Securities and Exchange Commission of Pakistan

Specialised Companies Division

5th Floor, NIC Building, Jinnah Avenue, Blue Area, Islamabad.

Before Sadia Khan, Executive Director

In the matter of

Industrial Capital Modaraba and M/s. National Industrial Management Ltd.

(Appeals under sub-section (2) of section 32 of the Modaraba Companies and Modaraba (Floatation & Control) Ordinance, 1980

Date of hearing: January 10, 2002

Present: Mr. Asim Iqbal, Counsel for and on behalf of Mr. Shahid Ansari,
Mr. Muhammad Ahmad Saeed Raja, Counsel for and on behalf of Directors of M/s. National Industrial Management Ltd.), Mr. Azhar Tariq Khan (Chief Executive/Director M/s. National Industrial Management Ltd.), Registrar Modaraba & others.

ORDER

Through this Order I intend to decide two appeals, Appeal-02 and Appeal-04 of 2001, which have been placed before me for decision:

1. Appeal-02 of 2001 (hereinafter referred to as "Appeal-A") has been filed by Mr. Shahid Ansari (hereinafter referred to as "Appellant-1") against the order no. SC/M-MS/ICM/1027 (hereinafter referred to as "Order-1027") passed by the Registrar Modaraba Companies and Modaraba (hereinafter referred to as the "Registrar") under sub-section (1) of section 32 of the Modaraba Companies and Modaraba (Floatation & Control) Ordinance, 1980 (the " Modaraba Ordinance").

2. Appeal-04 of 2001 (hereinafter referred to as "Appeal-B") has been filed by the following:

a) Mr. Azhar Tariq Khan ("Appellant-2");
b) Mr. Rana Abu Obaida ("Appellant-3");
c) Mr. M.A. Rehmani ("Appellant-4");
d) Mr. Syed Naveed H. Zaidi ("Appellant-5");
e) Mr. Shamim Ahmed Junejo ("Appellant-6").

Appeal-B is also filed against Order-1027 mentioned above. The said order imposes a penalty of Rs. 210,000/- each upon all the Appellants mentioned herein (that is, Appellant 1 to 6).

3. Brief facts giving rise to these Appeals are as under:

A. The National Industrial Management Limited, a public company, limited by shares (hereinafter referred to as the "Company"), was initially registered/incorporated under the Companies Ordinance, 1984 (hereinafter referred to as the "Ordinance") on 07.01.1990 as a private company, limited by shares under the name of 'National Industrial Management (Private) Limited'. The Company however was later on converted into a public company with effect from 21.08.1991. The Company was also registered with the Registrar in September 1990 under the Modaraba Ordinance, 1980. On 27.03.1991 the Company was allowed to float and manage a modaraba under the name of Industrial Capital Modaraba (hereinafter referred to as the "Modaraba") subject to compliance of the relevant laws and other terms and conditions as laid down in the Modaraba Authorization/Registration Certificate.

B. Appellant-2 is chief executive and Appellants 3 to 6 are directors of the Company while Appellant-1 by virtue of his resignation dated 01.03.2001 claims to be an ex-director of the Company. All the Appellants (Appellant-2 being chief executive as well as director) were also directors of the Modaraba.

C. The Registrar ordered special audit into the affairs of the Company and appointed M/s. Ejaz Tabassum & Co. to carry out the special audit. The special audit report (hereinafter referred to as the "Report") revealed to the Registrar that the Company had not been managing the Modaraba in compliance with the relevant provisions of law and that the business of the Modaraba was being conducted in a manner contrary to prudent business practices and prejudicial to the interests of certificate holders of the Modaraba. The Registrar, in view of the revelation made through the Report issued a show cause notice dated July 16, 2001 (the "Show Cause Notice") to the directors/Appellants of the Company who submitted a written reply to the Show

Cause Notice and reiterated their response during the hearing that took place before the Registrar. The Registrar, however, not being satisfied with the explanations provided by the directors/Appellants, through their response to the Notice and their arguments preferred during their hearing with the Registrar, passed an order (the Order-1027), whereby, a penalty of Rs. 210,000/- each was imposed on all the directors/Appellants. Hence the present Appeals.

4. In the following paragraphs, I will discuss and decide the issues involved in Appeal-A.

A. Mr. Asim Iqbal, Advocate for Appellant-1 submitted that the matters in dispute arose before the Appellant-1 was appointed nominee director and, therefore, it was unjust to hold him responsible for the offences that he could not possibly have committed. According to him the Appellant-1 is not even aware of the sequence of events that took place and led, eventually, to committing of violations alleged in the Show Cause Notice. He further contended that Appellant-1 never received the Show Cause Notice as by the time the Show Cause Notice was issued, Appellant-1 had already resigned. According to him due to non-receipt of the Show Cause Notice, Appellant-1 was incapacitated to respond to the same and thus was condemned unheard.

