

## MERGERS AND THE RIGHTS OF MINORITY SHAREHOLDERS IN PAKISTAN

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### Abstract

Mergers are not only becoming prevalent in the contemporary, but are also considered a phenomenon of the gravest concern both from a legal as well as from a business perspective. In fact the law seems to be suspicious when mergers involve controlling shareholders having vested interests making such consolidation decisions. The interest and betterment of the minority shareholders is considered to be a prime concern both from a societal as well as from an economic standpoint. It is for this reason that mergers are heavily regulated and monitored by both the Courts as well as administrative/regulatory agencies such as the SECP in Pakistan. This paper first lays out the procedural workings of a merger in Pakistan and then analyzes the legal provisions to determine the adequacy of such laws in providing requisite protection to minorities in mergers. An elaborate discussion of the relevant landmark cases follows. Judicial interpretation of statutes, judge made law, rules and policy considerations are also discussed. A pragmatic determination of the level of protection actually awarded to minority shareholder in mergers is also elaborated upon. At this juncture, the shortcomings in the relevant Pakistani legal infrastructure such as corruption, nepotism and ineptness are also highlighted.

**Keywords:** Minority Shareholder Protection, Corporate Governance, SECP, Swap Ratio Valuation, Merger

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### I. Introduction

Mergers, which are becoming prevalent in the contemporary, are both from a legal and a business perspective considered a phenomenon of the gravest concern because of the related implications. In fact the law is increasingly suspicious when mergers involve controlling shareholders having vested interests making such consolidation decisions, as the interest and betterment of the minority shareholders is considered to be a prime concern, both from a societal as well as an economic standpoint. It is for this reason that mergers in Pakistan are heavily regulated and monitored by both the Courts as well as administrative/regulatory agencies.

The paper begins with an outline of the procedural requirements that companies in Pakistan need to follow when carrying out a merger. It lays down the laws applicable, the most relevant being the Companies Ordinance, 1984. The paper then proceeds through the workings of a merger step-by-step. Since mergers in Pakistan are regulated by the Court, companies begin by preparing a Scheme that involves independent auditors valuing the stock and preparing an unbiased report. The company then files a petition with the Court. The paper describes the process by which a Court decides whether or not to allow the merger.

A layout of the provisions of law seeking to protect minority shareholders follows. The paper goes on to analyse the court's interpretation of these provisions in various cases, showing how Pakistani courts have refrained from laying out a clear test, and prefer applying the law on a case-to-case basis. This is followed by an overview of the SECP, the body governing corporate activity in Pakistan, and the protection it affords minority shareholders by virtue of its enabling Statute, The SECP Act, and the Code of Corporate Governance formulated by the SECP itself. While the SECP has the theoretical legal capacity required to protect minority shareholders, practically it is fraught with insufficiency of employees, coupled with problems of competency. The paper critiques the way mergers progress in Pakistan, due to the lopsided share evaluation on which the decision to allow the merger is based, along with the role played by the Courts. Undertaking a case to case analysis of the major mergers that have taken place in Pakistan, the paper sheds light on the inconsistency displayed by the Courts in deciding whether to play a judicially active role, or to step back and let the shareholders decide whether the merger is ethically sound.

The paper concludes that though functionally the level of adequate protection for minorities via the

judiciary possibly exists, the pragmatic reality is to the contrary. This is due to extraneous factors such as corruption, nepotism, feudalism etc, that greatly impact all branches of government in Pakistan, inclusive of the judiciary, police and administrative agencies like the SECP.

## II. Procedural Workings of a Merger in Pakistan

### A. General Overview

In developed economies, like the USA<sup>12</sup> for example, mergers do not require court approval to have a legal existence except in very limited scenarios, such as where other legal and pertinent issues are implicated like when, possible antitrust violations are encountered. However, in Pakistan, in the overwhelming majority of cases, mergers materialize only if they have been sanctioned by the appropriate court of law.

Therefore a Pakistani company when undertaking a merger, not only has to fulfill all of its *inter se* legal formalities (i.e. method of shareholder voting) that have been mandated both by relevant law ordinances such as the Companies Ordinance 1984 and the Memorandum and the Articles of Association, but also has to fulfill all the discretionary procedural requirements that have been requested by the courts, in addition to mandated procedural laws such as the Companies Court Rules 1997. It is the responsibility of the Court to be vigilant in over viewing that the company fulfills all aforementioned requirements and not to grant a merger if non-compliance is encountered.

Mergers of the overwhelming majority of companies, whether they be listed or unlisted, are governed under § 284 and more specifically § 287 of the “Compromises, Arrangements and Reconstruction” portion of the Companies Ordinance and are regulated and subject to the jurisdiction of the courts. However, it is imperative to note that there are exceptions to this general rule.

Firstly Non Banking Finance Companies “NBFC’s” are subject to the jurisdiction and regulated by the Security and Exchange Commission of Pakistan “SECP.” Under § 282 (L) of the Companies Ordinance<sup>13</sup> NBFC’s merger requires the eventual sanctioning of the SECP to be effectual. In addition banking company mergers are not governed through the Companies Ordinance at all. S. 48 of the Banking Companies Ordinance (LVII of 1962) governs banking mergers and such law pre-empts the

<sup>12</sup> Generally judicial approval is not required to get a merger sanctioned. However, if statutory requirements have not been fulfilled by the merging companies i.e. corporate fiduciary duties have been violated, voting requirements and board meetings have not been met, then the Courts can become involved when derivative or individual lawsuits are filed by shareholders. See Generally Delaware Code § 251.

<sup>13</sup> “Procedure for amalgamation for NBFCs.”

Companies Ordinance merger requirements. Banking company mergers require the approval of the State Bank of Pakistan to go into effect.<sup>14</sup>

### B. Preparation of the “Scheme of Arrangement”

The preparation of the Scheme of Arrangement for Amalgamation “Scheme” by a company is primarily the most quintessential step towards undertaking a merger. The Scheme, which is put down in document form, consists of the summarized rationale for desiring the merger i.e. the synergies involved and pertinent numerical information i.e. how the valuation of the shares held by shareholders is being determined that is how swap ratios are being formulized. All the involved valuation determinations are undertaken via auditors.

Under § 252 of the Companies Ordinance all companies have to appoint an auditor or auditors. In addition under the Code of Corporate Governance 2002 “CCG”<sup>15</sup> all listed Companies have to employ both internal and external auditors.<sup>16</sup>

In re: Pfizer Laboratories Ltd., 2003 CLD 120, the court held that swap ratio valuation relative to a merger that had been made earlier were void and valuation was to be made afresh by an *independent auditor*, with this independent auditor according due consideration to court provided valuation guidelines.

It is subject to debate whether the court by ordering the requirement of having an independent auditor was laying out a general rule, which had to be conformed to by all companies at least in the context of a merger, or the court had only put a requirement of an independent auditor relative to the case at hand, because there was proof that the company’s auditors had indulged in non-disclosures and had made financial determinations (swap ratio valuation) solely for the benefit of the majority shareholders. The effectuation of any such swap ratio was according to the court unfair and unreasonable on the related minority shareholders.<sup>17</sup>

At the least it is reasonable to believe that the court, in determining that it was solely the interest of the majority that the auditors had focused on, did give credence to the fact that the auditors’ report prepared was not made by an independent valuator, but by the company’s own chartered accountants.

It is also pertinent to note that being an independent auditor is not the same thing as being an

<sup>14</sup> PLD 1986 Karachi 297.

<sup>15</sup> The SECP utilizing the power conferred upon it under § 34 (4) of the Securities and Exchange Ordinance, 1969, under which the SECP can direct the stock exchanges to make any stock exchange laws that it considers appropriate, under the CCG via the stock exchanges made it mandatory on all *listed* companies to have both internal and external auditors.

<sup>16</sup> See generally Code of Corporate Governance § xxx-xxxliv (2002).

<sup>17</sup> In re: Pfizer Laboratories Ltd., 2003 CLD 120 at 45.

external auditor since external auditors having vested interests in a company for whom they are making financial determinations do not qualify as independent auditors.

Having formulized the Scheme, the auditors/accountants forward this document to the lawyers representing the company to ascertain whether the Scheme is in compliance with the law.

### **C. Appropriate Merger Petition filings with Court and Respective Court Orders.**

The general practice in Pakistan is that a company files a preliminary merger petition with the court even before any shareholder meetings related to the merger have taken place. Such petition includes all kinds of necessary information such as: the company's list of directors; list of shareholders; board resolutions; proof of the board of director's approval of the involved merger; balance sheets and income statements of the company; Scheme of Amalgamation and swap ratio valuation certificates prepared by consultants. Most often NOC's from creditors of the related company are also provided, though provision of such NOC's is not a requirement of law.

