



**Securities and Exchange Commission of Pakistan**  
*Company Law Division*  
*(Enforcement Department)*

[Islamabad]

**Before Dr. Sajid Qureshi, Executive Director (Company Law Division)**

**Order**

**In the matter of**

**M/s S.G. POWER LIMITED**

**Under Section 208 Read With Section 476 of the Companies Ordinance, 1984**

Show Cause Notice No. and Date: EMD/233/410/2002-6525-31  
Dated March 1, 2005

Date of final hearing: March 7, 2006

Present: Mr. M. Javed Panni, Chief Executive of MJ Panni & Associates on behalf of all the directors and chief executive of M/s S.G. Power Limited

Date of Order: April 6, 2006

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This order will dispose of the proceedings initiated against the Chief Executive and Directors of M/s S.G. Power Limited (the "Company") for making unauthorized investments in its associated company in violation of the provisions of Section 208 of the Companies Ordinance, 1984 (the "Ordinance").

2. The brief facts of the case are that while examining the annual audited accounts of the Company for the year ended June 30, 2004, it was observed by the Commission that as per Note 9 and 11 to the said accounts, Company has receivable balances of Rs.194,497,933 and Rs.28,694,388 as "Trade debts" and "Other receivables" respectively from its associated concern i.e. M/s S.G. Fibre Limited. These receivable balances from S.G. Fibre Limited were not falling in the nature of normal trade credit which is in violation of Section 208 of the Ordinance.



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**Quote**

	<u>2004</u>	<u>2003</u>
	<u>Rupees</u>	<u>Rupees</u>
<b>“Note 9</b>		
<b>DEBTOR</b>		
<i>Unsecured - considered good</i>		
<i>Associated undertaking - S.G. Fibre Limited</i>	<u>194,497,933</u>	<u>198,658,855</u>
<i>Maximum aggregate amount due from associated undertaking (S.G. Fibre Limited) at the end of any month during the year was Rs.231,514,771 (2003: Rs.198,658,855).</i>		

	<u>2004</u>	<u>2003</u>
	<u>Rupees</u>	<u>Rupees</u>
<b>Note 11</b>		
<b>OTHER RECEIVABLES</b>		
<b>Considered Good</b>		
<i>Interest on loan to associated undertaking - S.G. Fibre Limited</i>	<u>28,694,388</u>	<u>28,694,388</u>
<i>Maximum aggregate amount due from associated undertaking (S.G. Fibre Limited) at the end of any month during the year was Rs.28,694,388 (2003: Rs.28,694,388).”</i>		

**Unquote**

The above revealed that the trade debts amounting Rs.194,497,933 far exceeded the annual sales of the Company which amounts Rs.191,862,245 thus resulting in trade debt collection period of 374 days which appears to be an abnormal trade credit period. It appears from the above analysis that there was no movement or any recovery in the year 2004 with respect to the interest on loan which was recoverable from the said associated company. The aforesaid details have been further compared and analysed for the years 2001 to 2005 in Para 7 of this Order.

3. It has been observed that the Chief Executive and Directors of the Company during the year ended June 30, 2004, instead of recovering the trade debts which were not in the nature of normal trade credit, extended further trade credit which is evident from the fact, as disclosed in above quoted Note 9 to the accounts that the maximum aggregate amount due from said associated company at any end of any month during the said year was Rs.231,514,771 as compared to Rs.198,658,855 in the year ended June 30, 2003. Further the said trade debts have risen to Rs.242,515,485 for the year ended June 30, 2005. In this connection,



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attention is drawn to the decision of this Commission in the Order of the Appellate Bench dated April 12, 2002 of M/s Gharibwal Cement Limited which states:

**“An open ended credit without specific purpose cannot be termed as normal trade credit. Therefore, the mere fact that the parties have covered these financial facilities by subsequently entering into a Commercial Trade Agreement would not make the financial facilities extended fall within the ambit of “normal trade credit”. In our view the Appellants have failed to prove that the objective was for normal trade practice.”**

In view of the above, the said ever increasing receivables were open ended credit and cannot be termed as normal trade credit.

