



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
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***Before Tahir Mahmood
Executive Director (Enforcement)***

In the matter of

Al-Abid Silk Mills Limited

Number and date of show cause notice	EMD/233/299/2002-3984-92 dated May 15, 2008
Date of hearing	July 15, 2008
Present:	Mr. Raheel Butt, Associate of Mohsin Tayebaly & Company, Karachi

ORDER

Under Section 196 and Section 208 read with Section 473 and Section 476 of the Companies Ordinance, 1984

This order will dispose of the proceedings pertaining to contravention of the provisions of Section 196 and 208 of the Companies Ordinance, 1984 (hereinafter referred to as “the Ordinance”) which has arisen out of the show cause notice No.EMD/233/299/2002-3984-92 dated May 15, 2008 served on all the directors including the Chief Executive of Al-Abid Silk Mills Limited (hereinafter referred to as the “Company”).

2. The Company is a public company limited by shares incorporated in the year 1968 as a private limited company and was converted into a public limited company on December 24, 1987 under the Companies Ordinance, 1984. The Company is listed on Karachi and Lahore Stock Exchange. The principal activity of the Company is manufacturing and processing of various kinds of fabrics and export of printed and dyed cloth, bed sets and other textile made ups. The Company has authorized capital of Rs. 200 million divided into 20 million shares of Rs. 10 each and paid up capital of Rs. 95.783 million divided into 9.578 million shares of Rs. 10 each as reflected in its annual audited accounts for the year ended June 30, 2007.

3. The facts leading to this case are that the Enforcement Department (hereinafter referred to as “the Department”) of the Securities and Exchange Commission of Pakistan (hereinafter referred to as “the



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Commission”) while examining the annual audited accounts of the Company for the year ended June 30, 2007 (the “accounts”) sought explanation of note 34 of the accounts, reflecting following transactions:

Transactions with related parties:		
Associated Company (Al-Abid Exports Private Limited)		
	2007 (Rupees)	2006 (Rupees)
Sales	Nil	134,869,770
Confection and packaging availed	83,772,497	63,993,558

The Company was required to provide the detail of such contracts made with the associated Al-Abid Exports Private Limited (hereinafter referred as “AAEPT”). The Company provided the profile of AAEPT and the copy of the agreement dated December 08, 2003 made with AAEPT. AAEPT was incorporated in 1968 and is engaged in export of textile made ups.

4. The agreement between the Company and the AAEPT revealed following main relevant covenants:

Quote:

“WHEREAS Al-Abid Silk has stitching and quilting machines and requires additional space and human resources for stitching and quilting;

AND WHEREAS, at the request of Al-Abid Silk, Al-Abid Exports has agreed to use the machines of Al-Abid Silk at its premises and stitch certain products for Al-Abid Silk as per the terms and conditions of this agreement;

AND WHEREAS, the raw material will be provided by Al-Abid Silk, Al-Abid Exports will arrange necessary management, technical know how and labor to manage the production and will also be responsible for quality control of products. The day to day maintenance of the machines will be provided by Al-Abid Exports. Any major repair or replacement of the machines will be carried out by Al-Abid Silk at its own cost and expense.

AND WHEREAS, Al-Abid Exports will raise invoices on lot-wise/job-wise basis for charges for the products stitched by Al-Abid Exports. The charges for stitching of the products will be mutually decided by the parties from time to time, it is agreed that the prices charged will be in line with stitching charges for like products in the market. “

Unquote

5. The Company in its reply submitted that machinery having following value was transferred to AAEPT:



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(Amount in Rupees)

Particulars	Book Value as on June 30, 2006	Transferred during the year	Total	Depreciation for the Year	Book Value as on June 30, 2007
Total 456 machines of various types	9,380,552	2,492,000	11,872,552	1,040,722	10,831,830

Further, the Company provided the following details of quarter wise expenses incurred by AAEP on behalf of the Company, which were reimbursed by the Company to the AAEP, are noted as below:

Particulars	Amount in Rupees
July-Sep 2005	Nil
Oct-Dec 2005	Nil
Jan-Mar 2006	Nil
Apr-Jun 2006	1,558,286
Jul-Sep 2006	Nil
Oct-Dec 2006	3,225,787
Jan-Mar 2007	792,840
Apr-Jun 2007	1,688,173
Total	7,265,086

On a query of the Commission regarding submission of minutes of board of directors in which resolution was passed to enter into the agreement with the AAEP to allow AAEP to use the machinery of the Company. The Company submitted that the transfer of stitching machines from the premises of the Company to the premises of AAEP was not an acquisition or sale of those machines in any manner, or the Company had agreed to sell the same, therefore approval of the board was not applicable. The Company further submitted that the machines of the Company situated at AAEP proved to be beneficial to the Company in terms of time and quality. The machines situated at the premises of AAEP were dedicated machines placed specifically for the Company which solely produced for and to meet the orders of the Company. AAEP was not in the capacity to use the machines for its other customers. Therefore, the Company enjoys better rates and services.

