

Securities and Exchange Commission of Pakistan
Enforcement and Monitoring Division
7th Floor, NIC Building, Jinnah Avenue, Blue Area, Islamabad.

Before Rashid Sadiq, Executive Director

In the matter of
Spencer & Company (Pakistan) Limited

Number and date of show cause notice	19(270)CF/ISS/71 dated June 17, 2000
Date of hearings	September 20, 2000, April 24, 2001, December 11 & 31, 2001
Present	Mr. Byram D. Avari, Chief Executive Mian Mumtaz Abdulla, FCMA. Ahsan Zahir Rizvi, advocate

ORDER UNDER SUB-SECTION (5) OF SECTION 208
READ WITH SECTION 476 OF THE COMPANIES ORDINANCE, 1984

By this order, I propose to dispose of the issue pertaining to inter-corporate financing under the provisions of Sub-section (1) of Section 208 of the Companies Ordinance, 1984 (the “Ordinance”), which has arisen out of the Show Cause Notice dated June 17, 2000 issued to the Chief Executive of M/S Spencer & Company (Pakistan) Limited (hereinafter called the “Spencer”).

2. Spencer is a public limited company incorporated on June 12, 1948 having authorized and paid up share capital of Rs. 25 million and Rs. 15.423 million respectively, as per its latest Balance Sheet for the year ended June 30, 2001.

3. Spencer is listed on the Karachi Stock Exchange (Guarantee) Limited and is carrying on business of property management and pharmaceutical manufacturing through its subsidiary company.

4. The position of equity of Spencer, profits and distribution of dividends for the years 1995 to 2001 is as under:

(R u p e e s i n '000')

Description	2001	2000	1999	1998	1997	1996
Paid up capital	15,423	15,423	15,423	15,423	15,423	15,423
Capital reserves	4,167	4,167	4,167	4,167	4,167	4,167
Revenue reserves	286,111	286,111	286,111	152,262	152,262	142,262
Acc. Profit/(Loss)	(101,097)	(64,777)	(29,069)	340	1,797	2,120
Total equity	204,605	240,924	276,632	172,192	173,649	163,972
Net profit / (loss)	(36,320)	(35,708)	(29,069)	2,385	13,520	105,437
EPS	(23.55)	(23.15)	(19.07)	1.55	8.8	68.36
Dividends	NIL	NIL	NIL	45%	45%	40%

Note: Revenue reserves for the year 1999 to 2001 include Rs. 133.849 million representing realization of surplus on revaluation of fixed assets

5. The Board of Directors of Spencer as per its latest Form 29 (Particulars of Directors) dated May 03, 1999 filed with Company Registration Office, Karachi comprises of the following:

- i) Mr. Byram D. Avari-Chairman & CEO
- ii) Mr. Dinshaw B. Avari-Director
- iii) Mr. Xerxes B. Avari-Director
- iv) Mr. Nauzer B. Commissariat-Director
- v) Mr. Keki R. Dastur-Director
- vi) Mr. Zia-ur-Rehman Shami-Director
- vii) Col. (Rtd) Aziz Khan-Director

6. The above named directors/CEO were elected by the members of Spencer to take office effective May 13, 1999. Mr. Byram D. Avari was appointed as Chief Executive of Spencer for a term of three years commencing from May 13, 1999.

7. The examination of Accounts of Spencer for the year ended June 30, 1999 (the "Accounts") revealed unsecured investments of Rs. 504.697 million in Spencer Powergen Company of Pakistan Limited (hereinafter called the "Spencer Powergen") against paid up capital plus free reserves of Rs. 272.465 million. The said investments were substantially higher than the permissible statutory limit of 30% of the paid up capital plus free reserves of the investing company. Moreover, the said investments increased from Rs. 490.363 million as appearing in the Audited Accounts of Spencer for the year ended June 30, 1998.

8. Note No. 9.1 of the Accounts further disclosed the following information regarding the aforesaid investments:

QUOTE

"Although, the company is currently experiencing difficulty in recovering this advance, it is still hopeful that it could succeed in recovering the amount due from Spencer Powergen Company of Pakistan Limited and, hence, for this reason, it does not consider it appropriate to make provisions there against."

UNQUOTE

9. It was further noted from the Accounts that the Company also held 693 shares of the value of Rs. 6,930 as of June 30, 1998, which were disposed of during the year ended June 30, 1999 at cost as stands admitted vide Note No. 4.3 to the Accounts. The Accounts did not disclose the relationship of Spencer with Spencer Powergen. 693 shares held by Spencer constituted 99% of the total issued and paid up share capital of Spencer Powergen indicating the relationship of holding and subsidiary companies in terms of the provisions of Sub-section (3) of Section 3 of the Ordinance. However, the Accounts of Spencer for the year 1998 not only were silent on this issue but also did not comply with the mandatory requirements of Section 237 of the Ordinance.

10. Auditors of Spencer namely, M/S Ford, Rhodes, Robson, Morrow, Chartered Accountants have qualified their report to the members on the Accounts on the issue of non-provision against the aforesaid investments/advances in the following terms:

QUOTE

“provision against short term advances given to Spencer Powergen Company of Pakistan Limited amounting to Rs. 504.697 million (1998: 490.363 million) has not been made by the company in the accounts of the current year for the reasons disclosed by the managements of the company in note 9.1 to the accounts of the current year. Had the company made the above referred provision, advances at the year end would have reduced by Rs. 504.697 million, net loss for the year would have increased by the same amount and reserves at the end of the year would have converted into accumulated loss of Rs. 243.488 million at the end of the current year.

UNQUOTE

11. The Directors Report attached to the Accounts under Section 236 of the Ordinance did not give any information and explanation in regard to the Auditors’ qualification as required under the aforesaid provisions of the Ordinance. The Directors Report also omitted from its consideration the important issues of investments, their recoverability, the purchase and disposal of the shares of Spencer Powergen, which were essential for the appreciation of the company’s affairs by its members. The Directors report, in fact, suffered from several legal infirmities.

12. It was also discovered from the perusal of the Accounts that :

- i) Spencer has stopped charging mark up on its huge advances provided to Spencer Powergen with effect from January 01, 1998 due to the reason that Spencer was experiencing difficulty in recovering the said advances;
- ii) The Company has borrowed funds from one of its associated company whose name was not disclosed in the accounts. The amount payable as per Accounts is Rs. 107.256 million, reduced from Rs.188.644 million in 1998.
- iii) The associated company was charging mark up on the said advances at the rate of 20% (1998: 22%) per annum. The mark up charged by the associated undertaking during the year 1999 and 1998 amounted to Rs. 9.114 million and Rs. 7.424 million respectively;

- iv) The aforesaid advances were shown secured in the Accounts for the years 1997 and 1998, whereas the same were shown as UNSECURED in the Accounts for the year ended June 30, 1999.

13. The Commission, after noticing the aforesaid blatant violations of the mandatory provisions of the Ordinance, further felt concerned in this matter for the following reasons:

- i) Spencer did not disclose its relationship with Spencer Powergen in the Accounts although from the statutory record of Spencer maintained at the Company Registration Office, Karachi, it transpired that Spencer Powergen has been an associated undertaking of the Spencer.
- ii) Spencer has not obtained any approval from its shareholders for investments in Spencer Powergen as required under Section 208 of the Ordinance. It has exceeded the permissible statutory limit of investments in associated undertakings, it kept changing the terms and conditions of the said investments so much so that since 1998 no mark-up has been charged on the said investments contrary to the mandatory provisions of the Ordinance.
- iii) On the one hand Spencer was paying interest to its associated undertaking on amount borrowed from it which was also being reduced substantially and on the other hand the amount receivable from Spencer Powergen was increasing and even Spencer has suspended accruing mark up on those advances.
- iv) Spencer's revenues have dropped significantly and against income of Rs. 31.527 million in the year 1998, only Rs. 5.732 million could be generated during the year 1999. Spencer has suffered a substantial loss of Rs. 29.410 million during the year 1999 as against profit of Rs. 2.385 million during the year 1998.
- v) Spencer has resorted to heavy borrowings during the year 1999. It obtained Rs. 116.640 million from its bankers at mark up ranging between, 17.5 % to 18 % per annum. These borrowed funds were invested in Spencer Powergen in the form of advances free of any mark up. Substantial mark up was paid by Spencer to its bankers, which was not recovered from Spencer Powergen.

