Thesis/Dissertation on

EFFECT OF THE CORPORATE RESCUE OVER CORPORATE CREDITORS

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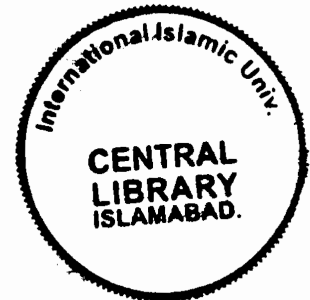

By

Adnan Rasheed

Registration No. 154-FSL/LL.M-CL.F-07

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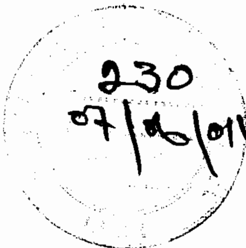

FACULTY OF SHARIAH & LAW

INTERNATIONAL ISLAMIC UNIVERSITY, ISLAMABAD

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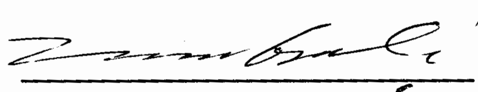
Submitted by: Adnan Rasheed

Registration No. 154-FSL/LLM-CL/F-07

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

Supervisor:

Mumtaz Ali Khan

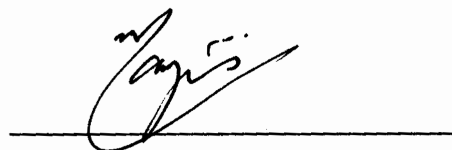


Internal Supervisor:

Ataullah Khan Mahmood

External Supervisor:

M. Ayub Bhatti



Dated:

Dean
Faculty of Shariah & Law
International Islamic University, Islamabad

Deputy Dean
Faculty of Shariah & Law
International Islamic University, Islamabad

TABLE OF CONTENTS

Abstract 6
Dedication 7
Acknowledgement 8
Chapter 1 Introduction 10
Chapter 1 Introduction 10
1.1 What is meant by corporate rescue? 10
1.2 The benefits of corporate rescue 10
1.3 Why rescue...12
1.4 Weather to rescue the business or the company is important 13
1.5 What amounts to a successful rescue attempt? 16
1.6 Importance of time in the success and failure of rescue attempt 17
1.7 Comprehension of two very important concepts that are essence of the corporate rescue laws 18
1.7.1 Property rights...18
1.7.1.2 Importance of the property rights in the bankruptcy proceedings 19
1.7.2 Corporate failure 19
1.7.2.1 Economic distress 20
1.7.2.2 Financial distress...20
1.8 Important elements of the corporate rescue process 21
1.9 Historical development of the rescue oriented system 29
1.10 Evolution and development of the modern rescue culture...30
1.10.1 Role of the court...33
Chapter 2 Salient Features of the English and American corporate rescue law 35
2.1 Corporate rescue laws prior to the reforms of the 1980s 35
2.1.1 Historical development 35
2.1.2 Schemes of arrangement...36
2.1.3 Administrative receiverships 38
2.1.4 London approach 40
2.2. Two new rescue system were introduced in the insolvency act 1986 to make the insolvency law rescue oriented 42
2.2.1 Company Voluntary Arrangements 42
2.2.1.1 Major reforms in CVA...44
2.2.2. Administrative order 45
2.2.2.1 Reform of the administrative regime under Enterprise Act, 2002 47
2.3 Now Detail Legal Rules, Core Mechanisms and Effect on Different Actors of the Corporate Rescue Law in England 48
2.3.1 Company voluntary arrangements (CVAs) 49
2.3.1.1 How to initiate a company voluntary arrangement and the role of moratorium 49
2.3.1.2 The role of the nominee in CVAs...50
2.3.1.3 Voting and approval of cva...51
2.3.1.4 The role of the court with respect to CVA...53
2.3.1.5 The impact of the CVA on corporate rescue law...54
2.3. The Administration Procedure 54
2.3.2.2 Court driven process 55
2.3.2.3 Moratorium 56

2.3.2.4 The statutory objectives of the administration 57
2.3.2.5 Role of the administrator in rescue proceeding 58
2.3.2.6 Role of the creditors meeting 59
2.3.2.7 End of the administration 60
2.4 Pre-packaged administration 61
2.5 The impact of the 2002 modifications on the bankruptcy result 62
2.6 Now brief description of the U S corporate rescue law 63
2.6.1 How to initiate a case under chapter 11 63
2.6.2 Debtor individuality in preparing a reorganization plan 65
2.6.3 Feasibility of the reorganization plan 66
2.6.4 Concept of the impairment 67
2.6.5. Cramming down an objecting class of the creditors 68
2.6.6 Automatic stay 69
2.6.7 New financing during the period of the reorganization 70
2.6.8 Concept of the adequate protection 72
2.6.9 The introduction of the pre-pack procedure 73
Chapter 3 Corporate rescue law in Pakistan 75
3.1 Introduction 75
3.2 What is meant by compromise, arrangement, and reconstruction? 75
3.2.1 Compromise 75
3.2.2 Arrangement 75
3.2.3 Reconstruction 76
3.4. How to bring into effect the organizational change 76
3.4.1 Application under Sec. 284 of CO, 1984 76
3.4.2 Person entitled to make an application for the sanction of scheme 77
3.4.2.1 Directors of the company 77
3.4.2.2 Managing Agent 77
3.4.2.3 Share-holders and creditors 77
3.4.2.4 When the company being wound up 77
3.4.2.5 Creditors of the foreign company 78
3.5 Courts which are authorized to hear the cases of reorganization 78
3.5.1 Role played by the courts in respect of a scheme 78
3.5.2 When an application may be dismissed 79
3.5.3 When a scheme sanctioned by the court 79
3.6 Burden of the proof as to reasonableness 83
3.7 Burden of the proof as to unreasonableness 83
3.8 Modification of scheme 83
3.9 When scheme become binding 84
3.10 Effect of the orders 84
3.11 Stay of the proceedings against the company 85
3.12 When stay may be granted 86
3.13 Appeal 86
3.14 Enforcement of the scheme 86
3.15 Scheme involving the reconstruction or amalgamation of companies 87
3.15.1 Power of the court relating to the scheme of "reconstruction" and "amalgamation" 89

3.15.1.1 Court's power to give directions as to the transfer of whole undertaking 90
3.15.1.2 Court's power to give direction as to the allotment of the shares 90
3.15.1.3 Court's power to give direction as to the dissolution of the transferorcompany 91
3.15.1. Court's power to make provision for dissentient shareholders 91
3.15.1.5 Court's direction as to the incidental matter 91
3.16 Obligation of the company 92
3.17 Instances where scheme can be sanctioned 92
3.18 Instances where scheme can not be sanctioned 92
3.19 The scheme for 'take-over' of shares 92
3.19.1 Principle of one-tenth of shares already held by the transferee company 94
3.19.2 Nine-tenth of the shares acquired by the transferee company 94
3.19.3 Completion of the transfers 95
3.20 Rehabilitation of the company facing temporary operational or financial problems 96
3.20.1 Who draw up the plan for the rehabilitation, reconstruction and reorganization of the company? 96
3.20.2 Who approve rehabilitation plan 97
3.20.3 Who supervise the implementation of the corporate rehabilitation plan? 98
3.20.4 Punishment for the failure to enforce the corporate rehabilitation plan 98
3.21 Rules relating to the rehabilitation of the companies owing sick industrial units, 1999 98
3.21.1 What is meant by the task force? 98
3.21.2 The procedure for declaring a company sick 99
3.21.3 Who will prepare a plan for the rehabilitation of the sick company? 99
3.21.4 Who will bear the expenses of the task force? 100
Chapter 4Comparison of the fundamental features of the corporate rescue law of English, American and Pakistani law and recommendations for the improvement of the Pakistani corporate rescue law 101
4.1 Introduction 101
4.2 Automatic stay or moratorium 102
4.3 New finance 103
4.4 Concept of the adequate protection 108
4.5 Debtor in possession 113
4.6 Entry routes into the process of corporate rescue law 115
4.6.1 Entry routes under American corporate rescue law 116
4.6.2 Entry routes into the UK corporate rescue law 116
4.6.2.1 Out of court appointment of the administrator 117
4.6.2.2 Court appointment of the administrator 117
4.6.3 Entry routes under the Pakistani corporate rescue law 118
4.7 Cram down 119
4.8 Exit routes 121
4.9 Informal workouts or private workouts 122
Bibliography 124
Journal articles 125
Reports, documents and conference papers 126

Abstract

Corporate rescue law which is a modern concept has been adopted by many countries. It offers an alternative to liquidation proceedings and revives the companies which are financially distress and have the capacity of revival, instead of putting them in the process of liquidation immediately .Therefore it saves the companies from dying .A successful rescue attempt brings many social and economic benefits. Therefore due to the great importance of the corporate rescue law, this thesis aims to improve the Pakistani corporate rescue law by doing a comparison between English, United States, and Pakistan .The research started with introduction of the corporate rescue law, and by identifying the factors which are the essence of the corporate rescue law and also by describing the historical background of the corporate rescue law. Subsequently, this thesis describes the salient features of the England and United States laws on corporate rescue. Lastly, this thesis explains the Pakistani corporate rescue law. It describes the inadequacies and weaknesses in the Pakistani corporate rescue law and also suggests some recommendations for the improvement of the corporate rescue law in he light of developed corporate rescue law of the England and the United States.

Dedication

This research work is dedicated to my honorable teacher **Dr. Azhar Javed** (late).

Acknowledgement

"I humbly thank to Allah Almighty, the merciful and the beneficent, who gave me health, thoughts and cooperative people to enable me to achieve this task".

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List of abbreviations

AOA	Article Of Association
BC	Bankruptcy Code
CVA	Company Voluntary Arrangement
CO	Companies Ordinance
DIP	Debtor in Possession
EA	Enterprise Act
FG	Federal Government
IA	Insolvency Act
IP	Insolvency Practitioner
MOA	Memorandum Of Association
SIU	Sick Industrial Units
TF	Task Force
UK	United Kingdom
US	United States

Chapter 1 Introduction

1.1 What is meant by corporate rescue?

"The term corporate rescue is used broadly to denote statutory corporate insolvency procedure that offers an alternative to the corporate liquidation procedure". This procedure has been established in order to attain financial results that are possibly better than those that might be realized under liquidation by safeguarding and potentially improving the company business assets through rationalization. This procedure may have many diverse possible results which may not result in the recoup of company, as opposed to the liquidation procedure. Indeed it will be very remarkable for a company to be effectively reinstated to its previous fitness state, performing the same activities, with the same management[1].

1.2 The benefits of corporate rescue

Rescue practice goes further than the customary managerial reactions to corporate difficulties. It offers a suitable mechanism which may function all the way through unofficial mechanism as well as through official legal routes. Therefore, in order to prevent ultimate collapse of the company surrounded by difficulties, corporate rescue procedure plays an important role.

Fundamental to the concept of the rescue mechanism is, the thought that radical curative measures are employed at the time of corporate catastrophe. . The full achievement might be supposed to entail re-establishment of the company to its previous vigorous state but in practice this state of affairs is not likely to be achieved[2]. The radical measures that a rescue mechanism essentially entails will almost unavoidably require alteration in the organization, funding, employment of the company and there may the victorious and unsuccessful in this process. As Belchers observes: "All rescue can be seen as in some sense partial".[3]

Corporate rescue promotes social and economic progress in the following ways;

[1] Katarzyna Gromek Broc and Rebecca Parry, *Corporate Rescue: An Overview Of Recent Development From Selected Countries.2nd edi (Hague:* kluwer law international,2006)
[2] Vanessa Finch, *Corporate Insolvency Law And Perspective* (Newyork:Camridge University Press,2002),187
[3] Ibid.

- By safeguarding the value of corporate possessions of a financially suffering company
- By safeguarding the employments of employees
- By allotting the possessions of a financially suffering but still economically feasible company in more well-organized way.[4]

Corporate rescue method involves some price. Therefore in order to use this price in an efficient way for the function of re-establishing company which can be re-established effectively, certain, assured measures during the process of the corporate rescue procedure make it possible that the company which are economically suffering and inappropriate for the purpose of corporate rescue mechanism immediately be put in the process of liquidation.

Therefore, fundamental intention of the corporate rescue would appear to be to offer a appropriate mechanism for the continued existence of the feasible companies or productions. But to make sure also that the companies which are inappropriate candidates for rescue can simply be cleared up in order that expenses are not misused.

In order to function productively, it is very essential for a system to get a equilibrium between the interests of the struggling groups. As, on the one hand the member, directors and workers of the company may desire for the business to keep on trading, and on the other hand creditors may wish that the business be murdered sooner rather than later in order that their costs can be minimized. A system that equipped a lot to meet the requirements of first group may carry the social benefits, especially through the persistent employment of the workforce. However such system may make possible for a rescue procedure, to be employed in situations, where there are no realistic hopes of the victory and fatalities to the creditors may enlarge in the outcomes.
On the other hand a system that gives special treatment to the concern of the creditors may offer insufficient support to struggling but feasible companies. Therefore such a system may produce unjustifiable social costs.[5]

[4] Ibid., 188.
[5] Ibid.

As for the finale produce of the rescue mechanism are concerned, these may be different:

- the company may be re-established to its former state
- it may be reorganized
- it may be restructured
- it may be refunded
- it may be slim downed
- it may be passed through the procedure of set-off; and
- it may be passed through the procedure of take-over[6]

1.3 Why rescue

The creditors "wealth maximization vision" see liquidation a mechanism of collecting debts. They also look at the liquidation procedure to be a resolution for their troubles in variance with the scheme of continued operation of firm,(and defending interests further than those of creditors) is an autonomous objective of the insolvency law.

It may be the case in some situations, that maximizing possible return to the creditors will require some kind of the rescue action but this will not for all time be the case and a unsuccessful rescue may reduce creditors return significantly.[7]
However the creditors' "wealth maximization vision" was extremely constricted. In looking at the insolvency process, attention should be paid to the other concerns ahead of the creditors. Therefore, while organizing the insolvency mechanism attention should be given the societal and distributional purposes; to communal as well as personal interests; and to the worth such as capability, justice and answerability.[8]

At this stage, it is worth talk about here, that a system which looks further than creditors "wealth maximization vision" in short "social" as opposed to an "economic system". Such a system lays down the basis of a corporate rescue process and gives good reasons for rescue action with

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[6] Ibid., 188.
[7] Vanessa Finch, *Corporate Insolvency Law And Perspective* (Newyork: Camridge University Press,2002),189-90.

[8] Ibid.

reference to a number of the purposes and principles. Therefore, a competent and successful corporate rescue mechanism accomplishes a number of results.

These results may include the following:

- The protection of a business that in longer term is worth saving or is more valuable as a "going concern" than if sold in piecemeal.
- The protection of the employment of the workforce.
- The prevention of harm to the provider, purchaser and state duty collector.

The prevention of harm to the general financial system or to business confidence in a segment.[9]

1.4 Weather to rescue the business or the company is important

The two terms 'to rescue the business' and 'to rescue the company' are totally different. There is a lot of discussion whether the business of the company or the company should be rescued.[10]

A company is a "artificial person" which own a business that is composed by its human resources and useful assets. All the economic activities is performed by the business and not by the company, the company cannot produce any financial activity without any well equipped, useful, and proficient business. Therefore, company is merely a covering without a business.[11]

The business of the company can be put up for sale to another company, when the company is in going concern position. Therefore, even if the company is wound up, its business could continue work with similar labor power under a changed ownership. This is so called "corporate recycling".[12]

In the words of N Davis

"In my opinion the true meaning of a company rescue is the saving of an entity in whole or in part by satisfying in some measure its unsecured creditors and enabling the company to continue in business. This will also in some measure preserve employment."

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[9] Ibid.

[10] Ibid.

[11] Haizheng Zhang, "*Making An Efficient And Well Functioning Corporate Rescue System In Chinese Bankruptcy Laws: From The Perspective Of A Comparative Study Between England And China*" (2008) p 36.

[12] S Frisby, "*In Search Of Rescue Regime: the Enterprise Act 2002*" (2004)67 M.L.R 247, 248.

If we look at the corporate rescue law from the British perspective, we find the fractional or complete selling of the business as "going concern" is common. Therefore, in order to remove the vagueness and misunderstanding[13], it is extremely essential to make a distinction among the rescuing the company and its business.[14]

Some analyst is of the view that "corporate rescue" literally mean or containing the inference of reorganization of the company and its business to its former good physical shape or state and it is called "pure rescue".

This type of move will help a lot in fortification of the feelings of employees who will not be pressured by fear of the "acquisition" and "merger" which is generally take place upon a alteration of the ownership. Because it could make possible for the entire or considerable portion of the business of the company to continue to generate its value by the unchanged employees with their known functioning unit or manufacturing line under the same ownership.

Therefore, it could also persuade the workers to combine together and to support the company surrounded by financial difficulties in order to overcome its financial difficulties, which is a very significant element for a victorious corporate rescue attempt and this important element, should not be ignored.

Beside this, the corporate rescue laws should take notice of the forever overlooked class, i.e. shareholder of the company. They also give directors motivation to make a start at an initial phase when the company surrounded by the financial troubles.[15]

It is worth mentioning here that corporate rescue laws of many countries do not require the proof of the real insolvency before rescue system can be brought into play, for example, Chinese

[13] R Mokal, "*Administrative Receivership and Administration*—An Analysis" (2004) 57 Current Legal Problems 355,357- 359.

[14] R Mokal, "*Administrative Receivership and Administration*—An Analysis" (2004) 57 Current Legal Problems 355,357- 359.

[15] Ibid 362-363

corporate rescue laws do not necessitate the evidence of the real insolvency before the rescue regime can be prayed to .

In the same way, presently there is no such stipulation in "Company Voluntary Arrangement, out of court appointment of administrator by a qualifying floating charge holder and in the schemes of arrangement under part 26 of the Companies Act 2006".[16]

It means that rescue laws unlock the gate to; in which shareholder have real interest that can be understood by the rescue process.

In large number of the situations the shareholders are also occupy the position of directors of the company particularly in the private company. Therefore, in majority of the situations they overtake the unsafe projects to restore the business of the company to former healthy state when the company is surrounded by the financial difficulties. Therefore, by adopting the extra uncertain projects the company may invite the risk of additional failure to the creditors and also misuse the limited liability notion. According to this notion the legal responsibility of the shareholder is restricted to the extent they have to make a payment, in case of the loss to the company. Therefore, in this way corporate rescue laws provide a ground to the shareholder for their own benefit, seek assistance at an early stage and consider the reorganization of the company.

The managers and the directors of the company are able to maintain their control over the company when a corporate rescue attempt is successful. In this way, they take the advantage of a victorious rescue attempt.

Therefore, it has been suggested that idea of liberating the financially distress company from financial difficulties could encourage the directors and managers of the company to start corporate rescue procedure in appropriate manner so that company can be successfully rescued. Because they are the most appropriate person, who can judge the financial difficulties of the company.

[16] IA 1986, Sch B1, Para 14.

As compared to this, if we consider the rescuing of the business of company, it can not save their directorship and manager ship, because when we rescue the business of the company then company remain no more and business goes in new hands. Therefore under new ownership they can not save their manager ship and directorship.[17]

In UK,although the primary objective of the new administrative regime is to rescue the company, but in reality to rescue the company is rare.[18]

1.5 What amounts to a successful rescue attempt?

There are different views about a successful rescue attempt because when we look at the definition of the corporate rescue law a question comes to our minds that what constitute a successful corporate rescue attempt, i.e., what amounts to a successful rescue attempt, this question involves the extent of successful corporate rescue that can reasonably be achieved.
in accordance with the definition of the corporate rescue, a complete successful corporate rescue involves or contains the following things

- That the company can be re-established to its previous healthy state successfully.
- All the business operations are run by the same management.
- All the employees occupy their jobs.
- The entire the possessions of the company are under the power of the unchanged management.

However in reality, a different thing happens, radical remedial actions is taken at the moment of the fiscal crisis. The radical remedial proceedings that is taken at the moment of the financial crisis of the company entail changes in respect of the following things; that are:

- Management
- Financing
- Operational scenario
- Workforce and disposal of assets

[17] R Mokal, above no 13.
[18] IA 1986, SchB1, Para 3.

For example, the fresh equity financiers may change the ownership arrangement, when they advance funds on the occasion of the fiscal crisis of the company. When they change ownership, most of the directors may lose their directorship and management team may be changed and the interest of the prior shareholder may be terminated. In the process of rationalizing most of the employees may lose their jobs.

If we look at the rescue process, from the viewpoint of some specific position we find that some parties are victor and some parties are being defeated in this process. Any rescue mechanism entails benefits for some parties and also incur loss to some interested parties.
Therefore, it has been argued that
"All the rescue can be seen as, in some sense, partial."[19]

1.6 Importance of time in the success and failure of rescue attempt

As the time scale is used to judge the achievement or collapse of the rescue attempt is very crucial. In case of the company surrounded by the financial difficulties, following a rescue effort, again surrounded by the financial difficulties in short period of time can not be regarded as successful rescue attempt.[20]

Prof-Zimmerman stressed that

"The endurance of the recovery should also be considered in determining whether success or failure has been achieved."[21]
Therefore a successful rescue attempt can be judged by two things that are:

- Stability
- Sustainability

Stability shows the continue existence of the company and its business in a reasonable manner.

[19] V Finch, above no 7, 188.
[20] Ibid.
[21] FM Zimmerman, *The Turnaround Experience: Real- world Lessons in Revitalizing Corporations.* (McGraw Hill Inc, 1991), 48.

Sustainability shows rescue attempt should generate the constant and prolong result, and the economic process will last for a long period.

Short period of the continued existence of the company in some cases may be beneficial to some parties. Therefore it can not be regarded as, failure of rescue attempt. This short period of the continued existence may give financial benefits. For example, when a company surrounded by the fiscal troubles, revived by rescue attempt, then it traded for small duration before it is finally liquidated. This short period of the constant trade may generate a enhanced return for the creditors than if the company is immediately liquidated. Therefore, it can not be regarded as failure of the rescue attempt.

1.7 Comprehension of two very important concepts that are essence of the corporate rescue laws

1.7.1 Property rights

In capitalist economies the property rights are very important. In fact, the capitalist economies are established on the edifice of property rights. By property rights we mean that when a person uses or put in force his property rights resting on a specific property, then any other body or person will be excluded for putting any hindrance in the way of exercising his property rights[22]. It means when a person enjoys the property rights over a particular property, then he is capable of enjoying the absolute possession, use, and disposal of the property as he likes. Therefore the property right holder can use his property in the manner as he likes, provided that he remains within the limitation of law and does not violate any law.

The society, in which the capitalist system of the economy is prevalent, strongly encourages the private property structure and as well the liberty of the contract which is the base of the marketplace financial system.