6. The department after analyzing the transaction and legal position in the matter issued a show cause notice number EMD/233/299/2002-3984-92 dated May 15, 2008 under Section 196 and Section



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208 read with Section 473 and Section 476 of the Ordinance to all the directors including the Chief Executive of the Company to explain their position within 14 days of the date of the notice.

7. The show cause notice was issued to all the directors of the Company, namely:

- i) Mr. Naseem A. Sattar, Chairman and Chief Executive
- ii) Mr. Azim Ahmed, Director
- iii) Mr. Zarina Naseem, Director
- iv) Mst. Adia Naseem, Director
- v) Mrs. Sadaf Nadeem, Director
- vi) Mrs. Reena Azim, Director
- vii) Mrs. Asra Amir, Director
- viii) Mr. Muhammad Shafi, Nominee NIT
- ix) Mr. Syed Raza Abbas Jaffari, Nominee NIT

8. M/s Mohsin Tayebaly & Company (hereinafter referred as “the Counsel”) submitted the reply of show cause notice on behalf of the directors of the Company through letter dated May 27, 2008. The Counsel submitted as follows:

- (i) The title of machines in question had not been transferred to AAEP and Section 196(2)(g) of the Ordinance was not applicable in the current situation and that shifting of the machines in question did not amount to investment by the Company in AAEP under Section 208 of the Ordinance was not applicable.
- (ii) With regard to the point that during the year 2007 AAEP made 99.98% of its sales to the Company and 28.76% of the total sales on the Company in the year 2006, the Counsel explained by reproducing as below:

Al-Abid Exports Private Limited: Note 13 to the Accounts		
	2007 (Rupees)	2006 (Rupees)
Sales Exports	Nil	158,669,872
Confection and packaging availed	83,772,497	64,066,296
Local sales-sales scrap	20,250	Nil
Total	83,792,747	222,736,168



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The “Local Sales-confection and packaging” row in the accounts represents the entire local sales made by AAEPT in the year 2006 and 2007. In the year 2006 AAEPT had rendered “confection and packaging service” amounting to Rs. 63,993,558 to the Company which is 99.88% of total confection charges. The difference of Rs. 72,738 services rendered to others for quilting charges with their own quilting machines by AAEPT. For the year 2007, AAEPT had rendered services for Rs. 83,772,497 for the Company which was 100% of their confection and packaging services. The “Sales-Exports” row in the accounts made by AAEPT in 2006 reflected sale/export of ready made items bought by AAEPT locally. Regarding “Local Sales”, the same which in fact were sales of scrap material by AAEPT in no way represents sales of items prepared on Company’s machinery.

(iii) Article 62(a) of the Articles of Association of the Company is reproduced as below:

“Management of business of the Company shall be vested in the directors who may exercise all such powers and do all such things (including dealing with the assets of the Company) as the Company is by its Memorandum of Association or otherwise authorized to exercise and do, and are not hereby or by any statute directed or required to be exercised or done by the Company subject nevertheless to provisions of the Ordinance, Memorandum of Association and these Articles and to any regulation not being inconsistent with the Memorandum of Association and these Articles, but no regulation made by the Company shall invalidate any prior act of the directors which would have been valid if such regulation had not been made.”

Therefore, the authority of the directors of the Company to allow AAEPT to use the machines of the Company was derived by the above excerpt from the Articles of Association of the Company, where such power was already in place under the Articles so no further action by the board of directors was required to be taken by way of passing a resolution in their board meeting. Therefore, board of directors’ resolution was not required to authorize the use of the Company’s machinery by AAEPT where the Articles expressly and clearly authorize the same. Regarding the issue pertaining to the Section 196(2)(g) of the Ordinance, it is clarified that the Commission has wrongly stated in their letter that the same is a requirement. Section 196(2)(g) of the Ordinance is power granted to the directors and does not oblige the directors.