- vi) A perusal of the accounts of Spencer Powergen were examined, but not audited, by M/S Hyder Bhimjee & Co., Chartered Accountants further revealed that the advance against shares amounting to Rs. 3.122 billion appearing in its accounts for the year ended June 30, 1998 was reduced to Rs 1.054 billion as on June 30, 1999 and further reduced to Rs. 434.149 million as on June 30, 2000. However, Spencer did not receive any amount from its outstanding advances from Spencer Powergen indicating repayment to all other promoters/sponsors except Spencer.
- vii) Spencer continued to make investments in Spencer Powergen from 1996 onwards despite the fact that the Government has cancelled the power project of Spencer Powergen in August 1999.

14. In view of the foregoing, it appeared to the Commission that the transactions of Spencer with its associated undertaking namely, Spencer Powergen were not at arms' length. Spencer has suffered colossal losses because of mark up free advances to Spencer Powergen, the recovery of which, according to the auditors, is doubtful. These investments, therefore, appears to have been prejudicial to the interest of the Spencer and its shareholders.

15. In addition to the above, several other contraventions of the provisions of the Ordinance were also observed in the Accounts. The above mentioned circumstances necessitated examination of the matter to determine the extent of contraventions of the mandatory provisions of the Ordinance and the loss, if any suffered by Spencer on account of such investment transactions.

16. Consequently, a Show Cause Notice No.19(270)/CF/ISS/71 dated June 17, 2000 was issued to the Chief Executive of Spencer highlighting, among others, the violations of Section 208 of the Ordinance. This order, as earlier proposed, will dispose of the issue of advances made by Spencer to Spencer Powergen in contravention of the provisions of Section 208 of the Ordinance.

17. In response to the said Show Cause Notice, Mr. Byram D. Avari, the Chief Executive vide his letter dated June 30, 2000 requested for more time till July 30, 2000, which was allowed. The Chief Executive responded to the Show Cause Notice vide his letter dated July 27, 2000 stating that:

- i) Spencer Powergen has never been an associated undertaking of Spencer. Spencer held no shares of Spencer Powergen nor were there any common directors.

- ii) Spencer Powergen is now a subsidiary of Spencer and although, Spencer has disposed of the investment in Spencer Powergen, the same was acquired by a company of the Group and hence the investment remained within the group and, therefore, it remained our subsidiary.
- iii) The approval of investments in Spencer Powergen was taken from the shareholders of Spencer at the Extraordinary General Meeting held on February 29, 1996.
- iv) In view of realization that the power project would be difficult to be reinstated, the mark up on the advances was not accrued. The power project was cancelled in August 1996 by the then Government.
- v) The investment of Spencer in Spencer Powergen complies with all the provisions of the Ordinance.

18. The Chief Executive also requested for a personal hearing. The case was, therefore, fixed before the then Commissioner (Enforcement and Monitoring) on August 24, 2000 vide this Commission's letter dated August 12, 2000. The Chief Executive made a request vide his letter dated August 17, 2000 to extend the date of personal hearing and submission of documents by one month due to Parsi new year celebrations and the birthday of Prophet Zoroaster. The request was allowed and the case was re-fixed on September 20, 2000 on which date the Chief Executive appeared and presented among other papers, the documents containing names of directors of both the Companies along with dates of the appointment and retirement, the notice of Extraordinary General Meeting held on February 29, 1996 and the statement of material facts appended to the said notice under Clause (b) of Sub-section (1) of Section 160 of the Ordinance.

19. Thereafter, in order to provide an ample opportunity to Spencer to advance arguments in support of its contentions raised in the reply to the Show Cause Notice, the case was heard a number of times, the final date of hearing being December 31, 2001. Mian Mumtaz Abdullah, FCMA along with Mr. Byram D. Avari, Chief Executive of Spencer represented Spencer in these hearings except the final date of hearing when Mr. Ahsan Zahir Rizvi, advocate represented the Company and Mr. Byram D. Avari.

20. At the time of hearings and in written replies (subsequent to reply dated July 27, 2000), Spencer raised the following contentions:

- i) Spencer and Spencer Powergen have never been associated undertakings up to the beginning of year 1998.
- ii) Spencer Powergen has become a subsidiary company of Spencer since the year 1998 and thereafter its shares remained with the Group companies and as such no resolution under Section 208 of the Ordinance was required.
- iii) Although the resolutions under Section 208 were not needed, Spencer has again gone to the General Body on June 20, 2001 and got the resolutions reaffirmed. Thus, there is no violation on the part of Spencer.
- iv) As Spencer Powergen has become a subsidiary, therefore, there was no requirement of mark up on advances to subsidiary company under Section 208 of the Ordinance.
- v) Being a subsidiary company of Spencer, the limit of 30% is not applicable on investments in Spencer Powergen.
- vi) Reliance is also placed on case law on the issue of ratification reported as Shahbazud-Din Chaudhry PLD 1988 Lahore 1.
- vii) No loss was suffered by Spencer by virtue of its investments in Spencer Powergen.
- viii) Erstwhile Corporate Law Authority has exonerated Spencer on the same point in 1997 and hence re-opening the case tantamount to harassment.
- ix) No shareholder of Spencer has objected to the investments made in Spencer Powergen.
- x) Spencer will be able to recover the advances from the sale of land held by Spencer Powergen.
- xi) Spencer charged mark up on its advances to Spencer Powergen at higher rate than its borrowing cost
- xii) Directors of Spencer have no vested interest in the investments made in Spencer Powergen.

21. In the context of the aforesaid arguments, the following were the issues, which required determination:

- i) Whether Spencer and Spencer Powergen have ever been associated companies and whether both the companies were associated undertakings at the time of making of investments by Spencer in Spencer Powergen?
- ii) When did Spencer Powergen become a subsidiary of Spencer? and whether the provisions of Section 208 are applicable for investments in subsidiary companies and to what extent?
- iii) Whether investments in Spencer Powergen complied with all the requirements of Section 208 of the Ordinance? i.e.,
 - a) Passing of Special Resolution before making investments
 - b) Aggregate investments did not exceed 30 % of the paid up capital plus free reserves of the investing company.
 - c) Return on investments in the form of loans was not less than the borrowing cost of the investing company.
 - d) Change in the nature and terms and conditions of the investments without authority of a Special Resolution.
- iv) Whether Spencer has suffered any loss on its investments in Spencer Powergen? and whether the investments of Spencer in Spencer Powergen have been prejudicial to the interest of its shareholders?
- v) Does the ratification by the shareholders could rectify the irregularity/default already made by the company? Does the ratification by shareholders can legalize the investments made by a company in excess of 30% threshold?
- vi) Whether Erstwhile Corporate Law Authority has exonerated Spencer in 1997 and re-opening of the case tantamount to harassment?
- vii) Whether the Directors have any vested interest in the investments made by Spencer in Spencer Powergen?

