

Securities and Exchange Commission of Pakistan

Enforcement and Monitoring Division

7th Floor, NIC Building, Jinnah Avenue, Blue Area, Islamabad

Before Rashid Sadiq, Executive Director

In the matter of

M/S Indus Dyeing & Manufacturing Company Limited

Number and date of show cause notice	EMD/233/298/2002-4015 dated May 14, 2002
Date of hearing	June 26, 2002
Present	Mr. M. Yousuf Adil, FCA

Order

Through this order, I intend to dispose of the show cause proceedings initiated against the Chief Executive of M/S Indus Dyeing & Manufacturing Company Limited (hereinafter called the "Company") for not following the procedure laid down in Section 178 of the Companies Ordinance, 1984 (the "Ordinance") for election of directors of the Company in its Annual General Meeting held on March 27, 2002 (the "AGM").

2. The relevant facts of this case, briefly stated, are that National Investment Trust Limited (NIT) is a shareholder of the Company. Through a letter dated March 06, 2002, NIT forwarded the nomination of Mr. Hasan Mahmood, through National Bank of Pakistan, its trustee, along with Form 28 and a notice of his intention to offer himself for the election of directors of the Company to be held in the aforesaid AGM. NIT was aggrieved that at the time of election of

directors in AGM, the Company has elected the directors by 'show of hands' instead of following the mandatory procedure stipulated in Sub-section (5) of Section 178 of the Ordinance. NIT has brought the aforesaid irregularity in the election of directors to the notice of the Company as well as this Commission through its letter dated April 05, 2002. Another shareholder of the Company namely, Mr. Taymur Ali, who was also a candidate for the said election, raised similar objections to the procedure, followed by the Company for the election of directors.

3. The aforesaid matter was examined by the Commission and it was noticed that the Company has *prima facie* violated the mandatory provisions of Sub-section (5) of Section 178 of the Ordinance while conducting election of directors in the AGM. A notice dated May 14, 2002 was, therefore, served on the Chief Executive of the Company to show cause in writing as to why action may not be taken under Section 186 of the Ordinance for the aforesaid contravention.

4. The reply to the show cause notice was received on June 03, 2002 through the Company's letter dated May 30, 2002. Thereafter, in order to provide an opportunity of personal hearing, the case was fixed on June 10, 2002, which was adjourned to June 12, 2002. Upon the request of the Company the hearing was adjourned once again and refixed at Karachi on June 26, 2002. Mr. M. Yousuf Adil, FCA represented the Chief Executive of the Company in these proceedings.

5. In the written submissions as well as at the time of hearing of this case, the Company admitted that it did not follow the procedure stipulated in Sub-section (5) of Section 178 of the Ordinance. It was, however, stated that the management never intended to violate the provisions of Sub-section (5) of Section 178 of the Ordinance. It was also argued that there was no intention to jeopardize the rights of any member / candidate contesting election of directors. The following justifications were also placed before me for not following the mandatory procedure for the election of directors:-

- i) the number of directors to be elected was fixed at eight. Nominations, for the election of directors, under Sub-section (3) of Section 178 of the Ordinance were received from the following ten candidates: Mian Muhammad Ahmed, Mian Riaz Ahmed, Mr. Shahzad Ahmed, Mr. Naveed Ahmed, Mr. Imran Ahmed, Mr. Irfan Ahmed, Mr. Kashif Riaz, Mr. Shafqat Masood, Mr. Hasan Mahmood (representing NIT) and Mr. Taymur Ali.
- ii) 8.57 % voting shares were available to NIT whereas Mr. Taymur held 0.002 % of the total voting shares. Mr. Naveed Ahmed, Mr. Irfan Ahmed and Mr. Shafqat Masood, directors who held shares in their own names and proxies aggregating to 84.17% of the total share capital of the Company, represented the other eight candidates.
- iii) Considering the attendance and votes needed to get a candidate elected as a director, it was decided with the consent of the majority of the members present in the meeting to declare Mian Muhammad Ahmed, Mian Riaz Ahmed, Mr. Shahzad Ahmed, Mr. Naveed Ahmed, Mr. Imran Ahmed, Mr. Irfan Ahmed, Mr. Kashif Riaz, Mr. Shafqat Masood as directors of the Company for the next term of three years.

