Securities and Exchange Commission of Pakistan
Enforcement and Monitoring Division

[Islamabad]

Before Rashid Sadiq, Executive Director

In the matter of
M/S PAK ELEKTRON LIMITED

Number and date of notice	19(529) CF/ISS/2001 dated January 18, 2002
Date of final hearing	April 21, 2003
Present	
Representing Directors:	Mr. Haroon A. Khan, Managing Director Mr. Manzar Hasan, Chief Financial Officer Mr. Irfan Rehman Malik of M/s M. Yousuf Adil Saleem & Co., Chartered Accountants
SECP:	Mr. Ashafaq Ahmed Khan, Director (Enf) Mr. Imran Bashir, Director (Enf) Mr. Amina Aziz, Deputy Director (Enf)
Date of Order	May 09, 2003

Order

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

This order shall dispose of the proceedings initiated against the Directors of ***M/s Pak Elektron Limited (hereinafter called "Pak Elektron")*** for making investments in the nature of advances and other amounts in contravention of the

mandatory provisions of Section 208 of the Companies Ordinance, 1984 (the "Ordinance"). These investments amounting in aggregate to Rs. 427.993 million as of June 30, 2001 are still outstanding and in fact have increased to Rs. 534.750 million as of June 30, 2002.

Jurisdiction

2. The Commission brings this action against the directors of ***Pak Electron*** pursuant to the provisions of Sub-Section (5) Section 208 of the Ordinance, which provides that in case of default in complying with the requirements of Section 208, every director of the company who is knowingly and willfully in default shall be liable to a fine, which may extend to one million rupees and, in addition, the directors shall jointly and severally reimburse to the company any loss sustained by the company in consequence of an investment, which was made without complying with the requirements of Section 208. The powers under the aforesaid provisions have been delegated to the undersigned through S.R.O. No. 862 (I) / 2000 dated December 06, 2000 and later through S.R.O. No. 386(1)/2002 dated June 18, 2002.

The Company- Its History and Past Performance

3. ***Pak Elektron*** is a public company limited by shares, incorporated on March 03, 1956. Its shares were listed on the stock exchanges in 1988 following the public issue of its shares on July 11, 1988. It has authorized and paid up share capital of Rs. 250 million and Rs. 185.418 million respectively, as per its audited Balance Sheet for the year ended June 30, 2002. The object for which ***Pak Elektron*** was established and its powers are contained in its

Memorandum and Articles of Association. It is principally engaged in production and sale of electrical capital goods and domestic appliances. The manufacturing facility of ***Pak Elektron*** is located at 14 K.M. Ferozepur Road, Lahore and Registered Office at 6-Egerton Road, Lahore. ***Pak Elektron*** has 1486 shareholders comprising individuals, joint stock companies, public sector institutions, financial institutions etc. as per pattern of shareholding annexed to the Directors' Report on the accounts for the year June 30, 2002. Associated companies, directors and their spouses hold around 39% of the paid up capital. This indicates that there is a substantial public interest in the shares of this Company.

4. The shares of ***Pak Elektron*** were offered to the general public at par. Subsequently, however, there were two right issues made in 1992 and 1993. These right issues were offered at premium of Rs. 23 and Rs. 30 per share respectively meaning thereby that one right share of Rs. 10 each was offered at Rs. 33 and the other at Rs. 40 respectively to the shareholders. ***Pak Elektron***, thus, collected an amount of Rs. 125.0 million as premium on these right shares, which is being reflected in its Balance Sheet as "Premium on Issue of Shares"

5. The position of equity of ***Pak Elektron***, its profits and distribution of dividends for the years 1997 to 2002 are as under:

Description	***2002***	***2001***	***2000***	***1999***	***1998***	***1997***
	Rupees in Millions					
Paid up capital	185.418	185.418	185.418	185.418	185.418	185.418
Reserves	125.100	125.100	125.100	510.100	510.100	510.100
Acc. Profit/(Loss)	(119.309)	(249.463)	(343.563)	(787.562)	(691.254)	(376.470)
Total equity	**191.209**	**61.055**	**(33.045)**	**(92.044)**	**4.264**	**319.048**
Net profit / (loss)	**130.154**	**94.100**	**58.999**	**(96.308)**	**(314.784)**	**(377.400)**
EPS	**7.02**	**5.08**	**3.18**	**0.00**	**(16.98)**	**(20.35)**
Dividends	**NIL**	**NIL**	**NIL**	**NIL**	**NIL**	**NIL**

6. The Board of Directors of ***Pak Elektron***, as per its Form A (Particulars of Directors) made up to December 31, 2001, filed with Company Registration Office, Lahore comprises of the following individuals

i) Mr. M. Naseem Saigol, Chief Executive
ii) Mr. M. Azam Saigol, Director
iii) Mr. Shahid Sethi, Director
iv) Mr. Haroon Ahmed Khan, Director
v) Mr. Mohibullah Usmani, Director
vi) Mr. Homaeer Waheed , Director
vii) Mr. Asif Jameel, Director

7. The above named directors were elected in the Extra Ordinary General Meeting held on November 03, 2001. Mr. M. Naseem Saigol was appointed as the Chief Executive of ***Pak Elektron*** for a period of three years.