22. After having considered the arguments of Spencer, the perusal of the documents and the cited case law, the undersigned holds, as under:

(i) **SPENCER POWERGEN AS ASSOCIATED COMPANY OF SPENCER.**

(a) Spencer has initially contended, vide its letter dated July 27, 2000, that Spencer and Spencer Powergen have never been associated companies. Moreover, Spencer never held any share of Spencer Powergen nor were there any common directors. However, during the course of argument, the Learned Counsel changed his stance and conceded that both the companies became associated undertakings in the beginning of the year 1998. In this regard, it would be appropriate to look at the relevant provisions of law, which are embodied in Clause (2) of Sub-section (1) of Section 2 of the Ordinance. According to this, any two or more companies/undertakings can be considered associated companies/undertakings if *interalia*, they are inter-connected with each other because of common ownership, common directorship, a person holding or controlling, directly or indirectly, 20 % or more of the shares of both the companies/undertakings, common management, common control or one company, directly or indirectly, controls, beneficially owns or holds more than fifty percent of the voting securities of the other company or otherwise has power to elect and appoint more than fifty percent of its directors (i.e., holding and subsidiary relationship). **On the basis of facts as emerged from the statutory documents of Spencer and Spencer Powergen and other documents placed on record, the undersigned holds that Spencer and Spencer Powergen are associated undertakings since the incorporation of Spencer Powergen in October, 1994 for the following reasons:**

- i) According to the statutory returns of Spencer and Spencer Powergen filed with the Company Registration Office, Karachi, the following persons were/are common Directors on the Boards of both the companies during the period mentioned against their names:

Mr. Byram D. Avari	December 12, 1994 to June 11, 1995
Mr. Byram D. Avari	October 31, 1997 to date.
Mr. Nauzer B. Commissariat	June 30, 1998 to date
Mr. Keki R. Dastur	June 30, 1998 to date
Mr. Xerxes B. Avari	June 30, 1998 to date
Mr. Zia-ur-Rehman Shami	December 09, 1998 to date
Col.(Rtd.) Aziz Khan	December 09, 1998 to date.

The above facts have not been controverted by the Learned Counsel. Therefore, both the companies were associated undertakings during the period from December 12, 1994 to June 11, 1995 and from October 31, 1997 to date on the basis of interconnecting relationship of common directorship. However, it will be seen that even prior to December 12, 1994 and during the period June 12, 1995 to October 30, 1997, they were acting as such and treating one and other as associated companies.

- ii) Copy of the Statement of Account of Spencer Powergen in the books of Spencer placed on record by the Learned Counsel vide his letter dated July 26, 2001 reveals that the first investment transaction was made on July 01, 1994 and these transactions continued till to date. These transactions were without any agreement with Spencer Powergen and without any approval from its shareholders. The nature of these transactions, i.e., day to day payments for expenses on behalf of Spencer Powergen abundantly establish that both the companies were profusely inter-connected with each other and Spencer and its directors have always exercised control over the affairs and policies of Spencer Powergen. This also establishes the element of common management and common control between Spencer and Spencer Powergen. In addition, it is admitted that Spencer and Spencer Powergen are companies of the same group.
- iii) The Chief Executive's admission in his letter dated July 27, 2000 in the context of relationship of the Spencer with Spencer Powergen also support the above said view. According to this, Spencer Powergen is NOW a subsidiary of the Spencer and although Spencer has disposed of its investment in Spencer Powergen, the same was acquired by a company of the Group and hence the investment remained within the group and, therefore, it remained our subsidiary and necessary control and investment was maintained as they were to be held in a beneficial capacity for Spencer and whenever a company directly or indirectly controls the shareholding, then the subsidiary, Spencer Powergen continues to remain a subsidiary. This also clearly indicates commonality of management and control between Spencer and Spencer Powergen.
- iv) The Learned Counsel has stated that the shares in Spencer Powergen were sold to a Group company, Beach Luxury Hotel in 1999. It has been admitted that Beach

Luxury Hotel is a family concern owned Mr. Byram D. Avari. Spencer has not provided any agreement for purchase or disposal of 99% shares of Spencer Powergen nor any Board resolution or special resolution in this respect has been placed on record. Instead, the Learned Counsel in his letter dated July 26, 2001 has stated that there were no agreements for purchase and sale of shares of Spencer Powergen as these shares were bought and sold on negotiation. This coupled with the abrupt and frequent changes in the Board of Directors of both the companies and sale and purchase of shares of Spencer Powergen lend further support to the view that both the companies were and are under common ownership, common management and common control since incorporation of Spencer Powergen.

- v) Spencer has contented that there were no common directors and both the companies were not associated undertakings, however, huge advances were provided to Spencer Powergen during the period June 12, 1995 to October 30, 1997. Further, no mark up has been charged to Spencer Powergen on these massive advances. The influence on the policies, constitution of the Board of Directors and the element of common management and control is obvious. This alone is an overwhelming evidence that the Directors of Spencer has acted in accordance with the directions and instructions of the Directors/shareholders of Spencer Powergen.
- vi) Spencer has admitted that Spencer Powergen was its project and because of this reason, it continued to provide finances to Spencer Powergen. It is not denied that during the period, June 12, 1995 to October 30, 1997, Spencer did not have any relation with Spencer Powergen. As it continued its investment transactions in the same manner as before and after the aforesaid period, therefore, it is established that Spencer continued to exercise controlling influence over the management and policies of Spencer Powergen during the aforesaid period.
- vii) The mode and manner of the daily business/transactions and the continued extension of mark up free advances manifest common control. If the contrary had been the case, then neither the aforesaid feature had been present nor such mark up free advances could have been made. It would be naïve to assume that without any special relationship such transactions could have taken place and then garbed as ordinary business dealings. There could be no other conclusion except that Spencer

and Spencer Powergen both acted for one another in the common interest, control and management.

- viii) The use of expression ‘directly and indirectly’ in Sub-section (2) of Section 2 of the Ordinance also indicates that the legislator intended widest possible application of this provision of law. Accordingly, based on the above facts, both Spencer and Spencer Powergen are held to be associated companies since incorporation of Spencer Powergen within the meaning of Clause (2) of Sub-section (1) of Section 2 of the Ordinance.
- i) Mr. Byram D. Avari, Chairman and CEO of Spencer is a sponsor and one of the first Directors of Spencer Powergen.

(b) The next question is whether both the companies were ‘associated companies/undertakings’ at the time the investments were made by Spencer in Spencer Powergen? In this regard, it is noted that admittedly Spencer has made investments in the form of advances/loans to Spencer Powergen as well as investments for purchase of shares of Spencer Powergen. With regard to the investments made in the form of loans/advances, it is admitted that these transactions were made from July 01, 1994 even before the incorporation of Spencer Powergen and continued till June 30, 1999 and also thereafter. A summary of the investment transactions from July 01, 1994 to June 30, 2000 is as follows:

(R u p e e s i n ‘000’)

S #	Period	Investment during year	Adjustment/repayment	Balance year end	Maximum during year
1	July 01, 1994-June 30, 1995	213,756	215	213,541	213,541
2	July 01, 1995-June 30, 1996	258,078	144,061	327,558	329,306
3	July 01, 1996-June 30, 1997	225,394	106,787	446,165	468,166
4	July 01, 1997-June 30, 1998	93,459	49,261	490,363	491,660
5	July 01, 1998-June 30, 1999	47,632	33,298	504,697	504,697
6	July 01, 1999-June 30, 2000	16,941	35,470	486,168	509,399

(c) A perusal of the Statement of Account of Spencer Powergen in the books of Spencer indicates that not only cash advances were provided to Spencer Powergen but substantial amounts were paid on its behalf for salaries, asset transfers, traveling expenses, electricity, telephone bills

and other day to day expenses, which again indicates the relationship of common ownership, common management and control.