Attached to this merger petition, is an application requesting the Court under § 284 (1) of the Companies Ordinance to pass an order for holding an Extraordinary General Meeting "EOGM" of the company under § 159. Subsequently the court provides a date for when such an EOGM is to be held. However the shareholders must be provided with 21 day notice of the "EOGM."<sup>18</sup> Hence the court directs that such notice be issued. Under the relevant §159 (7) and §158 (3) of the Companies Ordinance, the shareholders are to receive the notice in person when an unlisted company is involved. If a listed company is involved then both personal notice is provided to the shareholders and general/constructive notice is provided to the public via publication in the relevant newspaper. In addition, the court directs the company to provide notice to the SECP, and relevant stock exchanges but only if listed companies are involved.

A chairman, who is a lawyer and an appointed representative of the court, is charged with the task of attending, monitoring and overseeing the EOGMs for legal compliance and for registering shareholder objections. Such chairman, within 7 days subsequent to the EOGMs is to submit a report of his findings to the Court.<sup>19</sup> In turn, the related company files a petition with the court asking for confirmation of the compromise or arrangement in the form of petition in

Form No 19<sup>20</sup>, within 7 days of the filing of the report by the chairman.

Form 19, which is inclusive of information present in the initial merger petition i.e. financial statements and formulized reasons for the merger, also states the proposed terms of the merger and compliance with the original court order for EOGM, such as whether quorum requirements were met and by how many votes and percentage the resolution was passed and hence whether the resolution for merger was voted for "by a majority [of shareholders] in number representing three-fourths in value of ... members... present and voting."<sup>21</sup>

Subsequently the court<sup>22</sup> fixes a date for hearing the petition in form 19. The Court also directs the company to provide constructive notice to the public at large of such hearing, by publication in the relevant newspaper. Such notice must be provided at least 10 days antecedent to the hearing date on which court deliberation on the merger is to be undertaken.

If at the hearing the court is satisfied with the proposed merger, the merger will be sanctioned by the court in Form 21.<sup>23</sup> However if at any time during the course of such merger dealings/procedures, any objections are raised to the proposed merger i.e. by dissenting minority shareholders, then the court will entertain such objections before it provides its approval to the merger.

It is imperative to note that the court is required to provide notice of all aforementioned documents /applications made to it, to the Registrar of Companies and is to "take into consideration the representation if any, made to it by the Registrar before passing any order under any of these sections."<sup>24</sup>

### **III. Substantive Law Protection for Minority Shareholders**

#### **A. Provisions of Statutory Protection for the Minority Shareholders under Companies Ordinance 1984 "Ordinance" (§ 284-288)**

The aforementioned elaborate procedural filing requirements, which have been ordained under § 284-288 of the Companies Ordinance, coupled with other provisions of these sections, which will be

<sup>18</sup> See Companies Ordinance § 159 (7) (1984) PLD 1985 CS 69 dated 8<sup>th</sup> October 1984.

<sup>19</sup> The Companies (Court) Rules, Rule 57 (1997) Gazette of Pakistan, Extraordinary, Part II 26<sup>th</sup> March 1997. S.R.O. 187 (I)/97 dated 26.03.1997; See also International Multi Leasing Company v. Capital Asset Leasing Company Ltd., 2004 CLD 1.

<sup>20</sup> The Companies (Court) Rules, Rule 60 (1997) Gazette of Pakistan, Extraordinary, Part II 26<sup>th</sup> March 1997. S.R.O. 187 (I)/97 dated 26.03.1997.

<sup>21</sup> The Companies Ordinance § 284 (2) (1984) PLD 1985 CS 69 dated 8<sup>th</sup> October 1984.

<sup>22</sup> The Companies (Court) Rules, Rule 61 (1997) Gazette of Pakistan, Extraordinary, Part II 26<sup>th</sup> March 1997. S.R.O. 187 (I)/97 dated 26.03.1997.

<sup>23</sup> The Companies (Court) Rules, Rule 65 (1997) Gazette of Pakistan, Extraordinary, Part II 26<sup>th</sup> March 1997. S.R.O. 187 (I)/97 dated 26.03.1997.

<sup>24</sup> See Companies Ordinance § 288 (1984) PLD 1985 CS 69 dated 8<sup>th</sup> October 1984..

subsequently discussed objectively speaking functionally provide adequate notice and full disclosure of all relevant information to all minority shareholders to make an informed decision on the merger. This in addition to ascribing the courts with the power to overview mergers in complete transparency and hence sanction those mergers, which are being undertaken for the interest of the shareholders as a whole and not to oppress the rights of the minority shareholders.

§ 284 of the Companies Ordinance lays out the procedural and substantive requirements of all “Compromises, Arrangements and Reconstruction,” which is inclusive of mergers. Substantively the most pivotal provision of this section relative to minority shareholder protection is § 284 (2), which states that “[i]f a majority in number representing three- fourths in value of the ... members ... present and voting either in person or, where proxies are allowed, by proxy at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all ... the members ....”

Though the exact interpretation of this provision is subject to intense debate, as this provision till date has not been litigated upon, the provision clearly connotes (assuming the meeting’s quorum requirement is met) that if dissenting minority shareholders vote against the merger in the meeting and such minority shareholders in quantity constitute the majority of those present at the meeting, the merger cannot take place, irrespective of the fact that the value of the interest of the voting minority in aggregate is minuscule. This potential veto power in the hands of the minority can effectively give them immense bargaining power for protection of their rights. In fact some argue that if such interpretation of the provision is accurate, then it is vesting unwarranted power in the hands of the minority, which generates the potential to unfairly coerce majority shareholders or of being damaging to the company itself.

In addition under § 284 (4) of the Companies Ordinance, all companies employees who do not conform to their respective duties laid out under § 284 (i.e. inadequate disclosure that adversely impact minority shareholder protection), are subject to a fine/penalty. However objectively speaking, the deterrence value of such penalty is ineffectual, as the penalty of Rs. 500 per violation is diminutive.

Also under § 285 of the Ordinance, the courts have a lot of discretion to make modifications to the procedures of mergers, when one is taking place, in order to attain all the objectives of proper functioning of that merger, such as by according safeguards to minorities. § 285 (1) states that “[w]here the Court makes an order under Section 284 sanctioning a compromise or an arrangement in respect of a company, it may, at the time of making such order or at any time thereafter, give such direction in regard to any matter or make such modifications in the

*compromise or arrangement as it may consider necessary for the proper working of the compromise and arrangement.”*

Also under § 286 (a) of the Ordinance, when an arrangement/merger is involved, then in order to avoid conflict of interests the directors and chief executive are required to disclose their material interest. However, under § 286 (b) (4) fines for non-compliance are diminutive and hence pragmatically ineffectual in nature.

Finally under § 287 of the Ordinance, which solely deals with the procedural formalities of a merger,<sup>25</sup> the court is responsible for “ the provision to be made for any persons who, within such time and in such manner as the Court directs, dissent from the compromise or arrangement.”<sup>26</sup>

#### **IV. Security and Exchange Commission of Pakistan Act, 1997 “SECP Act”, SECP, and the Code of Corporate Governance.**

##### **A. General Overview of SECP**

The SECP came into being via the enactment of the SECP Act of 1997. SECP is a semi-autonomous body, whose commissioners are nominated by the federal government<sup>27</sup> and these commissioners must be by majority from the private sector.<sup>28</sup> The SECP was an institution that replaced the institution known as the Corporate Law Authority “CLA,” which had been purely a division of the Ministry of Finance.

Formalistically speaking, the SECP from its inception has the legal capacity to possess an elaborate and efficient administrative structure coupled with the power to employ consultants, bankers, stock brokers etc.<sup>29</sup> and with broad sweeping powers to monitor and regulate the financial sector.

The SECP itself is monitored by a Board consisting of the Chairman of the SECP, Secretaries to the Government from the Law, Finance and the Commerce division, a State Bank official and private sector professionals<sup>30</sup>. The Commission is subject to regulation via mandatory disclosure requirements relative to it’s own employees for protection against conflict of interest imbroglios.<sup>31</sup> The SECP is further required to provide annual reports/accounts and conform with all relevant legal formalities that are

<sup>25</sup> Provision for facilitating and amalgamation of companies.

<sup>26</sup> The Companies Ordinance § 287 (e) (1984) PLD 1985 CS 69 dated 8<sup>th</sup> October 1984.