4. The Chief Executive and Directors have breached their fiduciary duty by failing to exercise due diligence while providing open ended trade credits to its associated company and not recovering long outstanding interest receivables from the said associated company, without authority of the shareholders which is in violation of the provisions of Section 208 of the Ordinance which requires:

*“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.”*

This clearly establishes that the Chief Executive and all the Directors have knowingly and willfully avoided complying with the mandatory provisions of the Ordinance.

5. In this connection, a show cause notice dated March 1, 2005 was issued to the Chief Executive, Chairman and all the other Directors calling upon them to show cause as to why penal action may not be taken against them under Sub-section (3) of Section 208 read with Section 476 of the Ordinance for violating the statutory requirements of the Ordinance. A period of 14 days was given to respond to the aforesaid notice. The aforesaid notice was responded by the Company Secretary of the Company vide letter dated March 12, 2005 seeking extension of ten days for reply. The extension was granted and the Company was advised to submit reply by March 21, 2005. The reply was received on March 19, 2005. The submissions made by the Company in their said reply against the SCN are summarized as under:

- (i) The Company stated that it examined the provision of Section 208 of the Ordinance and are of the view that trade debts are normal business trade debts and do not attract the provision of Section 208 of the Ordinance. The outstanding amount against S.G. Fibre Limited is neither



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loan nor advance, but normal trade receivable on account of electricity sold to S.G. Fibre Limited, a sister concern. Explanation of Section 208 of the Ordinance clearly state “ 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. S.G. Fibre Limited, being sole buyer of their electricity, the Company had to extend credit facility with mutual consent, keeping in view their cash flow requirements. The associated company had been regularly paying the bills for electricity purchases.

- (ii) The Company stated that it was formed in 1994 with the objective of generation and sale of electricity to its sister concern and also to other industry in the vicinity. However, the concerned authorities did not allow sale of electricity to other industries which were mentioned in annual report of 1997, 1998 and 1999. The Company had no choice but to supply electricity only to its associated undertaking S.G. Fibre Limited.
- (iii) Buyer of the Company’s electricity is only the said associated concern and Company’s survival is totally dependant on S.G. Fibre Limited. The Company submitted that without compromising its own cash flow, **the receivable had to be staggered keeping in view the cash flow of the sister concern.** The Company’s cash flows were in stable condition and it had not borrowed any amount from banks for its working capital need.
- (iv) Filament industry is in deep problems due to the following factors:
  - (a) High price of polyester chip in international market where current import price of chips is US\$1,250 per metric tonne.
  - (b) Dumping of yarn in local market from far eastern countries. Declared value of yarn from China is US\$1,000 per metric tonne which is US\$250 less than imported price of chips (raw materials of the Company’s sister concern).
  - (c) Under invoicing of imported yarn.
  - (d) Disparity in custom duty on chips, PTA, MEG and polyester filament yarn.
  - (e) Smuggling of polyester fabrics.

Domestic filament yarn industry consists of 21 units of which 11 units have been closed down owing to the factors mentioned above and the rest are at the verge of their extinction and struggling for their survival. The Company also mentioned that to improve liquidity position of S.G. Fibre Limited, its Directors had given loan of over Rs.100 million which was interest free.

**In light of the above, the Board of Directors agreed and passed a resolution for soft payment terms of 12 months credit to the associated undertaking.**



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- (v) The Company contended that in order to maintain a good liquidity, the Directors of S.G. Fibre Limited have forgone their dividend of Rs.15,595,701 in the year 2003. This is duly reflected in the Statement of Changes in Equity of that year.
- (vi) The Company had assured that the amount of trade debts of the sister concern would not be allowed to exceed 12 months.