The concept of the legal personality is also established by private property rights. Because of the concept of the legal personality, the company is treated as an artificial person, and enjoys the

[22] BG Carruthers and TC Halliday, *Rescuing Business: The Making Of Corporate Bankruptcy Law In England and The United States*. (Oxford: Clarendon Press , 1998), 16.

profit and bears the risk of loss, and shareholders are capable to enjoy the concept of limited liability. Due to this concept they are able to refuse to accept the creditors asserts and make a payment to the company assets to the liability thy have undertaken.[23]

The private property rights also establishes the foundations of the corporate insolvency laws and in the liquidation proceedings of a company, the insolvency proceedings are strictly restricted to property pools of the debtor's company.

1.7.1.2 Importance of the property rights in the bankruptcy proceedings

As it has been argued above that when a person acquires property rights over a specific property then he gets an absolute right of the possession, control and use of the property. He can deal with his property as he likes as long as he does not act against any law. But, it does not imply that such a property rights will not be taken away from the person in any case, particularly in case of the insolvency.[24] Therefore, when the company put into the liquidation procedures, then problem arises in case of the liquidation process only when the residual possessions of the company are not adequate to satisfy the asserts of the large number of the applicants. Then the applicants of the debtors company who hold secured or superior property rights can satisfy their claims easily at the costs of others.[25]

Therefore, the basic purpose of the bankruptcy laws can be described as;

- First, to treat every party fairly and equitably.
- Second, to make powerful the different classes of the creditors, according to their property rights.

1.7.2 Corporate failure

As the corporate failure is harmful not merely for the companies but also for the society and state. Therefore, it is very necessary to make laws for the distress but still feasible companies, as not all the companies that are surrounded by difficulties are the subject of corporate rescue laws.[26]

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[23] PL Davies, *Gower and Davies, The Principles Of Modern Company Law*. 7 Th edi (London: Sweet &Maxwell, 2003), 33.

[24] Carruthers and Halliday, above n. 22, 16 17.
[25] Ibid.,17.
[26] see Finch, above n.7, 123 144.

Although, corporate rescue laws are basically designed to re-establish the ailing companies, but it does not mean that all the companies that are miserable can be successfully reformed or in other words suitable for the rescue laws.

Therefore, when a company is not capable to repay its debts, whether it be rescued or put in the process of the liquidation? To answer this question it is very necessary to understand two very important concepts which will help a lot in answering to this question. These two important concepts are "economic distress" and "financial distress".

1.7.2.1 Economic distress

The economic distress of the company can be defined as; a company is said to be in "economic distress" "if the net worth of the troubled company's business as going concern is less than the value of the assets broken up and sold separately".

It means that the company can not be restructured. When a company can not be rehabilitated, then solution for it to go for the liquidation process. Liquidation proceedings are designed for the liquidation of completely unsuccessful company so that to seize the residual possessions of the company and to distribute among the different classes of the creditors. The assets of an insolvent or ruined company may be used by the market for more productive purposes,[27] or the resources of the insolvent company will be used in an efficient company and where more workers will find job.

1.7.2.2 Financial distress

A company is said to be in "financial distress" when it is not capable to repay its debts when they become payable, or the company is said to be surrounded by the financial distress when there is some sort of the liquidity problems with company. A company surrounded by the financial distress usually face the problem of the cash flow. When a company is not capable to repay its debts when they turn into payable, it is called "cash flow test" of the insolvency[28], the cash flow test of the insolvency indicates to us three feature of the company in financial distress and these three aspects of the company which cash flow test of the insolvency indicates are as follow:

[27] Finch, above n.7, 189.
[28] IA 1986, s 123(1).

- First, incapability of the company to repay its debts when they turn into payable. Here the test only takes into account the debts that are due debts
- Second, lack of the liquid possessions of the company does not necessarily implies the inability of the company to repay, here the test takes into account the liquid assets of the company
- Third, default in repayment of the debts when they develop into payable does not show the incapability of the company to repay its debts

If we look at the cash flow insolvency test closely, we can easily conclude that this test does not show the irrevocable failure of the financially distress company. Therefore, a company which is facing temporary cash flow problems is still economically feasible company and can be successfully restored to its former healthy state. Hence, a company which is financially distress is the subject of corporate rescue laws and not the company which is economically distress.

1.8 Important elements of the corporate rescue process

a. New financing
b. Moratorium or automatic stay

a. New financing

New financing is very important element of the corporate rescue process. We can not achieve the success of the rescue attempt without the new financing, especially in the situation when the company facing financial difficulties due to temporary cash flow problems. It is very necessary for the company who is facing financial difficulties to get new financing at an early stage, particularly before the initiation of the proper "corporate rescue procedure".[29]

The company needs this new financing for the following things;

- For the continuous trading
- For the authorization of the restructuring plan

From the income of continuous trading the company needs to do the following things:

- To repay the debts of the existing creditors;

[29] United Nations Commission on International Trade Law (UNCITRAL), Legislative Guide, 114.

- To obtain the resources of goods and services; and
- To spend on other necessary expenses in order to enable the debtor and its business activity to continue its business.

As in most of the cases when the company is in insolvency, there will be no extra or sufficient assets available that can be used as guarantee for obtaining new funds. Then in such a circumstances it is very difficult for the corporate debtor who is facing financial difficulties to obtain new finance for the reorganization of the corporate debtor. Hence, it is very necessary for the corporate rescue laws to supply debtor with some choices, so that he can obtain new financing easily, because the new lenders and other financial institution, i.e., banks are not willing to advance new loans in under secured and unsecured situation because in such situation the full repayment of the loan will depend upon the successful turnaround of the borrower.[30]

After the initiation of the corporate rescue procedure, the new finance is considered as very essential for the success of a rescue attempt and the corporate rescue laws provide the corporate debtor with two option for obtaining new finance for the "reorganization of the company". The two options which the corporate rescue laws provide to the corporate debtor are the following:

i. Super priority option; and
ii. Security option, i.e., the security given on the encumbered or unencumbered assets that are surplus to the pre-commencement secured assets.

i. Super priority option

Super priority option applies in case of the company or the corporate debtor who is facing financial difficulties, if it has no surplus or surfeit assets available that can be employed as security for obtaining the new financing. In such a situation super priority option can be used. Therefore, for the objective of getting new finance from the lenders, for the success of corporate rescue procedure, the option of the super priority rule is created.

[30] "*A Review of Company Rescue and Business Reconstruction Mechanisms*", *The Insolvency Service* (London: HMSO, 1999), paras.6 (t)-6(v).

According to the super priority rule the lender will occupy a status in priority to the existing creditors, i.e., the new lenders will satisfy their claims in priority to the existing creditors. In other words the super priority means that new lender will be graded at the top of the distribution order. Therefore, priority becomes an effective option in the circumstances when the debtor has no property or assets available in order to give as security for new borrowing. In such a situation the lender will be conferred super priority status.[31]

The new lenders face a greater risk as compared to any other creditors. As their repayment mostly depends upon the successful turnaround of the company. Therefore, they should be worthy of distribution, prior to any existing creditors.[32]

It is proposed that the super priority rule has the outcome of reshaping the structure of the distribution order which should be in accordance with objectives or policy aims of the corporate rescue laws so that every party should be treated fairly and equitably, and the rights of every party should be protected.

It is a note able thing that UK government discarded the super priority rule and when it was put forward before the House of the Lords for discussion.

Similarly in the US unless the debtor and new lender show that the concerns of the exiting creditors are sufficiently safeguarded, the fresh lender could not obtain priority to the existing security interest[33].

Chinese corporate rescue law is also silent about the super priority rule.

ii. Security option

[31] G McCormack, "Corporate Rescue Law-An Anglo- American Perspective" (Edward Elgar: Cheltenham, 2008) p188.See also S364 (d) of the US Bankruptcy Code; Mc McCormack, "Super-Priority New Financing and Corporate Rescue Culture" [2007] J.B .L 702,707.

[32] V Finch, "*Re-Invigorating The Corporate Rescue Culture*" (2003) J.B.L 527, 538.

[33] S 364 (d) of the US BC.

In addition to the super priority rule the company, i.e., corporate debtor is also provided with security option. According to this option, the corporate debtor which is facing financial difficulties, can get new finance, when he makes available the encumbered or unfettered assets which still have adequate value, i.e. surplus of the value of the pre- start protected debt.

In the security option, the rights of all the parties are protected. Every party treated fairly and equitable, which is purely in accordance with policy aims of the corporate debtor.

In the security option, the assets or the property which is used as security for obtaining new finance in the post-commencement of the corporate rescue procedure should have value in excess of pre-commencement secured obligation. Therefore, the idea of the security option is helpful or advantageous in the following ways:

- First, all the pre-existing creditors are fully protected. Therefore, they don't need to worry about their collateral unless the economic value of the property begin to decrease;[34]
- Second, the new lender feels encouraged to advance new funds; and
- Third, the corporate debtor who is facing financial difficulties can also get easily the new finance for the corporate rescue procedure.

In this way, we can say that the security option offer a better alternative to super-priority rule only in the circumstances when extra assets are available or adequate value left in the property which can be used as security. Therefore, security option is the most appropriate option as compared to the super-priority rule, for getting new finance.

After the commencement of the corporate reorganization procedure, providing security to the new lender of unencumbered assets may not have detrimental consequences on the "pre-existing" secured creditors. It may have detrimental effects on the "pre-existing" unsecured creditors, because less unencumbered assets are available for the distribution to the unsecured creditors when more unencumbered assets are used to secure the new lenders, especially when the rescue attempt fails.[35]

[34] UNCITRAL, above n. 29, 116.
[35] Ibid., 115.

It should be note able point here that, in most of the cases when a company is surrounded by financial difficulties, normally there will be no unencumbered or surplus assets available for more borrowing.

It is also very essential point to note down that, whether or not the insolvency practitioner (who is in charge of the rescue attempt) is empowered power to dispose of the encumbered assets for the purpose of keeping in operation the business activity of the company.

In the UK, regardless of the opposition of the floating charge holder, the assets which are covered by the floating charge holder can be employed by the administrator to borrow the extra money.[36] As compared to this, the assets can not be disposed of without the approval of the court, if they are under fixed charge.[37]
Therefore, due to this fact it can be believed that the holder of the fixed charge enjoys a greater level of the confidence and security as compared to the possessor of the floating charge holder. As the holder of the fixed charge enjoys a greater control on the security assets.[38] It has an adverse effect on the corporate debtor, i.e., the company facing financial difficulties and which is in the need of new financing for the success of the rescue attempt. The less financing will be available to the company surrounded by the financial difficulties, whose large proportion of the possessions are under the fixed charge. In such a circumstances when large number of the possessions of the company are occupied by the fixed charge, then lenders are hesitant to advance loan or new finance, against the encumbered assets that are subject to fixed charge.[39]

Furthermore, it is also a very note able point from the view point of new financing, firms and companies should have a very good and cordial relationship with banks, which have a large involvement in the revival of the firms and companies entangled in the financial difficulties.

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[36] IA, 1986, SChB1, Para.70 (1).
[37] IA, 1986, SchB1, Para.71 (1).
[38] R Parry, "*Floating Charge Over Book Debts*" (2005) 16KCLJ 347.
[39] Ibid., 348.

The British bankers association published a paper in 1997. In which they highlighted the need of a very good relationship between the bankers and their clients. In this paper they laid a greater stress on the bankers, to advance loan to their financially distress client. In this way they can help them from coming out of the financial difficulties, and also contributing a lot in creating an ideal corporate rescue culture.[40]

b. Automatic stay or moratorium.

The term moratorium is the second essential ingredient of the corporate rescue activity. The success of the rescue attempt is very difficult without the moratorium. It provides the debtor surrounded by the financial difficulties, a comfortable period, or breathing space. It acts as a shield for the debtor in opposition to the enforcement measures of the creditors and protects the debtor from all the enforcement action of the creditors.

The term "moratorium" can be defined as: an automatic stay or bar on the enforcement action of all the creditors against a company and its assets. In general it can be described as, a bar on the execution of all the legal proceeding, and ongoing civil litigation against the company.

Usually the moratorium, have a freezing effect on all the actions of all the parties who have property rights adjacent to the property which is under the legal possession of the debtor.[41] The debtor holds that property due to some contract, it may be:

- Commercial contract; and
- Lease contract.

i. Aims of the moratorium

The very important and basic aim of the moratorium is to grant access to debtor with a period in which all the actions of the parties who hold a property rights against the property which is under

[40] The British Bankers Association (BBA), "*Banks and Businesses: Working Together When You Borrow*", March 1997; "*A Statement of Principles—Banks and Businesses Working Together to Manage Borrowing*", July 2005.

[41] G McCormack, *Corporate Rescue Law-An Anglo- American Perspective* (Edward Elgar: Cheltenham, 2008), p157. See also V Finch, above .n 7,196.

the legal possession of the debtor for the continuous trading shall be barred. A moratorium could enable the company or corporate debtor facing financial difficulties to do the following things:

- To feel at ease against the action of creditors;
- To discuss with all the creditors for debt restructuring;
- To negotiate with lenders in order to get new finance;
- To prevents its assets from the enforcement action of the creditors; and
- To recover from temporary cash flow problem.[42]

Two things are very significant for the success of the corporate rescue attempt:

- property of the company which are protected by the moratorium from the enforcement action of the creditors during the period of the corporate reorganization; and
- Second thing is new financing which is very essential, in post commencement of the corporate rescue procedure for the success of the corporate reorganization.

It is also observed that moratorium helps a lot of a corporate debtor who is facing financial difficulties. In this way moratorium helps in creating a mechanism, which is debtor oriented.

Moratorium also has a great effect on the unsecured creditors; this effect can be divided into two kinds, beneficial and harmful effect.

The beneficial effect can be described as the unsecured creditors who have a very low rate of the repayment and also have a very frail bargaining power during the bankruptcy proceedings because the moratorium prevents the authoritative creditors from cutting the property of the company into the pieces.

The harmful effect of the moratorium on the unsecured creditors can be described as, that it also prevents the unsecured creditors from putting into effect their asserts because they are unable to put into effect their asserts for a specified period.[43]

[42] UNCITRAL, above.n, 29, p 27. See also G Mc McCormack, "*Corporate Rescue Law In Singapore*" (2008) 20 SACLJ.
[43] See Haizheng Zhang above n 11, 41.

If we look at the moratorium in the perspective of the unsecured creditors we come to the conclusion that moratorium may not so much injurious to the interest of the unsecured creditors. Therefore they do not need to worry about their interest so much because as they occupy a position in last to the allocation order in which they may get little or nothing. The entire or considerable part of the company may be subject to the security. Therefore imposition of the moratorium may not be harmful to the interest of the unsecured creditors to some degree.

If we consider the moratorium from the side of other creditors, it certainly increases the risk of loss for other creditors, especially for secure creditors. A moratorium may increase its harmful effects for the creditors if it last for a long time. Therefore, legislative proposal of enforcing the moratorium needs to persuade the creditors for two points:

- Firstly, the corporate rescue oriented value is the main concern which could benefit the entire stake holder as well as general public; and
- Secondly, there is a reasonable chance that creditors would get more than or no less than as much after the moratorium as they would be able to get in the "liquidation".

The basic philosophy or the main idea behind the concept of the moratorium is to postpone the instant payment of the creditors. In order to obtain the long term goal of corporate turn around which may result in a better returned for the creditors.[44]

For the purpose of getting a better result for the all stakeholder the interest of the few parties, particularly the interest of the secured creditors may need to suffer. Actually they possess a strong power to enforce their claims, are barred from enforcing their claims for a specified period due to the moratorium, in order to attain an enhanced outcome for all the stakeholders than that they might not be competent to achieve in an immediate liquidation.[45]

Therefore, legislatively due care should be given while formulating moratorium. Especially length and process of entrance ought to be considered, in order to avoid the abuses of the moratorium and to make it beneficial to all interested party.

[44] Ibid.
[45] Ibid.

1.9 Historical development of the rescue oriented system

The creation of the corporate rescue system is very much connected to the highly success market economy of the western world. It is a well known principle, that market oriented system impose a sever competition among the competitors. Such competition would result in the success of the some of the competitor and would escort to the failure of the some of the competitor.[46]

As compared to this the insolvent liquidation would result in harmful effects economically and socially. For example, following are the negative effects of the insolvent liquidation:

- Firstly, one fruitless project could result in financial difficulties of closely related small activities, especially small business such as provider and consumers; and
- Secondly, social problems may be ensued as a result of the insolvent liquidation, because by reason of the insolvent liquidation of the company a large quantity of the workers of the company are out of work, when large number of the workers are out of the work then they pose serious social issue, through protests and crimes, and therefore they create in the country a situation of the social chaos and political instability and increase the burden of social security.[47]
- When a financial crisis started, then it would leads to very harmful effects for a country, because when a financial crisis started it disturb the natural function of the regulation, and the adjustment of the market by the unseen hand will be break down, then in such a situation a large number of the enterprises falling into financial crisis at the same moment, then it becomes very difficult for the state to adjust and redeploy them, and this entire situation bring about unexpected loss to the state and which the state can not afford.

Clearly the establish corporate insolvency laws unsuccessful to solve the problems of the corporate entity for a long time. They are only performing the function of insolvent liquidation till mid-19th century[48].

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[46] Ibid., 45.
[47] Ibid.
[48] Ibid, 46.

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However in 1870 in UK, and in the same century, in 1883, the Belgian legislation, introduced a new non-liquidation concept. According to this concept, the debtor company which is surrounded by the financial difficulties is permitted to negotiate with its creditors the terms of the agreement, under the composition proceeding. The role of the judiciary with respect to composition proceeding is minimum which is completely in accordance with contractual liberty and autonomy of the creditors.

This "Anglo-Belgian" model contributed a lot to the insolvency law reforms of the UK and Belgian, and it vanished the monopoly of the liquidation proceeding in the bankruptcy law.[49]

Since the "Anglo Belgian" model, the focus of the corporate insolvency law has been continuously changing from the traditional liquidation proceeding to the corporate rescue law. The composition regime which was the first rescue oriented step introduced by the "Anglo Belgian" model. This model encouraged the formulation of a debtor self-restructuring substitute for the financially distress company to settle their financial crisis outside the traditional liquidation proceeding and bring a better result for their creditors.

The regime introduced by the "Anglo-Belgian" was still used by many of the countries as one of their insolvency law procedure at present.[50] As the "scheme of the arrangement", under part 26 of the British "companies Act 2006". The "Anglo-Belgian" model proved very fruitful and it established a good example for many system of the world, especially Anglo-Saxon, and continental system.[51]

1.10 Evolution and development of the modern rescue culture

Anglo-Belgian model of composition proceeding had a huge effect on the development of the modern corporate rescue laws if we look at the historical development of the modern corporate rescue culture.

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[49] Ibid.
[50] Ibid., 46.

[51] Ibid.

However, rescue alike mechanism of the composition system was very weak. Therefore, they could not play an efficient and significant role in rescuing the company surrounded by financially difficulties to the level that modern system of the corporate rescue laws are doing. As the rescue like mechanism of the composition regime was very weak and fragile. Therefore, they were not used for rescuing the companies or their business. Instead they were used by the debtors and creditors as mean for reaching the compromise or arrangement for debt repayment.[52]

As the composition regime could not play a significant and effective role in rescuing the company facing financial difficulties. Therefore, traditional composition proceedings could not represent the real meaning of the corporate rescue culture. Although the traditional composition regime could not create a rescue culture in real meaning but they play an important function in the history of corporate rescue culture. They laid down the foundations of the modern corporate rescue culture and changed the form of bankruptcy law. They converted the bankruptcy law from single old function of traditional winding up proceeding into two ways bankruptcy legal system. These two forms of the bankruptcy legal system are winding up and corporate rescue proceeding. In this way the traditional composition proceedings play a significant role in the transition from the traditional bankruptcy law to the era of modern bankruptcy legal framework.[53]

The first recent corporate rescue civilization was recognized by the United States in 1978. If we look at the history of the US, we could easily found that US experienced a huge financial loss during the period of its most influential financial crisis, which started in October 1929and spread over the whole commercial world. The immense businesses failure and decline of the corporate sector demonstrated that there were lot of shortcomings in the existing corporate rescue system and called for instant reforms to its existing insolvency laws.

The famous "section 77B" of the United States Bankruptcy Act was established in this perspective. Although, in short period of time it was substituted by chapter X and XI of the Chandler Act in 1938. It had made great contribution for the cause of the chapter 11. Due to

[52] Ibid., 47.
[53] Ibid.

inadequacies in 1938 Act, there was a great need for the reforms in the bankruptcy laws especially in the corporate rescue laws in the 1970s.[54]

In this perspective, chapter11 of the "corporate reorganization" was created and enforced. It was proved very successful in rescuing the company facing financial difficulties. The model of the corporate rescue laws that was set up by the chapter 11, established a very good example for other countries especially the western European States. Such as for the UK, Germany, France, at the early stage of their national bankruptcy law reforms which commenced law reforms in reaction to the oil crisis in 1970s. Since then the wave of the corporate rescue laws restructuring pervaded in wide range of the countries whether developing or developed. The level of the corporate rescue law reforms reached to the highest level definitely.[55]

When the Asian crisis broke out in the 1970, the modern corporate rescue culture finally established and recognized world wide.

The US, corporate reorganization law has four main features:

- **First, automatic stay**

Due to the "automatic stay" the creditors are barred from enforcing their action against the debtor, i.e., the company facing financial difficulties and its property and debtor feels comfortable in this protected period, and this protected period allow the debtor to negotiate with creditors for rescheduling its debts and obtain new finance for the corporate reorganization procedure which formulates and produces a reorganization plan.

- **Second, "requirement of the insolvency"**

The second main feature of the corporate reorganization procedure of the US, is that there is no pre-requisite that the debtor is bankrupt or likely to become bankrupt in the near future before the initiation of the corporate organization procedure. This feature of the corporate reorganization play a significant role in the corporate reorganization procedure and make it possible for the company facing financial difficulties a rapid and simple right to use to the corporate

[54] Ibid.
[55] Ibid., 48.

reorganization procedure and which could cure the financially distress company at an initial phase and avoid the further decline of the financial status of the company.

- **Third, "debtor in possession" (DIP)**

This feature of the corporate reorganization law of the 'US' could enable the directors of the debtor company to occupy their position and remain in the control of the management, therefore due to this feature they do not have the fear of losing their directorship and they can commence the corporate reorganization procedure in timely manner, because they are the most appropriate person to sense the danger of the financial difficulties of the company.[56]

- **Fourth, "classification of the creditors"**

The fourth feature of the corporate reorganization procedure of the 'US' is that it classified the creditors with respect to debtor into different voting groups according to the nature and interest of their claims and the success of the corporate reorganization plan needs the sanction of every voting class which can be carried out by the majority in figure and two third in value of their claims.

