



Securities and Exchange Commission of Pakistan  
*Enforcement and Monitoring Division*

7<sup>th</sup> Floor, NIC Building, Jinnah Avenue, Islamabad

*Before Rashid Sadiq, Executive Director*

*In the Matter of*  
**M/S REGAL CERAMICS LIMITED**

|                           |  |
|---------------------------|--|
| Number and date of notice | CO/265/260/ISS/CL/98<br>dated January 04, 1999 |
| Date of hearing           | September 09, 2002                             |
| Present                   | Mr. Aziz-ud-din Hasanali<br>Director           |

**ORDER UNDER SECTION 265 OF  
THE COMPANIES ORDINANCE, 1984**

This order shall dispose of the proceedings initiated against M/S Regal Ceramics Limited (the “Company”) under the provisions of Section 265 of the Companies Ordinance, 1984 (the “Ordinance”) vide show cause notice dated January 04, 1999.

2. In order to dispose of the aforesaid matter, a brief narration of the background facts leading up to the issue of show cause notice is necessary. The Company was incorporated in 1974 under the Companies Act, 1913 (now Ordinance) as a public company limited by shares and was listed on the Karachi Stock Exchange in 1988. The Company was set up to manufacture and sell tableware and ceramics products. The manufacturing facility of the Company is



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located on Grand Trunk Road, Gujranwala with a production capacity of manufacturing 14 tons of porcelain tableware per day.

3. The financial statements of the Company for the year ended June 30, 1998 received at the Commission in terms of Sub-section (5) of Section 233 of the Ordinance were examined and it was found that the Company had reported a loss of Rs. 6.398 million for the year. Moreover, as on June 30, 1998, its accumulated losses amounted to Rs. 68.563 million against equity comprising only of paid up capital of Rs. 73.00 million. Equity of the Company had, thus, been reduced to a mere Rs. 4.437 million. Long-term bank loans amounted to Rs. 101.011 million and the existence of overdue loan installments amounting to Rs. 5.036 million and accrued interest amounting to Rs. 6.40 million indicated that the Company was unable to service its debts. The weak liquidity position was more evident by the fact that its current liabilities were more than twice of its current assets. The shareholders were suffering a dual loss, firstly they had not received any return on their investment as the Company had been unable to pay any dividend to its shareholders since 1992 and secondly the market value of their investment had also diminished as Rs. 10 share of the Company was being quoted at Rs. 7.50 per share.

4. The aforesaid state of affairs of the Company gave rise to the apprehensions as to whether affairs of the Company were being conducted in accordance with prudent management policies and accepted commercial practices. This also suggested that the members were being deprived of a reasonable return on their investment. Moreover, the liquidity position of the Company appeared to be such as to endanger its solvency.

5. Consequently, a notice dated January 04, 1999 was served on the Company and its Chief Executive calling upon them to show cause in writing as to why an



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inspector under Clause (b) of Section 265 of the Ordinance may not be appointed to investigate into the affairs of the Company.

6. The Company in its reply dated February 01, 1999 explained various reasons due to which it had been incurring losses. Furthermore, it also submitted a revival plan by way of improved marketing strategy and restructuring of bank liabilities. The said plan according to the Company had been partially implemented and was already showing positive result in the form of reduction in loss for the year ended June 30, 1999. Subsequently, the Company was provided with several opportunities of personal hearing. In the hearing held on March 11, 1999, Mr. Mohammad Tufail, General Manager of the Company and Mr. Ibne-e-Hasan FCA, of M/S S.M. Masood & Co., Chartered Accountants, appeared on behalf of the Company. They explained the problems faced by the Company and the efforts underway for its revival. They requested that the proceedings be deferred so that the Company can amply demonstrate the results of its revival plan through the financial results for the year ended June 30, 1999. The request of Company was considered and the same was acceded to. Hence, the proceedings under Sub-clause (b) of Section 265 of the Ordinance were deferred till August 1999.

7. Thereafter, a notice was issued fixing the hearing for September 06, 1999, and advising the Company to submit the draft accounts for the year ended June 30, 1999. The Company vide its letter dated September 01, 1999 requested for adjournment of the hearing and also conveyed its inability to provide the requisite accounts. The hearing was, however, adjourned on the request of the Company. Subsequently in order to provide ample opportunity to the Company, the case was heard a number of times, the final date being December 15, 1999, wherein the representative of the Company submitted that the Company's operations for the year 2000 have been profitable and that the management intended to pay dividend to the minority shareholders during the said year. Thereafter, the Company



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declared a dividend @ 5% based on the un-audited interim financial results for the half year ended December 31, 1999. Keeping in view the fact that the Company was implementing a revival plan as a result of which the financial position of the Company was showing some signs of improvement and the fact that the Company had also declared dividend, the proceedings initiated under Clause (b) Section 265 of the Ordinance were deferred with specific instruction that the performance of the Company be kept under watch. The decision of the Commission was conveyed to the Company vide its letter dated July 13, 2000.