6. The aforesaid submissions of the Company have been analysed as follows:

- (i) The average trade debt collection period based on annual audited accounts of S.G. Power Limited and the listed captive power producer companies are found to be as under:

Particulars	Average for three years ended June 30, 2004	Average for Year ended June 30, 2004
S.G. Power Limited	306 days	374 days
Sector (inclusive of S.G. Power)	191 days	240 days
Sector (exclusive of S.G. Power)	132 days	158 days

The average collection period for the three years from June 30, 2002 to June 30, 2004 of the Company is **306 days** and in the current said year 2004, it is **374 days** both of which are far greater than the sector averages. Moreover, the Company has informed in its reply that:

*“The Board of Directors agreed and has passed a Resolution for soft payment terms of 12 months credit to associated undertaking.”*

In view of the above, it is clear that the trade credit is for 12 months; hence, it cannot be termed as normal trade credit.

- (ii) The following analysis shows that the trade debts receivable from S.G. Fibre Limited rose by 341 % from 2001 to 2005 with a corresponding increase of only 46% in sales. In this connection, the intention of the Company to provide interest free financing to its associated company is very clear whereas it was considered by the Company as a normal trade credit. Further, the long term advances against which the said interest is receivable declined from Rs.86,200,000 in 2001 to nil amount in 2003. However, the interest accumulated thereon at the rate of 14 % per annum amounts Rs.28,694,388 as on June 30, 2003 has not been recovered or compounded until the year ended June 30, 2005. The non recovery of the said



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interest receivable further indicates intention of the Company to finance its associated company without charging further interest on the long recoverable interest.

Balances due from S.G. Fibres Limited:	2001 Rupees	2002 Rupees	2003 Rupees	2004 Rupees	2005 Rupees	% age change from 2001 to 2005
Debtors	55,014,821	133,573,181	198,658,855	194,497,933	242,515,485	341
Interest Receivable	22,008,602	27,957,643	28,694,388	28,694,388	28,694,388	30
Long Term Advance	86,200,000	24,200,000	-	-	-	(100)
Sales	126,635,250	163,576,738	181,242,704	191,862,245	184,925,568	46

Extract from the accounts for the year ended June 30, 2003 is as follows:

<b>Note 8 LONG TERM ADVANCE</b>	<b>2003</b>	<b>2002</b>
	<b>Rupees</b>	<b>Rupees</b>
<i>To associated undertaking</i>	-	<u>24,200,000</u>

*“It was unsecured and subject to mark up @ 14 % per annum. Maximum aggregate amount due to associated undertaking at the end of any month during the year was Rs.24,200,000 (2002: Rs.79,200,000).”*

- (iii) Attention is drawn to the decision of this Commission in the Order under Section 208 of the Ordinance dated August 12, 2002 of M/s Dadabhoy Cement Industries Limited which states:

*“In the circumstances, the payments made by the Dadabhoy Cement to Dadabhoy Sack Limited on day-to-day basis including payments for expenses apparently were **intended to provide financial benefit to the associated company and cannot be treated as normal trade credit.**”*

In the above matter the aim of the Company was to provide financial benefit to its associated company and therefore it is clear that if trade credit facilities are provided with intention to give financial benefit, then it will not be termed as normal trade credit.

- (iv) Approval through special resolution in general meeting of shareholders is required for such finances to be provided to associated companies without which it is against the shareholders' interest. Credit facilities had been given to a single company, and the credit balances are



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greater than the whole year's sale and also greater than the operating fixed assets of the organization.

- (v) In case of any default on part of the associated company with regard to payment against the trade debts, the Company may financially suffer to a great deal and will adversely affect the interest of shareholders.
- (vi) The amount receivable from associated company is a form of loan financing which is not in the nature of normal trade credit and it is an investment as defined in sub-section (1) of Section 208 of the Ordinance as follows:

*“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.”*

The Company had stated in its aforesaid reply the following statement which endorses the above fact:

*“.....the receivable had to be staggered keeping in view the cash flow of the sister concern”*

It is apparent that the credit facilities are provided to the associated company with an intention to facilitate it financially.