1.10.1 Role of the court

With regard to the approval of the corporate reorganization plan, Judges exercise the following powers:

- First, they have the power of 'cram down' i.e., to have the power to freeze the dissenting creditors in a voting class for the approval of the corporate reorganization plan;
- Second, judges also make it sure that the interest of every party is protected and every party is treated fairly and equitably;
- Third, when the corporate reorganization plan is sanctioned by the creditors then it is confirmed by the court; and
- Fourth, judges play the role of supervisor in relation to corporate reorganization plan.

When a plan is confirmed by the court, then it has a binding effect on all the parties i.e., the creditors including dissenting creditors and also the debtor.

[56] Ibid.

In real sense, this chapter 11 of the corporate reorganization plan represents the modern rescue culture and it has a far reaching effect on the insolvency law reforms of the many developed countries, such as France, Germany and UK etc.[57]

Conclusion

The Anglo-Belgian composition proceeding laid down the foundations of the modern corporate rescue laws. When we look at the historical development of the corporate rescue laws from the international point of the view, which provided for the companies surrounded by the financial difficulties, a self debt restructuring procedure, in order to solve their financial difficulties, we found that It had eliminated the monopoly of the liquidation proceedings which was the only method at that time available to deal with the company surrounded by financial difficulties and changed the form of the bankruptcy law.

It had also provided a two way bankruptcy procedure. Since that time there was a continuous shift from the single type of the liquidation proceedings into two way bankruptcy procedure.

Chapter 11 of the corporate reorganization of the US was created in order to deal with company surrounded by financial difficulties. This chapter laid down the foundations of the modern corporate rescue laws in true sense. It has a far reaching influence on the insolvency law reforms of many other countries, which set up their corporate reorganization mechanisms by keeping in view the institutions and policy aims of the corporation reorganization system of the US.

As compared to Pakistan, United States and UK established a very effective legal framework of the corporate rescue. Although there is a large similarity among the corporate rescue laws of Pakistan and US, UK, but Pakistani corporate rescue laws are outdated and cannot fulfill the needs of the present time. Therefore Pakistani corporate rescue laws require to be reformed with the guidance of the developed corporate rescue legal framework of the US and UK.

[57] Ibid., 49.

Chapter 2 Salient Features of the English and American corporate rescue law

(Successive reforms in the UK law towards a modern rescue culture in the past three decades)

2.1 Corporate rescue laws in the UK prior to the reforms of the 1980s

2.1.1 Historical development

The main progress in the English insolvency laws occur under the proposals of cork committee. when the English insolvency act 1986 was passed under the suggestions of the Cork committee[58].The cork committee suggested two noteworthy system in the English insolvency law. These two noteworthy systems are;

- Company voluntary arrangement
- Administrative Order

Before the recommendation of the cork committee there was only two methods in the English insolvency law which represent the limited signs of corporate rescue law. These two methods are

a) "Scheme of arrangement"

b) Administrative receivership

The "scheme of arrangement" which was recognized in the late 19th century with the purpose to provide an opportunity to the company and its creditors for debt restructuring. Schemes of arrangement was the only procedure which grant a rescue leaning approach to a company surrounded by the financial difficulty which could make possible for the company to conclude an accord with creditors. It was a substitute to the liquidation laws.

As the corporate rescue laws did not exist at that time. The scheme of arrangement was condemned as more intricate, difficult and costly method.[59]

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[58] *Insolvency Law and Practice: Report of the Review Committee* (Cmnd 8558, 1982) (Here After "Cork Report"), para.1975.

[59] Cork Report, para.495.

The administrative receiverships also have some attributes of the rescue other than the schemes of arrangements in the English bankruptcy law, mainly in the circumstances when the claim of the floating charge holder was unsecured then receiver and manager would carry on trading and try their most excellent to re-establish the ailing enterprise to its previous healthy state instead of immediate sale so that the asserts of the unsecured creditors could be fulfilled[60]. it should be distinguished here that administrative receiverships symbolize a limited rescue mechanisms.

Subsequent to the "second world war" the societal and financial situation in the England passed through a extraordinary change . Which encouraged the transformations of the insolvency laws. The oil and fiscal difficulties in the 1970s forced the England regime to examine the existing insolvency law which was not enough, productive and suitable to the existing circumstances. if the modern corporate rescue laws were existing at that time, numerous companies would be re-established which were finished by the insolvent liquidation.

in the result of the oil catastrophe and corporate decline the London approach was introduced. The London approach is discovered as most important substitute of the extra judicial debt restructuring for the large scales companies in the field of informal rescue procedure. This method carried on under the consensual support of the banks and was firstly framed by the bank of England .it is still a very well working procedure which propose a very fine solution to the corporate troubles in the modern corporate rescue law of England.[61]

2.1.2 Schemes of arrangement

If we observe the historical development of the scheme of arrangement, we find that scheme of arrangement owe its origin to the Victorian legislation. It offers a rescue oriented solution to the company surrounded by the financial difficulty as compared to traditional liquidation procedure. It has been employed for the rehabilitation of the large companies, such as "British Energy Plc and Cape Plc".

[60] R Goode, *Principles of Corporate Insolvency Law*.3 rd edn (London: Sweet & Maxwell, 2005).
[61] V Finch, "*The Recasting of Insolvency Law*" (2005) 68 M.L.R. 713, 727.

A scheme of arrangement can be commenced at an early stage, as there is no compulsion to show that the company is bankrupt or to be expected to develop into bankrupt in the near future. All the concerned parties will be considered by the court as it is a combined procedure[62].

For the objective of ensuring fairness and to save the scheme from abuse, it is suggested that the proposed scheme should be accepted in the each class of the creditors and members. So that each class of the creditors treated fairly and equitably and avert the majority from getting benefits at the costs of the minority. The approval of the scheme needs three-fourth in value of each class.

In order to take effect,[63] the scheme needs the authorization of the court besides the sanction of the creditors and other member. When the scheme has been permitted by the court, then it takes effect. The scheme, once take effect, then it binds all the parties, even the dissenting creditors. The court plays an important role with respect to scheme of arrangement. The court's involvement in the procedure of scheme makes it expensive. The court involve in the scheme of arrangement for the following objectives,

- Firstly, the court summon the meeting of the creditors and members on a petition[64]
- Secondly the court gives notices to the differing creditors in order to make certain justice and legitimacy.[65]
- Thirdly the court has large discretion to decline to sanction an arrangement if the court sees that some of the interested parties is not treated fairly.
- Fourthly the court can invalidate a scheme that has been accepted earlier if deceit is established[66].

It is worth mentioning here that moratorium period is not tendered to the debtor company during the scheme of the arrangement so the individual creditors action can not be stopped from the enforcement against the belongings of the debtor and the court has no powers to enforce informal moratorium to stop the action of the individual creditors against the financially struggling

[62] *A Review of Company Rescue and Business Reconstruction Mechanisms, The Insolvency Service*, (London: HMSO, 1999) (here after "IS 1999"), para.6 (l).

[63] CA 2006, s 899 (1).
[64] Ibid.
[65] V Finch, *Corporate Insolvency Law: Perspectives and Principles* (Cambridge: CUP, 2002), 325.

[66] D Milman, "*Schemes of Arrangement: Their Continuing Role*" [2001] Insolv. L. 145.

company property[67] . According to the cork report the procedure is time wasting, intricate ,burdensome and expensive. Therefore it is not appropriate for the small firms so it can not be imposed. Therefore the failure of the scheme of arrangement as main cause for the insolvency law restructuring that escorted to the introduction of other system.[68]

2.1.3 Administrative receiverships

Administrative receiverships was developed in the later part of the 19th century. the most important attribute of the administrative receivership is the floating charge. There is no concept of the administrative receivership without floating charge. It remains for a long time an important element of the English financial system.[69]

Administrative receivership has been defined in the following words;

"Administrative receivership is a procedure for the debt enforcement by the secured creditors having a floating charge over the whole or a large part of the company's assets and creditors include both present and future".

The administrative receiver is appointed by the floating charge holder. The administrative receiver takes over the control of the entire business of the company with following objectives;

- First ,to run the business of the company in a better way
- Second, to take the company out of the financial troubles and to carry out his duties by taking into consideration the interest of all the parties.

The administrative receiver can not achieve the above function in all the situations due to the fact the administrative receiver be indebted to its employer. Therefore the administrative receiver principal aim is to make certain the protection of the full interest of floating charge holder. Therefore if the remaining possessions of the company facing financial difficulties are not adequate to satisfy the claims of the floating charge holder, then the company put immediately in the process of the "liquidation".

The possibility of the rescue function that is performed by the administrative receivership summarized by the coke report in the following words;

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[67] Cork Report, para.406.

[68] Ibid at para.496.

[69] S Davies QC (ed), *Insolvency and the Enterprise Act 2002.* (Jordans: Bristol, 2003), 37-38.

"Such receivers and managers are given wide power to manage and continue the business of the company and in some cases they have been able to restore the ailing company to the profitability and give back it to the owners, in other words they have been able to dispose of the whole or part of the business of the company as going concern in either cases the preservation or profitable part of the business has been an advantage of the employees, the commercial activity and for the general public".[70]

Where there was nonexistence of the floating charge then in such a circumstances company voluntary arrangements and administrative order is used.

it was suggested in the cork report that the purpose of the key advancements is to curb the administrative receiver primary duties which he owes to its employer i.e. the "floating charge holder". Therefore in order to make the administrative receiver more answerable so that it keeps in mind the interest of all the parties, it is very necessary to put a restrain on the principal duties of the administrative receivers. Administrative receivership criticized severely due to the following factors;

- Firstly, as administrative receiver primarily protect the interest of floating charge holder i.e. to its employer. Therefore he normally carry out his duties without giving enough consideration to the interest of the general body of the creditors. However in certain situations where the enforcement of the rescue procedure is encouraged, then in such situations the administrative receiver may act for the interest of all the interested parties. However, if the charge holder is unsecured, then in this situation the administrative receiver does not have enough motivations to maximize the realization of property unless or as long as the value of the remaining resources is enough for gratifying the claims of the secured creditors.[71]

- Secondly, the "floating charge holder" is authorized to employ an "administrative receiver" at any time that the contract permits.[72]

[70] Cork Report, para.495.

[71] 67 DTI/*Insolvency Service, Productivity and Enterprise: Insolvency—A Second Chance* (Cm 5234, 2001), paras.2.2 and 2.3.

[72] IS 1999, para.6 (g).

- Thirdly, the administrative receivership is not a combined phenomenon. It is note able thing that as compared to company voluntary arrangements, the administrative receivership has a meager return for the creditors but has a better return as compared to the company liquidation.[73]

Fourthly, one more defect of the administrative receivership is that the administrative receiver is not answerable to other creditors who have no say in the process. Therefore the process is unfairly abuse the interest of the ordinary creditors who are in weak position. Therefore this approach can not secured their interest just like secured creditors. Therefore they are at the clemency of the one-sided action of the floating charge holder[74].

2.1.4 London approach

The source of the London approach can be drawn back to early 1970s, when during the financial catastrophe of England, a great number of the companies' particularly multi bank supported companies were facing financial difficulties and as a result the disaster also had bad effect on the secondary banking sector of the England. Because of the lack of effective prescribed rescue procedure at that time and because of the complexity of the multi banks and multi jurisdictional problems, bank of England engaged and achieved a mechanism which was purely informal and relies on the compromise, collaboration, sympathetic and continue support among the banks, in order to reconcile the interest of the different creditors and for the reorganization of the company in the financial difficulty.[75]

The London approach has been defined as
" a non statutory and informal framework introduced with the support of the Bank of England for dealing with temporary support operations mounted by banks and other lenders to a company or group in financial difficulties, pending a possible restructuring".[76]

[73] Ibid.
[74] Goode, above n.60, at para.9-04.
[75] C Bird, "*The London Approach*" (1996) 12 Insolvency Law & Practice 87.
[76] *British Banker Association, Description of the London Approach*, unpublished memo (1996), 1.

In out of the court mechanisms which are used for the reorganization of the companies the London approach is very successful in rescuing the companies surrounded by the financial difficulties. it should be worth mentioning here that the success of the London approach is useful due to the following points:

- First, it fashioned a very useful arrangement for the corporate recovery.
- Second, it fashioned a very useful unofficial rescue mechanism.

In spite of the many cultural and legal differences, it has been copied in many countries.

When a publicly owned company surrounding by the financial difficulties, the exposure of the financial statement may raise a fear of the creditors who intended to enforce individual debt enforcement action, therefore this grind down the hopes of the rehabilitation of the company. Then in such a situation London approach gives a suitable mechanism through which the reorganization of the company carried out.

The London approach offers a non statutory rescue procedure which is a set of standards instead of legal rules .It has no bad effects of the publicity and other related disadvantages. Hence the objective of the London approach is to provide a successful mechanism for the debt restructuring which mainly relies on cooperation of the banks and their collective support.

The process of the London approach usually has four phases;

- First, comes standstill procedure, this is purely a controlled process and during the process of the standstill no creditor is allowed to take action for their debt enforcement and make his position better for the debt reimbursement with respect to other creditors or by way of the security must remain only for short period under agreed limits.

- Second, after the stand still then comes the second phase, the banks send an examining accountant, and during the period of the standstill this examining accountant with the team of investigating accountants makes complete examination of the business affairs of the company and assembles information on the business circumstances of the company. This information is very useful for the creditors in their joint decision making with regard

to the restructuring, i.e. whether the restructuring process should be carried out or discarded.

- Third, this phase of the London approach involves negotiation, as there is no legal process available for the resolution of the disputes that arise during the negotiation, so a bank is chosen as to act as mediator for the resolution of the dispute that arise among the banks.
- Fourth, this phase of the London approach involves the new financing[77], following a victorious negotiation among the banks the entire lender reach a new financing agreement for the company in financial difficulties, which require all the banks to give loan to the company in the financial trouble on the pro-rata basis for the purpose of persistent trading.

It is a note able thing that the London approach has significant impact on the reorganization of the large companies at national and international level since its creation.[78]

2.2. Two new rescue system were introduced in the "Insolvency Act (IA) 1986" to make the insolvency law rescue oriented

2.2.1 Company voluntary arrangements (CVAs)

2.2.2. Administrative order

2.2.1 Company Voluntary Arrangements

The roots of company voluntary arrangements can be traced back to the cork committee recommendations. Which tried to formulate a rescue regime?

a- "That should be user-friendly and inexpensive.

b- Should facilitate the companies surrounded by financial difficulties to outline a plane for the restructuring of the company and conclude a binding agreement of the indebtedness or composition between the company and its creditors."[79]

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[77] Vanessa Finch, *Corporate Insolvency Law: Principle and Perspective* (Cambridge: CUP, 2002), 220.
[78] P Kent, "*Corporate Workouts—A UK Perspective*" (1997) 6 International Insolvency Review 165.

[79] Cork Report, paras.428-430.

Following are the most important features of the company voluntary arrangement:

- First, important feature of this company voluntary arrangements is that directors of the company keep on to run the company's affairs with the help and under the control of the nominee, who soon after become the supervisor of the scheme, after the scheme being accepted by the creditors committee.
- Second, desirability of the company voluntary arrangement is its voluntariness which provides an easy access for the director of the debtor company to rescue the company and ease the fear of the wrongful trading so that financially distress but still viable companies can be restore at an early stage[80].
- Third, important attribute of the company voluntary arrangement that it is a contract based approach which is normally arrived at out of the court.

It does not mean that court does not perform any function with respect to company voluntary arrangement, i.e. the court play an important role in company voluntary arrangement .It performs the following function

- It carry out the supervisory role in the approval and execution of the scheme
- It averts the unjust prejudice.
- It makes possible the approval of the scheme because it eliminates the hurdle in the way of the scheme.
- It also avoids unnecessary delay[81]

The company voluntary arrangement did not perform the anticipated role in rescuing the company surrounded by financial difficulties. The official figure have exposed that it was basically misused and series of deficiencies which hinder the use of company voluntary arrangement were discovered.

It was pointed out that the main flaw in company voluntary arrangement is the deficiency of moratorium period. Which encourage the individual creditors of the company to enforce their

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[80] Finch, above n.77, p333-334.

[81] K Gromek Broc, "*England And Wales: The Impact Of The Revised Company Voluntary Arrangement Procedure*", in K Gromek Broc and R Parry (eds), *Corporate Rescue: An Overview Of Recent Developments From Selected Countries*. 2 nd edi (Hague : Kluwer Law International, 2006), 98-99.

debt payment against the company in the financial difficulty before the game i.e. between the appeal for Company voluntary arrangement and approval of that appeal.

Company voluntary arrangement scheme proved to be infirm in the nonexistence of the protection that is given by the moratorium.[82] Although we can solve this problem by applying for an administrative order but that process is very expensive and not suitable for the small firm. Such shortage as the lack of the moratorium period was being centered in insolvency 2000.

2.2.1.1 Major reforms in CVA

The moratorium was introduced by the IA 2000. Which make the 'CVA, a more comprehensive for the company in the financial difficulty. It could prevent the company in the financial difficulty from the implementation of actions of the individual creditors.[83] it should be noted not every company but only small eligible company which satisfied the condition put in "sec 382(2) companies Act 2006"can avail the period of moratorium.

The moratorium introduced by the IA 2000 has the following effects;

- First, it prevents the petition for an order of administrative receivership and liquidation.
- Second, it protects the company from implementation of actions of the individual creditors in respect of the property which he holds under the title of conditional sale and lease.

If we look at the moratorium from the creditors' perspective certainly the introduction of the moratorium will enhance the creditors' threat. The creditors will suffer more loss than instant liquidation of the company if company voluntary arrangement fails to rescue the company in financial difficulty.

Therefore law should set mechanism to relieve the creditors concern regarding likely misuse of the creditors' interest to a possible extent. For this purpose the dependence is put on an independent insolvency practitioner to avoid the possible exploitation of the creditors so that feasible proposal can be separated from the non-feasible.[84] The nominee is compelled to analyze the pecuniary status of the company based on the information produced by the creditors. He is

[82] Finch, above n.77, P 328.
[83] IA 1986, Sch.A1, para.12.
[84] V Finch, "*The Recasting Of Insolvency Law*" (2005) 68 M.L.R. 713, 727,728.

also required to examine the company affair, indebtedness and company possessions and fundamental judgment should be made whether the proposal for the company voluntary arrangement should be accepted or rejected. He also makes sure that company have enough funds during the period of moratorium so that he can carry on its trading.[85]

The company is permitted to deal with its assets as long as there are reasonable hopes that any transaction could benefit the company. The process of dealing with assets has been permitted by the creditors committee and in the absence of the creditors committee by nominee and change affected by 2000 Act, imposed more duties on the nominee.

The company voluntary arrangement is price effective and efficient procedure for the small companies.

2.2.2. Administrative order

The administrative process was another method which was enclosed in part -11 of the 'IA 1986,. The objective of the administrative procedure under the recommendation of the cork committee report is to fill up the gap where there was no floating charge holder to initiate the administrative receivership which was viewed as rescue device by the cork committee.[86] It has already mentioned that the scheme of arrangements was intricate, burdensome costly. It also could not bind the differing creditors.

Therefore the basic purpose of introduction of administration supposed to fill up the weaknesses of the non statutory rescue arrangements and of scheme of the arrangements. It also acts as combined rescue oriented approach.

As the administrative procedure was introduced to remove the weaknesses of administrative receivership, therefore the authority of the administrator is alike to those of administrative receiver.[87]

The request for an administrative order can be presented by the following:

- First, by directors;
- Second, by the company, and
- Third, by any creditor, or creditors in respect of the company.

[85]Ibid, Para 6, 8. See also Finch, above n.77, 337.
[86] Cork Report, para. 496.
[87] Finch, above n.77, 278.

The main feature of the administration system is the statutory moratorium, which prevent the debtor from the legal actions of the creditors in opposition to the property of the endeavoring company in the financial difficulty.

However official figure shows that that the enforcement of the administration system failed to realize the intended purposes of the rescue culture and it suffered from series of the shortcomings that affected its effectiveness. Following are the main defects of the administrative system which affect its effectiveness:

- First of all a heavy burden of proof was imposed at initial stages as the petitioner need to prove that the company is bankrupt or likely to develop into bankrupt in the near future and there is any practical predictions of the success and one out of four purposes is expected to be achieved[88].

- Secondly the process of the entrance to the procedure was faulty and could easily be stopped by the veto of floating charge holder by submitting an application for the administrative receiver.

- Thirdly the court was very careful in granting a scheme and its takes a lot of time because it has to make investigation in the petition files.

- Fourthly the professional advices made the process slow and very expensive.[89]

- Fifthly, the exit route from the administration was ambiguous

The administrative system provides a rescue option to the company in the financial difficulty. It also keeps the directors in the existing management so that they can continue to carry out their role in the business affairs of the company facing financial difficulties.

[88] IA 1986, s 8 (3).
[89] Finch, above n.77, p283.

Once the administrative regime permitted by the court, after that the director of the company could avoid the wrongful trading liabilities by applying for an administrative order when the company is in the fiscal difficulty.[90]

Under the courts order an independent insolvency practitioner could meddle with the company management in appropriate manner and find out all the successful and reasonable solution to its problems.

It was perceived that if the company put in the rescue proceeding at the accurate time four out of five companies could be reorganized.

2.2.2.1 Reform of the administrative regime under Enterprise Act, 2002

The improvement in principle administration system was carried out under the "Enterprise Act 2002." The old part of the 'IA 1986 was replaced by the sec 248 of "Enterprise Act 2002." It put in the form of schedule B an overhaul administration regime into the "1986 Insolvency Act". Many changes were carried out to the old fashioned and incompetent rescue mechanism. The objectives of the reforms are enumerated below;

- First, to encourage a rescue culture which best fulfilled the needs of the ailing enterprise.
- Second, to shun the harmful effects of the corporate failure.
- Third, to make certain the protection of the employment of employee.
- Fourth, to create commercial risk taking environment.[91]

It is commendable that dramatic change is brought by the reforms. The main characteristic of the reforms are given below;

- First, it puts in the form of schedule B an overhaul administration regime into the "1986 insolvency Act."
- Second, it established new legal rules.
- Third, it remodeled the bargaining power and property rights of the different actors, whose stance automatically changed in the new rescue regime.[92]

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[90] Ibid., 280.

[91] V Finches, "*Reinvigorating Corporate Rescue*" [2003] J.B.L. 527, 529.

[92] Ibid at 530.

- Fourth, as compared to the old system of administration regime the newly created administration system almost eliminated the administrative receivership.
- Fifth, it has completed the introduction of an out of the court mechanism administration which provides quick and easy access to the rescue mechanism.
- Sixth, the reforms also improve the position of the unsecured creditors by eliminating the crown preferences and by constructing the ring fence fund[93].
- Seventh, the introduction of the new exit routes which are easy to carry out and save the time and make easy the difficult process for coming out of the administration.

All the aforementioned are the significant characteristics of the new administrative system.