Background Facts

8. In order to fully appreciate the issues raised by the Enforcement and Monitoring Division in the show cause notice and the arguments of the Directors / Chief Executive, it would be necessary to look into the relevant background facts of this case. As a part of its monitoring activities, the Enforcement and Monitoring Division has conducted an examination of the Balance Sheet and Profit & Loss Account of ***Pak Elektron*** for the year ended June 30, 2001, sent to the Commission in terms of Sub-section (5) of Section 233 of the Ordinance, which revealed investments of Rs. 608.333 million were made by ***Pak Elektron*** in its subsidiaries and associated undertakings, *whose names were not disclosed* in the aforesaid Balance Sheet. It was further observed that the paid up capital plus free reserves less accumulated losses of the Company as per its Balance Sheet as of June 30, 2001 stood at Rs. 61.055

million only. The aforesaid investments, therefore, were explicitly higher than the permissible statutory limit of 30% of the paid up capital plus free reserves of the investing company stipulated under Section 208 of the Ordinance (This threshold was subsequently relaxed through the Companies (Amendment) Ordinance, 2002). Moreover, the said investments increased from Rs. 506.942 million as appearing in the Audited Accounts of ***Pak Elektron*** for the year ended June 30, 2000, meaning thereby that an amount of Rs. 101.391 million was invested during the year ended June 30, 2001. This was again a *prima facie* violation of the proviso (a) of Sub-section (1) of Section 208 of the Ordinance. On perusal of the resolutions filed by ***Pak Elektron*** with the Commission, it was revealed that the aforesaid investments were made without the authority of Special Resolutions as required by the mandatory provisions of Section 208 of the Ordinance. It was also noticed from the perusal of the Balance Sheet and Profit and Loss Account that ***Pak Elektron*** had charged return on advances and other amounts provided to its subsidiaries / associated undertakings, at a rate lower than its own borrowing costs. This again was a *prima facie* contravention of proviso (b) of Sub-section (1) of Section 208 of the Ordinance.

9. It was also observed that the Auditors of ***Pak Elektron*** namely, M/S Manzoor Hussain Mir & Co., Chartered Accountants, in their audit report signed by them on December 08, 2001 have drawn attention of the members towards the violation of Section 208 in the following manner:

Quote

> "Investment in the shares of the associated companies and advances given to them aggregating to Rs. 608.333 million are in excess of 30% shareholders equity, which shows credit balance of Rs. 61.055 million, which is contrary to the provisions of Section 208 of the Companies Ordinance, 1984."

Unquote

10. The aforesaid qualification of the auditors categorically pointed out that ***Pak Elektron*** has made investments in its associated undertakings in contravention of the provisions of Section 208 of the Ordinance.

11. Note No. 4.4 of the aforesaid accounts provided the following information regarding investments in and advances to associated undertakings:

Quote

> "(i) Investment in shares of associated companies amounting to Rs. 113.282 million and advances of Rs. 427.993 million aggregating to Rs. 608.333 million are in excess of 30% of share holders equity of Rs. 61.055 million balance which is contrary to provisions of Section 208 of the Companies Ordinance, 1984."
>
> "(ii) Investment in shares was made prior to 1995. According to legal advisor, the proviso to Section 208 (I) was inserted in Finance Act 1995 prescribing the limit of 30% of the paid up capital plus reserves. The proviso being a substantive provision of law will be operative prospectively with effect from 2nd day of July 1995 and is not applicable to the investments made prior to amendment in statue.
> As per legal advice the investment in shares made by the Company in associated companies prior to insertion of proviso remains unaffected, if such investment exceed the threshold provided in the proviso as substantive rights and liabilities were established under the arrangements entered into by and between the investing companies and the associated companies in which the investments were made."

Unquote

12. The aforesaid Note unambiguously admitted the violation of the mandatory provisions of Section 208 of the Ordinance except investments in shares, which were made prior to 1995 and were legally protected as per advice obtained by ***Pak Elektron***. This legal opinion would be discussed in the later part of this Order.

Inter-Connecting Relationship and Commonality of the Directors

13. It was also noticed that ***PEL Appliances*** and ***PEL Daewoo*** were subsidiaries of ***Pak Elektron*** by virtue of 50.17% and 60% respectively of their shareholding held by ***Pak Elektron***. Moreover, the majority of the directors in the case of ***Pak Elektron*** and ***PEL Appliances*** were common. In such a situation, it was necessary for the directors of ***Pak Elektron*** to have obtained approval of the shareholders before entering into transactions with its subsidiary.

Show Cause Notice

14. In view of the facts and circumstances as narrated in the preceding paragraphs, the Enforcement and Monitoring Division considered that the investments ***Pak Elektron*** made in its subsidiaries / associated undertakings from time to time were in contravention of the mandatory requirements of Section 208 of the Ordinance. It was, therefore, considered necessary to ascertain the extent of violations committed by ***Pak Elektron*** and loss sustained in consequence of these investments, which were made without complying with the requirements of Section 208 of the Ordinance.

15. A notice dated January 18, 2002 was, therefore, issued to the Directors of ***Pak Elektron*** highlighting the *prima facie* violations of Section 208 of the Ordinance. They were also called upon to show cause as to why action may not be taken against them as provided in Sub-section (5) of Section 208 read with

Section 476 of the Ordinance. For ease of reference, the contents of the show cause notice are reproduced hereunder:

Quote

No.19 (529)CF/ISS/2001 January 18, 2002

Re: **SHOW CAUSE NOTICE UNDER SUB-SECTION (5) OF SECTION 208 READ WITH SECTION 476 OF THE COMPANIES ORDINANCE, 1984**

WHEREAS, the examination of the audited accounts of M/s PAK ELEKTRON LTD. (the "Company") for the year ended June 30, 2001, indicated that the Company has made investments amounting to Rs. 608.333 million (2000: Rs.506.942 million) to its associated companies, whose names are not mentioned in the accounts.