<sup>27</sup> Securities and Exchange Commission Act § 5 (1) (1997) PLD1997 CS 207.

<sup>28</sup> Securities and Exchange Commission Act § 5 (2) (1997) PLD1997 CS 207.

<sup>29</sup> Securities and Exchange Commission Act § 9 (1) (1997) PLD1997 CS 207.

<sup>30</sup> Securities and Exchange Commission Act § 12 (2) (1997) PLD1997 CS 207.

<sup>31</sup> Securities and Exchange Commission Act § 16 (1997) PLD1997 CS 207.

required of corporate institution to achieve truthful disclosure of its activities via transparency.<sup>32</sup>

## **B. SECP and Minority Shareholder Protection in Mergers**

Though the SECP Act does not expressly mention that it is the duty of SECP's to specifically protect minority shareholder in mergers, this can be implied from the text of the Act when the text is observed in totem. Under § 20 (4) (j) of the SECP Act, the SECP shall be responsible for the performance of "regulating substantial acquisition of shares and the merger and take-over of companies." Also it is the duty of SECP under §20 (6) (b) to strive "to maintain the confidence of investors in the securities markets by ensuring adequate protection for such investors." In addition, under § 21 (a) (ii) the Board of SECP "when so asked to do and after consultation with the Commission advise the Federal Government on ... regulation of companies and corporate sector and protection of the interests of investors."

The protection of such aforementioned "investors" by the SECP clearly includes minority investors, for minorities are a subset of "investors." A view to the contrary not only contradicts a textualist reading of the Act, but also goes against its spirit. In addition, notwithstanding the aforementioned statutory interpretation relative to minority shareholder protection as being one of the objectives of the SECP in the context of mergers, the case law, which will be subsequently elaborated upon in detail also maintains a view that the duty of the court and administrative/enforcement agencies is to make sure that merging companies are making such decision in the interest of the shareholders as a whole class, which is inclusive of the minorities and are not making such decisions solely for the protection and benefit of the majority shareholders. It is pertinent at this juncture to indicate that the SECP has the capability via its legislatively ordained broad enforcement and investigative authority, to achieve its objective of protection of investors interest inclusive of minority shareholders in mergers. For example, under § 31, an investigating officer of the SECP can in particular circumstances make forcible entry of any place or building. Under § 32 the SECP has the power to call individuals for examination and under § 30, the SECP has the authority to impose fines and refer matters to the courts for criminal penalties.<sup>33</sup>

## **C. Code of Corporate Governance "Code" (2002)**

This Code was formulated by the SECP and is enforced on all *listed* companies through §34 (4) and

<sup>32</sup> Securities and Exchange Commission Act § 25 (1997) PLD1997 CS 207.

<sup>33</sup> "Enforcement and Investigation" section of the SECP Act, PLD 1997 CS 207.

§35 (5) of the Securities and Exchange Ordinance of 1969.<sup>34</sup> The aim of the Code is good corporate governance with the objective of achieving transparency, fairness and smooth business dealings. Proper implementation of the Code therefore will formalistically have as a by-product proper minority interest protection in mergers, which is also a component of good corporate governance, for courts and enforcement agencies will have a clearer picture of what is the ground reality and hence respond accordingly. To achieve its objective the Code had developed elaborate and formulized procedural requirements for proper corporate governance, such as qualification and eligibility to act as directors and the responsibility, powers and functions of the board of directors,<sup>35</sup> stringent qualification and tenure requirements for the Chief Financial Officer and the Company Secretary,<sup>36</sup> a detailed director's report prepared under § 230 of the Companies Ordinance consisting of all relevant financial documents<sup>37</sup>, disclosure of interest by a director holding company shares<sup>38</sup>, prohibition on auditors holding company shares and the audit committees elaborate composition and reporting procedures.<sup>39</sup>

In fact some provisions of the Code have expressly dealt with the issue of fostering minority shareholder protection. § i of the Code states that "all listed companies, shall encourage effective representation of independent non-executive directors, including those representing minority interest, on their Board of Directors...[f]or the purpose, listed companies may take necessary steps such that: minority shareholders as a class are facilitated to contest election of directors by proxy solicitation...". In addition, § xxix of the Code states that "[w]here the offer price to minority shareholders is lower than the price offered for acquisition of controlling interest, such offer price shall be subject to the approval of the Securities and Exchange Commission of Pakistan."<sup>40</sup>

Currently the Code applies only to the approximately 700 existing listed companies. However, according to top officials at the SECP, the Code being only applicable to listed companies is

<sup>34</sup> § 34 (4) "Where the [Commission] considers it expedient so to do, it may, by order in writing, direct a stock exchange to make a regulation, or to amend or rescind any regulation already made, within such period as it may specify in this behalf. § 34 (5) "If a Stock Exchange fails or neglects to comply with any direction under sub-section (4) within the specified period, the [Commission] may make or amend, with or without modifications, or rescind any regulation directed to be made, amended or rescinded; and a regulation so made, amended or rescinded by the [Commission] shall be deemed to have been made, amended or rescinded by the Stock Exchange in accordance with the provisions of this section and shall have effect accordingly.

<sup>35</sup> Code of Corporate Governance § iii-xiv (2002).

<sup>36</sup> Code of Corporate Governance § xv-xviii (2002).

<sup>37</sup> Code of Corporate Governance § xix (2002).

<sup>38</sup> Code of Corporate Governance § xxvi (2002).

<sup>39</sup> Code of Corporate Governance § xxvii- xliv (2002).

<sup>40</sup> "Divestiture of shares by sponsor/controlling interest."

viewed as being a trial phase. Subsequently the SECP is planning to enforce the Code on all companies by incorporating the pertinent provisions of the Code directly into the Companies Ordinance, subject to the condition that the present application of the Code on listed companies provides positive results.

#### **D. SECP Regulatory Actions for Protecting Minorities in Mergers**

The SECP prides itself by specifying a couple of cases where it managed to convince the court that the merger as presented was inequitable and could not be sanctioned. By filing its objection to the merger with the court, SECP had successfully argued that adequate protection of the shareholders and especially the minority shareholders was being undermined. The court was extremely conducive towards the arguments of the SECP as it is the court's duty to "take into consideration the representation if any, made to it by the registrar [a SECP employee] before passing any order under any of these [Compromises or Arrangement] sections."<sup>41</sup> In the case of *Kohinoor Raiwand Mills Ltd. V. Kohinoor Gujar Khan Mills*, 2002 CLD 1314, the court denied the merger when the SECP, through its "Enforcement and Monitoring Division" filed objections jointly with the involved minority shareholders that the swap ratio determination that had been made by the company relative to the merger, was prejudicial to the interest of the minority shareholders and the shareholders as a class. In fact, the honourable division bench of the Lahore High Court dismissed an appeal that had been subsequently filed by the merging companies. Subsequently the swap ratios were improved and a new scheme of arrangement was presented to the involved shareholders. This scheme was finally approved by the court, which had given deference to the fact that the SECP had acquiesced with regard to the new scheme and swap ratio determinations.<sup>42</sup> In re: *Pfizer Laboratories Ltd.* And another, 2003 CLD 1209, as in the *Kohinoor* case, the court did not sanction a merger by concluding that the share ratio determination was inadequately determined and the interest of the minority shareholders was being undermined. Here again the SECP, by affirmatively being involved in the case, credits itself for convincing the court of its holding that the share valuation was incorrectly determined and was therefore inadequate.

#### **E. Pragmatic Workings of the SECP Relative to Mergers**

On paper the SECP appears to be a powerful and potentially apt institution; however, this is but a

distant reality. There are numerous reasons for the aforementioned holding. The primary and most pertinent factor responsible for the current state of SECP, is lack of human capital and expertise. Unlike industrialized nations such as in the U.S.A where the Securities and Exchange Commission heavily monitors the financial equity industry and publishes thousands of advisory opinions, inclusive of those on mergers on major equity imbroglios for purposes of guiding the related public or institutions, the SECP in Pakistan has not even started publishing advisory opinions.

Though there is an informal practice of the SECP to provide the most fundamental/basic variants of advisory opinions on a case by case bases on a particular company's course of action, undertaken or about to be undertaken, that is only if this particular company affirmatively and proactively approaches the SECP and asks for guidance/opinion. This basically results in such institutions, which cannot secure a meaningful dialogue with the higher authorities at the SECP (may it be due to lack of resources. i.e. influential government associations etc.) to be left in the dark. In addition, companies that lack awareness of the potential illegality of their related course of action, inevitably never approach the SECP.