2.3 Now Detail Legal Rules, Core Mechanisms and Effect on Different Actors of the Corporate Rescue Law in England

In order to make the England law more rescue oriented, a lot of reforms in the "insolvency Act 1986" of the England was carried out. The first step in this direction was the introduction of the company voluntary arrangement and administration procedure in the "insolvency Act of 1986" on the proposals of the cork report. The static have shown that both the procedure be unsuccessful to achieve the expected result due to some inherent deficiencies in the company voluntary arrangement procedure and administration regime.

Therefore the reforms were carried out in the company voluntary arrangement and administrative regime to make them comprehensive procedure. Since the Act of 1986,the primary most important improvement which increase the effectiveness of the company voluntary arrangement scheme was carried out in the company voluntary arrangement by the insolvency act 2000 and seen as, has a very attractive influence on the turnaround of the small companies[94]. Then the "Enterprise Act 2002" was passed to fill up the inadequacies of administration procedure so that its effectiveness can be increased. The "Enterprise 2002 Act" carried out the

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[93] EA 2002, s 251 (1) states that the Crown preference shall cease to have effect. The EA 2002, s 252 introduces a new s 176A into the IA 1986 which fully stipulates the new creature of ring fence.

[94] K Gromek Broc "*England And Wales: The Impact Of The Revised Company Voluntary Arrangement Procedure*" in K Gromek Broc and R Parry, *Corporate Rescue: An Overview Of Recent Developments From Selected Countries* .2 nd edi(Hague: Kluwer Law International, 2006), 99.

radical changes in the UK rescue legal system which almost eliminated the concept of administrative receiverships.

It is quite clear that the new corporate rescue law have in-depth impact in rescuing the company in financial difficulty.

2.3.1 Company voluntary arrangements (CVAs)

2.3.1.1 How to initiate a "company voluntary arrangement" and the role of moratorium

A company voluntary arrangement procedure starts when director of the company files a petition in the situation when the company is not under the processes of the liquidation or administration. The purpose of petition is to draft a voluntary arrangement scheme for the corporate reorganization of the company or for the debt repayment.[95] the introduction of the moratorium by the "insolvency Act 2000" is the chief reform that play an important role to make the company voluntary arrangement more attractive mechanism. The moratorium makes the company voluntary arrangement attractive in the following ways:

- First, it enables small but still viable companies surrounded by the financial difficulties to feel confidence and settle with the creditors any issue and try to convince the creditors and find out a binding composition that bind the creditors and company.
- Second, this moratorium also defended the company against the debt enforcement actions of the individual creditor.
- Third, it acts as shield for the company from other legal actions like recovery of the property, without the authorization of the court.

Hence to get benefit of the moratorium, the director should get a positive reaction from the insolvency practitioner (IP), which soon after acts as nominee. Now in judicial practice the directors of proposed company consult with the IP in advance and set out the proposal in line with the suggestion of the IP. In addition to this the director must file the following five documents with the court;

- First the document that shows the confirmation of the consent of the propose nominee to act as nominee.

[95] IA 1986, s 1(1) (3).

- Second, the document that lays down the terms of the proposal
- Third, the statement that shows the financial circumstances of the business affairs of the company
- Fourth, the statement of the anticipated nominee that in his opinion the proposed arrangement has reasonable chances of the success[96]
- Fifth, the directors must give a statement that shows that the company meets the eligibility standards of the moratorium[97]

A company is competent for the moratorium if it satisfies two or more condition out of three.

- First, maximum turnaround should be "(2.8million)"
- Second, the balance sheet should be of "(1.4million)".
- Third, the number of workers must be up to 50.[98]

The moratorium starts when the documents mention above being filed with the court and linger for a period of 28 days.[99]

2.3.1.2 The functions perform by the nominee with regard to CVAs

The nominee plays an important role with respect to company voluntary arrangement scheme and performs different work with regard to the scheme.

i. First, the nominee outline an opinion on the grounds of facts supplied by the director on the initiation of the procedure, on the basis of which company voluntary arrangement is concluded.[100] While forming his opinion the nominee should keep in mind the following things, whether

- "The company has adequate funds during the period of moratorium, so that he can continue the trading
- There is a reasonable hope of the company voluntary arrangement being accomplished

[96] IA 1986, Sch A1, para.7(1)(a)(b)(d)(e).

[97] IA 1986, Sch A1, para.7 (1)(c).

[98] CA 2006, s 382 (3).

[99] IA 1986, Sch A1, paras.8, 32 and 35

[100] IA 1986, s 2(3).

- The meeting of the company and creditors should be summoned to consider the proposed voluntary arrangement". [101]

The nominee while forming his opinion keeps in view the following thing that the new financial backers are ready to provide enough funds for the maintenance of its business or the existing supplier will continue its supply during the period of the moratorium for the continuous business of the company. The purposes of the requirements are as follows:

- First, to make certain the achievability.
- Second, to avoid the abuse of the moratorium.
- Third, to avert the unlawful connection between the company and nominee.

ii. Second, in addition to making his opinion the nominee is under a responsibility to put forward a report, with in twenty eight days of the notice of the proposal being served upon him. The nominee in which express his opinion that whether the scheme has the chances of the achievements or not and whether the assembly of the company and creditors should be call for or not. If the meeting of the creditors call for then he must inform about the place, time and date.[102]

iii. Third, the last and the final function which nominee carry out with respect to company voluntary arrangement is to control the implementation of company voluntary arrangement if it is accepted by the "meeting" of the company and its creditors. Then nominee be converted into the supervisor and fulfill his function of the supervision independently.[103] The supervisor must apply to the court if some problem arises during the enforcement of the voluntary arrangement. The performance of the supervisor is under the control of creditors of company and other interested parties, any of whom can apply to court for repairing any act of the supervisor.[104]

2.3.1.3 Voting and approval of CVA

The separate conference of the company and it creditors is being called by the nominee so that they consider the proposal and approve the proposal with or without alteration as they think

[101] IA 1986, Sch A1, para.7 (1) (e).
[102] IA 1986, s 2(2)
[103] IA 1986, s 7(2) Gromek Broc, above n.94, 97.
[104] IA 1986, s 7(3); Sch A1 para.26 (1).

fit.[105] All the creditors shall vote in single class of meeting, to whom the nominee be acquainted with in reference of the debtor company.

The voting procedure in company voluntary arrangement is not so much difficult as compared to schemes of arrangement. The approval of the scheme in company voluntary arrangement need 75%vote of the creditors who cast their vote in person or by the proxy with reference to their claim .They also needs the support of the 50% shareholder in the value of their share[106]. The scheme will be effective immediately if it is accepted by the both meeting.

However, if it is accepted by the creditors meeting and rejected by the company meeting then the decision of the creditors meeting will prevail. There is an option for the differing members of the company they can submit a petition to the court for the redress of their claim.[107] The appeal can also be submitted by he differing creditors and members of the company on the following grounds;

- First, to check the soundness of the proposal on the reasons that it unjustly exploit the interest of the petitioner.
- Second, there has been some basic wrongdoing at or with respect to either of the conference.

The court may do the following things, when it is satisfied with petition of applicant;

- ➢ First, it rescinds or postpones the approved proposal.
- ➢ Second, the court give instruction to call a new gathering for the contemplation of the original proposal or approve a modify proposal.[108]

It is a note able point here that court does not involve in the approval or the rejection of the scheme. The scheme must be permitted by the creditors committee. The approved proposal has a binding effect on all the interested parties . The interested parties are the following;

i. First, the company.
ii. Second, the parties who was permitted to vote including the parties who have a dissenting opinion on the proposal with other parties.
iii. Third, the parties who have the notice of the meeting but did not vote.[109]

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[105] IA 1986, s 3(1); Sch A1, para.29.

[106] IR 1986, r 1.19-1.20.
[107] IA 1986, s 4A (3); Sch A1, 36(3).
[108] IA 1986, s 6(4); Sch A1, para.38 (4).

The arrangement can not fasten the person who does not have any interest in the arrangement. The arrangement also can not fasten the preferential creditors and secured creditors against their will. The arrangement cannot restrain a person from commencement of the legal action whose claim was not brought within the arrangement form pursuing his claim. In nut shell the person who does not have voting right is not fastened by the arrangement.

2.3.1.4 The role of the court with regard to CVA

The objective of the creation of the company voluntary arrangement is to generate a plain, swift and user friendly rescue device. Which help the user to a great extent in reaching an agreement of the composition with creditors .The agreement has a obligatory effect on the company and its creditors.

Although the court does not actively employed with respect to company voluntary arrangement. It does not mean that court does not perform any function with respect to company voluntary arrangement.

The court performs various functions with respect to company voluntary arrangement;

- Firstly, the court play the role of the custodian which eliminates the barriers in the way of company voluntary arrangement and resolve the disputes of the various types that arise among the interested parties whether they are disputes of the substantive rights or the procedural issues.[110]
- Secondly, it performs the role of explanation of corporate rescue law with respect to company voluntary arrangement.
- Thirdly, the court throughout the phase of moratorium, stop the abuse of the protection that is provided by the moratorium to evade the exploitation of the interest of the creditors.
- Fourthly, the supervisor of the company voluntary arrangement can submit a petition to the court if any issue arises during the implementation of the company voluntary arrangement.
- Fifthly, the creditors and other interested parties can apply to the court if they have any complain about the performance of the supervisor and can apply for the correction of

[109]IA 1986, s 5 (2).

[110] IA 1986, s 7(4).

the acts of the supervisor and the court can modify, invalidate and validate an act of the supervisor and can also employ a new supervisor in place of the supervisor if the court thinks fit.[111]

These are some of the important function which the court performs with respect to the company voluntary arrangement.

2.3.1.5 The impact of the CVA on corporate rescue law

The company voluntary arrangement provides a procedure which supply swift and easy access for the director of small but still viable companies facing financial difficulties to start rescue procedure at an preliminary stage when the company fall into the financial difficulties.

As compared to the administration the company voluntary arrangement makes available for procedure which is alike to the DIP of the USA. As compared to scheme of arrangement the company voluntary arrangement afford for a procedure which is very cheap and easy to access.

The procedure of the company voluntary arrangement is very effective with respect to small companies and it is not for the large companies because the moratorium established by the "insolvency act 2000" is available only for the small companies. This limit may become a deficiency because the large companies can not avail the moratorium in company voluntary arrangement.

Thus the mixture of the company voluntary arrangement and administration becomes very well mechanism for rescuing the company that is in financial difficulty.

2.3.2 The Administration Procedure

Initiation of the administration procedure

There are two processes for the initiation of the administration procedure

- First out of the court process
- Second court driven process

Out of the court process

In the out of the court process the following can employ an administrator;

[111] IA 1986, s 7(3).

- Firstly, the qualifying floating charge holder i.e. the bank who grasp a mortgage or debenture can employ an administrator.
- Secondly a company or its director can also employ an administrator.

However, they must serve a prior notice of their intention of engagement of the administrator to the "qualifying floating charge holder". If the "qualifying floating charge holder" does not contain any opposition to the engagement of the administrator done by the directors of the company then the administration will go into operation immediately.

The director or the company cannot prefer an out of the court process if there is previously a petition filed by the creditors of the company for winding up.[112]

2.3.2.2 Court driven process

In the court driven process, the following can apply for the employment of the administrator;

- "The company"
- The company directors
- Any creditors of the company

In this mechanism they must have reason to believe the following things;

- First, the company is bankrupt or expected to become bankrupt in the near future.
- Second, the administrator is competent of attaining its purposes.[113]

The purposes of the administration are to accomplish one of the following objectives;

i. "First, to reinstate the company to its previous healthy state.
ii. Second, to obtain a better return for the company creditors.
iii. Third, to recognize property to make allocation to the secured or preferential creditors".[114]

If the submission for the engagement of the administrator is made by qualifying floating charge holder, then he does not need to demonstrate that the company is not competent to repay its debts. The court can make an administrative order, even the company is under compulsory liquidation on the petition of the floating charge holder.

[112] See Haizheng Zhang,above n 11, 117.
[113] Ibid., 118.
[114] Ibid., 123.

From academic point of view it was approximated that the qualifying floating charge holder engagement of the administrator out side the court would turn out to be the most frequent method. He frequently uses this mechanism as a replacement of the administrator receivership that is eliminated by the "Enterprise Act 2002".

From the legal standpoint the most frequent route of the entrance into administration is an "out of court" of employment of the administrator that is by and large used by the company or its directors.

Two reasons may explain this thing, first when the appointment is made by the company or its director there might be no qualifying floating charge holder.

2.3.2.3 Moratorium

There is an "automatic stay" on the enforcement of actions in opposition to the property of the company by the individual creditors or by the other interested party when the process of administration starts, this automatic stay called moratorium.[115]

The moratorium period play an important role with respect to the administration it covers two stages,

a) First there is a temporary moratorium, which commences when the petition for the administration has been presented but not yet has been approved. This moratorium phase defend the company from the legal actions of the creditors and other concerned parties during this temporary period, or for the duration of the phase when the employment of the administrator has been made by the company or "its directors" or by the "qualifying floating charge holder" but the administration has not comes into effect because other relevant prerequisites has not been yet fulfilled.[116]

b) The second phase of the moratorium begins when the administration has comes into existence. It encloses the whole period of administration i.e. the twelve month which is a statutory period of the administration, at the end of this period the administration mechanically comes to an end. This period can be lengthened for a time of six month

[115] Ibid., 122.
[116] IA 1986, Sch B1, paras.18 and 29.

with the approval of the creditors and for a specific period under the court order while the administrator occupies his position.[117]

As the moratorium guard the company facing financial difficulties from the enforcement actions of the creditors, therefore the time limit of the administration is very important. If there is indefinite time is given to the administrator it will damage the interests of the creditors.

It is very significant to note here that the mixture of company voluntary arrangement and administration create a comprehensive rescue procedure for the company facing financial difficulties and which the company facing financial difficulties can effectively pursue. By using the mixture the company can obtain the benefit of company voluntary arrangement procedure and also try to rehabilitate the company under the security of moratorium which is given by administration. From the view point of the insolvency practitioner the company voluntary arrangement under the procedure of administration symbolize a real rescue device.

2.3.2.4 The statutory objectives of the administration

The new legislation of the administration introduced the statutory objectives of the administration, and now the aim of the administrator is to try his level best to achieve these purposes, the following three are the statutory objectives of the administrator,

a) "First, to rescue the company as going concern.
b) Second, a better return for the company creditors as whole than if the company were immediately liquidated.
c) Third, to seize property in order to make the distribution to secured and preferential creditors".[118]

It is a notable point that the new legislation of the administration, gives great importance to save the company as "going concern", and it is main and basic objective of the administration. The real meaning of the "rescue the company as going concern" means to protect the legal body of the company with as much of its business as much achievable. It depends upon the personal evaluation of the administrator whether to save the company as "going concern" is possible or not ,for example if the company is surrounded by the problems of the temporary cash flow, and a third party or main creditors in relation of the company is prepared to give new finance to the company facing financial difficulty, then under this situation the administrator is compelled to

[117] IA 1986, Sch B1, para.76.
[118] IA 1986, Sch B1, para.3 (1).

form his opinion that to save the company as "going concern" is practically possible, or accomplishing the first objective is possible.[119]

If the first objective is not attainable then the administrator has to go on second objective, i.e. to attain a healthier outcome for the company's creditors as full. if there is no hopes of the new financing throughout the phase of the moratorium that enable the company to continue its trade, and pay the earnings of the employees then in this situation the administrator should think that it is better for the creditors of the company that the possessions of the company should be sold when the company is in the position of going concern, than the little by little selling of the company's assets.

if the fist two purposes of the administration can not be attainable then the administrator has to move on the final and last objective which is to attain the assets in order to give out among the secured and preferential creditors. However the last objective of the administration is reasonably analogous to the administrative receivership in which the receiver also dispose of the company's assets for the satisfaction of the claim of his appointer.

In a nutshell the endeavor of the statutory objectives is to produce the environment in which more company's can be saved as going concern.

2.3.2.5 Role of the administrator in rescue proceeding

The company, its directors, and floating charge holder, can appoint the administrator. As soon as the administrator is employed, it captures the control of the business dealings of the company. The administrator runs the affairs of the company in the light of the creditors meeting findings and instruction of the court.

It is in the most welfare of the company that the administrator should act on the policy of the collectivity instead of policy of the individuality. By the word collectivity mean, he must act in the welfare of the all the parties rather than in the interest of any particular party. Individual enforcement action is opposed to the policy of the collectivity. In individual enforcement measures, at the cost of other interested party the interest of any particular party is protected.[120]

There is a necessary prerequisite for the administrator to submit a report under the old administration on the following things of the company surrounded by financial difficulties;

- First, on the financial status

[119] See above n 114

[120] See Haizheng Zhang,above n 11,125.

- Second, on the business affairs
- Third, appropriateness of the appointment of the administrator

In order to make the process fast the new "administration" system eradicated this prerequisite of the old administration regime. However prior to the employment of the administrator the IP is under fiduciary duty to examine and understand the financial status of the company.[121]

The scheme for getting the statutory objectives of the administration has to be submitted by administrator after the administrative regime becomes operative within a time period of eight weeks.

2.3.2.6 Role of the creditors meeting

In the approval or rejection of the scheme the creditors meeting play an important role. The creditors meeting perform a significant function in the administration regime due to the following functions

- First, it is empowered to accept or reject the scheme that is submitted by the administrator.
- Second, it is empowered to check the fairness of the scheme. The creditors' conference performs a significant function in the acceptance or the rejection of the proposal that is submitted by the administrator.
- Third, it also has the power to test the performance of the administrator with regard to fairness and for the sake of collectivity.

The first meeting of the creditors should be summoned as soon as feasible or in any case within time of ten weeks after the administration comes into effect.[122] The first meeting of creditors considers the scheme and grant it without alteration, or with alteration to which administrator approve. The court can order, or the creditors whose claim at least comprise 10% of the company's debts can apply for more meeting to consider modify proposal of meeting of the company creditors[123]. The court may give a command to end the effects of the administration if

[121] Ibid.
[122] IA 1986, Sch B1, para.51 (2).
[123] IA 1986, Sch B1, para.56.

the initial meeting not succeeds to approve the proposal and additional creditors meeting turn down the modified proposal.[124]

2.3.2.7 End of the administration

The most important characteristic of the new administrative regime is the moratorium. the moratorium acts as shield in the way of enforcement action of the individual coeditor's and in this way protects the debtor company.

The duration of the moratorium should not be for unlimited period. There ought to be a bar on the period of moratorium. The long period of the moratorium has the following two effects;

- First, it makes the administration procedure costly
- Second, it is harmful to the welfare of the creditors

Therefore at the conclusion of the phase of twelve month, there is a mechanical ending of the administration regime. The court is also empowered to carry to an end the administration regime on the petition of the administrator.

One major default of the old administration regime was that it did not make available any easy course of getting out of the administration. It also did not provide for any connection between the administrative regime and winding proceeding.

The administration process makes available a moratorium which protects the debtor company facing financial trouble from the debt enforcement action and recovery of the property during the process of the administration. There should be a restriction on the protection granted by moratorium, because considerably lengthened administration damage the interest of the creditors and make the process lengthy and costly. Therefore there is an mechanical ending of the administration process at the end of twelve month although this period can be lengthened under certain situation,[125] and the court can also on the petition of the administrator expire the effects of the administration.[126]

[124] IA 1986, Sch B1, para.55 (2) (a).

[125] IA 1986, Sch B1, para.76.

[126] IA 1986, Sch B1, para.79.

It is a notable thing that the new administrative regime introduced two new things;

- First, it confers power on the administrator to make distribution to the secured or "preferential creditor" or with the permission of the court to a creditor who is neither preferential nor secured.[127]
- Secondly, the new administrative regime establishes a connection between the administration and creditors' voluntary winding up proceeding.

Administration can be transformed into voluntary winding up proceeding in the situation when the administrator thinks that

- "The total sum which every secured creditor is possibly to get has been paid to him.
- If there are the unsecured creditors of the company then a distribution will be made for them".[128]

Besides this if the administrator feels that the company has no sufficient assets available for the distribution to the secured creditors then the company will be placed directly into the liquidation proceeding. The company will be dissolved at the end of three month subsequent to a notice of bankruptcy given by the administrator to the registrar of to companies[129]. It is a note able point that transformation of the administration into the "creditors voluntary winding up" **is** under the consent of the administrator, and no isolate order is required for stopping the consequences of he administration.[130]

2.4 Pre-packaged administration

To deal with the corporate troubles the pre-pack sale has been developed into popular method. In pre-packaged administration as the company enters into the administration procedure the existing management of the company which is facing financial difficulties buy the business of the company.

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[127] IA 1986, Sch B1, para.65., see R Parry, *Corporate Rescue* (London :Sweet& Maxwell, 2008), para.8.
[128] IA 1986, Sch B1, para.83.

[129] IA 1986, Sch B1, para.84.

[130] Parry, above n.27, 83.

the decision of entrance into the pre-pack sale has been taken prior to the entrance of the company into administration procedure with help of the company board and with the guidance of the insolvency practitioner.[131]

In pre-pack sale the administrator is empowered to sell the business of the company. For this there is no requirement to obtain

- First, the approval of the unsecured creditors.
- Second, authorization of the court.

The main advantages of pre-pack arrangement are

- First, preservation of the jobs of the employees.
- Second, preservation of the business of the company.

However it is injurious to the welfare of the unsecured creditors, because in it no attention is given to the interests of the ordinary secured creditors. The buyer buys the business of the company at no cost from all the unsecured debts. It means at the cost of the unsecured creditors, the proposed buyer, insolvency practitioner will get benefit.

Instantly following the appointment of the administrator, the pre-pack sale will be carried out. As the pre-pack sale will be carried out before the creditors gathering. Therefore the objective of the "creditors meeting" has been eliminated in pre-pack arrangement.

The main objective of the pre-pack sale is to get a better return, when the company is in the going concern position as compared to when the company immediately put in the liquidation procedure. Therefore it is thought the pre-pack sale is not according to the intention of the administration which is to guard the company "going concern" value. The administrator will be in the violation of this duty, if he has not tested the other options of rescuing the company instead of pre-pack. In a sum up, the reorganization of the company and its business will not be concentrated in pre-pack.

2.5 The impact of the 2002 modifications on the bankruptcy result

The modification in the administrative system of the England corporate rescue law has a very healthy influence on the corporate rescue results. The "Enterprise Act 2002" has a considerable influence on the corporate rescue law of the England. The use of administrations procedure,

[131] P Walton, "*Prepackaged Administrations—Trick Or Treat*?" (2006) 19 Insolv. Int. 113.