8. Contrary to the contentions and submission made in writing and at the time of successive hearings, the Company reported a loss of Rs. 3.75 million for the year ended June 30, 2000. The Company had in fact declared interim dividend for the year ended June 30, 2000 based on the half yearly accounts for the period ended December 31, 1999 assuring the Commission that the operations of the said year were profitable.

9. The Directors Report appended to the aforesaid accounts under Section 236 of the Ordinance stated that:

*Quote*

*“The state of the Company finances is become critical to the extent that debt servicing is totally stopped. PICIC and Muslim Commercial Bank Limited have issued legal notices asking repayment of their overdues and to return total loan amounts. The loss for this year has been Rs. 3,232,014 as against a loss of Rs. 9,994,712 of the last year. Accumulated loss stands at Rs. 83,965,895. The minus equity persists and has attracted the prudential regulations of SBP. It has not been possible to utilize the production capacity of the Company beyond 40%.”*

*Unquote*



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10. It was further observed from the perusal of the Director's Report that the major part of the factory was closed down in June 2000:

*Quote*

*“Due to abrupt decline in the sales during April, May 2000, it was not feasible to keep the concern running and sustain huge losses. I therefore carried out a gradual “lay off” of the workforce and curtailed the production to avoid accumulation of recurring expenses. The major part of the factory was thus closed down as of June 05, 2000.”*

*Unquote*

11. The situation became all the more alarming when the company failed to hold its annual general meeting for the year ended June 30, 2001 and also failed to prepare and circulate the annual accounts for the said year in breach of the mandatory requirements of the Ordinance. In fact no further information was disseminated to the shareholders after the presentation of un-audited half yearly accounts for the period ended December 31, 2000. The Chief Executive and Directors of the Company failed to respond to the show cause notices issued under Section 158, 245 and 233 for non-holding of annual general meeting and non preparation and circulation of annual, half yearly and quarterly accounts, despite repeated reminders issued by the Commission, so much so that the Commission was forced to decide the cases on their merits.

12. It was against this backdrop that the Commission decided to reinstate the deferred proceedings under Section 265 of the Ordinance. For this purpose, a hearing notice dated September 04, 2002 was issued to the Company and its Chief Executive calling upon them to appear in person or through their authorized representatives before the Commission on September 09, 2002 and to explain as to why an inspector, under Clause (b) of Section 265 of the Ordinance should not be appointed to investigate into the affairs of the Company.



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13. On the date of the hearing, Mr. Aziz-ud-din Hasanali, director and authorized attorney of the Company appeared before me and explained the position of the Company. He also filed a written reply at the time of the hearing. He stated that as no resolution had been passed by the Company nor has there any court order for appointment of inspector, even otherwise there is nothing, which warrants invoking of the provisions of Section 265 of the Ordinance. As regards the financial position of Company and the management of its affairs, he made the following submissions:

- (i) The operations of the Company have been closed for the last two years and all the employees have been laid off.
- (ii) The annual general meeting of the Company for the year ended June 30, 2001 could not held due lack of quorum as there was a dispute between the directors of the Company.
- (iii) He further stated that the lenders M/s Pakistan Industrial Credit and Investment Corporation and M/s Muslim Commercial Bank Limited have filed recovery suits amounting to Rs. 148.48 Million and Rs. 41.58 Million respectively. Court has awarded a decree to PICIC to auction of the land, building and machinery of the Company and the Company has filed an appeal against the said decree.

14. Before discussing the contentions made by the authorized representative of the Company, I deem it necessary to look at the performance of the Company, which has deteriorated considerably over the last few years. The financial information given in the prospectus of the Company issued at the time of public subscription of the shares of the Company in 1988 on the basis of which the public was induced to invest in the shares of the Company disclosed that it had earned



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profit in each of the last five years. The unappropriated profits stood at Rs. 4.45 Million against a paid up capital of Rs. 9.00 Million, which indicated a sound financial position of the Company. However, from the year ended June 30, 1994, the Company started incurring losses and the latest available annual accounts for the year ended June 30, 2000 depicts an adverse financial position of the Company. Due to the fact that the Company had been incurring losses for the past seven years the accumulated losses stood at Rs. 83.97 Million exceeding the paid up capital by Rs. 10.97 Million as on June 30, 2000. The Company had defaulted on repayments of loans from the financial institutions and its current liabilities exceeded its current assets. The Directors in their report to the shareholders had admitted that the Company was in dire straits and the operations were closed down w.e.f. June 05, 2000.