(d) As far as investments in the equity of Spencer Powergen is concerned, these are stated to be bought and sold on negotiation. According to Form 'A, which is statutory document of Spencer, 594 shares of Rs. 10 each were transferred on June 30, 1998. However, according to the copy of the Register of Member of Spencer Powergen placed on record by the Learned Counsel on the last date of hearing, 693 shares were transferred to Spencer June 01, 1998 and 7 shares were transferred on June 30, 2000. The said copy of the Members Register of Spencer Powergen and its subsequent Forms 'A' do not indicate that these shares have been transferred to any other person. However, the Accounts of Spencer for the year 1999 indicates that these shares were sold to group company at cost. There are, therefore, apparent inconsistencies in the statutory record of Spencer Powergen and books of accounts of Spencer. The Chief Executive, however, admitted that these investments, even after disposal in the year 1999, remained under the control of Spencer. The Learned Counsel has also admitted that these investments were made when Spencer Powergen was an associated company of Spencer. On the date of transfer of shares to Spencer i.e., June 30, 1998, Spencer Powergen was an associated undertaking and the Spencer's investment in Spencer Powergen has already exceeded the statutory limit of 30% of paid up capital plus free reserves. Spencer was, therefore, not entitled to make any further investment either in the form of advances and/or shares in Spencer Powergen.

(e) The undersigned , therefore, has no hesitation in holding that the investments of Spencer in Spencer Powergen were made when both the companies were associated undertakings.

(ii) SPENCER POWERGEN AS SUBSIDIARY OF SPENCER. (a) It is an admitted fact that Spencer has acquired 693 shares comprising 99% of the total paid up capital of Spencer Powergen during the year ended June 30, 1998 from its then shareholders/owners, who were either director of Spencer or their associates. However, these shares were disposed of during the year ended June 30, 1999 to a group company at cost. No reason, whatsoever, has been given for the sale of these shares. Again 700 shares, comprising 100 % of the paid up share capital of Spencer Powergen were purchased in the year ended June 30, 2000, which were transferred in the name of Spencer on June 30, 2000. No agreement was placed on record except a statement given by the Learned Counsel that sale and purchase transactions were made through negotiation. The Chief Executive admitted that although the shares were sold, these were acquired by a company of the

Group and hence investment remained in the Group and necessary control exercised by Spencer on the said shares. **As at June 30, 1998 when the majority shares of Spencer Powergen were transferred to Spencer, both the companies were associated and investments of Spencer in Spencer Powergen amounted to more than Rs. 490 million.**

(b) The Learned Counsel has contended that:

- i) As Spencer Powergen has become a subsidiary of Spencer, therefore, no resolution was required under Section 208 for further investments.
- ii) Because of the same reason, there was no requirement under Section 208 to charge mark up on advances to Spencer Powergen.

The above referred submissions of the Learned Counsel gave an impression that according to his interpretation, the provisions of Section 208 are not applicable on investments in subsidiaries. A plain reading of the said provisions reveals that the provisions are applicable to all listed and unlisted public companies and the exemption is available only to banking companies, financial institutions approved by the Government and private companies which are not subsidiaries of public companies. It is obvious that Spencer does not fall in any of the aforesaid categories. Therefore, all the provisions of Section 208 are applicable on subsidiaries except that in the case of wholly owned subsidiaries the limit of 30 % is not applicable. **The arguments of the Learned counsel on this account are also untenable and unsustainable.**

(iii-a) COMPLIANCE OF SECTION 208 OF THE ORDINANCE - APPROVAL OF MEMBERS THROUGH SPECIAL RESOLUTION. The next question is whether shareholders approval through 'Special Resolution' was obtained as required under the provisions of Section 208 of the Ordinance for advances/equity investments in Spencer Powergen and disposal of investments in shares of Spencer Powergen?

(a) The relevant provisions of law for making investment in associated undertakings is contained in Section 208 of the Ordinance, which makes it mandatory that a 'Special Resolution' is passed for making investment in associated undertakings (prior to July 01, 1995, a resolution to be passed by the 60% of the members present in person or by proxy was required). It is also one of the conditions for making investment that the Resolution shall indicate the nature and amount of the investment and terms and conditions attached thereto. According to Sub-section (2) of the aforesaid Section, no change in the nature of an investment or the terms and conditions attaching thereto is to

be made except under the authority of a Special Resolution. These provisions are mandatory and no investments in associated companies can be made without getting prior approval from the shareholders. A plain reading of the said provisions shows that these are conditions precedent to be fulfilled before the investing company can make any investments in its associated undertakings.

(b) Apart from the above requirements of making investments in associated undertakings, it is also one of the requirements of Clause (b) of Sub-section (1) of Section 160 of the Ordinance that a statement is to be appended with the notice of the meeting setting out all material facts concerning the business including in particular the interest, if any, therein of every director, whether directly or indirectly. This information is considered essential so that all the members of a company must have knowledge about the exact scope of the business proposed to be transacted in the meeting and as to whether they should attend the meeting and use their right of vote considering the importance of the matter from their point of view. It was because of this reason and importance of this issue that Erstwhile Corporate Law Authority has issued S.R.O. 634(I)/96 dated July 30, 1996 which was later on superseded by another Notification No. S.R.O. No. 865(I)/2000 dated December 06, 2000 requiring the companies listed on stock exchanges to provide a comprehensive information to their shareholders in statement of material facts while issuing notices of general meetings where special business relating to investments in associated undertakings are to be considered.

(c) Here, it would be pertinent to mention that it has been held by the Superior Courts of this Country that the purpose of Section 208 of the Ordinance is to secure the funds of the company, curb abuse of powers by the directors who have interest in more than one company and make the matter as regards investments by a company in its associated companies transparent. These provisions of law, therefore, have been enacted with a view to make the matters concerning investments by companies in their associated companies transparent and at arm's length. These have been violated by Spencer as follows:

- (i) Spencer has made investments for purchase of 693 ordinary shares of Spencer Powergen during the year 1998 when Spencer and Spencer Powergen were associated undertakings and disposed of 693 shares of Spencer Powergen during the year 1999 without shareholders approval.
- (ii) Spencer has also invested over Rs. 500 million in Spencer Powergen without shareholders approval.

- (iii) Spencer has changed terms and conditions of the investments in Spencer Powergen i.e. security for advances and rate of mark up without the approval of shareholders.

(d) A scrutiny of the 'Resolutions' passed by the shareholders of Spencer to ratify/approve the investments in Spencer Powergen is also essential. According to the Agenda as disclosed in the notice of meeting held on February 29, 1996 and the minutes of the said meeting placed on record indicates that the following resolution was proposed and passed in the said meeting:

QUOTE

“Resolved that the Board of directors be and are hereby authorized to make an investment in M/s Spencer Powergen Company of Pakistan Limited of such value as may appear to the Directors to be appropriate and beneficial and in this connection to make requisite payments and take other steps in furtherance thereof.”

UNQUOTE

A statement of material facts was annexed to the notice of the aforesaid meeting as required under Clause (b) of Sub-section (1) of Section 160 of the Ordinance, the contents of which are as follows:

QUOTE

“The Company desires to make an investment in the ordinary shares of M/S Spencer Powergen Company of Pakistan Limited. The directors have themselves no vested personal interest in any of the above companies.