Even when a company approaches the SECP for an advisory opinion on the legality of its proposed merger, the SECP in determining its opinion relative to the merger and specifically minority shareholder protection, solely views the adequacy of the swap ratio determination to form an opinion. This is surely the incorrect approach, because a merger involves a lot more than what percentage a shareholder would own in the surviving company subsequent to a merger. Other considerations that are pivotal include whether the vision and culture of the surviving company is similar to the companies being merged; the synergies involved and any changes in the rights and obligation of the shareholders inclusive of minority shareholders of the involved companies. Though one is objectively sympathetic to the argument raised by some SECP officials that they don't want to be paternalistic, complete apathy which is what is being witnessed with regards to the aforementioned issue is unacceptable.

Even when the SECP is determining the adequacy of the company's swap ratio valuations by analyzing the three delineated factors under established law of break-up value, the dividend earning capacity and in the case of a listed company, the market value of shares,<sup>43</sup> in reality the SECP is not thoroughly analyzing all the financial information regarding the company, which is readily available. Only the most recent financial statements are analyzed and that also when a high profile case is involved and therefore previous financial statements /filings are not examined.

<sup>41</sup> Companies Ordinance § 288 (1984) PLD 1985 CS 69 dated 8<sup>th</sup> October 1984.

<sup>42</sup> Securities and Exchange Commission of Pakistan, Annual Report at 62 (2003).

<sup>43</sup> *Kohinoor Raiwand Mills Ltd. V. Kohinoor Gujar Khan Mills*, 2002 CLD 1314 at 4.

Such an incomplete analysis can result in the SECP formulating incorrect determinations of the three aforementioned factors, when undertaking the propriety of the swap ratio valuation. Officials at SECP argue that due to lack of resources (labor and capital) and other countless responsibilities in general, it is impossible to overview older documents. But critics of the SECP argue that this surely cannot be a valid excuse for justifying their sloppiness. For though the SECP has the jurisdiction to monitor all mergers of all forms of companies, a merger in Pakistan is a rare phenomenon, which overwhelmingly only listed, large companies indulge in and in fact according to the SECP, in aggregate only around 8 to 10 mergers per year on average take place in Pakistan. Therefore it is hard to believe that SECP does not have the resources to comprehensively view all the contemporary, as well as prior financials of the involved company. The SECP is an institution that is marred by a multitude of problems. According to the higher management at SECP, most of its employees do not have the requisite technical skill and training to do their respective jobs and as a result qualified personnel are supposedly inundated with work, which in turn affects their productivity.

Specifically with regards to mergers, the mechanism operational in the SECP for handling and utilizing all material information to the fullest is arguably faulty. Even though all papers filed with the court relating to an arrangement/merger have to be filed with the SECP for monitoring, these papers are filed with what are called the Companies Registration Offices “CRO’s” of the SECP. Such CRO’s are regional offices and their staff is relatively more inept than the supposed experts who sit at the head office. According to critics, it is arguable whether the supposed experts in the head office obtain all the material documentation in time or at all from the CRO’s, because of operational deficiencies, to be able to fully critique the related merger and thereafter provide satisfactory informative comments to the related court. Employees also feel they are not accorded sufficient compensation salary wise and consequently some at SECP feel that there is lack of enthusiasm at the institution. However, this lack of spirit could conceivably be more a result of the general state of the work environment in Pakistan, due to socio-economic conditions. Some have suggested that in order to ameliorate the pressure on the so-called inundated employees of SECP, in addition to guiding the institution to specific goals and in order to make the Commission more productive, a sectorized study and division of the industry (i.e.(e.g.?) textile) be made, with respective departments in the SECP being responsible for each sector. Even if this is a viable and productive option nothing tangible has been done to propagate this concept and this again sheds light on the lax attitude of the SECP.

Like other administrative and government institutions in Pakistan, the SECP is susceptible to pressure. This may be from the government;

legislators; judiciary; private business conglomerates or influential family cartels, which, according to critics, pressurizes the SECP to make its formal decisions inclusive of advisory opinion on mergers where minorities interest is being comprised, not based on merit. It is true that the SECP being only a nascent institution (it came into being just three years ago) has shown some promise, as was witnessed in the Kohinoor Raiwand Ltd. case. It is also reasonable to believe as a new institution, its efficiency and productivity has been hampered by genuine impediments associated with a start up, for the Corporate Law Authority was but another inefficient/ineffectual government body. However, most of the arguments for SECP inefficiency are pre-textual and at least with regards to the protection of minority shareholders relative to mergers, the SECP in its current state can do a much better job.

#### **F. SECP: A Mode of Protection for Minority Shareholders in a Merger via Utilization of the Securities and Exchange Ordinance, 1969**

The SECP also protects minority shareholder of listed companies by directly registering, overseeing and monitoring the Security Exchanges under the Security and Exchange Ordinance, 1969. The SEC regulates the brokers, members, directors or officers of a stock exchange and/or any relevant “persons”<sup>44</sup> and has the authority to inflict punitive and cause criminal penalties to be inflicted in certain situations, such as for example when insider trading is involved.<sup>45</sup>

It is the duty of the SECP to prevent price manipulation and have transparency and truthful disclosures prevail in the securities market. Hence under § 34 (4) and § 34 (5) of the Securities and Exchange Ordinance, the SECP has the power to make new regulations for the Stock Exchanges. Utilizing such powers the SECP can prevent any artificial stock price movement, so that the objective of those whose motive is to suppress the market value of shares, can be defeated. In turn theoretically minority shareholders are also adequately protected, as most often the incentive behind price manipulation is to prevent the minority shareholders in mergers from being awarded the fair swap ratio valuation, or monies, if minority shareholders are being awarded an appraisal remedy.

However there is intense speculation that in reality price speculation does take place and as a result it is primarily the minority shareholders that are defrauded and adversely impacted by it. The reasons cited are not inadequacies in the aforementioned law but lack of capital/technology and human expertise, both qualitatively and quantitatively relative to the

<sup>44</sup> See Securities and Exchange Ordinance § 2 (j) (1969) PLD 1970 CS 20, definition of “person.”

<sup>45</sup> See Securities and Exchange Ordinance §15-A, §15-B (1969) PLD 1970 CS 20.

administrative agencies such as the SECP, whose job is to monitor for activities that have objectives such as price manipulation. Critics of the SECP argue that the SECP is unable to detect/punish stock brokers who have developed several mechanisms to defraud shareholders specifically those who hold minority interests in listed companies.

One cited deceptive mechanism is where brokers corroborate with one another and buy shares of particular companies, irrespective of the financial status of such companies, with an agreement between themselves not to sell the aforementioned shares within a specified period of time, aiming to artificially increase the price of the related shares. Such brokers' aim is to induce those people who primarily happen to consist of minority shareholders, who buy/sell shares by primarily following the market price and do not heed to the functioning of the company, to buy the related stock. Subsequently once the shareholders have bought the stock at the artificially inflated price, the brokers dump their holding of the shares in the market en masse, with the result that the minority shareholders, who trusted the market price of shares as indicative of the shares value, witness a share decline in the value of their investment.

## V. Substantive Judicial Protection

The judiciary in Pakistan has interpreted the statutory provisions and the well established principles of common law relating to mergers, to award a level of protection to the minority shareholders that is arguably doctrinally adequate, but perhaps not adequate in practice in the relatively few merger proposals that have been brought before the courts.

### A. The Lipton Case <sup>46</sup>

The authority that all relevant courts view as an important foremost source (stare decisis) of what level of rights and protection should be accorded to minorities in mergers, is the in re: Lipton (Pakistan) Ltd. and another case, 1989 CLC 818. In this case the court had the prerogative of deciding whether a scheme of arrangement for amalgamation where Lipton Pakistan was going to merge into Lever Brothers Pakistan Limited, was fit to be sanctioned in compliance with the requirements of § 284 and § 287 of the Companies Ordinance. The court extensively analyzed what were four factors, to reach the determination that the scheme of arrangement qualified for sanction. The court extracted these factors, both for their value as precedence and rationale from the case of in re Alabama. New Orleans, Texas and Pacific Junction Railway Company (1891) 1 Chancery Division 213 at 238, 239 (Ca), where the court stated that “[w]hat the Court has to do is to see, first of all, that the provision of that statute have been complied with and, secondly, that

<sup>46</sup> In re: Lipton (Pakistan) Ltd. and another, 1989 CLC 818

the majority has been acting bona fide. That Court also has to see that the minority is not being overridden by a majority having interest of its own clashing with those of the minority whom they seek to coerce. Further than that, the Court has to look at the scheme and see whether it is one as to which persons acting honestly and viewing the scheme laid before them in the interests of those whom they represent, take a view which can be reasonably taken by businessmen.”<sup>47</sup>

Following the in re. Alabama, the Lipton court found that the statutory requirement, of the requisite resolutions concerning mergers, was undertaken and such resolutions were passed by the “statutory majority in value and in number in accordance with section 284 (2) of the Ordinance at the meeting or meetings duly convened and held.”<sup>48</sup> As previously discussed the interpretation of this factor arguably and favorably provides minorities with the power/discretion to potentially veto mergers.