15. Now reverting to the contentions made by the authorized representative of the Company wherein he had stated that in absence of a resolution or court order the Commission had no grounds to authorize an investigation into the affairs of the Company, it would be beneficial to discuss the scope of the jurisdiction of the Commission to initiate investigations. Section 263 to 282 of the Ordinance are grouped under the head 'Investigation and Related Matters.' Section 263 gives powers to the Commission to appoint inspectors on the application of requisite number of members or the Registrar. Section 264 prescribes the manner of making application under Section 263.. The members can approach the Commission to appoint inspectors and the Commission after being satisfied that all the requirements of law are fulfilled can initiate investigations. The Commission is bound to appoint inspectors under Clause (a) of Sub-section (1) of Section 265 when a special resolution is passed by a company for investigation of its affairs or when the Court directs the Commission to appoint inspectors to investigate the affairs of a company. Under Section 265, the Commission can also initiate *suo moto* investigations to investigate into the affairs of the companies There are, thus, three different ways by which a shareholder can get the affairs of a company



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investigated. If requisite number of members is available, then application can be made under Section 263 of the Ordinance. If the evidence of mal practices and mis-management are available but the requisite number of members could not be managed for filing application under Section 263, the shareholders can bring the evidence before the Commission and depending on the merit of the evidence provided, the Commission can initiate *suo moto* investigation under Clause (b) of Sub-Section (1) of Section 265 of the Ordinance. Thirdly, the inspectors could also be appointed through the Court or on passing of special resolution by the members of a company. The aforesaid makes it abundantly clear that the Commission has the discretion to appoint inspectors exercising *suo moto* powers under Clause (b) of Section 265 of the Ordinance. In view of the aforesaid discussion, the arguments of the authorized representative of the Company regarding the prerequisite of a court order or resolution for appointment of inspector under Section 265 is repelled for the simple reason that these proceedings have been initiated by the Commission in exercise of *suo moto* powers available to it under the Ordinance.

16. Regarding the closure of the manufacturing facility of the Company for the last two years it has been noticed that apart from the disclosures in the Director's Report to the shareholders and Chief Executive's report appended to the audited accounts for the year ended June 30, 2000 and the un-audited accounts for the half yearly accounts as on December 31, 2000 respectively, provided the following reasons for the cessation of production:

- General recession and decrease in demand of their products
- Adverse liquidity position and lack of working capital
- Lack of interest of the Sponsoring Directors in the affairs of the Company

Thereafter, no further information has been provided to the shareholders of the Company as to whether any efforts were underway for the revival of the





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Company. They have now defaulted the statutory requirements of the Ordinance. The cessation of production does not in any way relieve the Company, its Chief Executive and its Directors from the statutory obligations of providing the information to the members with respect to the affairs of the Company. The lack of the interest of the directors in the affairs of the Company is cause of great concern. This indicates that they are involved in personal disputes and have failed to protect the interest of the Company and its shareholders.

17. Regarding the conduct of the affairs of the Company, the written reply and submission made at the hearing depict a situation which is a cause of grave concern. The relevant extracts of the written reply are reproduced hereunder:

*Quote*

*“..... No meeting took place for want of Quorum as the Directors are not cooperating.”*

*Unquote*

*Quote*

*“..... And there is no meeting of the directors being called for the company in disarray and there is great deal of confusion and conflict among the directors.”*

*Unquote*

It appears that directors are involved in their personal disputes and are not interested in running the Company. The Company, therefore, is not being run as body corporate and it is not being managed in accordance with sound business principles or prudent commercial practices.

18. The aforesaid circumstances also demonstrate that the management of the Company did not pay any heed to the concerns raised by the Commission and that



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the submissions made earlier regarding the implementation of a revival plan were unfounded. The Directors' Report attached to the annual accounts for the year 2000 under Section 236 of the Ordinance failed to provide sufficient reasons for incurring loss with specific reference to failure of the alleged revival plans for the appreciation of the shareholders. They also failed to come up with any concrete plans to arrest declining performance and to bring back the Company on the revival path.

19. Non-preparation of the accounts of the Company and non-presentation of the same to the shareholders of the Company have in effect deprived the shareholders from statutory right to receive balance sheet and profit and loss accounts reflecting a true and fair state of the Company's affairs. This also denies the shareholders of the Company of their only independent impartial insight into its affairs and that too in a situation where the Company has been incurring losses. The right of information has been given special status in the law by providing that the refusal of information would be an act, which could activate the machinery of investigation.