UNQUOTE

It is apparent from the agenda disclosed in the notice of the Extraordinary General Meeting held on February 29, 1996, the draft resolutions, the statement appended to the said notice under Section 160 (1) (b) of the Ordinance, the minutes of the said meeting and the Resolutions filed by Spencer with Company Registration Office, Karachi, that the shareholders never passed any resolution authorizing Directors to provide advances to Spencer Powergen as the resolution proposed was for investment in ordinary shares and not in the form of loans and advances. The word used in the resolution is “investment” and not “investments’ which when read with the statement of a material facts only give one conclusion that investment in ordinary shares was proposed and approved. The

argument of the Learned Counsel that shareholders in the aforesaid meeting approved advances to Spencer Powergen is without any force and is unacceptable. It is also evident from the resolution and statement of material facts as reproduced above that in the resolution and statement there was no indication of the amount to be invested, the terms and conditions attached to the purchase of shares of Spencer Powergen. It was also not mentioned as to how this investment would be beneficial to Spencer and its shareholders and as to how much dividend was expected by the management of Spencer from the proposed investments in shares of Spencer Powergen. It is a mandatory requirement to give the name of the company, purpose of investments, terms and conditions and expected benefits from the proposed investments in the notice of meetings and statement of material facts. The proposed resolution does not speak of any of these aspects of the matter. **In my view, the notice of meeting held on February 29, 1996 did not comply with the mandatory provisions of Clause (b) of Sub-section (1) of Section 160 of the Ordinance and the resolution passed was also violative of the provision of the Ordinance as it failed to disclose the terms and conditions attached to the proposed investment in shares of Spencer Powergen. My view also finds support from the Judgment in the case reported as M. Shahid Saigol vs. Kohinoor Textile mills Limited, PLD 1995 Lahore 264 wherein it was declared, based on circumstances and facts of the said case, that the notice of Extraordinary General Meeting and the resolution passed therein were invalid with direction to the respondents to hold fresh Extraordinary General Meeting for the purpose of investment in right shares of associated company after making compliance with the mandatory provisions of Clause (b) of Sub-section (1) of Section 160 and Section 208 of the Ordinance.**

(e) Now coming to the Extraordinary General Meeting of Spencer held on June 20, 2001, it is noted that when during the course of successive hearings held in this matter, the management of Spencer appear to have realized the grave violations of the provisions of Section 208 of the Ordinance have been committed, it promptly convened the aforesaid general meeting for which a notice was issued on May 30, 2001 to pass resolution for investments already made in Spencer Powergen during the period July 01, 1994 to June 30, 2000. The proposed 'Special Resolutions' are reproduced as follows:

“ The resolution is being passed consequent to the Resolution passed at the Extraordinary General Meeting of the Company held on February 29, 1996, *wherein the members authorized the Board to make investments in Spencer Powergen of such value as may appear to the Directors to be appropriate and beneficial* and in this connection to make requisite payments and to take other steps in furtherance thereof.

As the Resolution passed at the Extraordinary General Meeting held on February 29, 1996 *did not disclose, in view of the circumstances prevailing at that time, all the material facts* required under Section 208 of the Ordinance, *in spite of the power to make such decisions being entrusted to the Directors by the members*, this Extraordinary General Meeting is being called to pass the following Special Resolutions in terms of Section 208:

SPECIAL RESOLUTIONS

“Resolved that the Company be and is hereby accorded approval for the investment of Rs. 398,937,045 made by the Company in Spencer Powergen Company of Pakistan Limited from time to time as was *empowered by the members vide Resolution passed at the Extraordinary General Meeting of the Company held on February 29, 1996 at the Beach Luxury Hotel, Karachi.*”

“Further Resolved that for the year ended June 30, 1995, the Company be and is hereby accorded approval for the investment made by the Company in an amount of Rs. 196,181,567 as an advance to Spencer Powergen Company of Pakistan Limited. The rate of mark up charged on this advance is 22 % per annum, which is not less than the borrowing cost of the Company. This advance and rate of mark up is hereby authorized, confirmed and ratified.”

“Further Resolved that for the year ended June 30, 1996, the Company be and is hereby accorded approval for the investment made of an additional amount of Rs. 74,010,552 as an advance to Spencer Powergen Company of Pakistan Limited. The rate of mark up charged on this advance is 22 % per annum, which is not less than the borrowing cost of the Company. This advance and rate of mark up is hereby authorized, confirmed and ratified.”

“Further Resolved that for the year ended June 30, 1997, the Company be and is hereby accorded approval for the investment made of an additional amount of Rs. 94,413,028 as an advance to Spencer Powergen Company of Pakistan Limited. A mark up rate of 17 % per annum is charged on the portion representing the amount borrowed by the Company. This advance and rate of mark up is hereby authorized, confirmed and ratified.”

“Further Resolved that the Company be and is hereby accorded approval for investment of Rs 7,000/- made in purchase of the entire shareholding of 700 shares of the face value of

Rs. 10/-each of Spencer Powergen Company of Pakistan Limited, making it a wholly owned subsidiary of our company with effect from July 01, 1997. This purchase is hereby authorized, confirmed and ratified.”

“Further Resolved that for the year ended June 30, 1998, the Company be and is hereby accorded approval for the investment made of an additional amount of Rs. 19,998,332 as an advance to Spencer Powergen Company of Pakistan Limited. A mark up rate of 22 % per annum is charged on the portion representing the amount borrowed by the Company. This advance and rate of mark up is hereby authorized, confirmed and ratified.”

“Further Resolved that for the year ended June 30, 1999, the Company be and is hereby accorded approval for the investment made of an additional amount of Rs. 14,333,566 as an advance to Spencer Powergen Company of Pakistan Limited. No mark up is charged on this advance. This advance, *free of mark up*, is hereby authorized, confirmed and ratified.”

“Further Resolved that for the year ended June 30, 2000, the Company be and is hereby accorded approval for reduction in investment in Spencer Powergen Company of Pakistan Limited by reduction of the advance by an amount of Rs. 18,529,081 thereby bringing the total aggregate advance down to Rs. 380,407,964. This reduction in the amount advanced, as well as total aggregate outstanding advance, *free of mark up*, is hereby authorized, confirmed and ratified.”

“Further Resolved that the Board of Directors be and is hereby authorized to make further investments by way of an advance or advances to Spencer Powergen Company of Pakistan Limited up to a maximum aggregate amount totaling Rs. 550 million (which includes all past, present and future advances) *free of any mark up*. The advances may be made from time to time as is required by Spencer Powergen Company of Pakistan Limited and as the Board of Directors deem fit.”

“Further Resolved that this Special Business be and is hereby passed for the purpose of compliance of Section 208 of the Companies ordinance, 1984.”

(f) After viewing the resolutions, the statement of material facts and the arguments of the Learned Counsel, the following shortcomings/inconsistencies/self-contradictory statements and violations are apparent:

- i) It is totally untrue that the shareholders in the general meeting held on February 29, 1996 have authorized the Board to make investments in the form of loans and advances to Spencer Powergen. The proposed Resolution, statement of material facts and resolution passed and filed by Spencer with Company Registration Office, Karachi speaks otherwise as discussed above.
- ii) It is admitted in the notice that Spencer did not disclose the material facts of investment in associated undertaking. However, it failed to indicate the circumstances, which prevented the disclosure of the information at that time and consequently violation of the mandatory provisions of the law.
- iii) It is a wrong presumption that the Board is authorized to make investments in associated undertaking. Approval of shareholders is a mandatory requirement for making investments in associated undertakings.
- iv) Spencer has made investments of much higher amounts than is indicated in the resolutions.
- v) No resolution has been passed for sale of shares of Spencer Powergen in the year 1999 and their re-purchase in the year 2000.
- vi) Shareholders have authorized investments exceeding 30% statutory threshold.
- vii) The shareholders have approved mark up free advances to associated undertakings, which is prohibited by the Ordinance.
- viii) No benefit has accrued to the shareholders of Spencer rather massive losses have been suffered by Spencer on its huge advances.
- ix) Spencer continued to make investments in Spencer Powergen in spite of the fact the power project of the associated company was cancelled by the Government.
- x) The Company's stance that investment in Spencer Powergen was expected to benefit the shareholders of Spencer by yielding substantial returns as the projection showed that the rate of return of the project was in excess of 25 % is totally incorrect as the project has already been abandoned in the year 1996.