2. AND WHEREAS, balance sheet of the Company as at June 30, 2001 shows an equity of Rs. 61.055 million, as under:

	Rs. in '000'
Issued, subscribed and paid-up capital	185,418
Reserves	125,100
Un-appropriated loss	(249,463)
Total Equity	**61,050**

AND WHEREAS, the auditors of the company M/s. Manzoor Hussain Mir & Co., Chartered Accountants, have qualified their report on the aforesaid annual accounts in the following terms:

" Investments in shares of associated Companies and advances given to them aggregating to Rs. 608.333 Million (Note 4.4) are in excess of 30% shareholders equity, which shows credit balance of Rs. 61.055 Million, which is contrary to the provisions of Section 208 of the Companies Ordinance, 1984."

4. AND WHEREAS, the return on the aforesaid advances to the associated companies is less than the borrowing cost of the company.

5. AND WHEREAS, Sub-section (1) of Section 208 of the Ordinance provides that Company shall not make any investment in any of its associated companies or associated undertakings except under the authority of a special resolution, which shall indicate the nature and amount of investment and terms and conditions attaching thereto;

6. AND WHEREAS, proviso (a) of Sub-section (1) of Section 208 of the Ordinance requires that aggregate investment in associated companies, except a wholly owned subsidiary, shall not exceed thirty percent of the paid up capital plus free reserves of the investing Company at any point of time;

7. AND WHEREAS, proviso (b) of Sub-section (1) of Section 208 of the Ordinance requires that the return on investment in the form of loan shall not be less than the borrowing cost of the investing Company;

8. AND WHEREAS, the Company has, *prima facie* contravened the provisions of Section 208 of the Ordinance; which attracts the penal provisions of Sub-section (5) of Section 208 of the Ordinance.

NOW THEREFORE, you are hereby called upon to show cause in writing within seven days and explain as to why penalty provided in Sub-section (5) of Section 208 read with Section 476 of the Ordinance may not be imposed on you and you may not be directed to reimburse the loss, if any sustained by the Company in consequence of the investments which were made without complying with the requirements of Section 208 of the Ordinance. Also send copies of the ledger accounts of all associated companies for the year ended June 30, 2001 showing details of each transaction along with your reply to the show cause notice

The receipt of this show cause notice should be acknowledged through return fax.

Unquote

Reply to the Show Cause Notice

16. The reply to the show cause notice was received from ***M/s Hameed Majeed Associates (Pvt) Ltd.***, on behalf of the Directors, vide their letter dated February 20, 2002. The following detail of investments as of June 30, 2001 was also provided:

Rupees in Million

	Investment in shares	***Advance***	***Total***
PEL Appliances Ltd	83.639	327.098	410.737
Kohinoor Industries Ltd	54.701	21.074	75.775
PEL Daewoo Electronics Ltd	42.000	70.189	112.189
Saigols (Pvt) Ltd		5.635	5.635
Saritow Pakistan Ltd		0.503	0.503
Conforce International		2.730	2.73
PEL Instruments Ltd		0.144	0.144
Azam Textile Mills Ltd		(00.34)	(0.34)
Saigols Qinggi Ltd		0.654	0.654
Total	**183.340**	**427.993**	**608.333**

It was contended that the names of associated companies were not disclosed in the accounts, as there was no such disclosure requirements under the Ordinance.

17. In order to provide an opportunity to the directors for personal hearing, the case was fixed on March 04, 2002. Thereafter, in order to provide ample opportunity to the Directors of ***Pak Elektron*** to advance arguments in support of their contentions contained in the reply to the show cause notice, the case was heard a number of times. Mr. Imtiaz Majeed, FCA represented the directors in these hearings. The final hearing was held on April 21, 2003 when Mr. Haroon A. Khan, Managing Director, Mr. Manzar Hasan, Chief Financial Officer and Mr. Irfan Rehman Malik of M/s M. Yousuf Adil Saleem & Co., Chartered Accountants appeared on behalf of the Directors.

Submissions of the Directors

18. In the written submissions as well as at the time of hearings, Mr. Imtiaz Majeed, FCA contended that:

i) Equity investments in PEL Appliances Limited (hereinafter called "PEL Appliances"), PEL Daewoo Electronics Limited (hereinafter called "PEL Daewoo") and Kohinoor Power Company Limited (hereinafter called "Kohinoor Power") were under the authority of special resolutions passed in the extraordinary general meetings held on August 30, 1990, December 27, 1993 and November 05, 1992 respectively. Since the initial investments there had been no change in the shareholding of ***Pak Elektron*** in ***PEL Daewoo*** and ***Kohinoor Power***. The movement of the investments in ***PEL Appliances*** was described as follows:

Year		No. of shares
1990	Investment in shares	2,000,000
1993	Sales of shares	(496,000)
1993	20% Bonus shares	376,000
1995 (May)	30% Right shares	564,000
	Adjustment	1,250
1995 (Dec)	20% Bonus shares	489,050
	Total	***2,934,300***

ii) Investments in shares of associated undertakings were made long before the insertion of the proviso in Section 208 of the Ordinance. As per legal advice, the investments in shares made by ***Pak Elektron*** in its associated undertakings prior to the insertion of the proviso remain unaffected even if they exceed the threshold provided therein.

iii) As regards the balances of RS. 427.993 due from associated companies, such balances arose as a result of *normal trade transactions* comprising of:

- Receipt and payments on behalf of one another relating to sales and purchases

- Inter-company sales of goods and services
- Goodwill sold by ***Pak Elektron*** to ***PEL Appliances***

iv) The bulk of transactions were with ***PEL Appliances***. These amounts could not be recovered due to heavy losses sustained by ***PEL Appliances***.

v) ***Pak Elektron*** has been charging interest to associated undertakings at rates varying from 16% to 19.71% applied on outstanding balances at month end.

vi) The management has not intentionally breached the provisions of Section 208 of the Ordinance and has acted in good faith for the benefit of the shareholders.

vii) The auditors have been harsh in classifying normal trade credit as advances.