B. I have perused the documents made available to me from which it appears that M/s. National Asset Leasing Corporation Limited ("National Asset") appointed Appellant-1 as its nominee director on the Board of Directors of the Company with effect from 05.06.2000. Appellant-1 resigned from the office of directorship of National Asset and the said resignation, according to him, was to be effective from 31.05.2001. Appellant-1 resigned from the office of directorship of the Company with effect from 01.03.2001 (it may be noted that the resignation from the directorship of the Company was addressed to the Chairman of National Asset and not the Company). Condition no. 6 of the Modaraba Authorization/Registration Certificate in this regard provides as follows:

"No change shall be made in the directors of the Modaraba Company or management of the modaraba except with the prior written consent of the Registrar."

C. Though approval of the appointment of Appellant-1 as (nominee) director on the Board of Directors of the Company was obtained from the Registrar (Letter dated 20.06.2000 of the Deputy Registrar Modaraba), the information pertaining to resignation of Appellant-1 was never conveyed to the Registrar. Under section 11 of the Modaraba Ordinance, the Certificates of Authorization/Registration are granted to companies and therefore, it is the responsibility of companies to ensure compliance of the terms and conditions contained in the said certificates. In the present case, therefore, it was the responsibility of the Company to seek/obtain approval of the Registrar for the change (resignation of Appellant-1) in the Board of its Directors. Had the Company brought the fact of resignation of Appellant-1 to the notice of the Registrar, the Registrar would have made arrangements to ensure service of the same upon Appellant-1. As the Registrar was not aware of the resignation of Appellant-1, the argument of non-service on Appellant-1 of the Show Cause Notice cannot be held against the Registrar. On the same basis the Appellant-1 cannot take the plea that an opportunity of hearing was not provided to him. The Registrar followed the necessary procedure of law in issuing show cause notice and did what he was required to do in order to provide a hearing opportunity to the Appellant-1.

D. As the Special Audit was carried out for the year ended 30.06.2000, therefore, the Report revealed the affairs of the Modaraba as they were at 30.06.2000, while appointment of Appellant-1 as (nominee) director was made on 05.06.2000. Thus the period prior to the Special Audit during which Appellant-1 was on the Board of Directors of the Company consists only of 25 days. Holding the Appellant-1 responsible for violations which pertain to decisions taken by the Board of Directors of the Company during the period prior to 05.06.2000, does not seem to serve the interests of justice.

E. It may however be noted that the Show Cause Notice also alleged non-disclosure of facts in the annual audited accounts of the Modaraba for the year ended 30.06.2000. The said accounts were approved by the directors on 29.11.2000 and as the Appellant-1 was on the Board of Directors of the Company at the time the said accounts were approved, he cannot claim non-involvement in all the violations alleged in the Show Cause Notice. The provisions of the Modaraba Ordinance/Rules as well as those of the Companies Ordinance, 1984 require the annual audited accounts to be true and fair. The directors must be aware of the laws governing the operations/business of the companies to which they are associated as directors, for if they remain ignorant of the relevant laws, compliance of the same cannot be expected from companies. The option to obtain advice from legal advisors for ensuring compliance of all the relevant laws is also available to the company and its directors. Appellant-1 was on the Board of Directors of more than one company and on assuming that responsibility, he should have, of his own volition, made enquiries as to the requirements of the laws pertaining to the business of the companies of which he was a director and delved further into the accounts to ascertain that they presented a true and fair picture.

F. It may also be noted that the 'office' of a director of a company, whether nominee or non-nominee, is not an 'honorary' or 'in name/title only' office. A person, on becoming a director of a company, assumes the heavy responsibility of ensuring that the mandatory provisions contained in relevant laws are complied with. The presumption of law, in this regard, is that the directors know their duties. Furthermore, the relevant provisions of the Modaraba Ordinance are enacted to protect the shareholders and the general public and these provisions impose a definite duty upon the directors of a company. It is necessary that these duties should be properly carried out and it is necessary, in my opinion, that when directors fail to do so, the penalties provided for in the Ordinance should be imposed and the directors should be penalized.