Normally a case started under chapter 11when the debtor .i.e. the company submits a petition with bankruptcy court willingly, when the petition is filed by the debtor. Then there must be following document with the petition,

- First, list of the possessions and liabilities
- Second, catalog of the in attendance creditors of the company
- Third, statement showing the pecuniary status of the company
- Fourth, record of the present earnings and expenses of the company
- Fifth, list of the executed contracts and uncompleted leases[133]

Although there is no official prerequisite that the Company is bankrupt or expected to become bankrupt in the near future, but there is a prerequisite of the good faith, which is a very crucial prerequisite.

if there is a good faith then there must be an intention;

a) First, of the reorganization of the company,

b) Second, to sell of its assets or

c) Third to liquidate it.

The petition that is filed under chapter11 of his bankruptcy code of the United States may be rejected if for example there is no real intention of the reorganization of the company.[134]

Creditors of the company can also commence a case under chapte11 under certain circumstances, when the company is in debt of amount at least $1000 and the company is not repaying that money owing unless that debt is the subject of the dispute. In doing so the creditors face the risk that if the statutory requirements are not fulfilled then company can recover the expenses from the creditors who file the petition and if the petition is not filed in good faith then the company can also recover the penalizing damages from the creditors.

It is usually the case that company enter into chapter 11 procedure under the force from the creditors and in most of the cases protected creditors in way force the company to obtain the protection of chapter11 otherwise they implement their security interest[135]. As the professor lopucki has said

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[133] GERARD McCORMACK, "*Corporate Rescue Law In Singapore And Appropriateness Of The Chapter11of The Us Bc As A Model*" (2008-20saclj-396-Mccormack.Pdf), 406.
[134] Ibid at p, 407.
[135] Ibid

"Congress has stated that the function of the reorganization case is to prepare and confirms a plane of the reorganization, and probably few of the debtor came to chapter 11 for this purpose intentionally and a large majority of the debtor entered into chapter11 procedure under the pressure from creditors and the filing under chapter 11 is the only way through that they could avoid liquidation or remain in business"[136].

2.6.2 Debtor individuality in preparing a reorganization plan

Reasons of the debtor's individuality in preparing the reorganization plan can be traced by investigating the legislative record of chapter11.The debtor's individuality in preparing the reorganization plan has advantages and disadvantages.

The first main cause and advantage of the debtor's individuality in preparing the reorganization plan is, the shareholder and management will not commence the procedure of chapter 11 in appropriate manner, until there is too much delay. If the chapter 11 procedure is not timely prayed to, then the company can not be successfully restructured[137].

The second advantage of the debtor's individuality is in preparing the reorganization plan. It grants an opportunity to the debtor to organize the negotiation with other parties and to keep under surveillance the reorganization factors.

On the other hand, debtor's exclusivity in preparing the reorganization plan also have disadvantages

- First, current shareholders may be cared for more favorably in plan that may be prepared by the management, than the plan that is prepared by any other concerned party.
- Second, as the shareholders and management has exclusive right in preparing the reorganization plan, they use this right to force the creditors to accept an unfair plan of the reorganization of the company.
- Third, the share holder could grab the entire going concern surplus, due to individuality in preparing the reorganization plan, when the company put in the procedure of the liquidation.

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[136] Ibid.

[137] Gerard McCormack, *Corporate Rescue Law: An Anglo-American Perspective* (Cheltenham :Edward Elgar,2008), 252.

- Fourth, an arrangement that defend the interest of the shareholders will be accepted by the court, because if a plan that guard the interest of shareholder more than any other concerned party ,refused by the court. Then, the shareholders will come with another plan that defends the interest of shareholders in any other manner and finally an arrangement that guard the interest of the shareholders is approved by the court.[138] , when the US critics analyze this situation of the individual right of the debtor's in arranging the reorganization plan in the context of the junior creditors they arrived at to the conclusion that this right of the debtor is neither advantageous nor unfavorable to the interest of the junior creditors. However, if a plan that is more advantageous to the interest of the shareholders and junior creditors accepted by the court erroneously, then in such a situation junior creditors' interest will get extra benefit.[139]

In order to make the decision making process effective with respect reorganization plan, i.e. whether to grant or disapprove the reorganization plan, it ha been suggested that the decision making process should be regularized. If more than one plan fulfills legal requirements than the plan that is more appropriate to creditors and shareholders will be accepted by the court.[140]

2.6.3 Feasibility of the reorganization plan

A plane must be feasible according to the US BC before it is sanctioned by the court. The main provision that deals with the feasibility of restructuring plan under the US BC is "section 1129(a)(11)". The court should consider the following thing before it authorized the plane:

- First, the plane to be sanctioned is not possibly to be pursued by the liquidation.
- Second, there is no further prerequisite of restructuring of the company unless the plane itself proposes.

The court may keep in mind a number of elements which have a effect on the company in order to see whether the feasibility standard has been met or not, including;

- First, producing power of the company
- Second, sufficiency of the capital structure
- Third, general financials state of the company

[138] Ibid., 253.
[139] Ibid.
[140] Ibid., at, 254.

- Fourth, potentials of the firm management[141]

The accomplishment of the reorganization plan can also be judge by the feasibility of the reorganization plan.

If the company does not have adequate funds at its disposal. Then it is not capable to fulfill some future obligation and to face some future losses. Such financial conditions of the company show that company does not fulfill the standard of the feasibility.[142]

Although there is no accurate formula for determining the best capital structure but the company should not come out with inadequate shareholder equity.

2.6.4 Concept of the impairment

The "concept of impairment" is another important feature of the corporate reorganization law of the US. The reorganization plan is accepted or rejected by the possessor of damaged claim or interest, because they are only permitted to cast their vote on the restructuring plan. The impaired claim or interest is defined under section 1124 of the US BC as follow;

"A claim or interest is impaired unless the plan leaves unaltered the rights outside bankruptcy associated with that claim or interest".

Chapter 11 of the US BC mainly based on the principle of negotiation between different classes of the shareholders and creditors .Therefore, it is very necessary to split the claims or interest into different classes. The division of the claims or interest into different classes is beneficial in the following ways:[143]

- First, from the voting view point ,if the members of a class vote into the favor of a plan, then a differing member can not insist on the application of absolute priority rule;.
- Second, preceding to the confirmation of court, each damaged class must consent to the "reorganization plan";
- Third, the member of class jointly can agree to give up the value to junior class of creditors; and
- Fourth, from the view point of the payment and treatment, it is very necessary to look that every class is treated justly and rightfully.

[141] Ibid., at, 255.
[142] Ibid.
[143] Ibid., at, 257.

A class is either regarded as impaired or not. According to "section 1126(f)" of the US BC, it is pre-assumed that the parties with non-impaired rights and interests have agreed to the plan. As the parties with non impaired claims or interest will be safeguarded fully outside the bankruptcy.[144]

2.6.5. Cramming down an objecting class of the creditors

The words "cram down" mean to force the dissenting class of the creditors to accept a plan of the reorganization.

To cram down an objecting class of the creditors a number of the conditions have to be fulfilled. These conditions are enumerated in sections "ss.1129 (b) (1) and 1129 (b) (2) (A)".

First, the plan should treat every party justly and rightly. Hence, if on the alike kind of the property if a junior creditor gets more gain than a senior creditor then it would be an injustice and it should be avoided.

Second, the secured creditors should be treated with just and impartial treatment, the just and impartial treatment means they should be kept away from the unfair risk of the loss of the plan collapse.

The just and equitable treatment also includes the requisites of the "s1129 (b) (2) (A)", according to this requisite creditors must obtain one of following three things,[145]

- Preservation of its secured interest with sufficient postponed payment to balance the current value of the collateral.
- Sale of the guarantee with creditor's security interest joint to the earning of the sale.
- The creditor's reception of indisputable equivalent to the security interest.[146]

When the plan is not agreed upon by all the creditors, the first option is the most common way of the restructuring of the secured creditor's claim.[147]

The second option is to authorize the corporate debtor to put up for sale the collateral free of charge. The producing of the sale of collateral the corporate debtor may be given by the corporate debtor to the creditors or he will keep it subject to the security interest.[148]

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[144] Ibid.
[145] Ibid., 263.
[146] Ibid.
[147] Ibid.
[148] Ibid., 265.

The third option, ponders upon the possibility of replacement of collateral by a solid or concrete alternative. As it would enhance the financial risk of the creditors to replace the old collateral with new one. Therefore, the courts are hesitant regarding this option. debtors however, offer to give up collateral to the secured creditors in exchange of contentment of the claims of the creditors, at the instant of the confirmation of the plan, up to the worth of collateral .on the other hand there is no question of unquestionable equivalence if the creditor are simply given shares in reorganized company[149].

The note able point here is that the ban of unjust favoritism be relevant only on the objecting class of the creditors and not to the arrangement in its totality. it seems that the intent of the drafter here is that the chapter 11 plan could not unfairly discriminate among the claims of the various classes of the creditors until all the classes vote in the favor of the arrangement,"sec1129 (a) (7)" offer safeguard for differing creditors in consenting class, by providing that every class member obtain at least to the extent that he would get in case of the liquidation under chapter 7.

It has been recommended that cram down power is often used to reach an arrangement rather than as a real club.[150]

2.6.6 Automatic stay

The automatic stay or the moratorium is the important feature of the chapter 11.when chapter 11 case started it puts a restrain on the enforcement, pressure, threats and harassment actions from the creditors "of the company" against the company and its assets.. Thus the debtor company feels comfortable and during the moratorium it has a chance to negotiate with the creditors of the company and convince the creditors and shareholder of the company for the rearrangement of the debt and conclude an arrangement for the reorganization of the company[151], the presence of the automatic stay has been has justified as follow:

- The moratorium is the defense that safeguard him from all the enforcement actions of the individual creditors ;

[149] Ibid .
[150] Ibid.
[151] Ibid., 156.

- it gives him an opportunity of making his repayment or to try a reorganization plane; and
- It brings to a standstill, all the collection efforts, all the intimidating action, and all the foreclosure action.[152]

In short it makes available a comfortable period for the debtor who is much worried due to the financial trouble that throwing him into bankruptcy.

The secured creditors who are wrongly influenced by the statutory stay can submit a petition to the court that granted the relief of the moratorium for lifting the relief, if for example the debtor has no equity in the assets and his assets are not compulsory for the reorganization of the company to foreclose the property and satisfy his debt.

There is a concept of the "adequate protection" to secure the interest of the secured creditors during the period of the moratorium, "section 361(d)" of the US BC provides that when the automatic stay is imposed as an element of the process of the reorganization then the any concerned party may submit a petition to the court to have the stay lifted for the lack of protection for an interest in the possessions. Although the possessions in question is necessary for the restructuring process but the interest of the secured creditors must be protected during the period of moratorium[153].

2.6.7 New financing during the period of the reorganization

The main provision under the US BC that is related to the financing of company surrounded by financial difficulties throughout the phase of the reorganization is "sec.364".[154]

According to the section 364 any loan given by the new lender to the corporate debtor during the process of the reorganization shall be repaid in prior to unsecured debts of the unsecured creditors.

The surety of the full payment from the new lender that is necessary for the process of the reorganization is an indispensable condition for the sanction of reorganization plan at the confirmation stage. However the claims of the new lender shall be fulfilled in preference to

[152] Ibid.
[153] Ibid.
[154] Ibid., 85.

the unsecured pre petition debts of the unsecured creditors if the plan fails to achieve its objective i.e. the reorganization of the company.

There are two kind of the way in which the loan is extended by the new lender to the debtor company for the purpose of the reorganization;

- First, "in the ordinary course of the business
- Second, not in the ordinary course of the business"

The priority of the claim of the new lender is automatic, if the loan is extended in the normal course of the business.[155]

However, priority of the claim must be sanctioned by the court if the loan is not extended in the normal course of the business

In order to verify whether the loan is given in the normal course of business or not two test are applied by the court

- First, vertical dimension test
- Second, horizontal dimension test

According to the vertical test, whether the deal is completed in the normal course of the business as compared to debtors own pre-filing operation. This test checks the deal in the context of supposed creditors.

According to the horizontal dimension test

Second test is horizontal dimension test, which looks in the perspective of the industry and assess the debtor's business with respect to other industry. It is a note able point that "s.364" looks on the loan granted and not on the utilization of the loan.

In some situations the assets of the company are protected to such a degree, that simply yielding preference over pre-petition unsecured debts creates small hopes of the recovery.[156] Therefore in such a circumstances section "364 (d)" grants a consequential priority. It grants priority over the claims of the pre-petition secured creditors. It allows the court to sanction this. There is also protection of the interest of the secured creditors, as the debtor has to prove;

- First thing that he can not get loan without giving such security

[155]Ibid, 184.
[156] Ibid.

- Second, secured creditors are sufficiently protected [157]

In nut shell, unless and until the court is fully contented about the protection of the old and new lender the court, the court will not consent to the priming security interest.

2.6.8 Concept of the adequate protection

The concept of the adequate protection is another important feature of the United States corporate reorganization procedure. The idea of the adequate protection based on the following principle;

To create such a circumstances, which make available to the business surrounded by the financial difficulties, with such flexibility under the procedure of chapter 11, it can be reorganized successfully, but at the similar occasion secured creditors interest should be fully protected.

Under the US BC "section 361" related to the concept of the adequate.

There are three types of protection that is provided by section 361to the secured creditors, which are as follows;

- First, at a time make complete payment.
- Second, to make payment from time to time or in installment.
- Third, to provide a corresponding substitute of the security.

A good new financing plan according to the court point of the view should make available to the secure creditors the protection they would have, if there was no super priority financing.

In order to get the new finance a company needs to assure the following condition;

- First, in spite of the subordination of the claims of the secured lender, they are sufficiently protected
- Second thing that it can not obtain loan without the subordination order .i.e. that the loan of new lender has priority over the pre-petition secured lender[158]

To fulfill the above conditions, although a very difficult task, but it must be satisfied.

If the future lender is not convinced to advance loan to the company in financial difficulty without main security status. The company is also not capable to convince the future lender to

[157] Ibid., 185.
[158] Ibid., 186.

advance loan on inferior position security interest. Then it can be inferred in the light of above circumstances that main security status will not protect the interest of the secure creditors. Therefore, we can presuppose at whatever time a case is filed by the company under section "364(d)" of the US BC of main security interest then, there will be no sufficient safety for secures creditors. Hence such a petition should be rejected by the court.

The collateral of the debtor need to satisfy the following two conditions to prove the adequate protection

- The in attendance lender is over secured
- It has ample value and it can defend both old and new lender[159]

According to "sec (506)" of the US BC, the secure creditors without a doubt given security to the amount that the worth of their collateral goes behind the amount of their debt. It was decided by the US Supreme Court "in the case of Timber of Inwood" by inference that unsecured creditors will not get in the post-petition any interest; therefore creditors may get an equity cushion for this reason.[160]

2.6.9 The introduction of the pre-pack procedure

In the 1980 there was introduction of the pre-pack, pre-pack procedure is noticed to have a considerable advantage as compared to both procedure i.e. that were taken place under usual chapter11, and corporate restructuring that occurred full outside the court and therefore minimizing the cost and disturbance for the parties.[161]

Following things are very necessary for the success of the pre-pack reorganization plan:

- First, management should be very efficient and prudent in accessing the real financial problem of the company
- Second, a feasible business plan that is agreed upon by a majority of the creditors and equity holder
- Third, preparation of the exit strategy in advance
- Fourth, for the execution of the plan, management should be ready to bear the expenses of the professional fees

[159] Ibid., 187.
[160] Ibid.
[161] Ibid., 103.

- Fifth, creditor group that is willing to negotiate the pre-packed reorganization plan

In pre-pack mechanism the company will file simultaneously, the appeal for the reorganization of the company and for the bankruptcy, the informal consent to pre-packed reorganization plan will be obtained in advance, the voting on the pre-pack reorganization plan may happen at any time either before or subsequent to the chapter 11 initiation ,as the chapter 11 is used to give effect to an agreement that is agreed upon by the majority of the creditors with the help of the pre-pack and in case the voting on the pre-pack reorganization plan take place before chapter 11 filing, then in such a case the result of voting Is attached with the chapter 11 petition for the reorganization of the company, if the court does not find any fault with the voting process, then the court consider whether the plan should be accepted or rejected.[162]

[162] Ibid., 184.

two parties, but it is not necessary for the word arrangement as contrasted to compromise that there should be some dispute or controversy.

The term arrangement occurring in Sec. 284 of CO, 1984, "comprises a reorganization of the share capital of the company by the consolidation of the share of the different classes or by the splitting up of the shares into the shares of the different classes".[165]

3.2.3 Reconstruction

According to the Black's law dictionary, the term "reconstruction" means "an act of constructing again or rebuilding again. Presupposes the non-existence of thing to be reconstructed as an entity; that the thing before existing has lost its entity, also the name commonly given to the process of the reorganizing an entity".

3.3 Different mode of reorganization

There are various ways of reorganization or rehabilitation of the company.

A company may be rescued or reorganized by the following modes:

- First, by a scheme of the compromise or arrangement;
- Second, by a scheme of the reconstruction or amalgamation; and
- Third, by take over bid.

3.4. How to bring into effect the organizational change

Below are the significant steps that are involved to bring into effect the organizational change.

3.4.1 Application under Sec. 284 of CO, 1984

The initial step in order to bring a scheme of arrangement, compromise, reconstruction, amalgamation into effect is to move an application under section 284 of CO, 1984.[166]

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[165] Kaikhosru J. Rustomji, *Company Law In Pakistan: An Exhaustive And Critical Commentary On The Companies Act, 1956* (Allahbad: The University Book Agency, 1991), 1081.

[166] Imran Ahsan Khan Nayzaee, *Company Law (Including Companies Ordiance, 1984)* (Lahore:Federal Law House,2008), 197.

3.4.2 Persons empowered to file an application for the sanction of scheme

3.4.2.1 "Directors of the company"

The directors of economically troubled company can validly formulate an application for the reorganization of the company under section 284 of CO, 1984, on behalf of the company[167]. They can also formulate an application where the scheme would engage a modification of the memorandum or articles. They do not need to be empowered previously by decision of the general body of the company.

3.4.2.2 Managing Agent

The "managing agent" of the company who is empowered to administer the business of the company can realistically formulate an application under Sec. 284 of the CO, 1984. It is put through the term of the agency contract which was singed by and between him and the company.

3.4.2.3 Share-holders and creditors

The Shareholder and creditors of a financially distressed company can also validly formulate an application under Sec. 284 of the CO, 1984, for the restructuring of the company.

3.4.2.4 When the company being wound up

Even after a direction for the end of a company under CO, 1984, a creditor or a member can file an application to the court under Sec. 284 of CO, 1984. This section does not grant an exclusive right on the liquidator to make an application for compromise and arrangement. As Venkataranama Roar, J, explained in re:Travancore Qrwilon Bank Limited.

That even after a direction for "winding up" of the company is given; an application can be made to cancel the winding up order and to allow the company to resume its normal business. The creditors and members are the people who are vitally interested in the life of the company. They are the best judges of their interest. It should not have been, therefore, objective of the legislature not to deprive the members or the creditors of their right, to move an application to cancel an order of "winding up", and allow the company to restart its normal business. Once, a direction for the "winding up" is made and placed it on the mercy of the liquidator who may or

[167]Ibid.

may not choose to move the matter. All that is intended by this section is that liquidator should also have the right to make an application.[168]

3.4.2.5 Creditors of the foreign company

A fellow of creditors of a foreign company has a license to formulate an application under Sec. 284 of CO, 1984, to a court in Pakistan before which the proceedings for the "winding up" of the company are pending. This court has jurisdiction to entertain the application although it has not given direction for the "winding up" of the company. In such a case the right to make an application is not confined to the liquidator only.[169]

3.5 Courts which are authorized to hear the cases of reorganization

The High courts are authorized under Sec. 7 of CO, 1984, to hear the cases of the scheme of the rehabilitation or the reorganization of the company under CO, 1984, in Pakistan.

3.5.1 Role played by the courts in respect of a scheme

When an application under Sec. 284 of CO, 1984, made to the court for the reorganization of the company it is not obligatory upon the court to sanction an order to ask for in the said application under sub section (1) of the section 284, without considering whether the proposed arrangement justified such an order or not.

When an application made under section 284, it must disclose all the relevant information as to the company's assets and liabilities so as to enable the court whether the proposed scheme is reasonable or not. The application for a scheme is not simply dismissed on the argument that the proposed scheme is not based on the correct information regarding the business of the company as on the date on which the affidavit is made.

The court can submit the report for the consideration by the general body of the creditors..[170]

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[168] Mian Muhib Ullah Kakakhel, *Company Law In Pakistan: An Exhaustive And Upto-Date Commentary On The Companies Ordinance, 1984 With Companies Rule 1985 And Other Connected And Relevant Statute And Statutory Rules* (Lahore: Khyber Lawpublisher,1998), 755.

[169] SH.Shukat Mehmood, above n. 164, 422.

[170] Ibid.

3.5.2 When an application may be dismissed

When an application for reorganization or promise is made to the court for the restructuring of the company, the court usually gives a command to call for the meeting of the members of the company to consider the proposal. Although the court has certain discretionary powers in this regard.

The court usually refuses to render an order to call for the meeting of members to consider the proposal in the following circumstances:

- Firstly, when the proposed scheme is ultra virus to CO, 1984;
- Secondly, when the proposed scheme in view of certain facts is incapable of execution;
- Thirdly, when the winding up was sought on the basis of the inability of the company to repay its debt; and
- Fourthly, when the company is being ended on the ground of oppression of majority on the helpless minority.

In the above stated circumstances the court would refuse to consider any scheme of compromise or arrangement to avoid the above situation.[171]

3.5.3 When a scheme sanctioned by the court

The assent of the majority of the shareholders and creditors are required for the approval of scheme.

According to Sec. 284 of CO, 1984, "where a compromise or arrangement is proposed between a company and its members or any class of them or a company and its creditors or any class of them the court may makes an order to call for the meeting of the creditors or any class of them, or of the members of the company or class of members, as the case may be, to be called, held and conducted in such a manner as the court directs".

According to sub-sec (2) of sec 284 of CO, 1984, the compromise or arrangement will be sanctioned by the majority in numeral, symbolize 3/4 in value of the "creditors or the class of the creditors, or members or class of the members", accepted any compromise or arrangement.[172]

Where the scheme is before the court, it is clear that the responsibility of the court are two fold in determining whether a scheme should be sanctioned or not.

[171] Ibid.

[172] Ibid., 423.

The primary duty is:

- ➢ To get satisfaction that the resolution is approved by the constitutional majority in value and figure in agreement with the Sec. 284 of CO, 1984,
- ➢ To see that resolution is passed at the meeting properly calls together and held.

The secondary duty is in the nature of the discretionary power.

Therefore, following conditions should be observed by the court while sanctioning a "compromise or arrangement":

- First, the statutory obligations as to the assent of the "members or creditors" have been fulfilled;
- Second, the court is contented that the application relating to the compromise or arrangement discloses all the material facts by affidavit or otherwise, that are necessary to judge the latest financial status of the company;
- Third, the scheme must be just and it is not in opposition to the public interest;
- Fourth, the reasonable scheme is not ultra virus the company; and
- Fifth, the scheme is competent for the execution.[173]

Even if the statutory requirements have been fulfilled, the court has wide discretion in sanctioning a scheme. Therefore, it does not mean that when the statutory requirements have been compiled with the court must sanction the scheme.

