IN THE HIGH COURT OF SINDH AT KARACHI

Judicial Company Misc. No.30 of 2016

Gulshan Weaving Mills Ltd. & others …petitioners

BEFORE:

Mr. Justice Muhammad Shafi Siddiqui

Date of Hearing:	30.03.2017
Petitioner No.1:	Through Mr. Shoaib Raashid Advocate
Petitioners No.2 to 9:	Through Mr. Mikael Azmat Rahim Advocate
SECP On Court Notice:	Through Mr. S. Imran Ali Shamsi, Law Officer along with Mr. Shahrukh Artani, Assistant Registrar SECP.
Objector Bank of Punjab:	Through Mr. Muhammad Jamshid Malik Advocate
Soneri Bank:	Through Mr. Haroon Shah Advocate

J U D G M E N T

Muhammad Shafi Siddiqui, J.- This petition is filed by a company called Gulshan Weaving Mills Limited along with some of the secured creditors/banking companies. These financial institutions have provided finances to the petitioner No.1. These petitioners have field this petition for sanctioning the Scheme of Arrangement as available and marked as Annexure 'F' to the petition with the prayer that it should bind not only the shareholders but all creditors of the petitioner No.1 which means that such list is not exhaustive and limited to those who have filed this petition.

2. The notices were issued to the regulator SECP and the meetings of the members/shareholders of petitioner No.1 was ordered to be

convened along with meeting of the secured creditors of petitioner No.1 as prayed in CMA No.314 of 2016. The requisite meetings as prayed for were convened and the matter thus came up for hearing of the main petition. A creditor i.e. Bank of Punjab has reservations as far as grant of this petition is concerned and hence filed the objections in relation thereof and so also the regulator SECP.

3. The Chairman who convened the meeting filed his report on 10.10.2016. By way of poll, the report shows, by majority the Scheme of Arrangement for settlement and repayment of the existing liabilities of the petitioner No.1 towards its secured creditors along with ancillary matter was approved.

4. The Bank of Punjab has filed the objections. In this regard it is the case of the objector that in terms of Section 284 of Companies Ordinance, 1984, the company enjoyed the privilege to enter into a compromise with the creditors and members or any class of them and the Court may on an application in a summary way order a meeting of the creditors or class of creditors or of the members of the company or class or members to be called, held and conducted in such a manner as the Court directs. It is urged that the Court has already directed the company to act upon and the meetings were convened and a report to such extent has also been filed by the Chairman who convened the meeting. It was by majority of ¾ in value of the creditors or class of creditors who were required to approve the scheme which was also successfully achieved. Counsel submitted that although without prejudice to the rights of objector, the Scheme of Arrangement is only meant for secured creditors, yet in the petition, petitioners prayed it to be binding on all. It may well be applied to secured creditors consenting to such Scheme and the objectors may exercise such power as available under the law. Besides this the motive and object behind this Scheme of

Arrangement, as urged, is malafide and the Court should exercise power by not sanctioning the scheme as required under the law.

5. Learned counsel for objector submitted that this Scheme of Arrangement at the very inception smells malafide as an impression is given that not only the secured and unsecured creditors are subjected to this Scheme of Arrangement but the company's directors and the guarantors are also immune from facing any such litigation as to the existing financial liabilities, as disclosed in the Scheme of Arrangement which include the claim of objector. It is urged that an amount of Rs.249,353,526/- with cost of funds is outstanding and decree has already been passed by the competent Court of law and an execution application is pending adjudication.