The next factor enumerated by the Lipton court and extracted from the in re. Alabama opinion was that “[t]he Court should satisfy itself that those who took part in the meeting are fairly representative of the class and that the statutory meeting did not coerce the minority in order to promote the adverse interest of those of the class whom they purport to represent.”<sup>49</sup> Subsequently the court laid out a third inter-related factor that “there should not be any lack of good faith on the part of the majority”<sup>50</sup> in the context of a merger. The Lipton court found that these aforementioned factors were conformed with. The court found that there was “no averment that there has been no fair representation of the members at the meetings of both the companies...no [evidence or] allegation of any undue influence or coercion exercised by the majority on the minority members [and the fact that] the minority of the members who did not vote in favor or against the acceptance of amalgamation at the meetings held under the order of the Court did not appear [before the court] and put forward their Objections.”<sup>51</sup>

The last major factor that the court delineated was whether “the scheme as a whole was fair and reasonable.” This factor which is extracted from the last sentence of the Alabama opinion, provides the adjudicating court with some discretion to render judgments, allowing or disallowing mergers, based on the merits of the merger, by being paternalistic in order to safeguard against the perceived threat of corporate opportunism. But historically both the legislator and the judiciary have been apprehensive and hesitant to encourage court intervention in determining the commercial merits/demerits or

<sup>47</sup> In re: Lipton (Pakistan) Ltd. and another, 1989 CLC 818 at 4.

<sup>48</sup> Id. at 3.

<sup>49</sup> Id. at 4.

<sup>50</sup> Id.

<sup>51</sup> Id.



viability of business activities such as mergers, for the fear is that this course of action would retard general corporate activity due to the fear of unnecessary state intervention. As a result of these two conflicting concerns faced by the courts<sup>52</sup>, the case law inclusive of the Lipton case has been extremely vague in outlining the role of courts in questioning the merits of a merger due to fairness concerns. For example in the Lipton case, at one juncture, the court stressed the point that courts cannot merely act as a rubber stamp, but have a duty to reject a scheme of amalgamation of a merger, if the court is of the opinion that “there is such an objection to it as *any* reasonable man would say that he would not approve.” However, at another juncture the court stated that if “the background and the object of the scheme is a *reasonable* one... then it is not for the Court to interfere with the collective wisdom of the members of the companies.” Both these statements do not adequately and in my view purposely define the term “reasonable” and hence purposely direct court involvement in such matters to remain ambiguous or case specific.

Unfortunately when courts have been involved actively in determining the fairness of a merger, they have hinged their determination of fairness and reasonableness of the merger on the sole determination of the adequacy of the exchange ratio valuation, which is itself based somewhat on a mathematical formula. This is an extremely incomplete, potentially erroneous, simplistic and narrow venue of determining fairness, as it does not take into account a multitude of factors i.e. synergy.

Though the guidance that the Lipton ruling provided courts deciding merger cases was general and vague, it did provide the requisite foundations for the development of concrete, tenable and clear guidelines and standards for such courts. Subsequently some courts have elaborated upon and have done such augmentation, because at present there is consensus among the courts that if a court believes that the merger put forward was being undertaken in the interest of the company as a whole and the decision to merge was made in good faith, without any evidence of the majority shareholders having any opportunistic motives, even though only the minorities in the related company are being adversely impacted by such decision, the court would sanction the merger.

### **B. The Atlas Autos Case<sup>53</sup>**

In the case of Atlas Autos Ltd. and another v. Registrar Joint Stock Companies, 1991 CLC 523, Panjdarya Limited was to merge into Atlas Auto Limited. The court approved the merger, because the procedural requirements of § 287 and 284 were

<sup>52</sup> Avoiding stifling of economic growth and prevention of corporate opportunism.

<sup>53</sup> Atlas Autos Ltd. and another v. Registrar Joint Stock Companies, 1991 CLC 523.

conformed to i.e. notice, and specifically “the proposed scheme of amalgamation had been approved by an overwhelming majority both in number and in value of the members of both the companies.”<sup>54</sup> With regards to the duty to protect minority shareholders, the court stated that “no objection had been received. The small minority of the members who had not attended the Extraordinary General Meeting of the 2 companies in which the motions for approval of the amalgamation were passed, have also not appeared before the court. In fact, no objection has been received from any quarters.”<sup>55</sup>

The court while indulging in the fairness analysis held that because “the exchange ratio adopted in the scheme for allotment of shares of Atlas Autos Limited to the shareholders of Panjdarya Limited is recommended by ... Chartered Accountants on the basis of the financial studies carried out by them and their recommendations had been accepted by the Directors of the 2 Companies”<sup>56</sup> the exchange ratio was adequate. The problem with this holding of the court is that as in the Lipton case, the court is assuming that the adequacy of the exchange ratio is the complete measure of fairness and the naïve view that Chartered Accountants and Directors of the companies will always look out for the interest of shareholders, inclusive of the minority shareholders. This assumption is seldom wrong, as directors most often breach their fiduciary duties to shareholders as a whole, since they almost always have vested interests and conflict of interests with regard to a merger transaction, such as a change in compensation, status and/or rights.

### **C. The Brook Bond Case<sup>57</sup>**

The next prominent merger case was the Brooke Bond Pakistan Ltd. and another v. Aslam Bin Ibrahim and another, 1997 CLC 1873, where the court favorably cited and utilized the aforementioned elements/factors and rule laid down in the Alabama, Lipton and the Atlas case, to hold that the merger of Brooke Bond Pakistan Ltd. into Lever Brother Pakistan was to be approved<sup>58</sup>. The court held that “[m]embers of both the companies have overwhelmingly supported the resolution for merger. The Corporate Law Authority has also extended their no objection and has declared the petition to be in accordance with the law. Except the objectors, none of the employees of both the companies or their creditors have raised any objection. Both the companies have also disclosed their latest financial position which has not been

<sup>54</sup> Atlas Autos Ltd. and another v. Registrar Joint Stock Companies, 1991 CLC 523 at 3.

<sup>55</sup> Id.

<sup>56</sup> Id.

<sup>57</sup> Brooke Bond Pakistan Ltd. and another v. Aslam Bin Ibrahim and another, 1997 CLC 1873.

<sup>58</sup> Brooke Bond Pakistan Ltd. and another v. Aslam Bin Ibrahim and another, 1997 CLC 1873 at 7.

disputed... Nothing in the scheme runs contrary to the Companies Ordinance 1984... minority shareholders of both the companies are not being oppressed by the majority nor such minority shareholders were coerced... this amalgamation would be in the interest of shareholders of both the companies. There is no material on the record to suggest that the merger would be against national or public interest.”<sup>59</sup>

Even though the Brooke Bond opinion was similar to the previous cases to the extent that it stated, by citing the case of Sidhpur Mills Company Ltd. (AIR 1962 Gujarat 305)<sup>60</sup> that the courts prerogative was to police the merger for the attainment of the shareholders benefiting as a whole, coupled with the prevention of oppression and coercion of minority shareholders, this opinion complemented earlier decisions by deliberating on the active role and the deference provided to the “Corporate Law Authority” (the predecessor of the SECP) by the court, when undertaking merger determinations. However, the Brook Bond case was also radically distinguishable and in conflict with the likes of Lipton.