The legislature intentionally has given a wide discretionary power to the court in this respect. Therefore, while sanctioning a scheme the court should consider the circumstances and apply its judicial mind whether to sanction or refuse a proposed scheme. It must judge whether it represents the class of the person for whom the majority acts and it represent the interest of the whole company, whether the scheme is such that it must be pushed through.[174]

Hence, in spite of the approval of shareholders and creditors the court has power to reject the scheme.

It is the duty of the courts to scrutinize the scheme from every respect and draw its conclusion thereon, whether:

- ➢ Whether, the scheme is fair or not; and

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[173] Mian Muhib Ullah Kakakhel, above.n.168, 763-764.

[174] SH.Shukat Mehmood, above n. 164, 433.

- Whether to sanction the scheme or not, although the scheme is sanctioned by the creditors and shareholders of the company.

If the scheme is fair and equitable and also permitted by the required majority of the creditors or members of the company then it will be approved by the court.

Brown L J., in the 'Alabama case' put the matter thus;

"The court would apply all the principle which it ordinarily would bring to bear in mind before sanctioning a scheme, the first thing that the court must do is to consider whether, although the meeting has been properly called, still it is satisfied with the result. It is not as it seems to me at all compulsory upon the court simply to register the decrees of the meeting, even if three-fourth in value of the meeting has given the assent which the statute renders a condition precedent to the jurisdiction of the court. The court has still to consider the circumstances".

A compromise or arrangement which is to be approved by the court must be a realistic compromise or a realistic arrangement and a no compromise or arrangement can be said to be realistic in which you can get nothing and give everything.

Brown L J in same case expressed "a realistic compromise must be compromise, which can, by reasonable people conversant with the subject be regarded as beneficial to those on both sides who are making it and he added to explain that I have no doubt at all that it would be improper for the court to allow an arrangement to be forced on any class of the creditors, if the arrangement cannot reasonably be supposed by sensible people to be for the benefit of the class as such".[175]

The court must be satisfied that the majority has been operating fairly and justly and the minority is not being superseded by a majority having interests of its own contradictory with those of the minority whom they try to persuade.

The court, prior to awarding its approval to the scheme of "compromise and arrangement", must be contented that the requirements of the statue have been fulfilled ; that the each class was fairly symbolized by those who participated in the meeting and statutory majority are operating fairly and justly and are not pressurizing the minority in order to encourage the interests, unfavorable to those of the class whom they claim to symbolize; and "the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest might reasonably approve".

[175] Mian Muhib Ullah Kakakhel, above.n.168, 764.

Hence, the correct approach to a case is to bear in mind that the court is neither requested to register a case of the majority nor it is called upon to act in such a manner that minority will create deadlock and thereby slow down the growth which the majority has justifiably and practically a right to anticipate and make.

The court should test the scheme not from the point of view of a fault-finding critic, fastidious lawyer or a meticulous "accountant" or hairsplitting expert, but it should observe it from the perspective of a practical and a fair-minded person.

The object of Sec. 284 of CO, 1984, is to devise such a mechanism that every party treated fairly and equitably. It should not be the situation that one person is the victim and the rest of the class with regard to whom the compromise is being discussed, should enjoy upon his rights. But, the compromises are devised in such a manner so that they represent the interest of the entire creditors and members of the company and also save the minority from the exploitation of majority. Hence, the interest of every party is protected and every party is treated fairly and equitably.[176]

The court can refuse to accept the result of the meetings of the creditors even in the situation when the court has given direction for the holding of the meeting for the consideration of the scheme. If the court is not contented with the result of the meeting of the creditors and it is not safe to proceed on the result of the meeting. In such cases the court may direct another meeting to be called.[177]

The court must examine the scheme and catch an analysis which can be rationally taken by business men. It also view the scheme just like a person acting sincerely and justly viewing the scheme put in front of him in the interest of those whom he represented.

If the creditors act honestly and timely and in the light of adequate information, they are the most appropriate judge of their "commercial advantage" than the court. If you lay before the creditors a scheme which they think is sufficient it is not the province of the court to say that every conceivable scheme was not laid before them and submitted to them. It is neither the duty nor the business of the members of the court to express their own opinion as to whether, if the happen to be the creditors they would or would not voted in favor of the scheme.

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[176] Ibid.

[177] Ibid.

The object of Sec. 284 of CO, 1984, is also to determine the desires of the creditors and members and not to get a verdict from the court as to the feasibility and practicability of the proposed scheme.[178]

The basic philosophy of the CO, 1984, in all the matter with regard to the distressed company whether:

- It is a matter of the "winding up" of the company; and
- It is matter of scheme.

To look at the desires of the majority of the creditors, however the rights of the minority of the shareholders should be safeguarded. Therefore, no court is entitled to say that it will not ascertain the wishes of the majority in respect of the proposed scheme.

Under sub-section (1) of section 284 of CO, 1984, certain discretion is vested in the court, but the scope of this discretion is limited. The court should not refuse to order a meeting unless the proposals are illegal as being in contravention of the act or incapable of the modification in view of certain facts.

3.6 Burden of the proof as to reasonableness

The burden of the proof as to fairness and reasonableness of the scheme is on the petitioner.[179]

3.7 Burden of the proof as to unreasonableness

The onus of proving unreasonableness or unfairness about the scheme or want of good faith is on those who object or criticize to the scheme.[180]

3.8 Modification of scheme

When a scheme is presented to the court for sanction, the court either to accept it or reject it. The court cannot replace the scheme with its own scheme. If the court is of the view that

[178] Ibid., 765.

[179] SH.Shukat Mehmood, above n. 164, 434.

[180] Mian Muhib Ullah Kakakhel, above.n.168, 766.

unless some radical amendments are made in scheme or alter fundamentally, it ought not to be sanction. The court should reject the scheme.

The court cannot suo motu impose any condition which will operate by way of modification of the scheme especially in the nonexistence of the consent of the persons who entered into the arrangement with company. However, the court after it has sanctioned a scheme, has only a power to correct accidental omissions or mistake in it or to review its order for sanctioning a scheme under the "Code of Civil Procedure, 1908". The variation must be approved by the meetings of the creditors and shareholders and then sanctioned by the court.[181] The company or its shareholders cannot do it themselves by their consent.

The court is empowered to modify a scheme, but it must not be exercised to substitute the scheme, but to make it effective and workable. The court's power of superintendence is confined to proper working of the compromise or compromises. It cannot be exercised to determine or adjudication any rights or interest claimed by a company against the person who are not parties to the scheme of "compromise or arrangement".

3.9 When scheme become binding

The agreement becomes binding from the date when it is formed but it is dependent on the subsequent authorization by the court. If that authorization be refused, the agreement is without effect. Therefore, the agreement becomes effective from the date of its formation and from the date of its confirmation by the court. Hence, the sanction of the court has thus retrospective effect.[182]

3.10 Effect of the orders

According to sub-sec (3) of Sec. 284 of CO, 1984, an order sanctioning a scheme begins to operate only when a licensed copy of such order is to be submitted to Registrar. This sub-sec merely lays down a condition precedent to the coming in force of a scheme and does not deal with the rights and obligation of the parties under such a scheme.

[181] SH.Shukat Mehmood, above n. 164, 424.

[182] Ibid., 436.

When a scheme is confirmed by the court, then it does not remain a mere agreement between the parties and has a statutory force. It binds the company, the creditors and the shareholders.[183]By virtue of the provisions of section 284 of CO, 1984, "a scheme is statutorily binding even on creditors and shareholders who dissented from or opposed to its being sanctioned. It has statutory force in the sense and therefore cannot be altered except with the sanction of the court even if the shareholders and creditors assented to such alteration. The effect of the scheme is to supply by recourse to the procedure thereby prescribed in the absence of that individual agreement by every member of the class to be bound by the scheme which would otherwise be necessary to give it validity".

The scheme does not become an ingredient of the constitution of the company. Sub-sec (4) of Sec. 284 of CO, 1984, clearly lays down that a photocopy of the order is to be annexed to a copy of the MOA, given after its approved copy has been submitted to the Registrar that is after the operation of the scheme commences.[184]

The scheme when sanctioned gets statutory operation and becomes something quite different from mere agreement. Its terms could thereafter only be varied by order of the court after the variations have been approved at meetings of the creditors and shareholders.[185]

3.11 Stay of the actions against the company

The court is empowered to stop the initiation or continuance of the suit or measures in opposition to the company, its officers and directors, at any time after a petition has been made to it.

A stay granted under sub-section (5) of the section 284of CO, 1984, will only stop the initiation or continuance of any suit or measures in opposition to the company, its directors and officers representing the company in its operation. It will not stay the proceedings against the directors

[183] Ibid., 435.

[184] Mian Muhib Ullah Kakakhel, above.n.168, 767.

[185] Ibid.

and officers for something done by them in their personal capacity, for example criminal breach of trust in relation to the property entrusted to them.

An order staying the initiation or continuance of the suit or measures would continue in force till the final order sanctioning the scheme is passed. The order continues to be in force even after the scheme is sanctioned by the final order. Therefore, on the scheme being sanctioned, it is not necessary to pass a formal order making the order of stay absolute.[186]

3.12 When stay may be granted

The stay is granted under sub-section (5) only when a petition is being submitted by the creditors or members of the company.[187]

3.13 Appeal

Where an order sanctioning a scheme has been completed, it becomes final and the party aggrieved has only the remedy of an appeal against it. In proper case the court can for sufficient cause extend the time for preferring an appeal.[188]

3.14 Enforcement of the scheme

The courts have the powers to enforce the scheme under Section 285of CO, 1984. In the enforcement of the compromises no question of the limitation arises. As section 285(1) of CO, 1984, uses the words "at the time of making such order or at any time thereafter". The court is empowered to give direction for the appropriate functioning of the scheme and to enforce it so long as any part of it remains unenforced. The matters remain pending for years in such cases as has been the usual experience.

A scheme once sanctioned becomes binding on all the parties including the dissenting members. It is very significant to make a note of a thing that the court is enforcing not an ordinary contract but a scheme sanctioned by the court under a statue.[189]

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[186] Ibid.

[187] Ibid.

[188] Ibid., 438.

3.15 Scheme involving the reconstruction or amalgamation of companies

The words "reconstruction" and "amalgamation" have no specific legal meaning. The characteristics of the reconstruction are very different from the amalgamation. A new company is produced under the scheme of the reconstruction and it takes over the assets of the old company. It is a scheme under which an old company goes into the liquidation for the specific purpose of selling its possessions to a fresh company in exchange of the partly paid shares carrying a further liability. "In fact it is just like putting old wine in new bottle after being refined". The new company is formed with precisely the same object, the similar name and composed of the same shareholders who are asked to provide additional working capital.

Reconstruction of the company may be carried out for the object of:

- Widening the sphere of the operation of the company by enlarging the scope of its memorandum; and
- Carrying into effect a compromise with the members or creditors of the company.

On the other hand, "amalgamation means a state of things under which two companies are so joined as to form a third entity, one company is absorbed into and blended with another company".[190]

There are three principle mode of the amalgamation:

- First, there is a formation of the new company i.e., purchasing company to take over the assets of two or more companies. The existing companies are wound up on completion of transfer;
- Second, there may be amalgamation by the absorption. In this case one existing company purchases and takes over the entire business of another company, and the latter is finished;
- Third, there may be amalgamation by the acquirement of the controlling interest, where one company purchases not a smaller amount than three-fourth of the issued capital of another company, and both the companies retain their separate existence.[191]

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[189] Kaikhosru J. Rustomji, above.n.165, 1094.

[190] H.,K.Saharay, *principle and practice of company law in India*.2nd edn (Delhi: Prentice Hall,1984), 340.

[191] Ibid.

Lindly M.R observes that "amalgamation does not mean the formation of the new company to carry on the business of the old company. It includes that, but is not confined to that."

For the purpose of getting the approval of the scheme of reconstruction and amalgamation, a petition under sec 284 of the CO,1984 is submitted to the court. The petition with the aim of getting sanction a compromise or arrangement planned between:

- "A Company and its creditors or any class of them; and
- A company and its members or any class of them".

The application contains inter alia the following material points:

- That the scheme is for the "reconstruction or amalgamation" of company or companies.
- That the entire or any portion of the undertaking, possessions or legal responsibilities of the "transferor company" is to be transferred to the "transferee company" under the scheme.

The transaction is in the shape of offer and approval. There should be consensus ad idem between the "transferor company" and the "transferee company" in the matter of amalgamation. The "transferor company" is under an obligation to put on notice of its shareholder as to the intendment and object of the scheme of amalgamation and to inform them of the benefits, facilities and privileges attached with such transaction. Even if there is no prerequisite in the memorandum for amalgamation. On amalgamation the "transferor company" amalgamates into "transferee Company" but for all the objectives remains active and thrives as an ingredient of the bigger whole.[192]

Absence of any power in memorandum of companies, for which application for amalgamation is made, would not invalidate scheme of amalgamation. Amalgamation or merger of the companies or corporation is a matter which relates to the incorporation or regulation of the companies. Amalgamation is an agreement also between the "transferee company" and its members. A court can always sanction a scheme if the statutory requirements are complied with.[193]

In case of amalgamation all the privileges and legal responsibilities are amalgamated and the transferee company becomes vested with every such privileges and legal responsibilities. In case

[192] Ibid., 341.
[193] Ibid.

of the reconstruction, the existing company discharges certain function for a certain time until it will be dissolved. The transferee company will fulfill other purposes.

If memorandum of the association does not provide for amalgamation or similar schemes, but scheme is approve conditionally, subject to alteration in memorandum, and at the time of approving scheme shareholder also pass a particular motion for variation of the memorandum, approval is not ultra virus the company.[194]

3.15.1 Power of the court with regard to the scheme of "reconstruction" and "amalgamation"

The scheme by which a company transfer . its undertaking to new company formed by the amalgamation of the several companies and for reorganization of rights of and distribution of assets among different classes of the shareholder can be sanctioned by the court even if it involves winding up and ultra virus acts. It is well settled principle that the court while putting into effect its discretion in according sanction to scheme of merger consider the following things:

- First, the legal requirements have been complied with;
- Second, the classes were practically symbolized by those who be present at the meeting;
- Third, the legal majorities were performing fairly; and
- Fourth, the scheme should be a realistic so that a man of business would rationally endorse.

In a nut shell, "the approach of the court is to see whether the scheme is such as a man of the business would reasonably approve".[195]

In the absence of very strong ground, court should not establish its own observation of reasonableness of the scheme in conflict to the view of majority shareholders. The court should, keep in mind the reality that the scheme has been accepted by the big majority vote, but it should not shrink its responsibility to scrutinize a scheme, particularly when it involve the merger of the big companies in which several interests are in danger. The court has the power to permit

[194] Kaikhosru J. Rustomji, above.n.165, 1104.
[195] Ibid., 1106.

amalgamation even apart from the memorandum of the association itself containing such power.[196]

3.15.1.1 Court's power to give directions as to the transfer of whole undertaking

If the transport of possessions from "transferor company" to the "transferee company" under a scheme of amalgamation is under the direction of the court, it is a transfer otherwise then by the assignment. For the execution of decree obtained by the merged company amendment of the decree in favor of the new company is not necessary; assignment by the amalgamated company is sufficient.[197]

The transfer does not require formal conveyances from transferor. The fact of unfairness of valuation of the assets has to be firmly established before the court rejects the amalgamation on this ground. Where a scheme of the amalgamation provides for the amalgamation of the entire undertaking, non-mention of a particular property in schedule of transferor Company will not keep property outside the scope of order of the transfer.[198]

3.15.1.2 Court's power to give direction with regard to the allotment of the shares

In the matter which involves the amalgamation of two large companies, it would be impossible for the court to form its judgment unless sufficient materials placed on the record as regard the method and the basis of the evaluation of the shares of the amalgamation of two companies. The exchange ratio of the shares in a scheme of the amalgamation is for the shareholder to decide. It is a well settled principle that the burden of proof as to the unreasonableness and unfairness of the exchange ratio and the scheme of the merger is entirely on the dissentient shareholders. The relevant factors which are to be keeping in mind in shaping the concluding share exchange ratio are enumerated below:

- "First, the stock exchange prices of the shares of the two companies before the commencement of the negotiation or the announcement of the bid;

[196] Ibid.
[197] Kaikhosru J. Rustomji, above.n.165, 1107.
[198] Ibid.

- Second, the dividends presently paid on the shares of the two companies;
- Third, the relative growth prospects of the two companies;
- Fourth, the relative gearing of the shares of the two companies;
- Fifth, the value of the net assets of the companies;
- Sixth, the voting strength in the merged enterprise of the two companies; and
- Seventh, the past history of the prices of the shares of the companies".[199]

3.15.1.3 **Court's power to give direction with regard to the dissolution of the transferor company**

The dissolution of the transferor company can be ordered under sec 287(1) (d) of CO, 1984, even where a company is a going concern. In case of the amalgamation all the privileges and legal responsibilities are amalgamated and the transferee company becomes vested with every such privileges and legal responsibilities. This section to some extent overrides ordinary law of the contracts under which assets alone can be assigned but not the liabilities and duties arising under the contracts.

Transfer or vesting takes place by separate command of the court under this section. Where a command under this section supplies for the shift of the possessions and legal responsibilities of a company in insolvency to another company. The possessions are by virtue of the command, conveyed to and vested in the "transferee company" and the legal responsibilities of the previous company are also transmitted to the "transferee company".[200]

3.15.1.4 **Court's power to make provision for dissentient shareholders**

Section 287(1)(e) of CO, 1984, empowers the court make provision for any person who dissents from that scheme.[201]

3.15.1.5 Court's direction as to the incidental matter

It is not necessary that matters are incidental, consequential and supplemental to amalgamation; it must be shown that directions are necessary to complete the amalgamation.[202]

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[199] Ibid., 1108.
[200] Ibid., 1109.
[201] Ibid.
[202] Ibid., 1110.

3.16 **Obligation of the company**

According to the Sec 287(3), every company with regard to which a direction sanctioning the scheme is given, must submit a licensed copy of such order or direction within thirty days subsequent to the order given by the court, to the Registrar for registration. In case of the failure to comply with this prerequisite, the company, and every officer of the company who is responsible for this failure, shall be penalized with a penalty to the extent of, one thousand rupees.

3.17 Instances where scheme can be sanctioned

- The company which is commanded to be wound up its application and a scheme for the reconstruction is presented by the workers.
- Where transferor Company is suffering losses and may have to be wound up, it is desirable that it be amalgamated with another company.
- When take over of healthy unit by the sick unit is held to be justified.[203]

3.18 Instances where scheme can not be sanctioned

- Where creditors approve a scheme without understanding its implication.
- Where the intention of the merger is to crush certain tax.
- The court will not sanction a scheme of the "reconstruction of the company limited by the guarantee" where members pass scheme without liability of the members and company court sanction a scheme leaving question of the liability to be decided when it arose.[204]

3.19 **The scheme for 'take-over' of shares**

There is another kind of the reorganization or rehabilitation of the company which is commonly called a 'take –over' bid. In this case another company puts a proposal to take over all the shares or the whole of the class of the shares of company. If the proposal is accepted, the necessary arrangement for transfer is made conditional on the protection of the interest of the dissenting shareholders.[205] The transferee company has power to obtain the shares of differing shareholders of the transferor company on the fulfillment of the following conditions:

[203] Ibid.
[204] Ibid., 1111.
[205] See H.,K.Saharay above n 190.

- First, there must be a scheme or contract concerning transport of shares or any class of shares in the "transferor company" to the "transferee company"; and
- Second, within four month after making of the proffer in that behalf by the "transferee company". The offer has been accepted by the owners of not below than nine-tenths in worth of the shares whose transfer is concerned (excluding the shares previously held at the date of proffer by, or by a nominee for, "the transferee company or its subsidiary").[206]

The "transferee company" may, give notice in the recommended manner to any differing shareholder at any time within two month of his intention to obtain his share subsequent to the termination of the said four months.. The expression "dissenting shareholder" includes the following shareholders;

  - First, a "shareholder" who has not agree to the scheme or contract; and
  - Second, any "shareholder" who has rejected to shift his shares to the "transferee company" in compliance with the scheme or contract. In other words, he expresses his dissent to the scheme of 'take-over' bid by the transferee company and is thus unwilling to transfer his shares in line with the scheme.

The period of four months is a maximum period, and the transferee company is debarred from prescribing a shorter time inside which the offer should be approved. When such a notice is given, the transferee company shall be permitted and under the duty to acquire the shares of the dissenting shareholders on such conditions as approved by the majority under the scheme or contract. But the dissenting shareholders are empowered to submit a petition to the court within one month from the date of the notice to prevent the "transferee company" from acquiring the shares of the dissenting shareholders. The court will order otherwise than compulsory attainment of the shares of the dissenting shareholders by the transferee company if the scheme is not unreasonable or unfair. In such circumstances heavy burden is upon the dissenting shareholders to prove the wrongness of the scheme.[207]

Generally stock exchange quotation is taken as the prima facie price of the shares. The application of the applicant will not be succeeded or permitted on the following grounds;

- First, where applicant has neither alleged nor proved that the majority had acted under inducement of fraud or misrepresentation, or that they acted unfairly or oppressively;

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[206] Ibid.
[207] Ibid., 345.

- Second, where he files application on the ground that the transferee company derive substantial benefit from the scheme or contract; and
- Third, a wrong basis of the valuation adopted under the scheme for the acquire of shares of a company by itself will not be enough to allow the application of a dissentient member under this section. There must, in addition, the proof that the valuation has affected reasonableness of the offer. [208]

When the dissenting shareholders can show that transferee Company in substance is the same as the majority shareholders in the transferor company who accept the offer. The burden is shifted on the majority to convince the court that there are good grounds for such a scheme which is made in the interest of the company.