Final Hearing Proceedings

19. On the date of final hearing on April 21, 2003, Mr. Haroon A. Khan, Managing Director submitted that huge credits were allowed by ***Pak Elektron*** to its subsidiaries namely, ***PEL Appliances*** and ***PEL Daewoo*** in an effort to keep these subsidiaries operational. This decision was motivated by the directors' desire to safeguard the interest of ***Pak Elektron*** and its shareholders in these companies. He forcefully averred that no *malafide* intention or personal interest of the directors of ***Pak Elektron*** was involved in these decisions as the directors of ***Pak Elektron*** held shares in these subsidiaries of an amount not exceeding nominal value of the qualification shares only. It was further argued that both the companies i.e. ***Pak Elektron*** and ***PEL Appliance*** use PEL as their brand name and closure of either one of them would have an adverse effect on the other. It was also stated that ***Pak Elektron*** has introduced new products in the market on the strength of the existing established products of ***PEL***

Appliances particularly in the home appliances division. It was further submitted that the name PEL carried lot of goodwill in the market because of its PEL air conditioners, which is the product line of ***PEL Appliances*** and ***Pak Elektron*** could not take the risk of its closure as it would have also adversely impacted the business of ***Pak Elektron***. It was also pointed out that as per the audited accounts of ***Pak Elektron*** Rs. 534.750 million appeared as receivable from associated companies, out of which Rs. 443.974 million related to ***PEL Appliance*** and Rs. 90.776 million to ***PEL Daewoo.*** The receivable from all other associated companies stand recovered. While giving recovery plan, it was proposed that ***Pak Elektron*** could take over the assets of ***PEL Appliances*** in lieu of settlement of its debts. It was further submitted that the value of assets of ***PEL Appliances*** was more than the amounts recoverable by ***Pak Elektron***, thus ***Pak Elektron*** would be able to recover whole of its receivables from the assets of ***PEL Appliances***. The value of any balance assets taken over by ***Pak Elektron*** would be settled by issue of shares of ***Pak Elektron*** to the shareholders of ***PEL Appliances*** as a part of the scheme of arrangement under Section 284 of the Ordinance. This would not only settle the amounts recoverable from ***PEL Appliances*** but also would give fair compensation to the shareholders of ***PEL Appliances***. Mr. Haroon A. Khan also elaborated the said recovery plan and its positive impact on the future profitability of the ***Pak Elektron***. As regards to the recovery of Rs. 90.776 million from ***PEL Daewoo***, no time frame was proposed at the time of hearing. The submissions made by him on behalf of the directors can be summarized as follows:

i) ***Pak Elektron*** did not violate Clause (b) of proviso to Sub-section (1) of Section 208 as it had charged mark-up on its advances to its subsidiaries / associated companies. The rate of mark-up charged ranged between 16% to 20%, which is in line with the aforesaid provisions of law.

(ii) Advances to associated companies other than ***PEL Appliances*** and ***PEL Daewoo*** have been recovered. As regards ***PEL Appliances*** and ***PEL Daewoo*** the directors give the assurance that sincere efforts are being made to look for plausible ways and means for the recovery of these outstanding debts.

(iii) The last two to three years have witnessed a tremendous turnaround in the financial results of ***Pak Elektron*** which is partly attributed to the fact that the ***Pak Elektron*** has introduced certain new products particularly in the home appliances division. Home appliances is the domain of ***PEL Appliance,*** its goodwill and the fact that its products are still in the market have contributed towards the successful launching of the new product line of ***Pak Elektron***.

(iv) The directors have no personal interest in ***PEL Appliances*** or ***PEL Daewoo*** except to the extent of the nominal qualification shareholding. The major stakeholder in them was ***Pak Elektron*** itself. The decisions for investments, although in violation of Section 208, was motivated to secure its equity investments in subsidiaries and to protect the brand name, PEL.

(v) In addition to its investments, the goodwill linked to the common brand name **PEL** shared by these associated undertakings was also at stake which provided commercial justification for injecting funds in ***PEL Appliances*** in effort to keep it operational.

(vi) The merger cum recovery plan of outstanding debts from ***PEL Appliances,*** would result in the following additional benefits for ***Pak Elektron***:

(a) Enhance the future prospects in terms of increase in profitability.

(b) Sizable reduction in mark-up cost.

(c) Access to cheaper sources of financing.

(d) Economies of scale

(e) Tax advantages and savings

(x) Another aspect to this recovery plan is that ***PEL Appliances*** is also a public limited listed company and the proposed plan would be beneficial its shareholders.

Issues

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

i) Whether advances and other amounts provided by ***Pak Elektron*** to its associated companies are in the nature of 'normal trade credit'?

ii) Whether ***Pak Elektron*** was required to disclose the names of associated undertakings from whom loans, advances and other amounts were outstanding at the year-ends?

iii) Whether ***Pak Elektron*** complied with all the requirements of Section 208 of the Ordinance while making investments in its associated undertakings? i.e.

a) Special Resolution was passed before making investments.

b) Aggregate investment was not in excess of 30 % of the paid up capital plus free reserves of the investing company and whether investment was made prior to the insertion of proviso in Section 208 of the Ordinance?

c) Return on investments in the form of loans and advances were not less than its borrowing cost.

Consideration of the Issues

21. After having considered the contentions of the Directors of ***Pak Elektron*** and the perusal of the documents and information placed on record, I hold on each issue as under:

i) Whether advances provided by Pak Elektron to its associated companies are in the nature of 'normal trade credit'?