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(iv) There have been no investments, loans or advances made by the Company in AAEPT and the expression 'investment' includes loans, advances, equity by whatever name called, or any amount, which is not in the nature of normal trade credit and shifting of the Company's machinery does not amount to investment in any interpretation of the term. The Counsel also reproduced certain covenants of the agreement dated December 08, 2003 in support of his claim.

9. In order to provide an opportunity of personal representation, a hearing in the matter was fixed on June 27, 2008. The Counsel requested to adjourn the hearing and requested to conduct hearing at Karachi. Therefore, finally the hearing was fixed for July 15, 2008 at Karachi. The hearing was attended by Mr. Raheel Butt, associate of the Counsel and presented 'wakalatnama' on behalf of all the nine directors of the Company. The Counsel presented his arguments, a brief of which is given below:

- i) The Company has transferred the possession of the machinery and not title to the AAEPT;
- ii) The machines have been physically transferred;
- iii) The machines often changes hand and are taken back;
- iv) The Company did not have state of the art stitching unit;
- v) AAEPT had established such a state of the art stitching unit;
- vi) To save rent and cost of premises around Rs. 40 million per annum, an arrangement has been made with AAEPT;
- vii) The AAEPT unit is customer verified and an ISO approved unit;
- viii) Proper security arrangement has been made at AAEPT to control any leakage of the stitched clothes;
- ix) AAEPT charges market rates to the Company for all the services provided by it;
- x) It is beneficial for the Company to maintain such an agreement; and
- xi) In true spirit there is no sale & purchase undertaken between the Company and the AAEPT.

The Counsel also presented a 'Rental Valuation Report of Property' owned by the AAEPT, dated June 27, 2008 reflecting total rental entitlement of Rs. 2,975,808 per month at the rate of Rs. 22.00 per square foot.



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10. I have gone through the facts of the case, record of the Company, relevant provisions of the Ordinance, arguments by the directors and their counsels in the hearings and written submissions given in response to the show cause notice. I feel it appropriate to quote here the relevant provisions of the Ordinance. Sub-Section (2) of Section 196 of the Ordinance clearly states:

(2) *The directors of a company shall exercise the following powers on behalf of the company, and shall do so by means of a resolution passed at their meeting namely:-*

- (g) *To authorize a director or the firm of which he is a partner or any partner of such firm or a private company of which he is a member or director to enter into any contract with the company for making sale, purchase, or supply of goods or rendering services with the company*

Section 6 of the Ordinance states:

Save as otherwise expressly provided herein,-

- (a) *the provisions of this Ordinance which come into force by virtue of a notification under sub-section (3) of section 1 shall have effect notwithstanding anything contained in the memorandum or articles of a company, or in any contract or agreement executed by it, or in any resolution passed by the company in general meeting or by its directors whether the same be registered, executed or passed, as the case may be, before or after coming into force of the said provisions; and*
- (b) *any provision contained in the memorandum, articles, agreement or resolution aforesaid shall, to the extent to which it is repugnant to the aforesaid provisions of this Ordinance, become or be void, as the case may be.*

The board of directors did not pass any resolution allowing the Company to enter into agreement of sale, purchase or acquiring services from AAEPT, a private company having common directors namely Mr. Naseem A. Sattar and Mr. Azim Ahmad at the time of making such agreement. The machinery of the Company, having book value of Rs. 10.832 million as of June 30, 2007, was shifted at the premises of AAEPT, as a result of an agreement dated December 08, 2003, without charging any rentals from AAEPT. Depreciation of Rs. 1.041 million was charged in the books of the Company for the period ended June 30, 2007 and as per the agreement major maintenance expenses were booked in the books of the Company. The Company availed services from AAEPT, at market rates, even the machinery was provided by the Company to the AAEPT. Therefore, it can be safely concluded that it was mandatory for the board of directors of the Company to pass a board resolution, in accordance with Section 196 of the



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Ordinance, while entering into agreement with AAEP, a private company, having common directors with the Company for rendering services with the company, and the board of directors of the Company failed to do so. Though articles of association define the nexus of powers of the directors of the Company, but it is mandatory to comply with the provisions of this Ordinance, and passing of board resolution is mandatory in the instant matters as defined in Section 196 of the Ordinance. Hence, conclusively, default of Section 196 of the Ordinance is established.

Going forward, the relevant provisions of Section 208 of the Ordinance are reproduced as below:

(1) A 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, period and amount of investment and terms and conditions attached thereto:

Provided that the return on investment in the form of loan shall not be less than the borrowing cost of investing company.