(g) From the above discussion, it is apparent and duly established that all Special Resolutions were passed contrary to the mandatory provisions of Section 208 of the Ordinance. The undersigned consider that the passing of Special Resolution after about five years and that too on the objection of the Commission is mockery of law. The undersigned also holds that the passing of the resolution for mark up free advances, which are also substantially exceeds the statutory limit, by Spencer to Spencer Powergen is a gross violation and abuse of the law. Also the resolutions as indicated above suffer from acute illegality for non-compliance with the mandatory requirements of the provisions of Clause (b) of Sub-section (1) of Section 160 and Section 208 of the Ordinance and S.R.O. No. 865(I)/2000 dated December 06, 2000. The manner of the investments, the disregard to the compliance of the provisions which are mandatory in nature, the subsequent ratification, show that the Directors were fully conscious of the violations and disregarded the same deliberately

(iii-b) **THE STATUTORY INVESTMENT LIMIT.** The following figures provided by the company in its annual accounts for the years ended June 30, 1995 to 2000 are relevant to determine statutory investment limit:

(R u p e e s i n ‘000’)

Description	2001	2000	1999	1998	1997	1996
Paid up capital (PUC)	15,423	15,423	15,423	15,423	15,423	15,423
Revenue reserves	286,111	286,111	286,111	152,262	152,262	142,262
Accumulated Profit/(Loss)	(101,097)	(64,777)	(29,069)	340	1,797	2,120
PUC plus free reserves	200,437	236,757	272,465	168,025	169,482	159,805
Admissible limit-30%	60,131	71,027	81,790	50,407	50,845	47,945
Investments at year end						
Equity	7,000	7,000	0	6,930	0	0
Advances	487,867	486,167	504,697	490,363	446,165	327,558
Total	494,867	493,167	504,697	497,293	446,165	327,558
Mark up charged	NIL	NIL	NIL	24,200	24,193	40,006
% age of PUC & reserves	247%	208.3%	185.2%	296%	263.3%	205%

As is evident from the above table, Spencer has exceeded the statutory permissible limit in all the years from 1996 to 2001. The contention of the Learned Counsel that the statutory limit of 30% is not applicable to investments made by Spencer because Spencer Powergen has become a subsidiary company, is without any force because of the following:

- i) Spencer Powergen became a subsidiary as on June 30, 1998 in the first place on June 30, 1998, as established above. On the said date, both the companies were associated companies and the Spencer's investments in Spencer Powergen amounted to more than Rs. 490 million.
- ii) The shares in Spencer Powergen were sold of to a Group company during the period ended June 30, 1999 at cost and again these were purchased and the transfer was registered on June 30, 2000.
- iii) The transactions of sale and purchase of shares do not appear to be transparent and at arms length and *prima facie* were made to take undue advantage by misrepresenting that the provisions of Section 208 of the Ordinance are not applicable on the advances made to Spencer Powergen.

The proviso (a) to Sub-section (1) of Section 208 requires that:

QUOTE

“aggregate investments in associated companies, except a wholly owned subsidiary company, shall not exceed thirty percent of the paid up capital plus free reserves of the investing company at any point of time.”

UNQUOTE

In my view, the exemption envisaged in the aforesaid provision of law is available only if, on the date the investment is made, the company in which investment is made is already a subsidiary of the investing company. The exemption would not be available to the investments made in other companies where by virtue of the said investments the other company becomes a subsidiary company. Therefore, only the investment made by a holding company in its wholly owned subsidiary company after it became a holding company are protected by the aforesaid provisions of law. The intention of law appears to be to allow the holding companies to invest in their wholly owned subsidiaries without any limit and not to allow the abuse of this provision by making the companies subsidiaries after making investments in the said companies when they were associated companies. In view of the above discussion, it is abundantly clear that Spencer has violated the mandatory limit of 30 % for investments in associated companies. **The undersigned, therefore, holds that Spencer has violated the provisions of Section 208 of the Ordinance which has fixed**

an upper ceiling for such investments at 30 % of the paid up capital and free reserves of the investing company at any point of time.

(iii-c) RETURN ON INVESTMENTS. (a) The next issue is return on extremely large investments made as advances/loans to Spencer Powergen. The requirement has been embodied in Proviso (b) to Sub-section (1) of Section 208 of the Ordinance, which is as follows:

QUOTE

“the return on investment in the form of loan SHALL not be less than the borrowing cost of the investing company.”

UNQUOTE

The aforesaid provisions of law are mandatory and do not provide exemption to any company including subsidiaries. These provisions are applicable irrespective whether the company’s own funds or borrowed funds are utilized for advances to associated and subsidiary companies. Therefore, any advances free of mark up are contrary to the provisions of law. **I, therefore, find no merit in the contention of the Learned Counsel that mark up was not charged as Spencer Powergen has become subsidiary of Spencer.**

(b) As stands admitted in the Accounts, notice of Extraordinary General Meetings, Statements of material facts and replies by Spencer that no mark up has been charged by Spencer on Rs. 222.289 million in the year 1997, Rs. 274.604 million in the year 1998, Rs. 398.937 million in the year 1999 and Rs. 380.408 million in the year 2000.

(c) **This, therefore, establishes and admitted as well that no interest was charged on the Spencer’s own funds utilized for the purposes of investments in Spencer Powergen. Interest on such advances/loans should not have been less than borrowing cost of Spencer. Mark up free advances by Spencer to its associated undertaking has the effect of siphoning of the gains to the shareholders of the associated company accruable from the aforesaid finances. This is obviously unfair to the shareholders of investing company as it benefited the shareholders of the associated company at the cost of the shareholders of the investing company. Had Spencer placed these funds in the market, it would have generated huge income on these finances. Also one cannot rule out the opportunity cost of these funds. I am of the considered view that interest free loans and advances are not envisaged by law. The undersigned, therefore, is**

convinced that Spencer grossly violated the aforesaid provisions of the Ordinance deliberately and intentionally over a long period of time resulting into colossal losses to Spencer and its shareholders.

(iii-d) CHANGE IN THE TERMS AND CONDITIONS OF INVESTMENTS.(a) Spencer also changed the terms and conditions of the investments in Spencer Powergen during the years 1996 to 2000 as follows:

- i)** Rate of mark up which was 22 % in the year 1996 was reduced to 17 % in the year 1997 and then again it was enhanced to 22 % in the year 1998, thereafter no interest was charged.
- ii)** From the year 1997 onwards, Spencer charged mark up only on the amounts, which were advances out of the borrowed funds.
- iii)** There has been change in the security for the investments: in the years 1997 and 1998, it was shown secured while in the years 1999 onwards, it is being shown as unsecured.
- iv)** The basis of charge of mark up during 1995 to 1998 was also kept changing

(b) The above changes were made by Spencer, without passing Special Resolution, which is again a gross violation of the provisions of Sub-section (2) of Section 208 of the Ordinance, according to which no change in the terms and conditions attaching thereto shall be made except under the authority of a Special Resolution. As regards to the security of the advances, the Learned Counsel has stated that the Auditors of the Spencer have not accepted this land as security due to delay in execution of the Lease, therefore, the advances were shown as unsecured in subsequent years.

From the above, it is abundantly clear that Spencer has not complied with the mandatory provisions of Section 208 of the Ordinance, which were rather grossly abused for the benefits of associated company of the Directors. The undersigned, therefore, find no merit in the arguments of the Learned Counsel that the Spencer complied with all the requirements of Section 208 of the Ordinance and there is no violation on the part of Spencer.

(iv) LOSS SUFFERED BY SPENCER AND INVESTMENTS PREJUDICIAL TO THE INTEREST OF SPENCER AND ITS SHAREHOLDERS. It has been denied that Spencer has

suffered any loss in consequence of its investments in Spencer Powergen, which were made without complying with the requirements of Section 208 of the Ordinance.

(a) It is evident from aforesaid discussion which stands admitted by the Learned Counsel that Spencer has not charged mark up on its huge advances to Spencer Powergen for a long period of time as required under mandatory provisions of the Ordinance. **This undue advantage is a SUBSTANTIAL LOSS to Spencer and its shareholders and is an unwarranted benefit to the shareholders of Spencer Powergen.**

(b) Spencer has resorted to borrowings for its own requirements and also to finance the investments in Spencer Powergen and is incurring substantial cost on borrowed funds. This cost is being charged to the profit and loss account of Spencer.