20. Minority shareholders are the medium, which could genuinely contribute towards economic growth through their savings if those are channelized for productive purposes giving them any reasonable returns and assuring the safety of their investments. The minority shareholders to whom the directors owe fiduciary obligations are without any reasonable return for the last several years. Viewed with the dismal state of affairs of the Company and the fact that no concrete revival plans are being provided by the Company, which would ensure any future dividend prospects it would not be incorrect to infer that the affairs of the Company have been so conducted or managed as to deprive the members thereof of a reasonable return.



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21. The irregularities pointed out in the preceding paragraphs, the continuous losses, contraventions of the mandatory provisions of law, dispute among directors, their unresponsive attitude towards the Commission and lack of interest in running the affairs of the Company reasonably suggest that the affairs of the Company are not being managed in accordance with the sound business principles and prudent commercial practices.

22. The recovery suits filed by the lenders in the Court of law indicates that the lenders have lost confidence in the management of the Company. The equity of the Company has turned negative due to accumulated losses and its current liabilities exceeded its current assets. Viewed with the fact that the operations have been suspended for the last two years, the Company seems to be in dire financial straits and on the brink of collapse. This, therefore, clearly suggests that the financial position of the Company is such as to endanger its solvency.

23. The above stated facts and figures clearly establish that the performance of the Company has been far from satisfactory; it is in danger of being declared insolvent. Moreover, the aforesaid irregularities also bring home the fact about management's non-serious attitude towards the Company. They are not paying any heed to the issues raised by the Commission to protect the interest of minority shareholders of the Company. They have, thus, failed to act in the interest of the Company and its shareholders. In the circumstances, the true financial position can only be ascertained by a detailed examination of the books of account of the Company.

24. The violations regarding non-holding of Annual General Meetings, non-presentation of accounts in Annual General Meetings, failure to hold election of directors and appointment of auditors and Chief Executive in violation of the provisions of the Ordinance are of serious nature. The shareholders and other stakeholders of the Company are not aware of the true position of the state of its



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affairs for about two years. It would be in the interest of all the stakeholders that a fact-finding exercise is conducted through an independent inspector so that correct legal and financial position of the Company and extent of violations committed by the Company and its directors and Chief Executive are ascertained. I also take support from a recent decision of the Learned Appellate Bench of the Commission given in the case of Barex Limited Vs. Executive Director (Company Law Division), which I would like to quote hereunder:

*Quote*

“ 10. If a company does not hold the Annual General Meetings within the prescribed time without any special reasons, it can be inferred that the Company is not taking interest to protect the interest of its shareholders-----  
-----.”

*Unquote*

On the basis of the above, the Learned Appellate Bench of the Commission upheld the decision of the Executive Director (Company Law Division) to appoint an inspector in the interest of justice to ascertain the extent of violations committed by the appellants and in consequence the prejudice caused to the minority shareholders of the company.

25. What emerges from the above discussion is that the Company has committed serious irregularities and that the directors have not fulfilled their fiduciary responsibility towards its shareholders. Non-holding of AGM and non-circulation of accounts amounts to deprivation of information that should reasonably be provided to them. In this case, the interest of the minority shareholders was seriously jeopardized by not giving them any information about the affairs of the Company for a long period of time. In the circumstances, it is the responsibility of the Commission to ascertain factual position through competent inspector(s) whose report can bring to light as to whether the affairs of the



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Company were managed in conformity with the accepted principles and standards of good and efficient management. If the inspector holds that the directors were not responsible for the current state of affairs of the Company, the report will be helpful to them rather than detrimental to their interests. The Commission can protect the interest of the investors only through timely initiating of a fact-finding exercise.

26. Securities and Exchange Commission of Pakistan has been established under the Securities and Exchange Commission of Pakistan Act, 1997 for the beneficial regulation of the capital markets, superintendence and control of the corporate entities and for matters connected therewith and incidental thereto. It is one of its functions to conduct *suo moto* investigations into affairs of the companies, through competent inspectors(s) if in its opinion there are circumstances suggesting one or more of the matters given in Sub-clauses (i) to (vii) of Clause (b) of Section 265 of the Ordinance. The Commission is further empowered to prosecute a company or persons found guilty as a consequence of such investigations. It would also be pertinent to discuss here the spirit of Section 265 of the Ordinance. It is not possible for the minority shareholders to act jointly to protect their interest. Moreover, they are not able to collect evidence where management is acting prejudicial to their interest to bring the same before the appropriate forums for appropriate action. It was because of this difficulty that the legislators have enacted Section 265 of the Ordinance to prevent the managements of companies from acting in a manner prejudicial to the interest of the minority shareholders. The object of this Section, thus, is to safeguard the interest of the shareholders, creditors and those dealing with the company to provide for investigation into its affairs where the affairs of the company are conducted to jeopardize those interests.