Explanation: The expression 'investment' shall include loans, advance, equity, by whatever name called, or any amount which is not in the nature of normal trade credit.

The Company purchased the machinery from its own funds and then transferred the same to AAEP without charging any cost for such transfer. It is believed that the transaction in question is an investment in terms of Section 208 of the Ordinance as if the Company would have not provided the machinery to AAEP then AAEP had to purchase or obtain on lease, the machinery to render the services to the Company. In case of purchase of machinery the AAEP had to arrange funds either from the banks / financial institutions or to borrow from the Company. In all the situations, AAEP had to pay interest / mark up on such funds besides arranging for security against the borrowings. Whereas in case of leasing, it had to pay lease rentals to the lessor. In both the cases the investor / financier would have got return on its investment / finance. In the instant case, the Company transferred the machinery costing more than ten million rupees to AAEP on one hand and on the other without any return on such investment contrary to the requirements of Section 208 of the Ordinance. Through such an arrangement AAEP is benefitted which got assets free of cost and free of interest and depreciation expense. AAEP is also getting business from the Company without fear of winning the contract and future competition. I am of the firm belief that the common directors of the Company and AAEP are the ultimate beneficiaries of the transaction. The shareholders of the Company are on the losing side getting no return on such investment.



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Further, merely emphasizing that the Company gained numerous advantages, from such transfer of machinery, does not relieve the Company to obtain the mandatory shareholder's resolution in terms of Section 208 of the Ordinance.

11. From the above discussion, facts of the case and arguments put forward by the Counsel, I am of a considered view that the provisions of Section 196 and Section 208 of the Ordinance have been violated by the directors. I have observed from the record that the directors of the Company made investment 'in kind' by shifting and allowing the AAEP to use the Company's machinery that too without any return in violation of Section 208 of the Ordinance. Further, the BOD did not pass any resolution in its meeting before entering into contract for rendering services to the Company thus violating the provisions of Section 196(2)(g) of the Ordinance. Therefore, I feel no hesitation to invoke the penal provisions of Section 196 and Section 208 of the Ordinance.

12. As the directors of the Company, have violated the mandatory provisions of law, therefore, I impose a fine of Rs.3,200,000/- (Rupees three million and two hundred thousands only) in the following manner:

Directors	Violation of Section 196 (Amount in Rs.)	Violation of Section 208 (Amount in Rs.)
Mr. Naseem A. Sattar	100,000/-	500,000/-
Mr. Azim Ahmed	100,000/-	500,000/-
Mrs. Zarina Naseem	100,000/-	300,000/-
Mst. Adia Naseem	100,000/-	300,000/-
Mrs. Sadaf Nadeem	100,000/-	300,000/-
Mrs. Reena Azim	100,000/-	300,000/-
Mrs. Asra Amir	100,000/-	300,000/-
Total	Rs. 700,000/-	Rs. 2,500,000/-
	=Rs. 3,200,000/-	

Besides imposing fines on the elected directors, I hereby also impose a fine of Rs.400,000/- (Rupees four hundred thousand only) each on Mr. Muhammad Shafi and Mr. Syed Raza Abbas Jaffari, nominee directors from NIT as they, being independent non-executive directors, had failed to discharge their duties effectively and efficiently. I expect that the independent non-executive directors are the main element of transparency in the decisions of BOD of the Company and they should be vigilant in playing their role to ensure transparency and observance of the requirements of law in letter and spirit.



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The above named directors of the Company are hereby directed to deposit the aforesaid fine in the designated bank account maintained in the name of the Commission with MCB Bank Limited within thirty days from the receipt of this order and furnish receipted bank vouchers to the Commission. In case of non-deposit of the penalty, proceedings for recovery of the fines as an arrear of land revenue will be initiated. It may also be noted that the said penalties are imposed on the directors in their personal capacity; therefore, they are required to pay the said amount from their personal resources.

12. Further, in terms of the provisions of Section 473 of the Ordinance I hereby direct the Chief Executive of the Company to evaluate the rental value of the machinery through the statutory auditor and recover the rent for the years for which the machinery was used by the AAEPT. The Company shall also ratify the transaction by passing a special resolution under the provisions of Section 208 of the Ordinance. These directions are to be complied with within 60 days of the date of this order.

Tahir Mahmood

Executive Director (Enforcement)

Announced

October 7, 2008

Islamabad