G. Though, in light of the discussion above, I conclude that the attitude of the Appellant-1 towards his duties was that of negligence, on account of the fact that he was not involved in committing of the violations pertaining to the facilities extended prior to his appointment as director and because of the fact that due to the Company's failure to inform the Registrar of the resignation of the Appellant-1, he was unable to take part in the proceedings that took place before the Registrar, I exonerate him from the payment of the penalty imposed upon him. Portion of the Order-1027, as far as it is applicable to Appellant-1, therefore, is hereby vacated/set aside and the Appellant-1 is no more required to pay the penalty of Rs. 210,000/- imposed upon him through the Order-1027.

5. I would now like to address the issues raised through Appeal-B.

(Appellants 2 to 6 are hereinafter collectively referred to as "Appellants")

I. The acts of violations as alleged in the Show Cause Notice can be placed under one or more of the following heads:

i. Violations of the provisions of the Modaraba Ordinance and the Modaraba Companies and Modaraba Rules (the "Rules");

ii. Violations of the conditions of the Modaraba Authorization/Registration Certificate (the "Certificate");

iii. Violations of the Prudential Regulations for Modarabas (the "Regulations");

iv. Violations of the Prospectus of the Modaraba (the "Prospectus").

II. I would now discuss the violations alleged in the Show Cause Notice in detail. It may however be noted that as the appeals under sub-section (2) of section 32 of the Modaraba Ordinance lie against imposition of penalty, I will discuss in detail only

those violations, which resulted in imposition of penalty and the violations which led to action by the Registrar under sections 19 and 20 of the Modaraba Ordinance shall not be dealt with in this order. For the sake of clarity, section 32 is reproduced below:

> "Penalty.- (1) If any person--
>
> (a) refuses or fails to furnish any document, return or information which he is required to furnish by or under this Ordinance; or
>
> (b) refuses or fails to comply with any condition imposed or made by the Federal Government or direction made or given under this Ordinance or the rules; or
>
> (c) contravenes or otherwise fails to comply with any provision of this Ordinance or the rules other than those referred to in sub-section (1) of section 31,
>
> the Registrar, may, if he is satisfied, after giving the person an opportunity of being heard, that the refusal, failure or contravention was willful, by order, direct that such person shall pay to the Federal Government by way of penalty such sum not exceeding one hundred thousand rupees as may be specified in the order and, in the case of a continuing default, a further sum calculated at a rate not exceeding one thousand rupees for every day after the issue of such order during which the refusal, failure or contravention continues.
>
> (2)……..."

Section 33 further provides as follows:

"33. Liability of director, manager or officer of a company.-(1) Where the person guilty of an offence referred to in sub-section (1) of section 31 or in section 32 is a company or other body corporate, every director, manager, or other officer responsible for the conduct of its affairs shall, unless he proves that the offence was committed without his knowledge, or that he exercised all diligence to prevent its commission, be deemed to be guilty of the offence.

(2).....

(3)....."

III. VIOLATIONS OF THE PROVISIONS OF THE MODARABA ORDINANCE, RULES, CERTIFICATE AND PROSPECTUS:

(1). A. The Show Cause Notice alleged that in light of the audited accounts for the year ended 30.06.2000, the management of the Modaraba placed Modaraba Fund of Rs. 5 Million in deposit account with an investment bank at a fixed mark up rate of 14% per annum and this being a Riba based transaction amounted to violation of the Prospectus (clauses 6.3.e, 17.b.ii and 17.h) of the Modaraba and also of section 10 of the Modaraba Ordinance. For this violation, the Registrar imposed a penalty of Rs. 50,000/- on each director of the Company.

Section 10 of the Modaraba Ordinance in this regard provides as follows:

"Business of Modaraba.--- No modaraba shall be a business which is opposed to the Injunctions of Islam and the Registrar shall not permit the floatation of a modaraba unless the Religious Board has certified in writing that the modaraba is not a business opposed to the Injunctions of Islam."

B. It may be noted that one of the Objects of the Modaraba as given in the Prospectus (Clause 6.2.d of the Prospectus) is "Promotion of interest free financial system through floatation of Modarabas". Also Clause 6.2.g mentions the object of the Modaraba to be "Providing an opportunity to the general public to participate gainfully in the commercially viable and profitable ventures on "Riba" free system as well as channeling private savings constructively towards industrial development." Furthermore, Clauses 6.3.f, 9 viii, 17.b & h, of the Prospectus provide as below:

> Clauses 6.3.f (Also Clause 9 viii):
> "-……The Modaraba shall not transact any business itself which involves the element of riba directly or indirectly nor shall it participate in a business project violative of the Injunctions of Sharia."
>
> "17.b.-The Modaraba shall not enter into any business, investment or other transaction which is:
> Repugnant to the injunctions of Islam; and
> Involves the element of Riba, either directly or indirectly."
>
> "17.h.-The Modaraba shall not enter into any business, investment or other transaction which is prohibited by the Modaraba Ordinance and repugnant to Islamic injunctions."