It has been contended that advances provided by ***Pak Elektron*** to its associated companies, were in the nature 'normal trade credit.' It was further stated that ***Pak Elektron*** the parent company and its subsidiaries namely, ***PEL Appliances*** and ***PEL Daewoo*** have appointed common agents/ distributors through out Pakistan for the sale of ***their*** products including household appliances under the name of ***PEL***. The sale by each company is accounted for in its own books of account whereas the agents remit the amount of total sale in the name of ***Pak Elektron*** without making any distinction between purchases from individual company on the basis of their products. Upon receipt of amounts from agents, ***Pak Elektron*** transfers the funds relating to ***PEL Appliances*** and ***PEL Daewoo*** to the respective companies. In order to determine the nature of these advances, it would be useful to refer to the expression "investment" which has been defined in "Explanation" to Sub-section (1) of Section 208 of the Ordinance. For ease of reference, the said provision, the same is reproduced as under:

Quote

> "Explanation.---The expression "investment" shall include loans, advances, equity, by whatever name called, or any amount, which is not in the nature of normal trade credit."

Unquote

It is clearly described in the aforesaid explanation that the term 'investment' includes all kinds of loans, advances, equity or any other amount excluding normal trade credit. Since the advances to associated companies are the main issue in this case, therefore, it is necessary at this stage to analyze the term 'normal trade credit' which could be of widest possible scope in legal usage, I am, however, of the view that the context in which these words had been used in the aforesaid provisions of law had limited meaning. In my opinion, the words 'normal trade credit' has been used to refer to the 'credit' allowed by the investing companies to its customers in the ordinary course of business. In the case of a company, which is in the business of extending credits on the basis of any of its major objects, the credit extended in the normal course of its business would also be considered as normal trade credit. On the other hand, the making of investment by a company, whose main object is to set up a textile mill or cement factory, in its associated undertakings, would not be considered as normal trade credit except the 'credit' allowed to them as a customer in the normal course of its business. This appears to be the clear intent of the aforesaid provisions of law. At this stage, it is necessary to examine the nature of transactions of ***Pak Elektron*** with its associated companies. The copies of current accounts of associated undertakings are the most relevant document in this context. A summary of the transactions as reflected in these current accounts would be of much help to determine the nature of transactions. I would first consider the transactions in respect of ***PEL Appliances***, the summary of which is as under:

Rupees in Million

	2001	***2000***	***1999***	***1998***
Opening balance July 01,	246.199	108.237	28.744	-65.569
Sales less purchases	118.880	102.456	104.642	96.496
Receivable from PEL Appliances	***365.079***	***210.693***	***133.386***	***30.927***
Received on behalf of PEL Appliances	697.936	565.865	356.343	708.283
Payable to PEL Appliances	***332.857***	***355.172***	***222.957***	***677.356***
Actual Payments	619.732	579.070	318.908	693.369
Excess payments	***286.875***	***223.898***	***95.951***	***16.013***
Mark-up accrued on advances	40.217	33.301	12.286	12.730
Closing balance as of June 30	***327.092***	***246.199***	***108.237***	***28.743***

A perusal of the aforesaid summary clearly manifests that ***Pak Elektron*** has been making sales to ***PEL Appliances***, which were being recovered from the money received from time to time by ***Pak Elektron*** from the agents of ***PEL Appliances***. It can be easily seen from the aforesaid summary of transactions with ***PEL Appliances*** that during the year 1998, an amount of Rs. 677.356 million was payable to ***PEL Appliances*** after setting of sales and purchases, however, an amount of Rs. 693.369 million was paid i.e, an excess payment of Rs. 16.013 million. During the year 1999, 2000 and 2001, such excess payments amounted to Rs. 95.951 million, Rs.223.898 million and Rs.286.875 million respectively. In addition, the mark up on these amounts in all the years also remained un-recovered. This financial assistance, though, motivated by the directors' desire to support ***PEL Appliances***, its subsidiary, which was in deep financial crisis, cannot be categorized as "normal trade credits" as elaborated in detail in the preceding paragraphs. The huge credits allowed for exceptionally long period of time could not be termed as "normal trade credits" rather these are, in my considered view, abnormal credits. It has also been noted that amount due from ***PEL Appliances*** has increased from 327.092 million as of June 30, 2001 to Rs 443.974 million as of June 30, 2002, meaning thereby that an amount of Rs 116.882 million has further been added, which includes sales/funds transferred in addition to mark up on outstanding balance. It has

further been observed that there is no agreement in place between associated companies for the aforesaid agency arrangement. Also Board's approval in this regard is found absent. The minutes of the Board meeting also do not contain any discussion on the transactions with associated companies and the rationale for providing assistance to ***PEL Appliance*** and its commercial justification. It has also been noticed that ***Pak Elektron*** has been incurring book keeping and selling expenses on behalf of ***PEL Appliances***, which are also outside the scope of normal trade credit as envisaged in Section 208 of the Ordinance. Charge of mark-up on balances due from associated companies is another factor, which negates the contention that advances were in the nature of normal trade credits. Now let us look at the summary of transactions of ***Pak Elektron*** with ***PEL Daewoo***. A similar pattern of regular excess payments has also been witnessed in its case. A summary of transactions with ***PEL Daewoo***, as provided, is as follows:

Rupees in Million

	2001	***2000***	***1999***	***1998***
Opening balance July 01,	55.159	25.048	8.029	3.651
Total debits less credit during the year	3.000	2.326	3.000	2.975
Receivable from PEL Dawoo	***58.159***	***27.374***	***11.029***	***6.626***
Received on behalf of PEL Daewoo	.380	6.102	5.126	11.589
Receivable (Payable) to PEL Daewoo	***57.779***	***21.272***	***5.903***	***(4.963)***
Actual Payments	3.221	28.168	16.722	12.171
Excess payments	***61.000***	***49.440***	***22.625***	***7.208***
Mark-up accrued on advances	9.189	5.719	2.423	.821
Closing balance as of June 30	***70.189***	***55.159***	***25.048***	***8.029***