- (vii) The said trade debts have been disclosed in the balance sheet of the Company under the account head of current assets. However, Para 57 of IAS-1 (Presentation of Financial Statements) states and requires the following:

*“An asset should be classified as a current asset when it:*  
*(a) is expected to be realized in, or is held for sale or consumption in, normal course of the enterprise's operating cycle; or*  
*(b) is held primarily for trading purposes or for short-term and expected to be realized within twelve months of the balance sheet date; or*  
*(c) is cash or a cash equivalent asset which is not restricted in its use.*  
*All other assets should be classified as non-current assets.”*



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The trade debts collection/settlement period during the year 2004 is 374 days which is more than 12 months period and thus reveals misclassification of trade debts by the Company which is in violation of the requirements of IAS-1.

In view of the above mentioned facts, it is stated that the Company has violated the provisions of the Section 208 of the Ordinance.

7. The Managing Director on behalf of the Company submitted the following information vide letter dated April 26, 2005 in furtherance to their previous letter dated March 19, 2005 for consideration:

- “(i) *S.G. Fibre Limited are the sole buyers of our electricity and we are not allowed to sell the power to any other company. This restriction has been imposed by the Government of Pakistan. As such we are totally dependant on S.G. Fibre Limited.*
- (ii) *S.G. Fibre Limited have their own problems which are being faced by the Filament Yarn Industry as a whole. The factors leading to the industry problems have been elaborately stated in their letter dated March 19, 2005.*
- (iii) *Efforts are being made to reduce the outstanding receivables. It maybe added that during the current accounting years S.G. Fibre Limited has paid the electricity charges amounting to Rs.196.023 million.*
- (iv) *With the improvement in the business conditions in the Filament Yarn Industry, we hope that S.G. Fibre Limited will become current in our payments.*”

8. With reference to the aforesaid letters the Commission in its letter dated August 1, 2005 asked for the following information:

- “1. *Reasons for non-recovery of interest at the time of recovery of principal amount of loan.*
- 2. *Copy of the Board resolution in which the directors had agreed for soft payment terms of 12 months credit to associated undertaking.*
- 3. *Monthly ledger accounts maintained in the books of the Company regarding the principal and interest on investment in associated company for the years 1999 to 2003.*”

9. In this connection, the Company submitted the following reply vide letter dated August 6, 2005 there against:

- “1. ***Non-Recovery of Interest on Loan:***  
*The company sells electricity only to its sister concern S.G. Fibre Limited. For our own sake the liquidity position of S.G. Fibre has a significant importance.*





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*In our letter dated March 19, 2005 and subsequent letter dated April 26, 2005, we have explained in detail the financial position and problems faced by the sister concern. As explained earlier payment of interest was deferred due to tight liquidity position of the sister concern.*

*We enclose a statement showing the detail of loans given and subsequently received during the period from December 1997 to November 2002. No loan was given after that date, where as all the loans were repaid, the markup amounting to Rs.28,694,388 could not be paid by the sister concern due to its poor liquidity position.*

*In the Budget 2005-2006, the Government has allowed concession to Fibre Industry, which will improve profitability and cash flows of S.G. Fibre. We are hopeful that by September 30, 2005, the Company will be able to clear 20% of the outstanding markup. We are also hopeful that with the present favourable environment, we will receive the balance in due course.*

**Resolution Passed by Board of Directors of  
S.G. Power Ltd., on 22<sup>nd</sup> April, 2003 at Registered  
Office, B-40, S.I.T.E., Karachi.**

*“The Board discussed the receivable of Trade debt from its sister concern. It was brought to notice that liquidity position and financial position of S.G. Fibre Limited is not so good. S.G. Fibre Limited is the only customer and consumer of our electricity. In case of closure of S.G. Fibre Limited, S.G. Power Limited will also be closed.*