C. In light of the above provisions, it appears that the Modaraba was prohibited by law to enter into a transaction which in any manner, either directly or indirectly, was interest based and entering into a Riba-based transaction by the Modaraba would have constituted violation of the various provisions of the Prospectus as well as of the Modaraba Ordinance.

D. The response of the Appellants to the allegation aforementioned as given in their response dated 01.08.2001 to the Show Cause Notice is reproduced below:

"The error of 14% fixed Mark-up shown in accounts will be rectified."

E. This explanation provided by the Appellants in my view is lacking, especially, keeping in mind the gravity and seriousness of the violation. Under no circumstances could the Modaraba have entered into a transaction that was based on interest and the fact that the only plea taken by the Appellants was that the figure of 14% fixed mark-up was mentioned by mistake while no documents proving the transaction to be interest-free were furnished, indicates that either the Appellants had failed to understand the seriousness of the violation in question or no satisfactory explanation of the said violation was available which the Appellants could have offered in their defense. In any case, being the directors of the Company, it was the duty of the Appellants to ensure that the mandatory provisions of the Modaraba Ordinance were complied with. Under these circumstances, I am left with no option but to hold that the Appellants were responsible for the violations of the provisions contained in section 10 of the Modaraba Ordinance and also of the provisions of the Prospectus of the Modaraba. I am, therefore, of the view that the violation of the relevant provisions of the Modaraba Ordinance and the Prospectus (given above) is established. Penalty of Rs. 50,000/- each, imposed upon the Appellants by the Registrar therefore stands.

(2). A. The Show Cause Notice alleged violation of Rule 8 (4) of the Modaraba Rules as the Modaraba had paid advance of Rs. 1,100,000 to M/s. Caravan East Fabrics Limited (Caravan), an associated company of the Modaraba, while this fact (that Caravan was an associated company of the Modaraba) was not disclosed in the annual audited accounts of the Modaraba, for the year ended June 30, 2000.

Rule 8 (4) of the Rules provides as follows:

"Every balance sheet of a modaraba shall give a true and fair view of the state of affairs of the modaraba as at the end of its financial year and every profit and loss account and every statement of changes in the financial position of a modaraba

shall respectively give a true and fair view of the result of operations and of the changes in its financial position for the year then ended."

B. According to the Appellants the advance made to Caravan was not disclosed/reflected (in accordance with Clause 5(C)(b) of the 3rd Schedule to the Rules) in the annual audited accounts of the Modaraba, for the year ended June 30, 2000 as the Modaraba and the Company *bona fide* believed that the said company was not an associated undertaking/company of the Modaraba. According to the Appellants, the basis of believing that the said entities (Caravan and the Modaraba) were not associated undertakings of each other were two legal opinions (placed on record) they had obtained from different law firms on the said issue. It was further contended by the Appellants that the facility in question was not of substantial amount and therefore the disclosure of the same could not have adversely affected the true and fair view of the annual accounts of the Modaraba.

C. According to the Registrar, Caravan was an associated undertaking of the Modaraba as Mr. Shahid A. Ansari (Appellant-1) was on the Board of Directors of the Company as well as on the Board of Directors of Caravan. According to the Registrar the contention of the company that Caravan and the Modaraba were not associated undertakings/companies as Appellant-1 was merely a nominee director could not be accepted as the law regarding associated companies does not make any allowances for nominee directors, rather it clearly lays down that as long as common directorship is present between the companies, the companies shall fall within the purview of the definition of 'associated undertakings.' Holding the Appellants responsible for violation of Rule 8(4), the Registrar had imposed a penalty of Rs. 20,000/-

D. In light of the Rule reproduced above, it is evident that a 'true and fair' view of the state of affairs of the modaraba has to be presented before the certificate holders of the modaraba. By investing money in the capital of the modaraba, the certificate holders repose their trust in the management of the modaraba and it is only fair and just that the certificate holders should be apprised of the true state of affairs that the