6. During the course of hearing, it was also averred by Mr. M. Yousaf Adil that even if the procedure under Sub-section (5) of Section 178 would have been adopted, the results of election

would not have been different and the same candidates would have been elected as directors. It was also stated that the management has offered NIT to nominate one director despite the fact that none has adopted the procedure for invalidation of directors under Section 179 of the Ordinance.

7. Before proceeding further in this matter, it is necessary for me to advert to the provisions of Sub-section (5) of Section 178 of the Ordinance, which contains the procedure to be followed by the Companies for election of their directors: -

“The directors of a company having a share capital *shall*, unless the number of persons who offer themselves to be elected is not more than the number of directors fixed under sub-section (1), be elected by the members of the company in general meeting in the following manner, namely:

- (a) a member shall have such number of votes as is equal to the product of the number of voting shares or securities held by him and the number of directors to be elected;
- (b) a member may give all his votes to a single candidate or divide them between more than one of the candidates in such manner as he may choose; and
- (c) the candidate who gets highest number of votes shall be declared elected as director and then the candidate who gets the next highest number of votes shall be so declared and so on until the total number of directors to be elected has been so elected.

8. The Articles of Association of the Company also contain similar provisions for procedure to be followed for election of directors of a company. It, therefore, follows that election of directors is not one of the matter to be decided by show of hands and poll must be taken for election of directors in the manner prescribed under Sub-section (5) of section 178 of the Ordinance. The above provisions of law are mandatory and the Companies are required to comply with the laid down procedure for election of their directors.

9. Reverting to the case in hand, the Company itself has admitted that the election was conducted by ‘show of hands’ and not in accordance with the aforesaid mandatory procedure. In this respect, the contention of the Company that the results would have been the same even if the procedure as stipulated under Sub-section (5) of Section 178 would had been followed appears to be erroneous. Even if the directors were of the view that the same candidates would have been elected; they were still required to hold election in accordance with the mandatory procedure. The holding of election by show of hands in effect prevented the shareholders from effectively using their right. This also amounts to exclusion of the other candidates from election of directors so that these may not be held. This fact is substantiated from the record that only eight directors other than Mr. Hasan Mahmood (nominee NIT) and Mr. Taymur Ali were declared elected. In this manner, the proceedings of the AGM pertaining to election of directors were irregular and not in accordance with the mandatory provisions of Sub-section (5) of Section 178 of the Ordinance. However, the powers to declare the proceedings invalid rest with the court in terms of Section 178 of the Ordinance. The Court may, on the application of members holding not less than twenty per cent of the voting power in the company, made within thirty days of the date of election, declare election of all directors or any one or more of them invalid if it is

satisfied that there has been material irregularity in the holding of the elections and the matters incidental or relating thereto. To my knowledge, none of the shareholders has approached to the Court under the aforesaid provisions of the Ordinance for declaring the aforesaid election invalid. Moreover, NIT, one of the major shareholder and contestant in the election of directors has nominated its representative on the Board of Directors of the Company and the Company has agreed with his nomination.

10. Although it has been sufficiently demonstrated that the results would have been similar even by the following of the laid down procedure, yet the companies cannot be allowed to escape the compliance with the mandatory provisions of the Ordinance. The Company has admitted the default, which attracts the penal provisions contained in Section 186 of the Ordinance. The default is considered intentional because of the simple reason that the Company has not followed the provisions of law although the other candidates had asked for the compliance of the laid down procedure for the election of directors. This was a major procedural lapse on the part of the Chief Executive who is held responsible for ensuring that election of directors are conducted in accordance with the provisions of the Ordinance.

11. For the forgoing, I impose a fine of Rs. 10,000/- (Rupees ten thousand) on the Chief Executive of the Company under Section 186 of the Ordinance for violating the provisions of sub-section (5) of section 178 of the Ordinance. The fine shall be deposited within thirty days of the date of this Order. No further action is warranted in this matter under Section 186 of the Ordinance. The Chief Executive is advised to ensure strict observance of the mandatory provisions of the Ordinance in future.

Rashid Sadiq
Executive Director (Enforcement & Monitoring)

Announced
June 27, 2002
ISLAMABAD