



Corporate Supervision Department
Company Law Division

Before Mr. Abid Hussain – Executive Director (CSD)

In the matter of

Fazal Cloth Mills Limited

Number and date of SCN: No. CSD/ARN/125/2015-2025-31 dated December 26, 2016

Date of hearing: February 08, 2017

Present: Mr. Asad Mustafa, Company Secretary
(Authorized Representative)

ORDER

**UNDER SECTIONS 160 AND 208 READ WITH SECTION 476 OF THE COMPANIES
ORDINANCE, 1984**

This Order shall dispose of the proceedings initiated against the directors including the Chief Executive Officer (*the "Respondents"*) of Fazal Cloth Mills Limited (*the "Company"*) initiated through Show Cause Notice (*the "SCN"*) dated December 26, 2016 under the provisions of Sections 160 and 208 read with Section 476 of the Companies Ordinance, 1984 (*the "Ordinance"*).

2. The brief facts of the case are that the Company in its 51st Annual General Meeting held on October 31, 2016 (*the "AGM"*), sought shareholders' approval in terms of Section 208 of the Ordinance to enter into a Sponsor Support Agreement ("*SSA*") with Fatima Transmission Company Limited ("*FTCL*"), an associated undertaking and NIB Bank Limited ("*NIB*") and others for availing a Term Finance amounting to Rs. 500 million by FTCL from NIB. Statement under Section 160(1)(b) of the Ordinance as annexed to the Notice of the EOGM disclosed that the terms of SSA bound the Company to pay to NIB the amount outstanding as per SSA, in case of default by FTCL, which constitutes a guarantee and amount to unfunded facility by the Company to FTCL. In this regard, it was observed that the notice of AGM and the annexed statement under Section 160 (1) (b) of the Ordinance was found deficient with respect to disclosures required by clause (b) of the sub-regulation (1) of regulation (3) of the Companies (Investment in Associated



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Companies or Associated Undertakings) Regulations, 2012 (*"the Regulations"*), in respect of the following disclosures:

- a. Benefits likely to accrue to the Company from subject guarantee.
- b. Average borrowing cost of the investing company.
- c. Rate of interest, mark up, profit, fee or commission to be charged.
- d. Repayment schedule and terms of financial guarantee.

3. In this regard, it was revealed that the Company has not complied with the provisions of Section 160 read with Section 208 of the Ordinance. Therefore, the SCN was issued to the Respondents wherein they were called upon to show cause in writing within fourteen days as to why penal action may not be taken against them under sub-section 160 (1) and (b) and section 208 (3) of the Ordinance.

4. The Company vide its letter dated January 5, 2017 submitted a written reply wherein it was submitted that:

- The Company has not provided any financial guarantee to NIB Bank or associated undertaking nor provided loan to any of them under SSA.
- Under the term of SSA, Company as a sponsor just committed and undertaken that the Company will be responsible for financial covenant of the SSA subject to failure of associated undertaking to perform the term of NIB.
- This is a kind of commitment/undertaking, which is subject to the fundamental condition in case of failure of the associated undertaking to perform with its lender, which is neither guarantee nor loan at the time of entering into SSA.
- The purpose of the SSA was to facilitate the associated undertaking to avail financial undertaking from NIB for setting up of operational line on urgent basis.
- Dividends shall be received as major benefits from the associated undertaking after the transmission becomes operational.
- It is therefore only a commitment/undertaking subject to certain conditions with no borrowing costs.
- The disclosures in the notice of the AGM are based on good faith and none of the facts have been concealed or misstated.



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5. Considering the reply of the Respondents, hearing in the matter was fixed on February 08, 2017 wherein Mr. Asad Mustafa, Company Secretary appeared on behalf of the Respondents as Authorized Representative. He reiterated the facts stated in the written submission along with the claim that no new agreement based on this resolution has been implemented yet. He committed that the Company will provide the deficient information to the shareholders by passing a new resolution in the upcoming general meeting.

6. Subsequent to the hearing proceedings, Authorized Representative vide his letter dated February 21, 2017 submitted that in follow-up of the hearing held earlier, the Company will conduct the Extra Ordinary General Meeting (*the "EOGM"*) to seek the approval of the following resolution with or without modification, which is stated below:

Resolved that the Company be and is hereby authorized to make investment up to Rs 250 million in associated company Fatima Transmission Company Limited ("FTCL") in the form of loan or advance in lump sum or in parts subject to occurrence of default by FTCL in repayment of Term Finance it availed from its lender, NIB Bank Ltd, hence, in such cases the Company be required to fulfill its guarantee/commitment/undertaking to NIB Bank under the Sponsor Support Agreement already approved by the shareholders of the Company in Annual General Meeting held on October 31, 2016 to enter into for execution. This investment will be subject to mark up under the provisions of the Companies Ordinance 1984 and will be repaid by FTCL within two years from the date of disbursement of loan by the Company.