modaraba is in and also the certificate holders have a right to know as to where and in what manner the funds of the Modaraba are being invested. In my view the fact that the Modaraba had paid advance to one of its associated companies should have been disclosed/shown in the annual audited accounts for the benefit of the certificate holders. In failing to disclose in the annual audited accounts that the advance given to Caravan was indeed an advance to the associated company of the Modaraba, the Appellants failed in discharging their duty towards the certificate holders and this puts the Appellants in a position where I find it difficult not to hold them responsible for violation of Rule 8(4) of the Rules (read with Clause 5(C)(b) of the 3rd Schedule to the Rules). I also feel that in order to ascertain the true position regarding Caravan being an associated company of the Modaraba or not, the Company should have corresponded with the Registrar/the Commission, instead of relying heavily on the legal opinions that the Company had obtained. However, as the advance made to Caravan was shown in the annual audited accounts (though not in the manner stipulated for in Clause 5(C)(b) of the 3rd Schedule to the Rules) and as the Appellants made efforts to ascertain the status of Caravan with respect to the Modaraba, I take a lenient view and set aside the penalty (Rs.20,000/- each) imposed by the Registrar upon the Appellants for violation of Rule 8(4).

(3) A. The Show Cause Notice alleged that the management failed to exercise due care for the protection of the assets of the Modaraba as the shares acquired by the Modaraba of its associated concern were acquired through a broker and the same were reported as lost when placed with the Central Depository Company Limited, for transfer in Modaraba's own name. According to the Registrar no legal proceedings were initiated against the broker and no other steps were taken to recover the investment. The Registrar therefore, finding the attitude of the management irresponsible and negligent, imposed a penalty of Rs. 10,000/- upon the Appellants.

B. In response, the Appellants contended that the management has taken up the matter with the concerned company for recovery of shares and ensured that the management will actively pursue the matter to effect recovery.

C. In my view the Company has been less diligent in managing the Modaraba from the time of floatation of the same and the violation in question, especially manifests the lack of exercise of diligence on behalf of the Company. Though, it is true that the stock market being on the declining side, it was difficult for the Modaraba business to thrive and show profits. However, in view of numerous, evidently imprudent decisions made by the Company, I feel that the actions and policies of the Company/management itself was leading the Modaraba towards its failure in achieving the objects for which the Modaraba was floated. The Company seems to have failed to understand that when dealing with public money, it should have shown extra care and circumspection, but as the amount of money involved in this transaction was not substantial (Rs.50,108/-), the penalty imposed is reduced from Rs.10,000/- to Rs.5,000/-.

IV. VIOLATIONS OF THE PRUDENTIAL REGULATIONS FOR MODARABAS

(1) A. The Show Cause Notice alleged that the management of the Modaraba acted imprudently and in violation of Regulation 8 (2) read with Regulation 21 while giving unsecured advances to M/s. Shani Enterprises, M/s Caravan East Fabrics Limited and M/s. Shamim Enterprises as the same had earlier defaulted in making repayments to the Modaraba. Also, the Management rescheduled the said advances/facilities on various occasions which was detrimental to the interests of the certificate holders.

Regulation 8 (2) in this regard provides as follows:

> "No Modaraba shall allow unsecured facilities or facilities secured only by guarantees other than bank guarantee of banks having rating grade not lower than BBB."

B. It may also be noted that Regulation 6 (4) provides: "when considering proposals for facilities, Modarabas shall give due weightage to credit report relating to the borrower

and his group obtained from Credit Information Bureau of the State Bank of Pakistan but in no case defaulter be financed."

Regulation 21 provides that the Modarabas shall bring their affairs and business operations in full conformity with these Regulations, by June 30, 2000.

C. According to the management, M/s. Shani Enterprises were granted various Musharaka and Morahaba facilities in years 1996, 1998 and 1999 against confirmed purchase orders from Sui Southern Gas Co. Limited and some other organizations and office equipment. The management also reiterated that Letter of Hypothecation and personal guarantees were obtained from the owners as security while advances given to M/s. Shamim Enterprises and Caravan East Fabrics Limited were un-secured. The management/Appellants further contended that hectic efforts were being made to effect recovery and safeguard the interests of the Modaraba. According to the Appellants, a director was nominated on the Board of Directors of Caravan to oversee its operations and a suit was filed for recovery in the High Court of Sindh.