The Brooke Bond court observed that “the required majority of the members of both the Companies have approved the resolution for merger of both the Companies.”<sup>61</sup> Though this was one of the factors that the court in Lipton viewed as being relevant in determining the sanctity of a merger, this factor was much more crucial, pivotal and determinative to the Brooke Bond court when deliberating on the sanctity of a merger. In their view by the fulfillment of such factor, there was created a strong presumption that the merger was fair. The court stated “In such circumstance, sanction cannot be withheld unless if it is shown that it is unfair, unreasonable or it is against the national interest. The burden is upon the person who alleges that scheme to be unfair and against the national interest.”<sup>62</sup>

Even though the Brook Bond case, like the Lipton case, did not clearly provide guidelines on what “reasonable” and “unreasonable” meant, it did elaborate on the burden of proof of determining fairness in such a way, that the case law presented was more adverse towards minority shareholders protection than the antecedent case law on mergers. In the Lipton case, the court had held that it was the discretion of the court to determine whether the merger was fair or unfair, which the court could exercise by evaluating a multitude of factors. Only once the court had determined that the merger was

unfair and not otherwise, would the objector to the merger have “to convincingly show that the scheme is unfair.”<sup>63</sup>

However, the court in Brook Bond did not accord such discretion/jurisdiction to the court in determining reasonableness and subsequently fairness, for once the requisite voting requirements in the related extraordinary general meetings relating to the merger were met, the merger was presumed fair. Also the Brook Bond court elaborated that the objector no longer had to prove that the merger was unfair under the much leniently worded Lipton standard of “convincingly” showing the scheme to be unfair, but under the more stringent standard mentioned in the case of Sussex Bricks.Co. Ltd. ((1960) 2 W.L.R 665), where it was stated “that it must be affirmatively established notwithstanding the view of the majority, that the scheme is unfair, the scheme must be shown affirmatively, competently, obviously and convincingly to be unfair.”

The Brook Bond court having found that the objectors were not able to bring on record any material in proof of their allegation,<sup>64</sup> further advocated this stringent standard adjudging fairness, by citing the case of Sidhpur Mills Company Ltd.(AIR 1962 Gujarat 305) where it was stated that, “ to see whether the scheme is such that a fair and reasonable shareholder will consider it to be for the benefit of the company and for himself. The scheme should not be scrutinized in the way a carping critic, a hair splitting expert, a meticulous accountant or a fastidious counsel would do it, each trying to find out from his professional point of view what loopholes are present in the scheme, what technical mistakes have been committed, what accounting errors have crept in or what legal rights of one or the other sides have or have not been protected. It must be tested from the point of view of an ordinary reasonable shareholder, acting in a business like manner, taking within his comprehension and bearing in mind all the circumstances prevailing at the time when the meeting was called upon to consider the scheme in question.”<sup>65</sup>

#### D. Dewan Salman Fibre Case<sup>66</sup>

The next relevant case on mergers and minorities was Dewan Salman Fibre Ltd., Islamabad v. Dhan Fibres Ltd., Rawalpindi PLD 2001 Lahore 230, where Dhan Fibres was to merge into Dewan Salman Fibres Limited. Both these companies were in the business of manufacturing fibres. “All the members of Dewan Salman present and voting unanimously approved of

<sup>59</sup> Id. at 8.

<sup>60</sup> “Therefore, in my judgment, the correct approach to the present case is (i) to ascertain whether the statutory requirements have been complied with, and (ii) to determine whether the scheme as a whole has, been arrived at by the majority bona fide and in the interests of the whole body of shareholders in whose interests the majority purported to act.”

<sup>61</sup> Id.

<sup>62</sup> Id. at 7.

<sup>63</sup> In re: Lipton (Pakistan) Ltd. and another, 1989 CLC 818 at 4.

<sup>64</sup> Brook Bond Pakistan Ltd. and another v. Aslam Bin Ibrahim and another, 1997 CLC 1873 at 7.

<sup>65</sup> Id at 8.

<sup>66</sup> Dewan Salman Fibre Ltd., Islamabad v. Dhan Fibres Ltd., Rawalpindi. PLD 2001 Lahore 230.

the scheme. From Dhan Fibres only one member voted against the scheme ... [who had argued] that the ratio of exchange of shares was unjust.”<sup>67</sup>

The court rejected this objection by firstly citing the Lipton case: “the task of the auditor was to act as an expert and not as an arbitrator; and, as an expert, he was to certify what, in his opinion, was the fair value of the shares” and thereafter stating that “the shareholders are the best judges of their interests and better informed with the market trends than the Court which is least equipped in the valuation of such trends.”<sup>68</sup>

The court never went into a detailed analysis of why the merger or specifically the exchange ratio was unjust, an occurrence that is indicative of the position of the Dewan court being more akin to the Brooke Bond court, where the court did not see judiciary having much discretion while overseeing mergers. Interestingly, this case interpreted and cited the Lipton, Brooke Bond and the case of Aslam Bin Ibrahim v. Monopoly Control Authority and 2 others, PLD 1998 Karachi 295, but it viewed both the Lipton and Brook Bond opinions as being completely harmonious with one another, which as mentioned earlier is not the case. However, the court in other portions of its opinion, took a position which at times indicated that this court recognized the judiciary as possessing some concrete level of discretion in determining the fairness of a merger.

This observation can be deduced by analyzing a portion of the Dewan court opinion, where it was stated that “[a]lthough the Court does *not act as a rubber stamp* and does not automatically put its seal of approval on all schemes for mergers but at the same time the Court does not act as a Court of appeal and sit in judgment over the informed view of the concerned parties to a compromise because the same would be in realm of corporate and commercial wisdom of the concerned parties for which the Court does not have the necessary expertise. In short the court *must act as an umpire*.”<sup>69</sup>

In fact, at other junctures the Dewan court contrary to its own opinion, takes a position which is more like the Lipton and less like the Brook Bond opinion. For example the Dewan court stated “[e]qually important would be the determination that the majority, which came to register itself, acted bona fide and in the interest of the general body of shareholders and that the minority was neither coerced nor victimized. *As to victimization, the Court would cautiously address the question whether the merger was not calculated to neutralized and render toothless an effective minority. The Court should be satisfied that the scheme was not only fair but also reasonable from the point of view of a neutral*

*observer*.”<sup>70</sup> These last few lines imply a proactive supervisory court for determining the reasonableness of a merger.

It can therefore be concluded that the Dewan case was unclear on the standard of law to be applied when mergers and minority shareholders are involved. This is consistent with the fact that concerned Pakistani courts generally wanted to keep the case law vague or brief<sup>71</sup> on the issue, because of the conflicting public interests involved and the general fact that courts in Pakistan are typically not structured, precise and lucid when it comes to writing an opinion, because of inferior legal and analytical reasoning and writing skills.

The subsequent pertinent cases concerning the topic of discussion, followed the inception of the SECP in 1997. As already discussed the creation of the SECP led the courts to be deferential to the SECP when determining the appropriateness of the related merger. This observation can be corroborated in the subsequently discussed case of Kohinoor Raiwand, 2002 CLD1314, and In re: Companies, 1984 and BSIS Balanced Fund Limited and another, 2002 CLD 1361, where both the related companies transacted “in the business of investments in assets and securities so as to provide a vehicle for the investors to invest their funds in the securities under the directions of its Investment Advisor.”<sup>72</sup> The court pointed out the centrality of deferring to the SECP by stating “the Registrar, Joint Stock Companies through their comments has not commented adversely. The Security and Exchange Commissioner of Pakistan has already approved the scheme subject to the sanction of the Court.... therefore the merger is allowed ....”<sup>73</sup>

The central role of the SECP and the well established rule propounded in previously discussed case law that the court’s prerogative is the attainment of the shareholders benefiting from the merger as a whole, can be further witnessed in the case of In re. R.R.P Limited and Nimir Resins Limited, 2002 CLD 872<sup>74</sup>, where the court stated that “*Comments of the Registrar of Joint Stock Companies are also on record...I have perused the proposed scheme of amalgamation. Members of both the Companies have by majority approved the resolution of the amalgamation/merger. Neither the employees nor any of of the creditors have come forward to oppose the scheme. ... In this view of the matter merger/amalgamation would be in the interest of shareholders of both the Companies.* There is no

<sup>70</sup> Id.

<sup>71</sup> See Nova Leathers (Private), I.I. Chundrigar Road, Karachi and another v. The Registrar Joint Stock Companies, I.I Chundrigar Road, Karachi, PLD 2001 Karachi 5. (opinion was one page long with no explanation of why merger was being sanctioned).

<sup>72</sup> In re: Companies, 1984 and BSIS Balanced Fund Limited and another, 2002 CLD 1361 at 2.

<sup>73</sup> Id.

<sup>74</sup> In re. R.R.P Limited and Nimir Resins Limited, 2002 CLD 872 at 2.

<sup>67</sup> Dewan Salman Fibre Ltd., Islamabad v. Dhan Fibres Ltd., Rawalpindi, PLD 2001 Lahore 230 at 3.

<sup>68</sup> Id.

<sup>69</sup> Id. at 4.

material on- record to suggest that the merger would be against public interest or in violation of any law.”