*Keeping in view of the above facts and in our own interest without compromising our own liquidity position. ‘The Board unanimously approved the following resolution.’*

*‘RESOLVED that soft terms of payments of 12 months credit be allowed to S.G. Fibre Limited.’”*

10. In order to provide an opportunity of personal hearing, the case was fixed for hearing on February 17, 2006 on which date Mr. M. Javed Panni, Chief Executive, MJ Panni & Associates (the “Representative”) on behalf of the Company, appeared, admitted the aforesaid default and contended in writing that:

- “(i) S.G. Power Limited are the sole buyers of the Company’s electricity and the Company is not allowed to sell the power to any other company. This restriction has been imposed by the Government of Pakistan. As such the Company is totally dependant on S.G. Fibre Limited.*
- (ii) S.G. Fibre Limited have their own problems which are being faced by the Filament Yarn Industry as a whole. The factors leading to the industry problems were elaborately stated in Company’s letter dated 19<sup>th</sup> March, 2005.*
- (iii) The detail of loans given and the subsequent repayments during the period from December 1997 to November, 2002 were sent to your office vide company’s letter*



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*No: SGP/MD/05/08/1532 dated August 06, 2005. No loan was given after that date. All the loans were repaid and out of the total outstanding mark-up amount of Rs.28,694,388, an amount of Rs.5,600,000 has since been repaid. A statement showing the sale of electricity to the sister concern from 1996 to 2005 and the payments received during the years is enclosed.”*

Enclosure to the aforesaid reply is as under:

***Quote***

***SALE AND RECOVERY POSITION FROM 1996 to 2005***

<b>YEAR</b>	<b>OP. BALANCE</b>	<b>SALE</b>	<b>TOTAL</b>	<b>RECOVERY</b>	<b>BALANCE</b>
1996		<b>112,500,726</b>	112,500,726	80,354,110	<b>32,146,616</b>
1997	32,146,616	<b>146,272,964</b>	178,419,580	106,228,720	<b>72,190,860</b>
1998	72,190,860	<b>154,229,557</b>	226,420,417	164,261,550	<b>62,158,867</b>
1999	62,158,867	<b>165,227,084</b>	227,385,951	143,849,226	<b>83,536,725</b>
2000	83,536,725	<b>130,254,750</b>	213,791,475	96,220,239	<b>117,571,236</b>
2001	117,571,236	<b>126,635,250</b>	244,206,486	189,191,665	<b>55,014,821</b>
2002	55,014,821	<b>163,576,738</b>	218,591,559	85,018,378	<b>133,573,181</b>
2003	133,573,181	<b>181,242,704</b>	314,815,885	116,157,030	<b>198,658,855</b>
2004	198,658,855	<b>191,862,245</b>	390,521,100	196,023,167	<b>194,497,933</b>
2005	194,497,933	<b>184,925,568</b>	379,423,501	136,908,016	<b>242,515,485</b>

***Unquote***

It is evident from the above, that in years 2003, 2004 and 2005 the receivable balance exceeded the annual sales figure and the gap kept on increasing and reached its maximum in 2005. This clearly shows that the credit allowed to S.G Fibre Limited was not a normal trade credit.

11. The Representative agreed in the hearing to submit a recovery plan for the said receivables in the next final hearing. The said hearing was held thereafter on March 07, 2006, in which the Representative submitted a schedule of recovery of outstanding mark-up and the outstanding receivable from the associated company and further agreed to extend the credit facility period of 120 days for future sale of electricity.

