Before Abid Hussain
Director (Enforcement)

In the matter of

Bannu Woollen Mills Limited

Number & date of the notice:	EMD/233/292/2002-3832-40 dated April 29, 2008
Date of hearing:	July 22, 2008 & August 29, 2008
Present:	Mr. Afzal Muniff, FCA of Muniff Ziauddin & Co., Chartered Accountant & Mr. Ashfaq Ahmed Khan, Corporate Consultant of Ashfaq Ahmed Khan & Associates

Order

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

This order shall dispose of the proceedings initiated against Bannu Woollen Mills Limited ("the Company") through show cause notice dated April 29, 2008 under the provisions of Sections 196 read with Section 476 of the Companies Ordinance, 1984 ("the Ordinance").

2. The Company is a public limited company and has been incorporated in Pakistan under the Ordinance. Its shares are presently listed on the Karachi & Islamabad Stock Exchanges. The Company is principally engaged in manufacture and sale of woollen yarn, cloth and blankets. The Company has authorized share capital of Rs. 100,000,000 divided into 10,000,000 ordinary shares of Rs.10.00 each and paid up capital of Rs. 50,700,000 divided into 5,070,000 ordinary shares of Rs.10.00 as per the latest annual audited accounts for the year ended June 30, 2007.

3. The brief facts of the case are that the Company had obtained shareholders' approval on October 30, 2006 under the provisions of Section 208 of the Ordinance for making equity investment of Rs.22.818 million in Janna De Malucho Textile Mills Limited ("JDTML"), an associated company, through subscription of 1,140,900 ordinary shares offered to the Company as rights at a price of Rs.20.00 per share including a premium of Rs.10.00 per share.

4. For this specific purpose, the Company had made payment of Rs.22.818 million in two tranches to JDTML on November 14 and December 6, 2006. Further examination of the minutes of the Board of Directors' ("BOD") meeting held on November 01, 2006, approved through circulation, revealed that the amount paid to JDTML for subscription of right shares was actually made to JDTML to avoid default in payment of overdue bank loan. Payment for subscription of rights shares was made even when the JDTML had not completed the legal requirements for issuance of rights shares. Subsequently, the JDTML cancelled the announced rights shares on October 31, 2007 however, the Company's amount, advanced for purchase of rights shares, remained struck up since December 6, 2006. On March 26, 2008, members of the Company had passed another resolution to subscribe 761,000 ordinary shares of JDTML at a price of Rs.30.00 per share in order to utilize the amount of Rs.22.818 million already advanced in 2006 for subscribing JDTML's right shares.

5. In view of the foregoing, a show cause notice under Sub-section (4) of Section 196 read with Section 476 of the Ordinance was issued to following directors of the Company in order to explain as to why penalty may not be imposed on them for contravention of the provisions of Section 196 of the Ordinance:

(i) Mr. Raza Kuli Khan Khattak, Chairman;
(ii) Mr. Muhammad Azhar Khan, Chief Executive;
(iii) Lt. Gen. (Retd.) Ali Kuli Khan Khattak, Director;
(iv) Mr. Ahmad Kuli Khan Khattak, Director;
(v) Mr. Mushtaq Ahmad Khan, Director;
(vi) Mrs. Zeb Gohar Ayub, Director;
(vii) Mrs. Shahnaz Sajjad Ahmad, Director;
(viii) Dr. Shaheed Kuli Khan, Director;
(ix) Mr. Manzoor Ahmad Sheikh, Nominee Director, NIT.

6. In response to the show cause notice, Mr. Muhammad Afzal Muniff, FCA of Muniff Ziauddin & Company, Chartered Accountant ("the Counsel") submitted the following reply on behalf of all the directors of the Company:

- The BOD of JDTML in their meeting held on 23-09-2006 had announced to issue 300% right share;

- The shareholders of the Company through special resolution in their Extraordinary General Meeting ("EOGM") held on 30-10-2006, had granted permission to subscribe 1,140,900 right shares of JDTML;

- The BOD of the Company through resolution by circulation dated 01-11-2006 had granted the permission to subscribe 1,140,900 right shares of Rs.10/- each at price of Rs.20/- each, including premium of Rs.10/- per share;

- Subsequently, the directors of JDTML cancelled the above stated right issue in their BOD meeting held on 04-10-2007 as JDTML could not arrange underwriting of the right shares. The shareholders of JDTML through special resolution in their AGM held on 31-10-2007, approved the cancellation of the above stated right issue;

- Since the amount for subscription of 1,140,900 right share was already received by JDTML, therefore, the directors of JDTML in their BOD meeting held on 29-02-2008, decided to issue shares under Section 86 (1) of the Ordinance against the share deposit money of the Company. The shareholders of JDTML through special resolution in their EOGM held on 26-03-2008 also given their permission to issue shares to the Company against the share deposit money;

- Under Sub-section (1) of Section 196, the Commission has challenged the action of the directors but the fact remains that the shareholders of the Company through special resolution in their EOGM held on 26-03-2008 had approved the decision of BOD of the Company to take shares against share deposit money. This means that after approval of the shareholders, the decision of the directors doesn't remain their decision, in fact it became the decision of the shareholders which cannot be challenged under the provisions of Sub-section (1) of Section 196 of the Ordinance. It is generally understood that directors cannot invest money in contravention of the mandate given to them by the Articles of the Association ("AOA"). Investment in associated undertakings is subject to the provisions of Section 208 of the Ordinance and the requirements of the said provisions were duly complied with. This is the reason that the Commission has not challenged the violation of Section 208 of the Ordinance;