(c) The financial position of Spencer due to the aforesaid investments in Spencer Powergen has become worse as is evident from the heavy losses sustained by Spencer in the last three years. The company having good track record of dividend payments to its shareholders have gone into losses due to imprudent investments.

(d) Spencer did not have adequate funds for making huge investments in Spencer Powergen. Moreover, the investments have blocked the funds of Spencer that have adversely affected the Spencer's own working and its financial position.

(e) **In view of the above discussion, the contention of the Learned Counsel is not sustainable that Spencer has not sustained any loss on its investments in Spencer Powergen. In fact, as the above facts establish, Spencer has not only suffered loss on its investments in Spencer Powergen but also is still exposed to substantial losses, due to non-recoverability of huge advances and interest thereon. The shareholders of Spencer have been defrauded by not charging interest and not recovering the outstanding advances from Spencer Powergen.**

(f) I could not escape from concluding that Spencer has suffered colossal losses on its investments in Spencer Powergen. The recoverability of the advances is doubtful and the auditors have also qualified their report on this issue. The Spencer's financial position has deteriorated because of these free of mark up advances to Spencer Powergen and these investments have not proved conducive to the interest of the shareholders of Spencer. The financial position of Spencer Powergen is also deteriorating due to continuous losses for the last three years and recoverability of advances and mark up thereon is doubtful. **In view of the above stated facts, it is abundantly**

clear that the investments made in Spencer Powergen are prejudicial to the interest of Spencer and its shareholders.

(v) **RATIFICATION ISSUE.** The question whether ratification by the shareholders through a subsequent resolution could rectify the irregularity/default already made by a company now requires consideration.

(a) In this respect, the contention of the Learned Counsel is that the shareholders of Spencer in an Extraordinary General Meeting held on June 20, 2001 have passed resolutions approving investments in Spencer Powergen and as such, there is no violation on the part of Spencer. He has also cited case law reported as PLD 1988 Lah.1 in support of his contentions and said that these resolutions validates all transactions made by Spencer with Spencer Powergen.

(b) It is a well settled principle laid down by the Superior Courts, that when law requires something to be done in a particular way, it should be done in that specified manner and none other. Moreover, if doing of a particular thing is made lawful, doing of something in conflict of that will be unlawful. The plain reading of the provisions of Section 208 of the Ordinance also indicates clearly that the words '*a company SHALL not make any investment in any of its associated companies or undertakings except under the authority of a special resolution*' have been used to show the intention of the legislator that it is a mandatory restriction on the companies for making investments in their associated companies. These provisions are mandatory is also established by the fact that these entail penal provisions for their violation. The undersigned is, therefore, of the firm view that 'prior approval' of the shareholders through 'special resolution' is a condition precedent for making investments in terms of Section 208 of the Ordinance otherwise the investment is *ultra vires* of the said provisions. Moreover, the shareholders cannot ratify an act, which is outside the powers of the company.

(c) The undersigned has considered the submissions in the light of the judgment on which reliance has been placed by the learned counsel. In the said case the issue was violation of the provisions of Section 208 of the Ordinance. It was decided by the Honorable Court on the basis of facts and circumstances of the said case, that on the promulgation of the Companies Ordinance, 1984, it was open to the lending company either to enforce the repayment of the loan under Sub-section (3) of Section 195 of the Ordinance or have the investments made regularized by passing a special resolution with the requisite majority under Section 208 of the Ordinance. As the respondent company has chosen the second course and passed a resolution to which petitioners were party,

therefore, they were estopped to challenge the action of advancing the loan to the associated companies. It was also observed by the Honorable Court that the purpose of Section 208 is to secure the funds of the company and to curb the abuse of powers by the Directors who hold interest in more than one company. **As is evident from the above, the facts of the cited Judgment are materially different from the facts of the case in hand. This Judgment, therefore, does not lend any support to the arguments of the Learned Counsel that subsequent resolutions passed by the shareholders have rectified the irregularity. Rather, the action initiated by the Commission is strengthened by this Judgment.**

(d) It has been held in several judicial pronouncements that ratification is accepted in scenarios where the acts that are under scrutiny are *ultra vires* the authority of the directors but within the competence of the company, which can be ratified by the general body, by amendment in Articles of Association. However, in the case of statutory contraventions they cannot condone an irregularity by subsequent ratification as they have no authority to alter or amend or condone the provisions of the Ordinance. Moreover, if the laid down procedure is not followed, the majority cannot ratify such conduct for that would be to deny the minority the protection afforded by initial provision. Therefore, the majority must follow the procedure laid down in the law. **Even if it is so assumed that ratification validates all actions, the same is of no avail as the shareholders have acted outside their statutory powers and the essential requirements of Section 208 were not fulfilled while passing special resolutions in Extraordinary General Meeting held on June 20, 2001.**

(vi) **LETTER OF CORPORATE LAW AUTHORITY.** The Learned Counsel has also placed on record a letter dated December 26, 1998 addressed to the Chief Executive of M/S Spencer & Co. (Pakistan) Limited from erstwhile Corporate Law Authority signed by Mr. Muhammad Ashraf, Assistant Chief on the subject of examination of the accounts for the year ended June 30, 1997 stating that:

“ Please refer to your letter dated November 03, 1998 on the above subject and to say that the reply of the Company has been examined thoroughly and found satisfactory.”

The Learned Counsel, on the basis of the aforesaid letter, contended that Corporate Law Authority has exonerated his client and re-opening of the case tantamount to harassment. I have given careful consideration to this issue. It would be pertinent to first look at the issue involved in the said case. Erstwhile Corporate Law Authority has raised several issues including investment in Spencer Powergen based on audited accounts of Spencer for the year ended June 30, 1997 and Spencer has

clarified that the investment was authorized by a special resolution passed under Section 208 of the Companies Ordinance, 1984 at the Extraordinary General Meeting of the Company held on February 26, 1996. **In my considered view, this letter of Corporate Law Authority does not in any way restrict the power given to the Commission to take up blatant violations committed by Spencer. This also does not tantamount to harassment of Spencer as alleged by the Learned Counsel. Even otherwise, the aforesaid letter of an Assistant Chief, is a letter on the administrative side given in the absence of facts, which are now under quasi judicial scrutiny.**

(vii) VESTED INTEREST OF DIRECTORS OF SPENCER IN INVESTMENT TRANSACTIONS. The Learned Counsel has contended, as informed to the shareholders in the statement of material facts, that the Directors of Spencer had no vested interest in the investments made in Spencer Powergen. At the time of making advances, the common interest, control and management was present between the two companies. On such a case, therefore, no ignorance or lack of interest could be pleaded. **It is ironical that the Directors of Spencer providing more than Rs. 500 million to its associated company which has been absolved from the huge liability of mark up on the said advances have no vested interest in the said transactions. I hold that they do have substantial vested personal interest in the said investment transactions and also not arranging payment of mark up on the said advances.**

(viii) Other Issues. (a) Faced with the above situation, the Learned Counsel contended that there was no complaint against these investments from any shareholders. On examination of the record, it was found that there was a complaint, which does not debar the Commission to initiate proceedings for the blatant and gross violations of the mandatory provisions of the Ordinance. **A reference to the scheme of the Companies Ordinance, 1984 as well as the Securities and Exchange Commission of Pakistan Act, 1997 show that a Regulator has been created to possess and exercise parental supervisory powers. This watch dog in exercise of its powers can take cognizance of all violations, minor or grave, so as to regulate the affairs of the companies subject of course to the parameters in law.**

(b) As regard to the contention that Spencer would be able to recover the advances, the Learned counsel could not prove the bona fide of the intentions and the capability of Spencer Powergen to pay such a huge finances with mark up thereon. Spencer has also failed to provide valuation of land to the Commission as agreed by the Chief Executive even after lapse of a long period of time. However, on the last date of hearing i.e., on December 31, 2001, the Learned Counsel of Spencer provided a letter dated December 03, 1998 of MINOO MISTRY, Chartered Architect of Karachi

stating that the market value of the said land is approximately Rs 900 million. It is pertinent to note that this land was allotted by SITE, Karachi to Spencer Powergen for its power project in the April, 1996 for a consideration of Rs 69 million. Since the power project of Spencer Powergen was cancelled in August, 1996, therefore, the recovery of the advances through the sale of land at this stage is not certain.