It can be seen that ***Pak Elektron*** has been making payments to ***PEL Daewoo***, which over the period of time has accumulated to Rs 70.189 million. This figure has now increased to Rs. 90.776 million. The aforesaid summary of transactions with ***PEL Daewoo*** clearly indicates that during the year 1998, an amount of Rs. 4.963 million was payable to ***Pak Elektron*** after setting of debits and credits, however, an amount of Rs. 12.171 million was paid i.e, an excess

payment of Rs. 7.208 million. During the year 1999, 2000 and 2001, such excess payments amounted to Rs. 22.625 million, Rs.49.440 million and Rs.61.0 million respectively. In addition, the mark up on these amounts in all the years also remained un-recovered. These amounts, in my considered view, cannot be categorized as "normal trade credits" as deliberated at length in the preceding paragraphs. I, therefore, hold that the amount recoverable by ***Pak Elektron*** from ***PEL Appliances*** and ***PEL Daewoo*** are not in the nature of normal trade credits.

ii) Whether Pak Elektron was required to disclose the names of associated undertakings from whom loans, advances and other amounts were outstanding at the year-ends?

In this context, it was contended that there is no requirement stated in the Ordinance to disclose the names of the associated undertakings from whom the advances and other amounts are recoverable. This argument is absolutely devoid of any force because the Fourth Schedule to the Ordinance specifically require the listed companies to state the names of associated undertakings. The relevant provision in this respect is Part II, Para 6 (C) (b) which is reproduced as under:

Quote

> "aggregate amount due by associated undertakings, controlled firms and managed modaraba [names to be specified in each case]"

Unquote

In view of the aforesaid provisions of law, the argument on behalf of directors is not sustainable. ***Pak Elektron*** was required under the aforesaid mandatory

provision to disclose the names of its associated undertakings from whom the advances are outstanding at the year-end.

iii-a) Whether Special Resolution was passed before making investments?

Having discussed that the nature of advances made by ***Pak Elektron*** to its associated undertakings are not in the nature of 'normal trade credit' I next come to the issue as to whether shareholders' approval through 'Special Resolution' was obtained by ***Pak Elektron*** for investments, both in equity and as advances, made in its associated companies. The relevant provisions of law for making investments in associated undertakings are contained in Sub-section (1) of Section 208 of the Ordinance, which make it compulsory to pass a Special Resolution for making any investment by a company in its associated companies or undertakings. It is also one of the conditions that a statement of material facts including the nature and amount of the investment and terms and conditions attached thereto accompanies the notice of meeting in terms of S.R.O 634 (1)/96 replaced subsequently through another notification No. 865 dated December 06, 2001. These provisions of law are mandatory and no investment in associated companies can be made without following the laid down procedure. ***Pak Elektron*** has contended that approval from shareholders was obtained in Extraordinary General Meetings held on August 30, 1999, December 27, 1993 and November 05, 1992 for investing Rs. 20 million, Rs. 42 million and Rs. 60.00 million in the shares of ***PEL Applainces***, ***PEL Daewoo*** and ***Kohinoor Power*** respectively. As regards to loans and advances provided to associated undertakings, directors of ***Pak Elektron*** have admitted that these investments were made without the authority of Special Resolution. So far as, the contention regarding investment in shares is concerned, the perusal of the record substantiates that the assertion of the directors is correct. However, this is not the case in respect of advances and other amounts provided by ***Pak***

Elektron to its associated companies. I, therefore, hold that investments made by Pak Elektron in the form of advances and other amounts to subsidiaries / associated companies were made without the authority of Special Resolutions as required by Sub-section (1) of Section 208 of the Ordinance.

iii-b) Whether Investments made by Pak Electron in its associated undertakings are in excess of the prescribed limit?

I now take up the issue of breach of statutory investment limit. The following figures of the Accounts of ***Pak Elektron*** as on June 30, 2000 are relevant to determine this question:

Description	Rupees in million
Paid up capital (PUC)	185.418
Reserves	125.100
Accumulated Profit/(Loss)	(249.463)
PUC plus free reserves	**61.050**
Admissible limit-30%	**18.315**
Investments at year end	
Equity	183.340
Advances/loans	427.993
Total	**608.333**
% age of PUC & reserves	**996.45%**

According to the audit report dated December 08, 2001 the auditors have qualified their opinion because the investment in associated companies exceeds 30% of equity threshold. At this point, it is necessary to refer to the proviso (a) to Sub-section (1) of Section 208 of the Ordinance, which 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

It is abundantly clear from the above discussion that the investments of ***Pak Elektron*** in its associated companies were in excess of the statutory permissible limit. I would also refer to the legal opinion in this context referred to by ***Pak Elektron***, while justifying the excessive investments in subsidiaries / associated companies. It is the opinion of the legal adviser that investments made prior to 1995 are legally protected. I am in total agreement with this opinion. What, however, needs to be seen is that which of the investments were made prior to 1995 and which after the year 1995. The investments in shares, as discussed, in the earlier part of this Order are the only investments, which were made prior to 1995 and, therefore, are legally protected. The investments in the form of advances were continued to be extended to subsidiaries / associated undertakings even after the insertion of the statuary limit in 1995. Therefore, I hold that the directors of ***Pak Elektron*** has violated the provisions of proviso (a) of Sub-section (1) of Section 208 of the Ordinance by making investment in excess of 30 % of its paid up plus free reserves and the directors were aware of the contravention. This threshold has lately been removed to allow the private sector to make inter-corporate investments without any limit. Moreover, the accumulated losses, which as on June 30, 2000 were Rs. 249.463 million has now been totally wiped out and the reserves as of March 31, 2003 indicates a positive balance of Rs. 85.026 million.

iii-c) Lending at less than borrowing cost.