6. It is urged that the petitioner No.1 secured its liabilities in relation to the aforesaid outstanding/decreed amount through pledge of stock which stock was misappropriated by the petitioner No.1 and in pursuance thereof the objector initiated criminal proceedings by filing criminal complaint. This Scheme of Arrangement only gives an impression that they are in the process of writing off their existing loan liabilities. Hence such Scheme of Arrangement to the extent of writing of such loan or curtailing the civil remedies of other creditors is not covered by Section 284 to 288 of Companies Ordinance, 1984. Learned counsel submitted that this compromise is malafide in the sense that this object could conveniently be achieved by the secured creditors by filing winding up petition under section 305 of Companies Ordinance, 1984 and this Scheme of Arrangement would be of no benefit to the creditors except the fact that unpaid liabilities of petitioner No.1 would be wiped out without trial. This is only an attempt made by the directors of petitioner No.1 to wriggle out of their obligation. He further added that the applicant (objector) cannot be equated with the term creditor,

either secured or unsecured, since the objector is a decree holder and does not come in any of the forms and/or class referred above and is at a higher pedestal. He thus concluded that the Scheme of Arrangement should not override civil and criminal liabilities and the decree in favour of the objector against petitioner No.1.

7. The Law Officer, representing the regulator SECP while adopting arguments of learned counsel appearing for Bank of Punjab has only referred to the Auditor report to the effect that there are certain anomalies in the books of accounts of the company, which tend to smack some foul play.

8. Learned counsel for petitioner No.1 on the other hand submitted that the objector was provided with a proportionate return of their outstanding liability and there can hardly be any error in the justification accorded to this proportionate disbursement of the amount through sale of assets of the company. The terms of Scheme of Arrangement is such that repayment of the existing liabilities of the petitioner No.1 shall be made by sale of all its fixed assets by and under the supervision of Assets Sale Committee consisting of four members amongst the secured creditors. The continuous running or operations of the plant on a tolling arrangement on commercially viable terms was also one of the significant features of this Scheme, which shall continue till consumption of sale of all fixed assets and discharge of liabilities. All securities available with the creditors were pooled in subject to subsequent release of the security interest over all fixed assets. In addition to the above additional security as mentioned in the Schedule 'A' to this Scheme to be provided by the principal sponsor and release of stock of goods/raw material of petitioner No.1 followed by withdrawal of legal proceedings. The creditors were also secured that upon default of any obligation the creditor shall become absolutely and ultimately

entitled to pursue all such rights and remedy available to each of the creditors under the law.

9. In response to the objections of the learned counsel it is urged that the liability of the surety is co-extensive with that of the principal borrower and if the principal borrower is being discharged for all unpaid liabilities, the guarantor/surety cannot be made liable to pay any amount over and above the amount agreed to be paid by the principal debtor under the Scheme of Arrangement, which is otherwise accepted by all creditors under the Scheme of Arrangement. Learned counsel for petitioner No.1 in this regard relied upon an unreported judgment/order of Indian Court in Civil Writ Petition No.2713 of 2009. The relevant part of the judgment is reproduced as under:-

> *"9. Now we come to the second point, namely, assuming that the intention of the Madras Agriculturists' Relief Act is to extinguish the whole or portion of the debt affected by the scaling down, would such extinction of the debt as regards the principle debtor ensure to the benefit of his surety and extinguish his liability also regarding that portion of the debt so extinguished? I have absolutely no doubt that it will. Section 128, Contract Act, clearly enacts that the liabilities of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. There is nothing in Section 133 etc., to alter this general proposition. In Sami Iyer v. Ramaswami Chettia, AIR 1923 Mad. 340 already referred to, it was held that the liability of a surety for a debt ceased to exist when his Civil Writ Petition No.2713 of 2009 (I&M) [17] principal's debt was extinguished, in that case by an act which caused the merger of the estate of the principal debtor and the creditor. It was observed there by Venkatasubba Rao J. at p. 177:*
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> > *"The debt due by the judgment debtor having become extinguished, are the plaintiffs entitled to proceed against the surety? They are not. To my mind, the question does not admit of any doubt. Cunningham and Shephard in their Indian Contract quote the following passage from the Pothiar when dealing with Section 134 : 'It results from the definition of a surety's engagement as being accessory to a principal obligation that the extinction of the principal obligation necessarily*