(c) There is also no force in the argument of the Learned Counsel that Spencer charged mark up higher than its borrowing cost for the simple reason that no mark up was charged for most part of the period and also that nothing was brought before me in support of the said contention.

23. On perusal of the Memorandum and Articles of Association of Spencer, it appears to me that the Spencer is not even authorized to make investments of this nature.

24. **CONCLUSION.** (a) The net result of the above discussion is that it is demonstrably established that Spencer has contravened the provisions of Section 208 of the Ordinance as under:

- i) Purchase and sale of shares of Spencer Powergen without Special Resolution
- ii) Huge advances to Spencer Powergen in excess of prescribed ceiling and without authority of Special Resolution
- iii) Advancing loans to Spencer Powergen at less than the borrowing cost.
- iv) Change in terms and conditions of investments in Spencer Powergen without approval of Special Resolution.
- v) Shareholders were prevented due to non-compliance with the mandatory provisions of the Ordinance from effectively using their rights in the general meetings in relation to the investments in Spencer Powergen .

(b) **Keeping in view the above discussions and after careful consideration of the facts and circumstances of this case as well as the arguments of the Learned Counsel during the hearings, the undersigned holds that Spencer has contravened the provisions of Section 208 of the Ordinance and an action under Sub-section (5) of Section 208 read with Section 476 of the Ordinance has to be taken. In addition, this action also becomes more important because of the responsibility put on the Commission under sub-section (6) of Section 20 of the Securities and Exchange Commission of Pakistan Ordinance, 1997 which requires that, in performing its**

functions and exercising its powers, the Commission, which is the Regulator, is to strive, among others, to maintain facilities and improve the performance of companies and securities markets, in the interest of commercial certainty, reducing business costs, and efficiency and development of the economy.

(c) The Chief Executive is held responsible for violation of Section 208 of the Ordinance and has made himself liable for punishment under Sub-section (5) there under. The Chief Executive did not exercise due care and restraint regarding the legal position and tried to cover up his acts of violations to pre-empt any action by the Commission by calling an Extraordinary General Meeting against the provisions of the Ordinance. He also continued disregarding the same and also continued an action not warranted in law for making investments in associated undertakings and enhancing the same up to Rs 550 million by passing an unlawful and illegal resolution. In view of the foregoing facts, it is established that the Chief Executive and apparently the Directors has purposefully and deliberately avoided to comply with the mandatory provisions of the Ordinance knowing well that they were duty bound to do so. The default, therefore, is considered deliberate and willful. The providing of this huge amount of mark up free advances despite cancellation of the power project of Spencer Powergen is nothing less than a FRAUD on the minority shareholders of Spencer. The Chief Executive and the apparently the Directors have, therefore, made themselves liable for fine as provided under Sub-section (5) of Section 208 of the Ordinance which may extend to one million rupees and in addition, the directors are, jointly and severally liable to reimburse to the company any loss sustained by the company in consequence of the investments which were made by them without complying with the requirements of law. However, as the Show Cause Notice was issued to only Chief Executive, therefore, the undersigned, in exercise of the power conferred on me under Sub-section (5) of Section 208 of the Ordinance, hereby impose a fine of Rs 1,000,000 (Rupees one million) on the Chief Executive of Spencer. As other Directors of Spencer have appeared to have joined hands with the Chief Executive in intentional and deliberate disregard and gross violations of the provisions of Section 208 of the Ordinance, therefore, they are also *prima facie* responsible for glaring violations of the provisions of the Ordinance. I hereby direct my office to issue Show Cause Notices to the said directors immediately so as to ascertain their conscious involvement in the affairs and to adjudge their liability, if any.

(d) Mr. Byram D. Avari, the Chief Executive is directed to deposit Rs 1,000,000 (Rupees one million) as indicated above in the following head of account within 30 days of the date of this order:

Account No. 10464-6
Habib Bank Limited
Habib Bank Plaza, I. I. Chundrigar Road,
KARACHI.

However, if the Chief Executive will satisfy the Commission that the principal amount of loan/advances and mark up thereon can be recovered pursuant to report to be provided under Para 25 (a) of this Order, the Commission may review this penalty imposed on the Chief Executive.

25. VALIDITY OF INVESTMENTS MADE IN EXCESS OF PRESCRIBED LIMIT.

The validity of investments subsisting till now which have been made without prior approval of the shareholders assumes importance and requires a decision. The Company has suffered loss due to the imprudent investment made by the directors without approval of the shareholders. I have serious doubt about the recoverability of the investments. I, therefore, direct the Chief Executive to recover from Spencer Powergen, the outstanding advances amounting to Rs 486 million as appearing in the balance sheet of the Spencer as on June 30, 2001 along with mark up on the said advances not less than the borrowing cost of Spencer. Mr. Ahsan Zahir Rizvi appearing on the last date of hearing, has requested to give two year time for the recovery from Spencer Powergen, without prejudice to the legal rights. Considering the quantum of funds to be brought back to Spencer, I consider the request of the Learned Counsel reasonable and justified. The undersigned hereby in terms of Section 473 of the Ordinance orders as follows:

(a) Spencer should submit a report providing for a time frame within one month of the date of this order and modus operandi as to how it will recover the advances along-with mark up thereon at not less than borrowing cost of Spencer, which shall not go beyond December 31, 2003.

(b) Within one month from the date of this order, Spencer shall submit a certificate, from a reputable firm of Chartered Accountants acceptable to the Commission, confirming the amount of mark up on advances on daily product basis, to be brought back to Spencer in terms of this order. The Learned Counsel has also agreed to this arrangement on the date of final hearing, subject to the legal rights.

(c) Quarterly progress report on the implementation of the aforesaid direction, as agreed by the Learned Counsel, shall be submitted to the Commission by 5th of next month of the close of every quarter along-with affidavit of the Chief Executive and certificate of auditors for compliance, till the whole amount is recovered. The first quarterly progress report shall fall due on April 05, 2002.

(d) The above transactions should also be reflected in the interim and final financial statements to be published by Spencer along with certificate of the auditor confirming compliance for the said period.

(e) In the event of failure to comply with the above said directions, the amounts or shortfall, if any would be recovered from the Chief Executive who has been declared responsible for making unauthorized investments under Sun-section (5) of Section 208 of the Ordinance. In case of default, he shall be liable to prosecution under Section 495 of the Ordinance.

26. ROLE OF AUDITORS. Auditors being responsible to the shareholders are required to bring to the notice of the members the major breaches observed in the financial statements of the company during the course of their audit. The examination of the Audited Accounts revealed that Spencer did not disclose its relationship with Spencer Powergen as associated/subsidiary Company in the accounts at the relevant point of time. Spencer has provided huge advances to Spencer Powergen in contravention of the provisions of Section 208 of Companies Ordinance 1984. Despite the cancellation of the power project of Spencer Powergen in the year 1996, the Spencer kept on advancing huge advances to Spencer Powergen. The Audited Accounts for the year 1996 to 1999 contains contradictory statements regarding mark up on the advances to Spencer Powergen. The Audit Reports of Spencer, however, are silent on the aforesaid matters. The lack of material disclosures and inconsistencies in the information regarding advances made by Spencer to Spencer Powergen, constitute serious violations under the Companies Ordinance, 1984. The office, therefore, is also directed to take up this matter with the Auditors of Spencer.

RASHID SADIQ

(Executive Director (Enforcement and Monitoring))

Announced
January 02, 2002
ISLAMABAD