The next issue is the return on investments in the form of advances to associated undertakings. The proviso (b) to Sub-section (1) of Section 208 of the Ordinance being relevant, is reproduced hereunder:

Quote

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

Unquote

This provision of law is mandatory and a public company cannot make advances/loans to associated companies whereby the return thereon is less than its borrowing cost. In the case in hand, the auditors have certified that the return accrued by ***Pak Elektron*** on the balances due from associated undertakings during the year ended June 30, 2001 was not less than its borrowing cost. I, therefore, hold that the return on investments made by ***Pak Elektron*** in its subsidiaries / associated undertakings in the form of advances was not less than borrowing cost of ***Pak Elektron***. These returns, however, are still outstanding.

Recovery Plan Submitted by PEL Appliances

22. ***PEL Appliances*** had submitted to the Commission a repayment plan whereby the outstanding amount was to be paid back to ***Pak Elektron*** in equal monthly installment over a period of seven years including a grace period of two years. During the final hearing, however, Mr. Haroon A. Khan, Managing Director presented before me an alternative plan to recover the outstanding debts from ***PEL Appliances***. He stated that a proposal for merger of ***PEL Appliances*** with ***Pak Elektron*** has been submitted to the Commission. He has also averred that value of assets of ***PEL Appliances*** is more than the amounts payable to ***Pak Elektron***. While preparing scheme of arrangement, the Swap ratio would be based on the value of net assets after the settlement of the inter-company debts. In this way both the whole of the receivables would be recovered from ***PEL Appliances***. Both the companies manufacture electrical

goods and appliances and the plant and equipment in both the mills are more or less similar and can be used to supplement the production of one another. It was also pointed out that although the auditors have been qualifying the report to the member's of ***PEL Appliance*** on the validity of the going concern assumption, it was still very much a going concern and regular incurrence of losses were due to the seasonal nature of its products, location of the mills, exorbitant mark up charged by ***Pak Elektron*** on its advance and difficulty in acquisition of financing. As per the proposed plan ***Pak Elektron*** shall acquire ***PEL Appliance*** on the basis of the fair value of its assets.

Conclusion

23. It has been amply demonstrated in the preceding paragraphs that ***Pak Elektron*** has provided funds to its associated undertakings without complying with the requirements of Section 208 of the Ordinance. The intention to benefit the subsidiaries and associated companies is, thus, clear. The auditors have been raising the going concern issue in their report on the accounts of ***PEL Appliances*** to the members since 1996. Despite the unabated downward slide of ***PEL Appliances*** and ***PEL Daewoo, Pak Elektron*** continued to pump money into these companies. Besides, funds were also provided to other associated undertakings in violation of the provisions of Section 208 of the Ordinance, which, however, as of this date, stand recovered. In fact ***Pak Elektron*** has been acting as a financer providing funds to them to fulfill their working capital requirements. Placing of funds at the disposal of its associated companies has effected its ability to pay back its lenders in time and ***Pak Elektron*** had to resort to rescheduling of its credit facilities, to borrow for its own requirements. Provisions of abnormal credit to associated undertakings put undue strain on the liquidity position of the ***Pak Elektron***, which contributed towards its financial

woes. The directors owe fiduciary duties to the Company they serve and its shareholders. They must discharge their statutory obligations in good faith with fairness, morality and honesty. The decision to provide continuous assistance to ***PEL Appliances*** and ***PEL Daewoo*** was apparently motivated by the Directors' desire to bring the subsidiaries out of crisis as the future prospects of ***Pak Elektron*** would have been adversely effected due to their closure. However, in the process the directors have also failed to exercise reasonable care to see that mandatory provisions of law were being violated. Therefore, the directors have breached their fiduciary duties, which they owed to ***Pak Elektron*** and its shareholders.

24. Considering the conclusions drawn in the preceding paragraphs, I find that ***Pak Elektron*** has contravened the provisions of Section 208 of the Ordinance as under:

i) Advances provided by ***Pak Elektron*** to its associated companies were not in the nature of 'normal trade credit'

ii) ***Pak Elektron*** was required to disclose the names of associated undertakings from whom loans, advances and other amounts were outstanding at the year-ends

iii) Investments in the form of advances were made after the insertion of proviso in Section 208 of the Ordinance. These investments/advances were, therefore, made in contravention of the aforesaid provision of the Ordinance.

iv) ***Pak Elektron*** has not complied with all the requirements of Section 208 of the Ordinance while making investments in its associated undertakings i.e.

    a) Special Resolution was not passed before making investments.

b) Aggregate investment was in excess of 30 % of the paid up capital plus free reserves of the investing company.

c) Return on investments in the form of loans and advances were not less than its borrowing cost.

Order

25. For the foregoing reasons, an action under Sub-section (5) of Section 208 read with Section 476 of the Ordinance has to be taken. This action 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.

26. The Chief Executive and the directors have breached their fiduciary duty by not exercising due care while providing advances to associated concerns. The legal opinion obtained by the ***Pak Elektron*** discussed in the earlier part of this Order points towards the fact the that the Directors were aware of the provisions of Section 208 of the Ordinance and the consequences of their non-compliance. In addition, the fact that they continued with the practice of advancing funds to associated undertakings even after the issuance of the show cause notice clearly establishes that the Chief Executive and all the directors have knowingly and willfully avoided to comply with the mandatory provisions of the Ordinance knowing well that they were duty bound to do so.