> *induces that of the surety, it being the nature of an accessory obligation that it cannot exist without its principal. The learned Commentators add the rule may also be put upon the less technical ground that if the release of the surety did not follow from that of the debtor, the latter's release would be purely illusory because the consequence would be that the surety on being compelled to pay would immediately turn around on the debtor. I find it impossible to hold that the creditor can proceed against the surety although the debt has been recovered.*"

10. The other judgment relied upon by learned counsel for petitioner is in the case of Subramanyia v. Narayanswami reported in AIR (38) 1951 Madras 48 when an issue was referred to a Full Bench as to whether a non-agriculturist surety would be liable for entire debt even though the principal debtor was scaled down under the provisions of Madras Agriculturist Relief Act.

11. Another judgment relied upon on the same point is of Venkataswami v. Kotilingam reported in AIR 1926 Madras 184.

12. Thus, learned counsel for petitioner submitted that since the liability of the surety is co-existent with that of principal borrower and since the creditors have agreed to the disbursement of their proportionate share out of the assets towards satisfaction of their outstanding liability, therefore, no other creditor including objector creditor could enforce any right in relation to such liability of civil nature against principal borrower or any of its guarantor since any liability other than the one agreed upon to be satisfied by proportionate payment in the Scheme of Arrangement ceased to exist after the Scheme of Arrangement. The liabilities other than recognized in the Scheme of Arrangement in terms of proportionate shares, would ceased to exist and once it (liabilities) ceased to exist the creditor cannot pursue such matter which relates to recovery of any non-existing liability. However,

for the purposes of this case the counsel has conceded to the extent of criminal proceedings without prejudice to the fact that alleged complaint of objector has already been closed by FIA.

13. I have heard M/s. Shoaib Raashid, Jamshed Malik and the Law Officer SECP and with their assistance perused the material available on record and so also the case law cited.

14. There are two questions which emerges out of the arguments of the learned counsels; i.e.

(i) whether this compromise in terms of Scheme of Arrangement, in terms of Section 284 of Companies Ordinance, 1984 could be effective under the law; and how far this compromise between secured creditors and company would restrict non-consenting creditors to exercise their statutory rights available under the law against guarantors/surety.

(ii) whether this Scheme of Arrangement binds all classes of creditors and financial institutions.

15. The object of Scheme of Arrangement apparently, as disclosed therein, is to record terms and conditions for ensuring settlement of existing liabilities of petitioner No.1 and its ancillary measures. By virtue of an application bearing CMA No.314 of 2016 petitioner prayed for passing an order for holding meetings of (i) members/shareholders of petitioner No.1 and (ii) of secured creditors of petitioner No.1 within 60 days respectively. It obviously includes a class of creditors i.e. secured creditors. The Scheme of Arrangement has defined word “creditors” which means creditors of petitioner No.1 described in Schedule ‘B’, which includes the objector i.e. The Bank of Punjab, to whom petitioner No.1 owe an existing liability. The “consenting creditors” means creditors mentioned in Schedule ‘C’, which does not include the

objector i.e. The Bank of Punjab. The scheme if at all intend to include all classes of creditors, it must have called a separate meeting for different classes. But the contents of petition reflect otherwise. Only one class of creditors was invited for the purpose of Scheme. It could very conveniently be held that it relates to one class of creditors i.e. secured creditors and would not bind other classes, but whether the terms of Scheme, as argued by petitioner's counsel, would also bind non-consenting members of same class is a moot question.

16. The background, as disclosed in the Scheme of Arrangement, are the difficulties being faced by the company in meeting its financial obligations towards creditors as they have not been able to fulfill its obligations towards creditors. The Scheme of Arrangement discloses the terms of the scheme, repayment of existing liabilities, tolling arrangements and also discloses some additional securities in dispensing such obligations with the suspension of legal proceedings and remedies subject to fulfillment of the obligations and appointment of Sale Assets Committee. They are thus precisely seeking its winding up as the terms demonstrate.