27. In view of aforesaid discussion, I am convinced that the circumstances falls under Sub-clauses (iii), (iv) and (vi) of Clause (b) of Section 265 of the Ordinance



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and that substantial and worthwhile basis exist to form an opinion warranting investigation into affairs of the Company. These circumstances reasonably suggest that:

*Sub-clause (iii) of Clause (b) of Section 265*

The affairs of the Company have been conducted or managed as to deprive the members thereof of a reasonable return.

*Sub-clause (iv) of Clause (b) of Section 265*

The members of the Company have not been given all the information with respect to its affairs, which they might reasonably expect.

*Sub-clause (vi) of Clause (b) of Section 265*

The affairs of the Company are not being managed in accordance with sound principles and prudent commercial practices.

28. I, therefore, in exercise of the powers conferred on me under Clause (b) of Section 265 of the Ordinance, hereby appoint Mr. Mujahid Eshai, Chartered Accountant, 6-A, Block H, Gulberg Heights, Ancillary Building, Gulberg II, Lahore, to act as Inspector to investigate into the affairs of M/S Regal Ceramics Limited on a remuneration of Rs. 250,000/- to be paid by the Company.

29. Without limiting the scope of investigation, the inspector shall conduct investigation on all aspects of the operations of the Company and shall, after scrutiny of all the records and books of account, furnish a report, *inter alia*, on the following matters:



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- a) Reasons of heavy losses sustained after public offering. Whether these losses were due to mismanagement imprudent policies or some other reasons.
- b) Utilization of funds raised through public offer.
- c) Whether or not the Company has kept proper records as required by Section 230 of the Ordinance.
- d) Compliance with the provisions of Section 234 relating to disclosure of information.
- e) Diversion of funds to unauthorized objects.
- f) Sales / revenues of the Company with particular reference to prices of the comparable units.
- g) Transactions with associated undertakings, if any and whether they were at arm's length.
- h) Investigation of cash transaction made by the Company with particular reference to unusually huge amounts being transacted and/or items incurring repeatedly without proper documentation.
- i) Investigation of Expenditures incurred by the Company with particular reference to the following:
  - Expenditures versus sales /revenues/production
  - Energy consumption versus capacity utilization



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- Expenses of the Company versus expenses of the comparable companies
  - Expenditure analysis in terms of:
    1. Organization
    2. Personal
    3. Production
    4. Selling overheads
    5. Financial charges
- j) Whether or not adequate system of internal controls has existed as to prevent misappropriation and misapplication of Company's assets and resources.
- k) Reasons for the failure of the Company in context to:
- Over capitalization
  - Bad management practices
  - Leakage of sales
  - Over spending in expenditures
  - Assessment of capital expenditures of the company in respect of Company's requirements.
  - Excessive borrowings
- l) Determination of any false and incorrect statement in directors' report.
- m) Compliance with statutory requirements of the ordinance.
- n) To report any lapses or other delinquency detected during the course of investigation.





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- o) In-efficiencies in production.
- p) In-out record of the Company particularly relating to sales and purchases.
- q) Statutory books including particularly minutes books of the Board and general body meetings.
- r) To suggest future course of action in the interest of the shareholders of the Company.
- s) Results of circularization to lenders, legal advisors, trade debts, advances, receivables and bank balances as at June 30, 2002.

30. The inspector shall submit his report in triplicate along with supporting documents to the Commission within sixty days from the date of this order. The Commission expects that the report shall be made specifically on each terms of reference along with the names of persons responsible for any irregularities and mismanagement in the affairs of the Company.

31. The inspector, for the purpose of his investigation, shall have the same powers as are vested in a Court under the Code of Civil procedure, 1908 while trying a suit in respect of the matters enumerated under Section 266 of the Ordinance and every proceeding before the inspector shall be deemed to be judicial proceeding within the meaning of Section 193 and 228 of the Pakistan Penal Code, 1860. Any contravention or non-compliance with any orders, direction or requirement of the inspectors shall entail the consequences under the Code of Civil Procedure, 1908 and Pakistan Penal Code, 1860.

32. It shall be the duty of all the officers, employees and agents and other persons having dealing with the Company to provide all assistance to the inspector



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in connection with the investigation, and any default whereof shall be punishable under Section 268 of the Ordinance.

*Announced*  
*October 31, 2002*  
*ISLAMABAD*

***RASHID SADIQ***  
Executive Director (Enforcement & Monitoring)