27. The Directors and Chief Executive are held responsible for the violation of Section 208 read with Section 476 of the Ordinance and are liable for fine under Sub-section (5) there under. I have, however, noted that the Directors are sincerely making efforts to look for plausible ways and means for the recovery of outstanding debts and are also taking in account the fact that the interest of minority stake holder is at stake in both ***Pak Elektron*** and ***PEL Appliance*** both being public listed companies and a just and equitable solution to this issue would be necessary to protect the interest of investors of both the companies. I am inclined to take a lenient view while imposing a fine on the Chief Executive and directors of ***Pak Elektron*** in view of the fact that 30% threshold of paid up capital plus free reserves of the investing company has since been amended to allow the companies to make inter-corporate investments without any limit, ***Pak Elektron*** has charged mark-up on its advances to its subsidiaries / associated companies as required under Section 208, advances to associated companies other than ***PEL Appliances*** and ***PEL Daewoo*** have been recovered and that the advances recoverable from both ***PEL Appliances*** and ***PEL Daewoo*** include principle along with substantial amount of mark-up. Further, the last two to three years have witnessed a tremendous turnaround in the financial results of ***Pak Elektron*** which is partly attributed to the fact that the ***Pak Elektron*** has introduced certain new products particularly in the home appliances division. Moreover, the directors have no personal interest in ***PEL Appliances*** or ***PEL Daewoo*** except to the extent of the nominal qualification shareholding. The major stakeholder in them was ***Pak Elektron*** itself. The decisions for investments, although in violation of Section 208, was motivated to secure its equity investments in subsidiaries and to protect the brand name, PEL. Moreover, the merger cum recovery plan of outstanding debts from ***PEL Appliances,*** as demonstrated to me, ***prima facie*** could result in the additional benefits in terms of enhanced profitability for ***Pak Elektron***. Another aspect to this recovery plan is that ***PEL Appliance*** is a public limited listed company and

the Commission is duty bound to look at the interest of its shareholders as well. The proposed plan ***prima facie*** could be beneficial for both ***Pak Elektron*** and ***PEL Appliances***. However, I am not called upon for the purpose of this Order to take any decision on the proposed merger plan, which would be examined in accordance with the provisions of the Companies Ordinance, 1984.

28. In view of the above discussion, I, in exercise of the power conferred on me under Sub-section (5) of Section 208 of the Ordinance hereby impose a fine Rs 400,000 (Rupees four hundred thousand only) in aggregate, Rs 100,000/- (one hundred thousand only) on Mr. M. Naseem Saigol, the Chief Executive of ***Pak Elektron*** and the remaining Rs. 300,000 (three hundred thousand) on the following directors, Rs. 50,000 (Rupees fifty thousand) to be paid by each director:

S.No.	Name of Director
1	Ms. M. Azam Saigol
2	Mr. Haroon Ahmed Khan
3	Mr. Mohibullah Usmani
4	Mr. Homaeer Waheed
5	Mr. Shahid Sethi
6	Mr. Asif Jamil

29. The Directors including the Chief Executive are directed to deposit penalty aggregating to Rs. 400,000/- (rupees four hundred thousand only) in the designated bank account of the Commission and submit a receipted challan to this Commission within 30 days.

Recovery From PEL Appliances

30. The recovery plan by taking over assets of PEL Appliances in settlement of receivables of ***Pak Elektron*** through the merger of ***PEL Appliances*** and ***Pak Elektron*** will be examined by the Enforcement and Monitoring Division with regard to the

determination of the fair value of the assets proposed to be taken over by ***Pak Elektron*** in settlement of its debt. In this regard, the directors of ***Pak Elektron*** are hereby, directed to submit a certificate from the statutory auditors of ***Pak Elektron*** confirming the principal amount along with return thereon to be recovered from ***PEL Appliances*** as on the effective date of the proposed merger scheme. In case the directors do not succeed in obtaining all requisite approvals in respect to the proposed scheme within a period of six months from the date of this order i.e. by November 09, 2003, they shall be personally liable under Sub-Section (5) of Section 208 of the Ordinance. In that case, the following direction in terms of Section 473 of the Ordinance would be operative:

(a) Within one month from the date of expiry of the six month period provided to implement the proposed recovery plan that is November 09, 2003, a certificate from the statutory auditors of ***Pak Elektron*** confirming the principal amount along with return thereon to be recovered from ***PEL Appliances*** would be submitted to the Commission.

(b) The Directors of ***Pak Elektron*** shall submit a report providing a time frame within one month from the date of expiry of the six month period provided to implement the proposed recovery plan that is November 09, 2003 and modus operandi as to how they will recover the advances along-with mark up thereon at not less than borrowing cost of ***Pak Elektron***, which shall not go beyond November 09, 2005.

(c) Quarterly progress report on the implementation of the aforesaid direction shall be submitted to the Commission by 5th of next month of the close of every quarter along with a certificate of auditors for compliance, till the whole amount is recovered.

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

Recovery from PEL Daewoo

32. As regards to the recovery of outstanding debts from ***PEL Daewoo***, I in terms of Section 473 of the Ordinance direct that:

(a) Within one month from the date of this order the directors of ***Pak Elektron*** shall submit a certificate to the Commission, a certificate confirming the principal amount along with mark up thereon to be recovered by ***Pak Elektron***.

(b) The Directors ***Pak Elektron*** shall submit a report providing a time frame within one month from the date of this Order and modus operandi as to how they will recover the advances along-with mark up thereon at not

less than borrowing cost of ***Pak Elektron***, which shall not go beyond May 09, 2005.

(c) Quarterly progress report on the implementation of the aforesaid direction shall be submitted to the Commission by 5th of next month of the close of every quarter along-with a certificate of auditors for compliance, till the whole amount is recovered.

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

RASHID SADIQ
Executive Director (Enforcement and Monitoring)

Announced
May 09, 2003
ISLAMABAD