17. One of the significant features of this Scheme is that meeting was convened in relation to a particular class of creditors i.e. secured creditors and under the law. i.e. Section 284(6) of Companies Ordinance, the mandatory requirement of 3/4th of the majority of that particular class of creditors was required to vote for the approval of such scheme and an independent meeting of each class of creditors should have been convened separately so that the issue of one kind of class may not overlap the issues of other class of creditors and/or the meeting should not be held in a manner to circumvent any interest of the minority class of creditors.

18. In the case of Caravan East Fabrics Limited v. Askari Commercial Bank Ltd. reported in 2006 CLD 895 learned Single Judge of this Court held that if applicant chooses to call a meeting of a particular class of persons leaving out other class of persons whose rights or interest is affected or where a joint meeting of persons having diverse or conflicting interest is called to secure statutory majority then the applicant runs risk of rejection of the petition. Learned Single Judge made this observation while relying on the case of Commerz Bank AG v. Arvind Mills Ltd. (2002) 110 Comp. Cases 539 Gujrat. It was held that commonality of interest constitutes classes to be dealt with separately. It was thus for the applicants to show which class of creditors they intend to enter into such compromise which class may also be distinguished on the basis of commonality of interest. The Company has already disclosed their intention as to whom they intend to enter into in a Scheme of Arrangement i.e. the secured creditors who are willing to forgo all remedies either against borrower or its guarantors/sureties.

19. The interest of secured creditors and that of unsecured creditors may be common but only to the extent of sale of mortgaged, pledged and/or hypothecated assets and for its distribution on proportionate basis but they do not share in common that by entering into such Scheme the statutory rights and remedies against guarantor/sureties is also ceases at the time of approval. These statutory rights may be of civil or criminal nature as against guarantor/directors. The consenting creditors may have been compounding all their rights by way of sale of assets but such consent of some of the creditors cannot curtail the legal remedies of any other class of creditors or of the same class which include but not limited to pursuing their civil and criminal matters against the guarantors/sureties. The guarantor’s liabilities and obligations cannot be wiped out by virtue of this compromise between

consenting creditors and the company/respondent No.1. The judgments cited by learned counsel for petitioner No.1 in support of his case relates to an adjustment of their liability as against the security which itself extinguishes the remedies against not only the principal borrower but also against guarantor, which is the not the case here. The consenting creditors may have conceded or bartered their rights against the guarantors but not the non-consenting creditors who may still be entitled and eligible under the law to exercise their right against the guarantors. In terms of Schedule 'B' the consenting creditors mentioned in Schedule 'C' may have chosen to distribute the sale proceeds of the assets amongst creditors, as disclosed in the existing liabilities Schedule 'D', but this is not any kind of variation in the terms of finance and does not extinguishes the legal and statutory rights of other class of creditors not involved in consenting to the approval of the Scheme of Arrangement. In determining the liability of guarantors and/or surety the contract and/or bond in every case be carefully studied. I do not see any material change or variance in the mode of repayment. All that was agreed in the Scheme of Arrangement is a stepwise disposal of property to discharge liability of company and payment is released on proportionate basis. Nothing varied to the disadvantage of guarantor and/or surety. Principal debtor is not being released from any of its unpaid liability which could act as variance for guarantor/surety. These arrangements under the Scheme is nothing but follow up for the recovery which otherwise is available to all creditors under the law and the distribution of sale proceeds is as required under the law.