3.19.1 Principle of one-tenth of shares previously held by the transferee company

The provision 289(1) of CO, 1984, shall not apply where at the date of offer in excess of one-tenth of the aggregate value of the entire shares whose transfer is concerned, are previously owned by the "transferee company". But this principle of one-tenth of shares previously possess by the "transferee company" operates again subject to two limitations:

- First, the "transferee company" proposes the same requisites and conditions to the entire possessor of the shares of that class, whose transport is involved.
- Second, the shareholders who agree to the scheme or contract should possess the following two qualities;
    - They should possess nine-tenth in value of the shares whose transfer is concerned
    - They should not be below than three fourth in figure of the holder of these shares.[209]

3.19.2 Nine-tenth of the shares attained by the transferee company

According to the section 289(2) of CO, 1984, when a scheme approved by the shareholders of the company and under that scheme shares in company are conveyed to another company or its nominee or to its subsidiary, and at the time of transfer, the "transferee company" or its nominee or its subsidiary hold shares together with another share of the "transferor company" of the value

[208] Ibid.
[209] Ibid.

of nine-tenth in transferor company, the transferee company is required to observe the following statutory requirement:

- First, the "transferee company" must serve a notice of the fact in the recommended manner inside one month from the time of the transport to the shareholders of that class or to the holder of the residual shares, who have not agree to the scheme; and
- Second, on such notice, any dissenting shareholder may oblige the "transferee company" to obtain his shares in question, within three month from the time of the notice.[210]

When a notice is served by the dissenting shareholder to the "transferee company", to get his shares, the transferee company on such notice is bound to get the shares of the dissenting shareholder on such stipulations as

- ➢ May be decided
- ➢ The courts thinks fit
- ➢ The shares of the approving shareholders under the scheme or contract were transferred to it.[211]

3.19.3 Completion of the transfers

When a notice is served by the "transferee company" under sub-section(1) of the section 289,to the dissenting shareholders, then "transferee company" on the termination of one month from the time on which notice is served, must do the following things:

- First, pass on a copy of the notice to "transferor Company" together with an deed of transfer accomplished on behalf of the "transferee company"; and
- Second, give the consideration amount to the "transferor company".

On the completion of the above prerequisites by the "transferee company", the "transferor company" shall take the following steps

- ➢ It will register the "transferee company" as the owner of those sharers.
- ➢ It will notify the "dissenting shareholders" of the truth of such registration, within one month, and also inform them the consideration sum received by them.[212]

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[210] Ibid., 346.
[211] Ibid.
[212] Ibid.

3.20 Rehabilitation of the company facing temporary operational or financial problems

The law relating to the rehabilitation, reorganization or the reconstruction of the company facing temporary operational or financial problems is contained under section 296 of the CO, 1984, and it provides for the following things

Section 296 of CO, 1984, is applied, when a company owing a sick industrial unit and is acknowledged as sick company by the "Federal Government(FG)".[213]

3.20.1 Who prepare the plan for the "rehabilitation", "reconstruction" and reorganization of the company?

A plan for the reconstruction, rehabilitation and for the reorganization of the company is prepared by:

a. Any individual;
b. Committee;
c. Any institution; and
d. Any authority.

Empowered by the FG in this respect, for the preparation of the plan. The plan or arrangement may in spite of any other contain the entire or some of the following things:-

When a plan is related to the reduction of the share capital then it contains all or any of the matters as provided in section 96 of the CO, 1984.

A plan, when provides for the reconstruction, compromise or for the merger of the companies, it contains the entire or some of the topics provided in sec 284, or sec 287, or sec 289 of CO, 1984.

A plan may provide:

- For the dismissal, and appointment of the directors or other officer of the company;
- For the alteration, modification, and termination of the existing contract;
- For the amendment in the "memorandum of association(MOA) or the article of the association(AOA)" of the company;

[213] NAZIR AHMAD SHAHEEN, *Practical Approach To The Companies Ordinance, 1984.* 3rd edi (Lahore: Federal Law House, 2007), 963.

- For the issue of further share capital, carrying shares which provide for the special rights and obligations in respect of the voting powers, dividend, and a special treatment in situation of the company being wound up;
- For the transfer or attainment of shares of the persons who are running the dealings of the company on definite terms and conditions; and
- For a change in the structure of the loan i.e. debt rearrangement or conversions into shares carrying special rights, or change in the terms and conditions relating to the outstanding debts and liabilities of the company or in any part of the debt or out standing liabilities of the company or change in the rights of the creditors of the company.[214]

3.20.2 Who approve rehabilitation plan

After the rehabilitation plan has been drawn up fully, then it is presented to the FG for the approval of the "rehabilitation plan". The FG unless it makes a decision for the reason to be shown, otherwise; reveals it in the official gazette, so that the views of shareholders, creditors, and other persons, who are interested in the rehabilitation plan, can be determined within a particular period and if they have any grievance regarding the rehabilitation plan that can be removed, before the sanction of the "rehabilitation plan".[215]

When the FG approves the rehabilitation plan, then it turn out to be binding on all the parties relating to the rehabilitation plan, and enforceable in all respects, with such modifications in the rehabilitation plan, as may be expressed by the Federal Government. if anything contained, in CO, 1984, or in the MOA of the company or AOA of the company, or document executed or in any agreement or into any supplementary law for the time being in power, which is in contradiction with the provisions of the corporate rehabilitation plan, become void.

The requirements contain in this section shall not stop the company or its shareholders or creditors to conclude, or come to or make any "compromise or arrangement" in any mode approved by the CO, 1984, or into any supplementary law presently in power, until the time of the sanction of the corporate "rehabilitation plan" by the FG.[216]

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[214] Ibid., 964.

[215] Ibid.

[216] Ibid, 965.

3.20.3 Who supervise the implementation of the corporate rehabilitation plan?

The FG has the power to modify or cancel the "corporate rehabilitation plan" and issue such direction to the concerned parties as regard to its implementation and affairs supplementary thereto as it deems fit and necessary and the FG may also authorize some authority or person to administer the execution of the plan, and the authority or person so, empowered by the FG also has the power to issue such direction as regard to the execution of the plan, to the concerned parties as it deems fit and expedient.[217]

3.20.4 Punishment for the failure to enforce the corporate rehabilitation plan

Whoever fails to enforce the corporate rehabilitation plan or carry out any matter provided for there in corporate rehabilitation plan, to a punishment of detention which may be extended to two years and may also with a fine which will not exceeded "one million rupees", and in case of the continuing default or failure, to a additional fine not more than "five thousand rupees" for each day in which failure continue.[218]

3.21 Rules relating to the "rehabilitation of the companies owing sick industrial units(SIU)", 1999

The FG while exercising the power given in Sec. 506 made rules for the sick industrial units(SIU). "The rules may be called the companies Rehabilitation of Sick Industrial Units rules, 1999."

3.21.1 What is meant by the task force(TF)?

According to the rule 2(d) of SIU Rules, 1999, "task force" means, "task force" that are composed under rule three of these rules, and according to the rule 3, the FG shall form a TF known as TF force for the revival of the SIU and this TF force shall fulfill such tasks as may be awarded on it by these rules or subject to section 296 of the CO, 1984.[219]

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[217] Ibid.

[218] Ibid.

[219] Ibid., 966.

3.21.2 The procedure for declaring a company sick

According to the rule 2(a) of Rules, 1999, "the bankers committee means the committee constituted by the State Bank of Pakistan comprising of heads of the banks and financial institution to implement the recommendation of State Bank of Pakistan coordination committee relating to the revival of the sick units".

According to the rule 5(1) of Rules, 1999, a bankers committee shall submit a report to the TF about a company owing an industrial unit when in opinion of bankers committee the company is facing financial difficulties or operational problems.

According to the rule 5(2) of Rules, 1999, the task force shall examine the statement of the "bankers committee" and such other facts as may be necessary for making an opinion about a company, and if the TF is of the opinion that the company is a sick company then it shall submit a suggestion to the FG.

According to the rule 5(3) of Rules, 1999, and if the FG after examining the statement of the "bankers committee" and the suggestion made by the TF is of the view that the company is a "sick company", then it may state publicly the company to be a "sick company" within the meaning of Sec. 296 of the CO, 1984.[220]

3.21.3 Who will prepare a plan for the "rehabilitation" of the sick company?

According to rule 6(1) of Rules, 1999, after declaring a company, a sick company by the FG then asks the TF to prepare a plan for the restructuring of sick company, and then, TF set up an arrangement for the rehabilitation of the sick company by keeping in view the provision of section 296 of CO, 1984.

According o the rule 7(1) of Rules, 1999, the TF with the previous assent of the commission and subject to the provisions and the rules made under CO, 1984, also set out the parameters for declaring a company owing an industrial unit a sick company. The parameters determined by the TF will help a lot in determining the factors with the support of which a company may be judged as sick.[221]

[220] Ibid., 967.

[221] Ibid.

3.21.4 Who will bear the expenses of the TF?

All finances that are required for the proper functioning of the TF shall be borne by the bankers committee on the voluntary basis.[222]

[222] Ibid.

Chapter 4 Comparison of the fundamental features of the corporate rescue law of English, American and Pakistani law and recommendations for the improvement of the Pakistani corporate rescue law

4.1 Introduction

In this chapter, I will evaluate the primary features of the UK, American and Pakistani law, and then I suggest the recommendations under the guidance of the law of English and American corporate rescue law for the betterment of the Pakistani corporate rescue law.

The rationales, why I will compare the Pakistani corporate rescue law with UK and American corporate rescue laws are:

First, although, there is a need more of improvement in the UK, and American corporate rescue law but both are developed forms of the corporate rescue law.

Second, a large portion of the Pakistani corporate rescue law is based on the UK corporate rescue law at the time of its formation. Since that time there is no development made in the Pakistani corporate rescue law but there is a lot of changes occurred in the UK corporate rescue law.

Third, the proposed corporate rehabilitation bill of Pakistan which is now in the process of approval. It is structured by keeping in view of the UK, American and Indian models of the corporate rescue law.

Fourth, a large number of the developed jurisdictions such as, Germany, France and UK developed their corporate rescue laws by keeping in view the American corporate rescue law.

Therefore, due to the above reasons, I have chosen the American and UK model of the corporate rescue law for comparison with Pakistani corporate rescue law. Through this, I can suggest some reforms in the Pakistani corporate rescue law for making it updated and comprehensive. As the Pakistani corporate rescue law is out dated and is unable to fulfill the needs of the time.

By studying the American, UK and Pakistani corporate rescue law, I infer that following fundamental characteristics of the American and UK corporate rescue law should be included in the Pakistani corporate rescue law to make it more comprehensive and effectual.

4.2 Automatic stay or moratorium

Moratorium or automatic is a mechanism that puts a restrain on the enforcement action of the creditors of the company against the company and its assets. It also stops the pressure, threats and harassment actions from the creditors of the company. The debtors company feels comfortable and during the moratorium it has a chance to negotiate with the creditors of the company and convince the creditors and shareholder of the company for the rearrangement of the debt and concludes an agreement for the reorganization of the company[223], the "automatic stay" has been justified as follows:

- the moratorium is a protection that prevents him from all the enforcement action;
- it gives him an opportunity of making his repayment or to try a reorganization plane; and
- It brings to a standstill all the collection efforts, all the threatening action and all the foreclosure action.[224]

In short, it provides a comfortable period for the debtor who is much worried due to the financial trouble that throwing him into bankruptcy.

In US, automatic stay or moratorium is an essential feature of the American corporate rescue law and when a chapter 11case starts it automatically becomes effective[225] and without the provision of the automatic stay the American corporate rescue law is incomplete.

In UK, automatic stay or moratorium is also now an essential feature of the English corporate rescue law. Previously it was not the part of the English corporate rescue law. It was firstly introduced in the English corporate rescue law by the Insolvency Act, 2000[226], and is available to small but still via able companies and at that time large companies were unable to get the benefit of the moratorium. But now when the company put in the process of administration the facility of the automatic stay is available to a company without distinction whether it is a large or small company.

In Pakistan, there is no provision under the Pakistani corporate rescue law is available that deals with the automatic stay or moratorium, and without the automatic stay the corporate rescue law is incomplete and unable to fulfill the requirements of the modern corporate rescue law.

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[223] Gerard McCormack, *Corporate Rescue Law: An Anglo-American Perspective* (Cheltenham : Edward Elgar, 2008), 156.
[224] Ibid.
[225] Ibid., 78.
[226] Ibid., 148.

4.3 New finance

The basic idea behind the reorganization or the restructuring or the rehabilitation of the company is that, a company is more valuable, if it is kept alive or sold off as going concern, than if it is put in the liquidation or sold off bit by bit. Therefore, the reorganization or rehabilitation procedure is very important not only from the social point of view but also for the company itself.[227]

Therefore, the second essential requirement of a corporate rescue law is new finance, which is very essential for the success of corporate rehabilitation plan,[228] because it is very necessary to think at the time of the preparation plan, that who will provide the new finance to the company surrounded by the financial difficulties, because once the reorganization proceedings are started, then no one is ready to lend the company surrounded by the financial difficulties. Even the existing lenders of the company stop lending in order to limit any further experience or prepared to lend the company on such requisites and stipulations which are not affordable to the company, because if they lend to the company surrounded by the financial difficulties they will bear the danger of not being repaid in full. Secondly, the company assets may not be available to get new loan because they are already used as security for the previous loan, then it is very necessary for the company in order to avoid the liquidation proceedings and to maintain its value as going concern to get new finance for the continuity of its operation.[229]

Then in such situation, it is very necessary to evolve such a mechanism that makes possible for the company to get new finance easily.

In order to tackle this problem of the new finance, the concept of the super priority is prevalent in some countries. According to this concept the loan of the lenders, who will advance loan to the company surrounded by the financial difficulties will be repaid in priority over all other claims. New priority financing make it possible for the company to continue its operation during the restructuring or the reorganization procedure. Although, it is provided to the company at a higher interest rate than would be charged if the company is working normally.[230]

There is no difficulty in receiving the new finance for the company surrounded by the financial difficulties as long as the unencumbered assets are available or on the other hand, secured

[227] Ibid., 177.
[228] Ibid., 176.
[229] Ibid., 177.
[230] Ibid.

property has sufficient value so as to be used as security for the new loan, but the difficulties may arise in getting the new finance in a situation when there are no unencumbered assets or the secured property has no surplus value that can be used as security for new loan, therefore, in this way substantial indebtedness of the company surrounded by the financial difficulties creates a barrier in the way of willingness of the new lender to extend loan to the company through funding profitable business projects of the company, so that company can be reorganized.[231]

Therefore offering super priority status to the new lender in such a circumstances is the best solution for the financial problems of the company.

Many economists and law scholars consider the super priority financing, the best mechanism for the solution of the financial problems of the company in situation when the existing assets of the company are fully secured by the existing lenders of the company i.e. debt overhang, and also in case of underinvestment problem i.e. where there are no enough incentives are available for investor to finance the value generating projects.[232]

In US, the law relating to the new finance is contained under section 364 of the US BC. According to this section any loan given to a company or corporate debtor surrounded by the financial difficulties during the reorganization or restructuring plan has priority overall the pre-filing unsecured claim or in other words any loan extended by the lender during the reorganization plan will be repaid in priority as compared to the pre-petition unsecured claims.

A company cannot get the confirmation of the reorganization plan without guaranteeing the full payment of the new lender. In the non existence of the any accord by the lender to the opposite, the debts of the new lender will have priority, even in the case of failure of the reorganization plan.[233]

The priority of the new lender is automatic, if the loan is given in the ordinary course of the business but if the loan extended by the creditor is not in the normal course of the business i.e. out side the ordinary course of the business, then in such a circumstances before granting the credit to the new lender the priority must be sanctioned by the court.[234]

For the objective of the determining whether a deal is done in the normal course of the business or not two tests have been designed by the court. They are:

[231] Ibid., 178.
[232] Ibid., 179.
[233] Ibid., 184.
[234] Ibid.

- First, vertical dimension
- Second, horizontal dimension

Vertical dimension looks at the expectation of a hypothetical creditor, and judge the transaction from the point of view of the debtor's pre-petition operation. The horizontal dimension test focuses on the industry and judge whether the transaction is in the normal course of the business or not by comparing the business of the corporate debtor with other businesses in the same industry, thus it must be remembered here that sec 364 takes into account the mode in which the loan is given to the debtor, and not take into consideration the debtor's use of new finance. The manner in which the loan is extended to the debtor should be in the normal course of the business and not the debtor's use of funds.[235]

Under certain situation when the assets of the corporate debtor are protected to such an degree, that simply yielding priority to the new lender over the pre-petition unsecured claims creates only little chance of the recovery of he payment extended by the new lender during the reorganization procedure. In case of the liquidation, then in such a circumstances meaningful priority is granted to the new lender, and by meaningful priority we mean the priority over all the pre-petition secured claims, and section 364(d) expressly states that the court is empowered to authorize this, but only under certain circumstances, for example, the debtor must demonstrate:

- First, "he cannot get the loan without granting such a security interest".
- Second, the pre-petition secured creditors are satisfactorily safeguarded against loss.

It seems that, US courts permit the meaningful priority only in narrowly defined circumstances and statutory requirements are strictly fulfilled.[236]

Thus there is elaborate law relating to the new financing in the US.

In UK, the law with regard to the financing of the company facing financial difficulties is introduced by the Enterprise Act. Although Enterprise Act does not expressly mention about the financing of the financially distress company, but expressed about the new financing by implication.

According to the administration procedure the company which is put in the process of administration then the responsibility of the running of the affairs of that company is entrusted to an outside insolvency practitioner, known as administrator. The administrator has wide power

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[235] Ibid.
[236] Ibid., 185.

relating to the financially distress company. The administrator usually possesses the following powers relating to the financially distress company:

- First, he may have all the powers of the management usually possess by the "board of the directors".
- Second, he is empowered to take loan for the company and give security on behalf of the company.
- Third, he is empowered to transact with the property that is under an existing security. The power to take care of the charge property and the property that belong to third party but in the company's possession is contained in the Insolvency Act, 1986, Schedule B-1, however there is a distinction in the power of the administrator to deal with the assets of the company those are under a fixed charge, and the assets that are subject to a floating charge.[237]

The administrator can deal with the possessions that are exposing to a "floating charge" in the manner as he sees fit or in other words he can take action with respect to such assets in the manner as they are not subject to "floating charge" and with no reference to the "floating charge" holder and other contractual restrictions.

When the administrator disposes of the property that is expose to a "floating charge", then the possessor of the "floating charge" would have had an equal status with respect to a property openly or in some way representing the asset that is disposed of.

There is a restriction on the power of the administrator with regard to the disposition of the property that is expose to a fixed charge, in order to deal with property that is expose to a fixed charge, prior assent of the court is required, and the court may grant its sanction to a petition of the administrator for the disposal of the property that is subject to fixed charge only if it is contented that the disposal of the relevant property is required to achieve the objectives of the administration relating to the company.[238]

This power of the administrator to deal with the property that is expose to an existing security, is the main provision in which there is an implied concept of super priority financing, because when administrator obtain loan on a property which is already subject to an existing security,

[237] Ibid., 196
[238] Ibid.

then clearly in such a situation the new lender will give loan only when he will be promised priority or in other words his loan will be repaid in priority.

Hence there is an elaborate system for the financing of the company during the reorganization or restructuring process in the US and UK corporate rescue law.

In Pakistan, no provision, expressly or impliedly relating to the new financing during the corporate reorganization or restructuring procedure is found in the Pakistani corporate rescue law, and which is a big lacuna in the Pakistani corporate rescue law, because now the concept of the super priority financing is a part of the global agreement on the insolvency law transformation or improvement.

For example, the concept of the super priority financing is also form part of the core "principles of the European Bank for Reconstruction and Development (EBRD)" for the insolvency law system, core principle clearly states that insolvency law regime should provide for the new financing for the process of the reorganization or restructuring of a financially distress company, where the reorganization or restructuring is the most suitable solution for a financially distress company.[239]

Moreover, (EBRD) also describes that there is no threat to existing secured lender from the provisions of the super priority financing, and it may benefit to them, as the new finance may help a lot in the development and success of the debtor's business, and in this way the debtor may be able to repay its old to the excising secured creditors in much better way.[240]

Similarly, "United Nation Commission On International Trade Law (UNCITRAL)" also describe the importance of the new finance in the post commencement reorganization procedure, and emphasize on the continued process of the debtor's business is very important for the reorganization of the debtor's business subsequent to the commencing of the bankruptcy procedures, and for this purpose they consider that the new finance is crucial for the success of the reorganization or the restructuring of a financially distress company.

It is described by the (UNCITRAL) that insolvency law system of a country should recognize the value of post-commencement reorganization financing and for this purpose should evolve a mechanism that provide for the new finance in the post-commencement reorganization

[239] Ibid., 181.
[240] Ibid., 182.

Normally a case started under chapter 11when the debtor .i.e. the company submits a petition with bankruptcy court willingly, when the petition is filed by the debtor. Then there must be following document with the petition,

- First, list of the possessions and liabilities
- Second, catalog of the in attendance creditors of the company
- Third, statement showing the pecuniary status of the company
- Fourth, record of the present earnings and expenses of the company
- Fifth, list of the executed contracts and uncompleted leases[133]

Although there is no official prerequisite that the Company is bankrupt or expected to become bankrupt in the near future, but there is a prerequisite of the good faith, which is a very crucial prerequisite.

if there is a good faith then there must be an intention;

a) First, of the reorganization of the company,
b) Second, to sell of its assets or
c) Third to liquidate it.

The petition that is filed under chapter11 of his bankruptcy code of the United States may be rejected if for example there is no real intention of the reorganization of the company.[134]

Creditors of the company can also commence a case under chapte11 under certain circumstances, when the company is in debt of amount at least $1000 and the company is not repaying that money owing unless that debt is the subject of the dispute. In doing so the creditors face the risk that if the statutory requirements are not fulfilled then company can recover the expenses from the creditors who file the petition and if the petition is not filed in good faith then the company can also recover the penalizing damages from the creditors.

It is usually the case that company enter into chapter 11 procedure under the force from the creditors and in most of the cases protected creditors in way force the company to obtain the protection of chapter11 otherwise they implement their security interest[135]. As the professor lopucki has said

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[133] GERARD McCORMACK, "*Corporate Rescue Law In Singapore And Appropriateness Of The Chapter11of The Us Bc As A Model*" (2008-20saclj-396-Mccormack.Pdf), 406.
[134] Ibid at p, 407.
[135] Ibid

therefore, the concept of the adequate protection should form part of the insolvency law of every country.

In US, the concept of the adequate protection is contained under sec 361, of the US BC. According to this section, the "adequate protection" of an interest of a body in the property of the corporate debtor or the company facing financial difficulties can be obtained by the following procedure:

- First, the trustee should make the periodic or cash payments to the entity;
- Second, the entity may be provided with security rights in the additional assets in exchange of an asset that may be used by the corporate debtor as security for getting the new loan; and
- Third, by making available for the entity any other adequate remedy.[243]

The basic concept that lies under the concept of the adequate protection is to safeguard the concern of the secured creditors and at the same time provide the business of the company facing financial difficulties with flexibility, and which is very important for the reorganization or the restructuring of the company surrounded by the financial difficulties under chapter 11of BC processes.

In real sense, the adequate protection provided by section 361of BC is of three types;

- First, by periodic cash payment;
- Second, by lump sum payments; and
- Third, by providing additional security through unquestionable equivalent.[244]

The US Senate Judiciary Committee, while commenting upon status of the secured creditors during the restructuring or reorganization procedure gave its comment as follow;

Under certain circumstances in the bankruptcy laws, conferring upon the secured creditors' absolute right of his bargain is really harmful to the policy of bankruptcy laws, although the secured creditors should be given the benefit of their bargain.