7. Later on, the Company vide its letter dated March 02, 2017 submitted that the Company in its Board Meeting held on February 27, 2017, has obtained the approval of the board on the new resolution ratifying the disclosure made previously. It also stated that the Company shall hold EOGM on March 25, 2017 where it will seek approval from the members and statement under Section 160(1)(b) of the Ordinance was also issued to the shareholders. Subsequently, record of the office verified that the EOGM has also been held in this regard.

8. Before proceeding further, it is necessary to advert to the following relevant provisions of the Ordinance.

In terms of sub-section (8) of section 160 of the Ordinance provides as under:



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"Every officer of the Company who knowingly or willfully fails to comply with any of the provisions of this section shall be liable to,-

- (a) *If the default relates to a listed company, to a fine which may exceed to fifty thousand rupees and in the case of continuing default to a further fine which may extent to two thousand rupees for every day after the first during which the default continue"*

In terms of section 208 (3), the Ordinance provides-

"if default made in complying with the requirements of this section, or the regulations, every director of a company who is knowingly and willfully in default shall be liable to fine which may extend to ten million rupees and in addition, the directors shall jointly and severally reimburse to the company any loss sustained by the company in consequence of an investment which was made without complying with the requirements of this section"

Regulation 3 (1) of the Companies (Investment in associated companies or associated undertakings) Regulation, 2012, inter alia, provides as under:

"A company shall, while issuing notice of its general meeting where a special business related to investments in any of its associated companies or associated undertakings is to be transacted under section 208 of the Ordinance annex a statement pursuant to clause (b) of the sub-section (1) of section 160 of the Ordinance, setting out, among other, the following information, namely:

In the case of loans and advances:

- iii) purpose of loans or advances and benefits likely to accrue to the investing company and its members from such loans or advances;*
- vi) average borrowing cost of the investing company or in case of absence of borrowing the Karachi Inter Bank Offered Rate for the relevant period;*
- vii) rate if interest, mark up, profit, fees or commission etc. to be charged;*
- xii) repayment schedule and terms of loans and advances to be given to the investee company;*

Regulation 7 (b) & (d) of the Regulations provides that:

"b) In case of unfunded facilities (for example a guarantee, letter of indemnity, etc.) the rate of return shall be determined based on the rate of interest, mark up, profit, fees or commission etc., as



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the case may be, charged by commercial banks or Islamic Finance Institutions on similar unfunded facilities;

d) The company shall not invest in its associated companies or associated undertaking by way of loans or advances except in accordance with an agreement in writing and such agreement shall inter alia include the terms and conditions specifying the nature, purpose, period of the loan, rate of interest, mark up, profit, fees or commission, penalty clauses in case of default or late payments and security of for the loan in accordance with the approval of the members in the general meeting"

9. In terms of notification S.R.O 751(I)/2017 dated August 02, 2017, the power to adjudicated cases under Section 208 of the Ordinance has been delegated to Executive Director (Corporate Supervision Department).

10. I have analyzed the facts of the case, relevant provisions of the Ordinance, arguments put forth by the Respondent during the hearing. I am of the view that the Company has provided a commitment to the lender in case of default of FTCL to perform the terms of NIB Bank. Shareholders also in the AGM held on October 31, 2016 approved such a commitment under section 208 of the Ordinance, which was subject to the condition that in case of failure of the associated undertaking the Company will perform obligation with its lender. The Company has not provided any financial guarantee to NIB Bank or associated undertaking nor provided loan to any of them under SSA. Furthermore, the Company later on addressed the issues raised by the Commission in light of Regulation 7 of the Regulations. The Company in its EOGM dated March 25, 2017 passed the specific resolution and fulfilled the deficiencies identified and submitted the evidence of compliance with the Commission. The said Resolution was specific to the fact that the shareholders' of the Company resolved to authorized the company to make investment up to Rs 250 million in FTCL in the form of loan or advance in lump sum or in parts. Said investment was subject to occurrence of default by FTCL in repayment of Term Finance it availed from its lender, NIB Bank Ltd and in such cases, the Company is required to fulfill its guarantee/commitment/undertaking to NIB Bank under the SSA. The Company also resolved that this investment will be subject to markup under the provisions of the Ordinance and will be repaid by FTCL within two years from the date of disbursal of loan by the Company.

11. In view of the foregoing, I hereby appreciate the level of compliance shown by the Respondents. However, I am of the view that it is the responsibility of the directors and



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management of the Company to place the matter in complete details, containing all the terms and conditions, before the shareholders for their consideration and approval. The necessary information was not provided to the shareholders. The Company in the forthcoming general meeting sought necessary approval from the shareholders in this regard. I therefore while taking a lenient view conclude these proceedings with a warning to the Respondents and advise them to observe strict compliance of the law in future.

Abid Hussain

Executive Director (CSD)

Announced:

May 29, 2018

Islamabad