D. The Regulations were promulgated with effect from 20.04.2000 under which the Modaraba was required to bring its affairs and business operations in full conformity with the Regulations by 30.06.2000. Though, keeping in mind the fact that the Modaraba had only a time period of two months and ten days to conform its affairs with the Regulations, one would tend to hold that the view of law taken by the Registrar was rather stringent. However, it also seems obvious that the management was not running the business of the Modaraba in line with prudent business and commercial practices as in no way can the act of extending advances/facilities to companies/persons who have defaulted in making repayments, be called prudent. Rescheduling on more than one occasions, when no repayments were forthcoming, was evidently unwise. These imprudent acts of the management seem to suggest that the management was acting more in favour of the debtors of the Modaraba and less for securing the interests of the certificate holders towards whom, it (the management) had a fiduciary duty. In my view the management must exercise a high

standard of care in managing property which is not of its own but that of certificate holders. It may also be noted that Condition 3 (iii) of the Certificate requires the Modaraba to give in its annual accounts an aging analysis of bad and doubtful receivables along with efforts made to recover the same. The rationale behind inserting in the Certificate the condition aforementioned must have been to ensure that the funds of the Modaraba are utilized in a vigilant manner and the acts of extending unsecured facilities and rescheduling the facilities done by the management defeat the spirit of the said condition. Again, however, taking a lenient view (in light of the fact that from the time the Regulations became operative, Modaraba had two months and ten days to bring its affairs in conformity with the Regulations and in light of the fact that the Report pertains to the affairs of the Modaraba as at 30.06.2000) I reduce the amount of penalty imposed upon the Appellants from Rs. 20,000/- to Rs. 10,000/-.

(2) A. The Show Cause Notice alleged that the Modaraba made investment of Rs.10 Million in shares of Sihala Biotech Limited, an associated (unlisted) company of the Modaraba, in violation of Regulation 8 (6) read with Regulation 21 as the said company was not a running concern at the time the shares were acquired. Modaraba therefore, has obtained no return on this investment since 1995.

Regulation 8 (6) provides as follows:

> "Modaraba may make investment in shares of un-listed companies subject to fulfillment of the following conditions:
>
> (i) Total exposure in such companies does not exceed 5 % of the modaraba's equity;
>
> (ii) The directors of the modaraba company have no direct or indirect interest in the investee company; and
>
> (iii) The investee company must have operational track record of three profitable consecutive years preceding the decision"

Provided that where a modaraba is engaged in Venture Capital Financing as set out in its prospectus, this regulation may be waived on an application made to the Registrar.

B. According to the Appellants, investment in the said company was made through a subscription agreement in 1994 with intention to disinvest after public offering but the company ran into snags as the Government changed its policy of zero duty/tax on companies located in Rural areas. The Appellants also contended that Sihala Biotech was not an associated undertaking of the Modaraba as no common directorship/control (direct or indirect) existed between the two companies. According to the Registrar, Sihala Biotech to this day has not started its operations and according to him the investment made by the Modaraba is a dead investment. The Registrar also contended that Sihala Biotech is an associated concern of the Modaraba and though no common directorship existed between the Modaraba and Sihala Biotech, the shares of Sihala Biotech held by the Modaraba constituted more than 20% of the paid up equity/capital of Sihala Biotech. The Registrar being of the view that investment in Sihala Biotech was in violation of Regulation 8 (6), imposed a penalty of Rs. 20,000/-

C. The percentage of Modaraba's equity investment in Sihala Biotech is more than 20%, of the paid-up capital of the latter, the two entities therefore, are associated undertakings. The investment in Sihala Biotech is contrary to the provisions of the Regulation 8(6), however, since the investment was made in 1994 while the Regulations were promulgated in 2000, taking a lenient view the penalty imposed is hereby reduced from Rs. 20,000/- to Rs. 10,000/-.

(3) A. The Show Cause Notice alleged that the Modaraba made investments in violation of Regulation 8 (7) as the aggregate investments made by the Modaraba in various listed securities amounted to Rs.45, 577,359/- which constitutes 47.22% of Modaraba's equity.

Regulation 8 (7) provides as follows:

> "The investment of modaraba fund in listed securities shall not be more than 20 % of the equity of the modaraba. However, this restriction shall not apply where the modaraba has taken up the shares as consequence of underwriting obligation, or the modaraba became the absolute owner due to default of its borrowers.
>
> Provided that in exceptional cases the Registrar may relax this condition."

B. According to the Appellants the Modaraba has disinvested substantial part of short-term portfolio and have been making efforts to further disinvest but the continuous decline of the stock market has hampered the process of disinvestments. According to the Registrar the investment by the Modaraba far exceed the limit of 20% as prescribed by Regulation 8 (7) and as the Modaraba never applied for relaxation in light of the proviso given above, a penalty of Rs. 20, 000/- was imposed upon the Appellants.

C. Again, keeping in mind that the Modaraba had less time to bring its affairs in conformity with the Regulations, I will take a lenient view. It may however be noted that the management in investing more than 20 % of the paid up fund of the Modaraba also committed violation of Condition 3(i) of the Certificate which is given below:

> "Commitment not to be more than 20 % of paid up fund of modaraba and 20 % of the capital of any company/individual etc."