Therefore, in such a circumstances when it is not feasible to confer an absolute benefit of their bargain, section 361 of BC gives an alternative methods to protect the interest of secured creditors, where some steps are necessary to be taken, such as, granting super priority status to the new lender for the objective of getting the new finance for reorganization of the company

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[243] Ibid., 185.
[244] Ibid.

facing financial difficulties. Now in such a circumstances the secured creditors might not possess the same property as collateral which they had at the occasion of filing for the reorganization plan for the company facing financial difficulties.[245]

Therefore, the main purpose of the section 361of BC is to safeguard the concern of the secured creditors, and to make it sure that the secured creditors will obtain the value for which they bargained.

In order to obtain new finance for the reorganization or restructuring plan, a company should prove the following two things:

- First, notwithstanding subordination of the claims of the secured creditors they will be adequately protected; and
- Second, the company cannot get new finance without granting a priority status to the new lender.[246]

Although these conditions are very difficult to be fulfilled but a company must have to satisfy these condition before getting new finance.

It has been argued that if a company is unable to persuade a lender to lend on inferior ranking security, then how it will be possible, that the inferior ranking security will protect the interest of the existing secured creditors, therefore it creates a presumption in the mind that whenever a company prepares a case under section 364(d) of BC for super priority financing of the company, there will be no "adequate protection" of the interest of the secured creditors, but section 364(d) of BC provides that super priority financing is permitted only when the debtor company satisfied two condition:

- First, without new finance reorganization or restructuring is impossible; and
- Second, the existing secured creditors are over secured i.e. the value of their collateral exceeds the value of their debt.

Section 361 (3) of BC gives another method of protecting the interest of the secured creditors by providing unquestionable equivalent of the secured creditors interest in the possessions of the company.[247]

From the above discussion it is clear, that there is a complete mechanism of the adequate protection of the interest of the secured creditors under the "US bankruptcy law". Although in

[245] Ibid.,186.
[246] Ibid.
[247] Ibid.,187.

US the property rights of the secured creditors are surrendered to some extent but the same time protected a lot, because in the US bankruptcy law there is a clear statutory requirement that the secured creditors will get adequate protection of their property rights. In other words under the US law there is a concrete, well defined ,prerequisite of the model of the adequate protection.

In UK, there is no specific proviso that speaks about the concept of the adequate protection under the British corporate bankruptcy law, as the "Enterprise Act, 2002", introduced a number of amendments in the administration procedure in order to make the administration procedure a more corporate rescue oriented procedure, and it is also obvious from the Enterprise Act that the Enterprise Act borrowed some characteristics from other corporate rescue law model of the developed countries especially from US, but it does not merely transplant the main features of corporate rescue law of other developed counties but redesigned them according to their own system.[248]

One main feature of the US corporate rescue law which is introduced by the Enterprise Act, is a procedure for the financing of a financially distress company during the reorganization or the restructuring procedure, because the new finance is very essential for the continued existence of the business of the company unless some source of the new finance is available the property of the company have to be sold bit by bit and the company finally put into the liquidation, but it does not reproduce this feature of the US corporate rescue law in their own corporate rescue law as it is in the US corporate rescue law but redesigned it according to their own system of the corporate rescue law .[249]

Although the Enterprise Act does not talk about for the mechanism of the super priority financing explicitly but it provides for the new financing impliedly, as it gives wide powers to an outside insolvency practitioner who is called administrator, relating to a financially ailing company in order to achieve the objectives of administration. The administrator in order to achieve the objective can dispose of property of the financially ailing company even the property that is used by the debtor's company as security for getting the loan. Therefore, this power of the administrator which empowers him to dispose of the property that is used by the debtor's company as security for getting the loan contain the implied concept of the new financing.[250]

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[248] Ibid., 176.
[249] Ibid.
[250] Ibid., 196.

As the Enterprise Act does not talk about the new financing explicitly, but it contains the law relating to the new financing for the company facing financial difficulties impliedly, similarly it does not talk about the concept of adequate protection explicitly but it describes the law of adequate protection of the secured creditors impliedly.

As there is a distinction in the power of administrator relating to the disposal of the property that is expose to a fixed charge and the property that is expose to floating charge. The administrator can deal with property that is expose to a fixed charge without reference to the floating charge holder or without prior permission of the court, according to his own wish,[251] but the remedy for the floating charge holder is that he possess the same status of priority relating to any possessions of the company that represent directly or indirectly the assets of the company that is dispose of, and in case when the administrator wants to dispose of possessions of the company that is expose to a fixed charge then in such a case the prior permission of the court is required. Hence, when the administrator deals with the property under the fixed charge, then the interest of the secured creditors are protected by maintaining indubitable equivalent in the property of debtor's company, and when the administrator wants to dispose of the property which is subject to fixed charge, then in such a situation prior authorization of the court is required for disposition of the property,[252] and court may authorize such disposition if it is satisfied:

- First, the interest of the secured creditors are safeguarded; and
- Second, such a disposition is necessary for achieving the goals of administration.

It is obvious From the above discussion that there is a law relating to the concept of the adequate protection under the UK corporate rescue law, but this law of adequate protection does not available clearly under any specific provision of the corporate rescue law, as it is available under the US corporate insolvency law. In other words, there is no clear statutory framework for the concept of adequate protection under the UK corporate rescue law.

In Pakistani corporate rescue law as there is no mechanism available for the financing of the facing financial difficulties, and also there is no idea of super priority financing, therefore, there is also no concept of the "adequate protection" because the financing mechanism for the financially ailing company and the concept of the adequate protection are connected with each

[251] Ibid.
[252] Ibid.

other. Where there is no concept of the financing a company facing financial difficulties, there is also no concept of the adequate protection.

4.5 Debtor in possession(DIP)

The fourth important point which is very necessary for the comparative study and which also form an important part of the corporate rescue law is the management of the company, and the point here for discussion is whether the existing management should be replaced or be maintained in their position.

In US, as chapter 11 of the US BC deals with the reorganization or restructuring of a financially distress company and according to the chapter 11of BC the old management of the company occupy their respective positions during the reorganization of financially distress company but it adopts the form of quasi trustee during the process of the reorganization of a financially distress company and is known as "debtor in possession (DIP)".[253]

The DIP operates the business of the company in the normal course of the business but for the sale of a considerable component of the assets of the company he will need prior court approval. The DIP is considered as the best party to conduct the business of a financially distress company during the reorganization process, as it is generally thought that DIP was in the control of management of the company at time of the filing of the company for the reorganization and therefore familiar with the business of the company. The DIP owes "fiduciary duties" to the creditors of the company and also to other interested parties of the estate, and therefore, refrains from doing any act which causes damage to the interest of creditors and belongings of the company.[254]

An out side trustee to manage the affairs of a financially distress company can only appointed in case of the causes mention in section 1104(a) (1) of the US BC, and these causes are, fraud, dishonesty, and gross mismanagement by the debtor in possession, and this appointment of the trustee is only an exception and not a rule as it is stated in the case of "Re Marvel Entertainment Group"

An alternative remedy to the engagement of the outside trustee is the appointment of an investigating examiner by the court, and the employment of the outside examiner is also not a rule, and the examiner is required to carry out the investigation of such matters as are entrusted

[253] Ibid., 80.
[254] Ibid.

to it by the court, but under section 1104 of BC, the examiner has the power to investigate any matter of fraud, mismanagement and dishonesty, and the employment of the examiner does not replaces the in attendance management of the company as happen in case of the appointment of the trustee, and the examiner may continue to perform its function in a cycle.[255]

Therefore under the US corporate rescue law, the management of the company at the time filing of the company for the reorganization occupies their position, or in other words the existing management of the company occupies their position during the restructuring or the reorganization procedure, because they are deemed as the best party to conduct the business of the company during the reorganization or restructuring procedure.

In UK, the UK corporate rescue law does not maintain the existing management in their position to perform the management functions, although the existing management i.e. "the board of directors" remains in office but they lose their management function to an administrator, as it is clearly mention in Para 64 of "Schedule B1" (I A 1986), that the company or any office of the company may not use their managing authority lacking the previous sanction of the administrators.[256]

It has been argued that the UK corporate rescue law must not provide for the displacement of the existing management for the following reasons:

- First, it is the only existing management i.e. the board of director that can commence the reorganization proceeding in the timely manner and not the creditors of the company;
- Second, the management may not feel encouraging to work hard, when in case of the business distress, sever action may be taken against them, for example their removal from the management function;
- Third, the existing management of the company is considered as the best party to conduct the business of a financially ailing company during the reorganization or restructuring procedure, because they are familiar with the business of the company; and
- Fourth, if the existing management of a financially ailing company feels that their jobs will be protected in case of the reorganization or restructuring of the company, then they file for the reorganization or for the restructuring of the company in timely manner, when there is a real expectations of the success of the reorganization or restructuring of the

[255] Ibid., 81.
[256] Schedule B1 Insolvency Act 1986 Para 64.

company, but if they have a real threat of losing their jobs in case of the reorganization or restructuring of the company, then they will not file for the reorganization or for the restructuring of the company in timely manner or file for the reorganization of the company when there is no chances of the success of the reorganization of the company.

Therefore due to above mention reasons it is necessary for a corporate rescue law to make available that the existing management of the company should not be replaced form their position, because it is in the greatest advantage of the financially ailing company that the existing management of the company retain their control with regard to the dealings of the company. Although there are different factors that causes the displacement of the present management of a financially distress company by an administrator under the UK corporate rescue law and maintenance of the control of the present management i.e. DIP under the US corporate rescue law, but the law of US corporate rescue law which provides for the control of existing management in the form of debtor in possession, is best suited for the reorganization of a financially distress company .

In Pakistan, Pakistani corporate rescue law does not provide whether the existing management maintain its control or be displaced, in other words there is no provision under Pakistani corporate rescue law is available that provides expressly or impliedly for the control or displacement of the existing management, therefore, I can conclude that Pakistani corporate rescue law is totally ambiguous in this respect.

4.6 Entry routes into the process of corporate rescue law

For the success of a corporate rescue law, it is generally considered as very important that company should trigger the reorganization or restructuring procedure in timely, and in order to make the company to make use of this facility of the reorganization instead of liquidation, the legislature should create incentives for the companies to make use of the process of reorganization and should not create obstacles in the way of companies wanted to make use of the process of the reorganization, one of the facility that can encourage the company to make use of the process of corporate rescue law is that, the access to the process of corporate rescue law should be easy and quick and clearly mention under the provisions of corporate rescue law

4.6.1 Entry routes under American corporate rescue law

As the corporate rescue law of the US is contained in chapter11 of the US BC, under chapter 11 it is the right of debtor company to begin a chapter11 case, therefore case under chapter 11 commences when the debtor company submits a petition with bankruptcy court voluntarily, and following things have to be attached with the petition;

- First, "a list of the creditors of the company"
- Second, a list showing the possessions and responsibilities of the company[257]

In practice there is no essential pre requisite that the company should be bankrupt or expected to turn into bankrupt.

The first and foremost aim of the chapter 11 of BC is to rescue the companies that were surrounded by financial difficulties but in practice chapter 11 of BC has been used for other purposes also for example to refuse pension obligation, to settle poisonous waste related liabilities etc.[258]

Therefore sometimes chapter 11 of BC may be used for the purposes by inventive bankruptcy lawyers that were not expected by its creator.

But the process of chapter 11 of BC must be used for the objective of the restructuring or reorganization of the company surrounded by the financial difficulties in good faith or may be used for the sale of the company and not for any purpose that was not expected by its designer, and if the petition of the debtor company does not contain any genuine re-organizational purpose then the creditors of the company can submit an application for the dismissal of the application for the restructuring of the company.

4.6.2 Entry routes into the UK corporate rescue law

Under the UK insolvency regime the 'administration' is known as restructuring or the re-organizational law for the company surrounded by the financial difficulties, now under UK corporate rescue law there are variety of methods for entry into the process of administration unlike under the originally drafted Insolvency Act, 1986, when there is only one method for entry into the process of administration, and that was by the court selection of the administrator.

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[257] Gerard McCormack, *Corporate Rescue Law: An Anglo-American Perspective* (Cheltenham : Edward Elgar, 2008), 123.

[258] Ibid., 124.

Under the new insolvency regime of the UK, there are two method of entry into the administration

- First, out of court appointment of administrator
- Second, court appointment of the administrator[259]

4.6.2.1 Out of court appointment of the administrator

Under the out of court employment of the administrator, the employment can be made

a. "First, by the company or by qualifying charge holder
b. Second, by the company or its director"

a. Out of court appointment of the administrator by the company or by qualifying floating charge holder

In the out of court appointment of the administrator a company can appoint an administrator by giving a prior notice to qualifying floating charge or a qualifying "floating charge" holder or in other words the person holding general security interest in the possessions of the company can also appoint the administrator.

b. The appointment of the administrator by the company or its director, out of court

The company or its directors can also employ an administrator out of the court, but should give prior notice of the proposed appointment of the administrator to a "qualifying floating charge holder", the company or directors are unable to use out of the court route if there is already a winding up petition for the company.[260]

4.6.2.2 Court appointment of the administrator

The company or its directors, or any creditor can use the court route for the employment of the administrator, but the court must be contented prior to making an administrative order on the petition of the company or its director or on any of its creditor that the company is incapable to repay its debts, and there are sound chances that the administrator will achieve it objectives.

A "qualifying floating charge holder" can also use the court way for the employment of the administrator as soon as floating charge has become enforceable, and for this purpose they don't need to prove that the company is unable to pay its debts and there is also no requirement for the

[259] Ibid., 119.
[260] Ibid.

qualifying floating charge holder that for the appointment of the administrator that he necessity give prior notice of his intent to the company.

From above discussion it is clear that there is obvious difference in the entry procedures of the corporate rescue law of the US and UK, as under the US corporate rescue law the debtor company is fully empowered to trigger the process of chapter 11 of BC without considering the desires of the creditors of the company, but in the UK law the state of affairs is very different and the court play a very important role with reference to the entry of the company into the process of administration i.e. when a petition is submitted to the court for an administrative order, the court has discretion in accepting or rejecting the application for an administrative order, and in the out of court route, the "qualifying floating charge holder" has a right to appoint an administrator, just like the company or its director.[261]

After studying the procedure of entry routes into the corporate rescue law under the US and UK law, the entry route which look more rescue oriented and helpful to the debtor company surrounded by the financial difficulties is under the US corporate rescue law, because under the US corporate rescue law the debtor company can commence the reorganization procedure without considering the desires of the creditors of the company.

4.6.3 Entry routes under the Pakistani corporate rescue law

Under the Pakistani corporate rescue law the only way of entry into the process of corporate rescue law is through court, and the court has discretion with respect to the petition for the planned scheme whether to sanction or dismiss the petition for the scheme.

A petition for the commencement of the reorganization or restructuring process can be made by the following;

- First, by the "company" i.e. the directors of the company who are managing the business of the "company";
- Second, "by the creditors of the company";
- Third, by the managing agent of the company, if specially empowered by agency agreement;
- Fourth, by the official liquidator of the company if the company is in the process of "winding up"; and

[261] Ibid., 123.

- Fifth, by the shareholder of he company

Although the law confers power on the above person to make an application for the initiation of the reorganization restructuring procedure of the company facing financial difficulties but the court may or may not confirm the application filed for the commencement of the reorganization procedure.[262]

There are lots of hurdles in the way of initiation of the reorganization procedure of the company facing financial difficulties under Pakistani corporate rescue law because when a scheme is proposed by the company for authorization by the court, the court first order the creditors meeting to consider this proposal, and if they approve the proposal by three fourth majority, then court may sanction the proposal otherwise it is not easy for the court to go against the decision of the majority of the creditors that is passed in the creditors meeting.

As it is clear that the entry procedure into the reorganization or restructuring law under the originally drafted Insolvency Act, 1986 was only by way of the court, but the Enterprise Act, 2002 transformed the act significantly and now under the transformed Insolvency Act there are variety of methods of entry into process of administration, but under the Pakistani corporate rescue law there is no change in the procedure of entry into to the corporate restructuring law since its adoption, therefore Pakistani law on entry procedure is outdated and need reforms in this respect with the guidance of the of the entry procedures of the UK and US law.

4.7 Cram down

'Cram down' means the secured creditors are enforced to agree to the reorganization plan against their desires if the essential requirements for the exercise of the power of 'cram down' are fulfilled.

For the effectiveness of the corporate rescue law system it is very necessary that cram down should form part of the corporate rescue law regime of a country

In US, there is a complete mechanism of the 'cram down' under the US system of the corporate rescue law, and therefore in order to cram down an objecting class o the creditors certain

[262] SH.Shukat Mehmood, *Company Law In Pakistan: An Exhaustive And Upto-Date Commentary On Companies Ordinance,1984 With Companies Rule 1985 And Other Connected And Relevant Statue And Statutory Rules* (Lahore: Legal Research Center Noor Villa,1986), 421-22.

essential requirement which are contained under section 1129(b) (1) and 1129(b) (2)(A) of the US BC, and under1129(b)(1) of BC the plan should be just and reasonable and should not discriminate unfairly, and by fair and reasonable standard of the plan, means that plan should have reasonable prospects of the success and the creditors must not be forced to face the unreasonable risks of the plan failure and it also contains section 1129(b)(2)(A) of BC requirements, and according to the section1129(b)(2)(A) of BC a secured creditors must have one of three remedies:

- First, preservation of secured benefits of the creditors and in order to balance the present value of the collateral, certain deferral payments is also made to the secured creditors;
- Second, the maintenance of the 'indubitable equivalent' of the secured creditors' interest in the assets of the company surrounded by the financial difficulties; and
- Third, for the protection of the interest off the secured creditors, the collateral should be sold with creditors' security interest and that should be put together with proceeds of sale.[263]

Therefore there is a complete mechanism for using cram down power under the US corporate rescue law.

Under the UK corporate rescue law there is no provision which deals with the facility of cram down, and there is much respect and flexibility shown for the rights of the secured creditors in administration and CVAs, by not keeping cram down power under these procedure, it means whatever rescue plan is the result of administration, the secured creditors must be adjusted in this plan i.e. their security interest can not be enforced against their wishes or otherwise they must be kept out of the process completely and should be permitted to enforce their security or being paid off.

In Pakistan, the Pakistani corporate rescue law is largely influenced by the UK corporate rescue law, and therefore there is provision under the Pakistani corporate rescue law to deal with an objecting class of the creditors but there is no provision that deals with the 'cram down' facility, and one of its reason is that Pakistani corporate insolvency law is more oriented towards creditors and because of this creditor prefer to use the procedure of liquidation than reorganization of the company facing financial difficulties.

[263] See above.n 73, 263.

4.8 Exit routes

To provide for the exit routes or for the discharge of the corporation when the purpose of the reorganization or restructuring has been achieved is very essential for the corporate rescue law of a country, and without providing for the exit routes of the corporation the corporate rescue law is incomplete, and therefore it is very important to make available the exit routes of a corporation after the purpose of the reorganization or restructuring has been achieved.

In US, the US corporate rescue law clearly provides for the exist route of the corporation, and a case of the reorganization or restructuring under chapter 11 of the US BC become close when it comes out in the form of reorganization plan.[264]

In UK, the British corporate rescue law provides variety of the exit routes for the corporation from the administration; a petition is submitted to the court for the exit, when the plan of the administration has been adequately accomplished, by giving a notice to the registrar of the companies and also to the court, and the creditors of the company will also be informed.

The company then loses the shield of the moratorium and can keep on its normal business as usual.

If the administration is unable to achieve the objective of plan, then administrator loses its job automatically at the close of the time of twelve month, but with the consent of the company's creditors this period can be enlarged for a time of six month, and the court is empowered to extend this time for any number of times, in addition to this following are the exit routes from the administration:

- First, the company will be wound under the process of "creditors voluntary liquidation", if there is distribution to the unsecured creditors of the company; and
- Second, the company will be considered to have dissolved at the end of the phase of three month from the day of the filing of notice with registrar of the companies, if there is no distribution to the unsecured creditors of the company.[265]

Therefore there is a complete mechanism of exit from the restructuring or reorganization procedure under the UK corporate rescue law.

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[264] Ibid., 42.
[265] Ibid.

In Pakistan, Pakistani corporate rescue law does not provide for the discharge of the corporation or for the exit routes from the reorganization or restructuring procedure, or in other words there is no provision that deals with the exit routes of a company surrounded by the financial difficulties, and the law is totally ambiguous in this respect.

4.9 Informal workouts or private workouts

Informal workouts are contractual based and there is no need to resort to any legal insolvency procedure, the informal procedure are usually employed by the directors or creditors of the company, and for the success of the restructuring and reorganization of the company they may take the help of company doctor to investigate the affairs of the company and suggest remedial actions for the successful restructuring of the company. Informal workouts are advantageous for the company facing financial difficulties from different angle and summarized below in the form of points

From the perspective of the shareholders and management of the company the informal rescue procedure is attractive due to following reasons:

- First, through informal rescue procedure bad publicity of the company relating to the corporate trouble can be avoided, and which in turn result in the preservation of good reputation of the company;[266]
- Second, as the informal rescue procedure may result in the protection of good will of the company, and which may in turn result in the avoidance of formal insolvency procedure, because the adverse publicity of the company surrounded by the financial difficulties often result in the initiation of the formal bankruptcy procedure;
- Third, the cost of the informal workout likely to be lowered than formal rescue procedure because in informal workout court proceedings are not involved;
- Fourth, informal rescue procedure is more flexible than formal rescue procedure, as the terms and conditions can be regulated in a way that formal rescue procedure do not permit; and
- Fifth, from the perspective of the management of the company the informal rescue procedure avoids the investigation of the affairs and change in the control of the company and formal rescue procedure.[267]

[266] Vanessa Finch, *Corporate Insolvency Law: Perspective And Principle* (Cambridge: Cambridge University press, 2002), 208.

From the point of the view of creditors of the company the informal rescue procedure is attractive due to the following reasons:

- First, the informal rescue procedure is the only way which ensure the prospects of full repayment, in case of the success of the rescue procedure;
- Second, the informal rescue procedure also allows the creditors who finance the company facing financial difficulties, to improve their position with respect to priority or with respect to security, for example a bank who advance loan to company facing financial difficulties, during the restructuring procedure may get the status of floating charge holder; and
- Third, the informal rescue procedure also enables the company facing financial difficulties to get fiancé from other sources such as from the shareholders or other banks.[268]

In most of the developed countries there is a strong stress on informal rescue procedure for the solution of troubles of a company facing financial difficulties.

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[267] Ibid.
[268] Ibid., 209.

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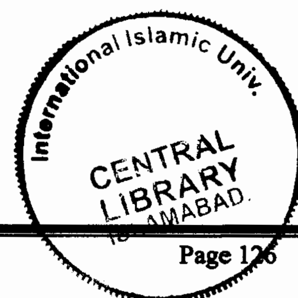
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