20. In the above referred case of Caravan East Fabrics Ltd. (Supra) a similar question was raised but to the extent that the opposing bank was a secured creditors as against scheme for unsecured creditors having a

ratio of 15.90 to 85.5% respectively. The relevant part of which is reproduced as under:-

> *"42. In instant case, petitioner chose to call joint meeting of all the creditors together. Admittedly there are two separate and distinct classes of creditors, as discussed in paras.33 to 35 K above, one comprising of Objector-Bank, being secured creditors comprising 15.90% of the total number of creditor present in the meeting. Other category comprised of unsecured creditor commanding 85.5% of total number in value. It may be observed that out of 14 creditors 10 creditors are existing shareholders of the petitioner-Company including Assets Investment Bank Limited (AIBL), one of the major unsecured creditors. AIBL alone hold almost 24% share capital, in the petitioner's company (see para.5.4 of the proposed scheme as reproduced above) and represent almost 44% of total debt. Annual report placed on record shows that AIBL also have two directors on the board on the petitioner's company. Looking at the interest of unsecured creditors in the petitioner's company their natural inclination towards the petitioner's company is quite understandable. Where subordinated creditors have an interest in the company and otherwise have no interest or charge over the assets and property of the company, then they would, constitutes a different class. Therefore, in my opinion, joint meeting of secured creditors having charge over assets and property of the company and unsecured creditors who are also a subordinated creditor, having no charge over the assets and property of the petitioner's company was improperly convened by the petitioner's company. Both secured and unsecured creditors have no commonality of interest. As observed in para.28 above, where applicant chooses to call a meeting of a particular class of person leaving out other class of persons whose rights or interest is affected. And or where a joint meeting of Stakeholders having diverse or conflicting interest is called to win over statutory majority then such exercise is always viewed with suspicion. In such a situation applicant runs potential risk of rejection of petition. In the instant case, applicant chose to call the joint meeting of creditors of conflicting interest, having no commonality of interest inter-se. In my opinion joint meeting of secured and unsecured creditors was not properly constituted. Joint meeting was called knowing fully well that unsecured creditors having clear-cut over all statutory majority will easily ride over the wishes and stampede the interest of minority secured creditors aimed at defeating mortgage decrees in their favour. As noted above, scheme of arrangement will not be sanctioned merely because it has been approved by*

> *seemingly homogenous majority of stake holder, unless sponsors satisfies the sanctioning Court that the scheme is fair and equitable, which the petitioner failed to establish in this case.*
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> *43. Proposed scheme of arrangement is between the petitioner's company' and its creditors. Neither the meeting of shareholder was called nor was their approval of the scheme sought. Though it is not always necessary to call meeting of such class of person to which scheme is not targeted. However where proposed scheme between one set of stakeholder also affects or varies rights and interest of any other set of stakeholder, then it is necessary to call meetings of affected class of person and seek approval of proposed scheme from such class of stakeholders as well. If such course is not adopted and affected class is neglected, then also the sponsors of the Scheme of arrangement may fail to secure the approval of the Court."*

21. This Scheme of Arrangement although is silent as to surety's liability but it was argued to propose and suggest in a manner which tend to take away the statutory rights of non-consenting creditors of the same class or of any other class of creditors. There are of course contractual rights and statutory rights which members of the same class of creditors may barter for any consideration but the consent of the majority of one class of creditors cannot sweep the statutory or legal rights available to them under the law unless the variance is established. The majority view could prevail over minority and releases the guarantors only in case of variance in terms of repayment and in its absence it does not interfere any other statutory rights. Such sanction could only be deemed to be to the exclusion of objectors or non-consenting creditors who merely seeks to enforce statutory rights available to them under the law. The principle of Section 133 of the Contract Act in its strict sense would not apply to a case of Scheme of Arrangement under the present circumstances of the case.

22. I am not interfering to challenge the wisdom of those creditors who opted for the approval of the Scheme but the decision should be

limited to them only and it cannot trespass the rights and obligations arising out of the law. It is perhaps this common interest of consenting creditors which distinguishes the objector from rest of the secured creditors and since there is no commonality of interest between the objector and the consenting secured creditors the effect of this Scheme of Arrangement would not bind the objector.

23. Upshot of the above discussion is that this Scheme of Arrangement is approved with the clarification that it binds the consenting creditors and not otherwise and the petition is thus allowed to this extent and with the clarification mentioned hereinabove. The pending applications also stand disposed of.

Dated: 03.04.2017 **Judge**