An interesting but incidental point of discussion, which courts have avoided a direct discussion upon, is what the attitude of a court should be when in a merger context, the minority is both in number and value so minuscule that in effect what might be in the interest of all the shareholders as a whole, might be completely contrary to the interest of the minority, apart from it also being coercive. Mostly courts implicitly assume that what is in the interest of the shareholders as a whole, will be in the interest of the minority shareholders. Therefore historically, unless there has been an explicit or blatant show of bad faith by the majority shareholder relative to a merger, the courts have generally sanctioned mergers.

### E. The Kohinoor Case <sup>75</sup>

The next prominent case, Kohinoor Raiwand Mills Limited v. Kohinoor Gujar Khan Mills 2002 CLD 1314, apart from being a landmark case for delineating the extreme centrality of the role played by and the power bestowed upon the SECP when determining the sanctity of the merger, also extensively deliberated upon the rights of minorities. This was done in the context of a merger, in a manner so favorable to minority shareholders that even previous harsh decisions on minorities, were interpreted to be extremely conducive towards minority shareholder protection via judicial intervention. The case materialized when three petitioner companies, Kohinoor Raiwand Mills Ltd. “KRM”, Kohinoor Gujar Khan Mills Ltd. “KGM” and Kohinoor Textiles Mills “KTM”, sought sanction of the court to a scheme of arrangement relative to a merger, with KTM as the surviving entity, which had been approved by their shareholders in general meetings, when a control group managed all these three companies. Some minority shareholders of KRM, one of those being Asian Securities Ltd., filed objections with the court arguing that the control group was forcing the merger of KRM for their overall interest and not for the interest of the shareholders of KRM as a whole. The court refused to sanction the merger as it felt that the share ratio valuation of KRM under the merger arrangement was inadequate and unfair on the shareholders of KRM, inclusive of the minority shareholders.

In elaborating on the courts judicial authority and the SECP’s authority of intervention in mergers, the court stated that it “is not a by-stander obliged to grant its approval to all schemes of arrangements approved by the special majority of shareholders specified in section 284 of the Ordinance. If that were so it would be pointless to give to the Court a power to review the proposed scheme and to decline approval even where such scheme has been approved by the requisite

majority. It is for this reason subsection (2) of section 284 of the Ordinance stipulates that a proposed scheme will have effect only if sanctioned by the Court. The Registrar under the Ordinance has also been given a statutory right of 1) being heard. Section 288 of the Ordinance mandates consideration of any presentation made by the Registrar before an order is passed by the Court in relation to a proposed scheme of arrangement.”<sup>76</sup>

The court by citing Aslam Bin Ibrahim v. Monopoly Control Authority PLD 1998 Karachi 295,<sup>77</sup> held that “it is by now well-settled, that where a majority of shareholders has voted in a manner which is coercive or oppressive to the minority or where the majority shareholders of a company have not voted in the interest of the shareholders as a class, the Court will not approve a proposed scheme, even though approved by the requisite three-fourth majority.”<sup>78</sup>

The court further added that “[w]herever the Court reaches the conclusion that a scheme is unfair or unconscionable, and to which material objections have been raised by any shareholder either in a general meeting or before the Court, it will become a duty of the Court not to approve the scheme. The fact that the objecting shareholder constitutes a small minority in proportion to the majority will be wholly irrelevant in such circumstances.”<sup>79</sup> Applying this principle to the case at hand the court stated “[t]wo percent of the shareholdings in KRM may be insignificant in terms of the voting rights exercisable at a general meeting of KRM. Seen, however, from the prospective of the objecting shareholders, the amount of their investment in KRM might constitute a substantial proportion of their total assets and investment. Even if this were not so, they would be entitled to raise objections to the proposed scheme as they have done, on the grounds that the scheme is unconscionable.”<sup>80</sup> “It is clear that section 284 of the Ordinance which requires the sanction of the Court to any scheme of arrangement is meant for the protection of the rights of powerless small minorities who can be outvoted at general meetings and cannot, therefore, adequately safeguard their interests on the strength of their voting rights alone. It is, therefore, open to these minorities to show to the Court that the proposed scheme of arrangement is unfair, unreasonable and prejudicial to their interests, or to the interests of the shareholders generally.”<sup>81</sup>

Focusing on the controlling shareholders and the directors, the court stated that “[i]t is incumbent upon the Court to ensure that the provisions of section 284 are not abused by the directors or majority shareholders or are used by them in a manner which

<sup>75</sup> Kohinoor Raiwand Mills Limited v. Kohinoor Gujar Khan Mills 2002 CLD 1314.

<sup>76</sup> Kohinoor Raiwand Mills Limited v. Kohinoor Gujar Khan Mills, 2002 CLD 1314 at 5.

<sup>77</sup> Id. at 6.

<sup>78</sup> Id. at 5.

<sup>79</sup> Id. at 6.

<sup>80</sup> Id. at 11.

<sup>81</sup> Id. at 7.

unfairly or unreasonable deprives the minority of its right to property<sup>82</sup>... that the directors of a company which propose a scheme of arrangement cannot act arbitrarily. Although they may have discretion in selecting one out of various suitable courses of action, which may come before them for consideration, they have no discretion to choose a course of action which is not in the interest of the shareholders.”<sup>83</sup>

As previously discussed, the crucial and at times determinative measure (which as mentioned earlier is potentially dangerously simplistic) that courts utilize to determine the fairness of and hence sanctioning of the merger, is the appropriateness of the stock ratio valuation. In the Kohinoor case, the minority shareholders and the SECP challenged the stock valuation, as they argued that the three recognized measures/factors of breakup value, dividend earning capacity and in the case of a listed company, the market value of shares were not adequately considered. Though the court reasonably agreed with the defendant that there cannot be a completely mechanistic determination when indulging in valuation, the court stressed on the point that the valuation must be reasonably undertaken by entertaining the aforementioned measures, unless a compelling justification can be made to the contrary. The court stated “[a]s in any scheme proposing a merger the swap ratio constitutes a crucial element of such scheme. If the swap ratio is fair, it will ensure that the shareholders of the companies involved in the merger retain the value of their investment, post merger.”<sup>84</sup>

The court held that the petitioners had failed to come up with any reasonable argument why the stock earning capacity was not and the break up value was, inadequately considered in the valuation process. All this was constructive proof to the court that the directors and controlling shareholders were looking solely at their own interests and in such circumstances the directors could not argue that the business judgment rule protected their actions. The court stated that “had the directors deliberated on the matter and had they given reason for excluding the earning capacity of shares as a factor in the valuation, it would have been possible for the Court to examine the reason and to defer to the opinion of the directors if the reasons given by them reflected fairness and a genuine concern for the interest of shareholders<sup>85</sup>.” With regard to the determination of the disparate break up valuation, the court stated that KRM share value was being suppressed “as a consequence of the aforesaid unequal and inherently unfair difference in accounting policies.”<sup>86</sup>

Thereafter the court elaborated upon prominent case law, such as the Dewan, Brook Bond and the

Lipton case etc., in a manner advocating greater minority shareholder protection without directly negating the holdings of some of these cases.

The court deliberated on the much cited paragraph in earlier cases that stated “a scheme of arrangement should not be scrutinized in the way a carping critic...would do trying to find out from his professional point of view what loopholes are present in the scheme, what technical mistakes have been committed, what accounting errors have crept in...”<sup>87</sup> by stating “ I am in respectful agreement with the aforesaid observations, I however, find that the same are wholly inapplicable in the circumstances of the present case, where even a layman without any accounting or legal expertise can see the obvious inequity of the proposed scheme of arrangement and its unfairness to the shareholders of KRM as a class.”<sup>88</sup>

In discussing the Dewan Fibre and the Brook Bond case in a similar minority protection conducive manner, the court stated that such cases “expressly mandate that a Court while considering a proposed scheme of arrangement must test it from the point of view of an ordinary and reasonable shareholder acting in a business like manner. The rationale of the two cited cases is that the sanction of the Court should be withheld if it is shown that the proposed scheme of arrangement is unfair or unreasonable.”<sup>89</sup>

The court further stated “in the case of Asim Bin Ibrahim v. Monopoly Control Authority,...the learned Bench did advert to an objection raised by the appellant, Asim Bin Ibrahim to the swap ratio proposed in the scheme under consideration of the Court. From a discussion by the Court on the said objection, it is clear that the fairness of the swap ratio is a legitimate concern of the Court while considering a scheme of merger. It is only because the appellant in the preceding case had failed to demonstrate to the Court through evidence that the swap ratio was unfair, that the said objection did not prevail with the Court. It follows that if the objector had in fact been able to show to the Court that the swap ratio was unconscionable, the Court would have been persuaded to withhold its sanction to the proposed scheme. In the present case, the discussion above in relation to the swap ratio, amply demonstrates that the objection raised by the objecting shareholders are well founded as the same are substantiated by the audited financial statements of the three petitioner-companies ....”<sup>90</sup>

#### F. Pfizer Case <sup>91</sup>

The next relevant case on mergers and minorities was the In re: Pfizer Laboratories Ltd. and another, 2003

<sup>82</sup> Id.