12. After having considered the admitted default of the Chief Executive and Directors of the Company and the perusal of the documents and information placed on record, it is evident that the said credit facility extended to the associated company, cannot be termed as a normal trade credit and therefore falls under the ambit of Section 208 of the Ordinance and was extended without seeking prior approval of the shareholders through a special resolution, in violation of the requirements of Section 208 of the Ordinance and without charging any return on such credit given. Had there been any return on such credit it would have been higher than the borrowing cost under the Law. It is important to mention that the Company's paid up capital is just Rs.178.332 million for both of the years 2004 and 2005 whereas the closing balance of trade debts due from the associated company during the year ended June 30, 2004 and 2005 was Rs.194.498 million and



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Rs.242.515 million respectively. The said trade debts for both said years are far exceeding the paid up capital of the Company.

13. For the foregoing reasons, it is established that the Chief Executive and the Directors have violated the provisions of Section 208 of the Ordinance and have not exercised due care while extending the said credit to the associated concern. I have, however, noted that the Directors of the Company have admitted the default and are in a process of rectifying the default by recovering the balance of trade debts due from its associated company along with outstanding interest and reduce the credit extension period to 120 days in order to bring it close to the three years' sectoral average being practiced as normal trade credit period. The Representative of the Company has also assured that Company would ensure strict compliance of the provisions of the Ordinance in future.

14. In view of the above, I, instead of imposing maximum penalty as prescribed by Sub-section (3) of Section 208 of the Ordinance, take a lenient view of the default and impose a fine of Rs.100,000 (Rupees one hundred thousand) on each of the directors namely, Mr. S.M.Ahmed, Mr. Asim Ahmed, Mst. Zubaida Khatoon. Mr. Sohail Ahmed, Mrs. Saba Sohail, Mr. M. Rafiq Dawood and Mr. Rafiq Ahmed. The afore-named directors are directed to deposit the aforesaid fine in the designated bank account maintained in the name of Securities & Exchange Commission of Pakistan in the Habib Bank Limited within 30 days of the date of this order and furnish a receipted challan to the Commission in this regard.

### **Direction under Section 473 of the Ordinance**

15. Before parting with this Order, it is necessary for me to issue directions regarding the aforesaid outstanding receivables from the said associated company. I deem it appropriate in the said circumstances, to invoke powers contained in Section 473 of the Ordinance and direct the Company to:

- (i) Recover the balance receivable as outstanding interest of Rs.28,694,388 from its associated company in quarterly installment of Rs.5 million each commencing from the quarter April – June 2006. The payment is required to be made in the first month of each said quarter. Upon full recovery of the aforesaid interest, the Company shall submit an auditors' certificate certifying the full recovery.
- (ii) Recover the outstanding amount of electricity sales from the associated company and settle in quarterly installment of Rs.10 million each beginning from April - June 2006 quarter. The payment is required to be made during the months of each quarter. In this connection, the Company shall reduce the said credit period in order to bring it in close proximity to the



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sectoral normal trade credit collection period, with a limit of maximum 120 days, which had already been assured by the Company. The Company shall enter into a written agreement with the said associated company and specify the said collection period therein. The said agreement shall be submitted to the Commission thereafter.

- (iii) The Company shall calculate and thereafter, recover the interest as return on its previous years' credits which were not in the nature of normal trade credit. The return to be calculated on such credits shall not be less than the borrowing cost of the Company. In this connection, the chief executive and directors of the Company are called upon to submit a certificate from statutory auditors of the Company within 30 days indicating that interest is calculated in accordance with the provisions of proviso (b) of Sub-section (1) of Section 208 of the Ordinance. The Chief Executive and Directors are further called upon to recover the interest from the said associated company within a reasonable period.
- (iv) The minutes with regard to Board of Directors decision on the below mentioned matters shall be submitted to the Commission:
  - a. Recovery of electricity bills from associated company in future shall be made within a period not exceeding 120 days.
  - b. The said associated company shall pay off its bills on the said due date in future as per agreement to be signed between the associated companies.
- (v) Auditors' certificate on full compliance of the above directions shall be submitted by the Company to the Commission.

*Dr. Sajid Qureshi  
Executive Director (CLD)*

**Announced**  
April 6, 2006  
**Islamabad**