.com

http://wwwtheaic.co.uk

http://wwwmacdonaldhenderson.co.uk/contacts

http://www.mpra.ub.uni-muenchen.de

http://www.ukgardian.gov.uk

http://www.thenews.com.pk/print1.asp?id=91681

http://www.jstor.org/stable/4508678

http://www.finance.kalpoint.com/economic-updates/exclusive-articles/corportae-governance-practices-in-pakistan.html

http://www.braconline.eu

http://www.defence.pk/forums/economy-development/12191-permanent-solution-sick-industries-corporate-rehabilitation.html

http://www.oecd.org/dataoecd/42/14/3818412.pdf

http://www.freelance.co.uk/legal/directorresponsibility.shtm/#topper

http://www.sheansolicitor.com

http://www.findarticles.com/p/articles/mi-m1309/is-2-40/ai-105657565/

http://www.opfblog.com/1275/pakistan-political-instability-compounds-economic-challanges/&linkname

http://www.law.etetr.uk/staff/clrury/documents/directors

http://www.hrmc.gov.uk/business.com

http://www.opsi.gov.uk/acts2006/ukpga-20060046-en-1-

http://www.insolvency.gov.uk:8765

http://www.insolvencyhelpline.co.uk/itd-companies/directors-responsibilities.php#wrongful-trading

http://www.turbervilles.co.uk

http://www.routledgelaw.com/..../co-directors-responsibilities-to-creditorsisbn9781845680084