D. In light of the above, penalty of Rs.20,000/- is hereby reduced to Rs.10,000/-

(4) A. The Show Cause Notice alleged that the Modaraba violated Regulation 8 (8) by investing more than 5% of its equity in the shares of National Asset Leasing Corporation Limited, Asset Investment Bank Limited, Caravan East Fabrics Limited

and Nayab Spinning & Weaving Mills Limited. The Regulation 8 (8) provides as follows:

> "No modaraba shall make investment in the shares of a listed company of an amount exceeding 5 % of its own equity or 10 % of paid up capital of that company whichever is less:
>
> Provided that these limits may be exceeded on an application made to the Registrar."

B. According to the Registrar, the Modaraba neither obtained approval under Regulations for relaxation with regard to its investment in listed securities, nor did it bring its position in conformity with Regulation 8(8) as required under Regulation No. 21 of the Regulations. According to the Appellants they had nominated a director to oversee operations of Caravan East Fabrics Limited to safeguard Modaraba's exposure and to effect recoveries. The Appellants further submitted that the two companies mentioned herein were not associated concerns of the Modaraba. The Registrar, being dissatisfied with the explanation, had imposed a penalty of Rs. 20,000/- each on all the Appellants.

C. Having received no information regarding the resignation of Mr. Shahid Ansari, the Registrar was correct in assuming that Caravan was an associated concern of the Modaraba/Company at the time the Show Cause Notice was issued. National Asset Leasing Corporation Limited is an associated concern of the Modaraba/Company by virtue of common directorship. M/s. Nayab Spinning, it appears is not an associated concern of the Modaraba. It may however be noted that the question of the companies (in which Modaraba made investment) being associated concerns of the Modaraba is not relevant for the purpose of Regulation 8 (8), which, while making no mention of an associated company/concern, prohibits investment of an amount exceeding 5 % of the equity of the Modaraba or 10 % of paid up capital of the company in which the investment is made. The investment by the Modaraba in the companies mentioned herein is violative of Regulation 8 (8). However, keeping in mind the fact that it was

difficult for the management to bring its affairs in conformity with the provisions of the Regulations within the time granted, I take a lenient view and reduce the penalty imposed upon the Appellants from Rs. 20,000/- to Rs. 5,000/-.

(5) A. The Show Cause Notice alleged that the Modaraba had violated Regulation 9 which requires that unrealized profit on overdue morabaha/musharikas should be taken into suspense account. The Modaraba on the other hand transferred Rs.3,664,000/- to income account and later reversed/re-transferred the said amount to suspense account which was violative of Regulation 9.

B. According to the Appellants the Modaraba reversed the accrued profit in order to avoid tax on income not actually received. On finding this explanation lacking, the Registrar imposed a penalty of Rs. 20,000/- each on all the Appellants.

C. In my view the explanation provided by the Appellants is not satisfactory and the reasons given by them fail to justify non-compliance with Regulation 9. Rather, it appears that in order to avoid income tax, distortion of facts was resorted to and the certificate holders were not presented with the true and fair view of the state of affairs of the Modaraba. However, taking a lenient view (consistent with the view taken in case of other violations), I reduce the penalty imposed from Rs. 20,000/- to Rs. 10,000/-.

6. Having dealt, in detail, with the violations alleged in the Show Cause Notice (for which penalty was imposed by the Registrar), I now revert my attention to the other grounds of appeal which are relied upon by the Appellants in their Memorandum of Appeal and which were reiterated before me by Mr. Muhammad Ahmed Saeed Raja, Advocate for the Appellants, during the hearing.

(1) The Appellants contented that the Order-1027 passed by the Registrar was not lawfully served as the same was not served through one of the three modes of service prescribed under section 48 of the Ordinance.

Section 48 of the Companies Ordinance, in this regard, provides as follows:

> "Service of documents on company.-- A document may be served on a company or an officer thereof by sending it to the company or officer at the registered office of the company by post under a certificate of posting or by registered post, or by leaving it at the registered office of the company."

According to the Appellants it was mandatory upon the Registrar to serve the Order-1027 at the registered office of the Company. The Advocate for the Appellants also submitted case law in support of the contention made by the Appellants.

The Registrar contended that in his view section 48 does not restrict the Registrar to adopt only the three modes of service mentioned therein, as the word used in section 48 is "may" and not "shall".