<sup>83</sup> Id. at 8.

<sup>84</sup> Id. at 3.

<sup>85</sup> Id. at 8.

<sup>86</sup> Id. at 9.

<sup>87</sup> See note 48.

<sup>88</sup> Id. at 10.

<sup>89</sup> Id. at 12.

<sup>90</sup> Id. at 10.

<sup>91</sup> In re: Pfizer Laboratories Ltd. and another, 2003 CLD 1209.

CLD 1209 case, where the court refused to approve the scheme of arrangement under which Parke Davis Company Ltd. was to merge into Pfizer Laboratories Ltd., because as in the Kohinoor case, this court felt that the undertaken valuation analysis was inadequate and was undertaken keeping the interest of the majority shareholders in mind. Consequently the scheme was hence unjust and oppressive in nature on the minorities and therefore could not be approved.<sup>92</sup>

This court's legal analysis, interpretation and holding conformed with the Kohinoor case. This court like the Kohinoor court cited the Alabama, Lipton, Sidhpur and Aslam Bin Monopoly cases and interpreted them in a manner conducive to minorities protection. In addition new case law was also cited, to strengthen the holding that merger decisions must be undertaken for the benefit of the shareholders as a whole, in a bona fide manner and must be reasonable with the court having relatively expansive jurisdiction in determining what is reasonable.

The court cited the Anglo-Continental Supply Co Ltd. (Re 1992) 2 Ch. 723 case, where it was stated that "before giving its sanction to a scheme of arrangement the court will see firstly that the provisions of the statute have been complied with, secondly that the class has been fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority ... and thirdly that the arrangement is such as a man of business would reasonably approve."<sup>93</sup>

The Pfizer opinion was ground breaking in one respect when the opinion stated that "*shareholders* have a *fiduciary* responsibility to act not in the interests of the majority only, but in the interest of the shareholders as a whole. Where this position is abused there is a fraud on the minority, as the term is understood in law, and there need not be necessarily fraud or deceit in the ordinary sense." Earlier case law had only expressly singled out the corporate entity via its directors and officers, as owing a fiduciary duty to the minority shareholders. This court attached such fiduciary obligations directly to the shareholders. In addition, the majority breaching such a fiduciary duty, can be easily adjudged by courts under the standard laid out by this court, for this court has textually defined what could constitute fraud on the minorities in a very expansive manner.

### G. Pak-Water Bottlers Case <sup>94</sup>

The case of Pak-Water Bottlers (Pvt.) Limited and 2 others, 2003 CLD 1634, is the relevant contemporary

case dealing with the issue at hand. Interestingly, though the background of this case was similar to the Pfizer case, the holding of this court was to the contrary. Even though the Pak-Water court did not expressly contradict the rationale of the Pfizer opinion, it conveniently ignored, as well as at times, superficially distinguished that opinion. The court eventually sanctioned the scheme of amalgamation that was presented, under which the merger of Messrs Pak Water Bottlers and Northern Bottlers (Pvt) into Messr Nestle Milkpak Limited had been proposed.

The objection raised had challenged the correctness of the stock ratio valuation and after highlighting the fact that Nestle was the principal majority shareholder in both Pak-Water Bottlers and Northern Bottlers corporations, had claimed the merger as being of an unfair nature.

By undertaking a comparative analysis, it is pertinent to point out that in the United States, when a company, which acts via its officials or shareholders, has a vested interest/self interest or in other words, the company is involved on both sides of the transaction like in a merger, then what is termed as the "Duty of Loyalty" is triggered with regard to the company. A duty which the company must as an agent, fulfill. As a result the burden of proof shifts from the dissenter, to the interested company and its directors and officials, to prove that the transaction i.e. merger is fair and therefore such directors and officials are not awarded any deference as to the appropriateness of their decisions, undertaken under what is termed as the business judgment rule, with regard to the related transaction. The Pak-Water case did not really acknowledge any such duty of loyalty. It held that even when Nestle was an interested party to the transaction, it were the dissenters who had the complete burden of proving that the merger was unfair. This is apparent when the court stated "the objector ... has not been able to establish that valuation of shares was done to protect the interest of the majority shareholders."

The court was further critical of awarding minority shareholder protection when it stated that "the purpose of the provisions of sections 284 to 287 of the Companies Ordinance will stand defeated if a merger is denied on the sole ground that it is opposed or is otherwise not liked, as in the present case, by a small number of shareholders. Even if the alleged nexus between the holding and subsidiary companies is assumed yet that factor does not under any provision of law require that majority shareholders should concede the will of the minority shareholders. As noted earlier, the only legal requirement being that the scheme is not oppressive, unreasonable and unjust."<sup>95</sup>

The Court further added by favorably cited the case of *re: Messrs Pakland Cement Ltd.*, 2002 CLD 1392, "that the onus was on the objector to show that the scheme was mala fide and unfair. Further that

<sup>92</sup> Court held that for scheme approval, fresh valuation must be undertaken by independent auditors who must include trademark, patent and goodwill in their valuation of assets; In *re: Pfizer Laboratories Ltd.* and another, 2003 CLD 1209 at 49.

<sup>93</sup> *Id.* at 26.

<sup>94</sup> *Pak-Water Bottlers (Pvt.) Limited and 2 others*, 2003 CLD 1634.

<sup>95</sup> *Id.* at 12.

unfairness should not be enough *unless it was patent, obvious and convincing*... a court should not go into the commercial merits or viability of the decision reached by the majority.”<sup>96</sup>

Finally the court held that as the three enumerated factors determining stock ratio valuation had been considered, the valuation was adequate as “no rule of law or property demands that valuation or determination of swap ratio cannot be made by Chartered Accountants of the companies sought to be amalgamated.”<sup>97</sup> It is pertinent to point out that this case is similar to the Atlas Case and unlike the Pfizer case in the respect of shielding work product of company accountants from review and scrutiny.

Pakistani case law addressing minority shareholder rights and protection in mergers has generally and formalistically been obtuse, vague and ambiguous. However, it is reasonable to state that case law in aggregate has shown to perhaps move in a direction, where increased court scrutiny, paternalism and involvement has been witnessed, especially in determining the reasonableness and fairness of a merger. It would be naïve based on field research, to assume that the legal analysis and reasoning of all related courts is solely based on the merits and the rule of law, in a third world third world country like Pakistan, where corruption and nepotism and other extraneous factors have adversely and wholly impacted the judiciary.

Factors such as lack of legal expertise, training and resources relative to the judiciary, also adversely impact upon the quality of legal opinions, specifically in specialized fields, such as corporate law. Frequently, because of the pressure exerted upon the judiciary, through familial affiliations, politicians, armed forces, bureaucrats or even the influential parties implicated in the case, the ruling of the case is greatly influenced. In fact, sometimes judiciary rulings are determined when judges are blackmailed or threatened directly by the related influential feudal turned business families in the back drop of the lack of proper security functioning in the country i.e. inadequate police force.

## VI. Conclusion

Mergers in Pakistan are a recent phenomenon and overwhelmingly involve international corporations, but seldom a few large established Pakistani family/feudal owned conglomerates. Though functionally mergers in Pakistan have to comply with intrusive procedural and substantive statutory requirements and are arguably potentially subject to intense court scrutiny, the role of the judiciary and the case law relative to mergers and minority shareholder protection in Pakistan, is vague, incomplete and nascent. Therefore in reality the ability to ascertain as to what level mergers in Pakistan, are monitored by

state and judiciary, against unfairness and majority shareholders indulging in corporate opportunism, is subject to debate. In addition, lack of training and expertise, nepotism, feudalism, corruption in all segments of society including the judiciary and other extraneous socio-cultural ill wills, impact upon how mergers are dealt with.

This is not to say that the development of lucid and elaborate case-law on mergers and how and to what level minority shareholders protection is accorded, will not be dependant on the juridical philosophical determination, on what level of minority shareholder protection will be optimal, from a legal/justice as well as a macro-economic standpoint, keeping in mind Pakistan’s related socio-economic state. However, material development will be dependant on whether the judiciary in Pakistan, is able to overcome all its aforementioned material short-comings.

<sup>96</sup> Id. at 11.

<sup>97</sup> Id. at 10.