I have looked through the case law submitted by the Advocate for the Appellants, however, I feel that facts of the judgments cited appear to be materially different from the facts of the present case. I tend to agree with the view held in Allester v. Chicester (1875) LR 10 CP 319 that 'in addition to serving a notice on the company which is complete when it is received by the company in the ordinary course of business, it is also possible to give notice to the company through its proper officers.' Also in Bank of Ireland v. Cogry Spinning Co., (1900) 1 IR 219, European Bank, EX p., Oriental Commercial Bank, (1870) 5 Ch App 358 it was held that 'notice to a director or other officer in the course of a transaction in which he is concerned as such director or officer amounts to notice to the company. In Jute and Gunny Brokers Ltd. V. Union of India (AIR 1961 SC 1214) it was held that section 48 is only an enabling provision and the method of service provided therein is not the only method of serving documents on a company …."

The purpose of serving a document in my view is to ensure that the contents of the same are available to the recipient and the said purpose, seems to have been sufficiently served. Grounds 8 (i) and (ii) of the Appeal are therefore repelled.

(2). The Appellants contend that the allegations made in the Show Cause Notice were also the subject matter of two earlier show cause notices issued by the Registrar in 1993 and 1996 and as the allegations contained in the said show cause notices were duly replied to, the matter stood settled and revival of the same in the present Show Cause Notice fell foul of the principle of estoppel which expressly prohibits re-agitation of the matters already dealt with. I have compared the said show cause notices and found that most of the issued raised in the Show Cause Notice were substantially different from those contained in the show cause notices issued in 1993 and 1996. Also, no orders were passed by the Registrar in the said show cause notices, exonerating the Appellants. The matters thus were not settled and dealt with and the principle of estoppel therefore does not become operative in the present case.

(3). The Appellants contend that the Registrar had approved the appointment of Appellant-2 as Chief Executive of the Modaraba and asked for a strategy plan which was submitted to him. However in total disregard of the mutually agreed strategy plan, the Registrar proceeded to appoint special auditors to conduct audit of the Modaraba. Resultantly, the Appellants could not implement the strategy plan owing to audit proceedings and the newly appointed chief executive was not allowed a chance to improve the sate of affairs of the Modaraba. The Registrar's response to this contention is that the Chief Executive of the Company was directed to present a "strategy plan" whereas the Chief Executive only sent an 'initial response' which was yet to be approved by the Board of Directors of the Company. According to the Registrar the Special Auditor was appointed under Regulation 11 which

empowers the Registrar to appoint a special auditor at any time. The Registrar further contended that by the time new chief executive (who it may be noted was on the Board of Directors of the Company/Modaraba throughout) was appointed, the Modaraba fund was reduced to such an extent that there was almost nothing left to manage. In my view, the Appellants should have prepared and presented the 'strategy plan' on time and the fact that they did not, prohibits them from taking the plea that an opportunity to turn the Modaraba around was not provided to them (the Appellants).

(4). The Appellants also contend that the Show Cause Notices and proceedings thereunder were directed against the chief executive and directors of the Company but the Order-1027 was passed against the chief executive and directors of the Modaraba which in their view is tantamount to min-joinder/non-joinder of parties. The Registrar's view on the same is that the directors and chief executive of the Modaraba are the same as those of the Company. In my view the proceedings and the Order should have been against the directors of the Company which was responsible for the management of the Modaraba. However this being a mere technical error, and the directors of the Modaraba and the Company being the same (the Appellants), no injustice appears to have been done to the Appellants. The contention of the Appellants therefore, lacks force in substance.

(5) The Appellants contend that the defaults and contraventions alleged to have been committed by the Appellants were not willful. The default/contravention, in my view, is willful if the directors, who are responsible for the management of a company/modaraba and who presumably knew the duties imposed upon them by law, do not make sufficient efforts to ensure that those duties are carried out. In the present case, there is justification for holding that the

directors have willfully permitted the business of the Modaraba to be run in a manner prejudicial to the interests of the certificate holders. The lack of exercise of due care and diligence on the part of the directors of the Company is apparent.

(6) The Appellant also contended that the amount of penalty as contemplated in section 32 of the Modaraba Ordinance was not to exceed Rs.100,000/- for all the violations alleged in the Show Cause Notice. This interpretation of law in my view is not tenable as the prescribed maximum amount is for one violation and not for all the violations taken together.

7. In light of the above I hereby direct the Appellants to pay Rs.1,00,000/- each as penalty. The amount of penalty shall be deposited with a branch (designated By the Securities & Exchange Commission of Pakistan) of Habib Bank.

8. Issued under my hand and seal this 5th day of March, 2002.

(SADIA KHAN)
Executive Director