- It is clear that use of power by directors under Section 196 of the Ordinance with reference to investment in associated undertakings is linked with the provisions of Section 208 of the Ordinance;

- Action of directors didn't cause any loss to the Company as the break-up value of JDTML's shares (as per the financial statements as on 31-12-2007) was Rs.63.20 and the average market price (during the last six months) of the same was Rs.32.56 per share;

- Regarding belated issuance of shares, it is stated that it was due to the fact that JDTML could not arrange underwriting of right shares which was beyond control of Company's directors and they cannot be penalized for the happening which was beyond their control;

- Reason for increase in the price of share of JDTML from Rs.20.00 per share to Rs.30.00 per share is apparent that initially all the shareholders of JDTML were required to avail the benefit of right shares. Now, in this instance, the shareholdings of the Company in JDTML shall be increased from 13.22% to 30.04% and the right of the Company in the assets of JDTML shall also increase.

7. In order to provide an opportunity of personal hearing, the case was fixed for June 25, 2008 which was adjourned for July 10, 2005 and then again for July 22 2008 on the request of the Counsel. Finally, the

Counsel appeared on behalf of all the directors of the Company on July 22 2008. He reiterated his earlier stance as was given through written submissions in response to the show cause notice. However, during the course of hearing he requested to provide further time in order to compile all the relevant documents. The request of the Counsel was acceded to and as agreed by him the hearing was fixed for August 5, 2008. However, the Counsel again failed to appear on the scheduled date. The case was fixed for August 13, 2008, however no one appeared on the date of hearing. Yet again, the matter was finally fixed for August 29, 2008 on which date Mr. Ashfaq A. Khan of Ashfaq A. Khan & Associates ("Second Counsel") appeared before me as an authorized representative and presented following submissions in writing:

- The allegations are incorrect, baseless and without any substance. The BOD had neither acted imprudently nor blocked Company's funds or has caused any loss by way of approval of subscription of associate company's share at a higher price under the provisions of Section 86 of the Ordinance;

- The BOD in the matter under consideration have performed their functions honestly, prudently and in the best interest of the Company and shareholders and has not caused any loss to the Company or shareholders;

- All acts performed by the BOD were bona fide, judicious, and legally correct and within the parameters provided in the relevant provisions of the Ordinance.

8. I have analyzed the facts of the case, provisions of Section 196 of the Ordinance, arguments put forth by the Counsels and observed as follows:

(i) The Company had made payment of Rs.22.818 million to JDTML, an associated company , on November 14 and December 6, 2006 for subscribing 1,140,900 ordinary shares of JDTML which were offered to the Company as rights at a price of Rs.20.00 per share including a premium of Rs.10.00 per share;

(ii) The BOD of the Company vide their resolution through circulation dated November 1, 2006 approved to release amount of subscription money for taking up the rights shares even when the legal requirements for issuance of rights shares were not completed by the JDTML;

(iii) The contents of the BOD resolution dated November 1, 2006 approved by circulation clearly reflects that payment was made to meet the JDTML's requirement for payment of its overdue bank loan to avoid default and this amount remained struck up since then.

(iv) Despite the fact that the rights announced by JDTML were cancelled on October 31, 2007, the Company's aforesaid amount advanced for purchase of rights shares remained struck up;

(v) Instead of demanding the amount back along with return, the BOD of the Company on February 29, 2008 resolved to subscribe shares of JDTML as otherwise than rights against the same amount after lapse of almost one and a half year;

(vi) On March 26, 2008, members of the Company had passed another resolution to subscribe 761,000 ordinary shares of JDTML at a price of Rs.30.00 per share in order to utilize the amount of Rs.22.818 million, already advanced in 2006, for subscribing JDTML's right shares; and

(vii) Based on the aforesaid facts, it can be safely concluded that the directors of the Company had failed to exercise their fiduciary powers for the purposes for which they were conferred and bona fide for the benefit of the Company as a whole.

9. Before proceeding further, it is necessary to advert to the following provisions of law:

- Provisions of Sub-section (1) of Section 196 of the Ordinance provide that the business of a company shall be managed by the directors, who may pay all expenses incurred in promoting and registering the company, and may exercise all such powers of the company as are not by this Ordinance, or by the articles, or by a special resolution, required to be exercised by the company in general meeting;

- Provisions of Sub-section (4) of Section 196 of the Ordinance provide that whatsoever contravenes any provision of this section shall be punishable with a fine which may extend to one hundred thousand rupees and shall be individually and severally liable for losses or damages arising out of such action.

10. The aforesaid provisions of law are clear and explicit. Sub-section (1) of Section 196 of the Ordinance establishes a relationship between directors and company which is fiduciary in nature and directors are duty bound to act in good faith. The directors are trustees of the Company's funds which must be applied in the best interest of the Company and shareholders and if any misapplication or misuse thereof is proved they are liable to make good the loss to the Company. Further, they should ensure that the company's funds are properly invested and in discharging their duties they must act honestly and exercise such degree of skill and diligence as would amount to reasonable care, which is expected from an ordinary man.

11. It is evident from the scheme of law that it gives complete authority to the directors of the company to use the funds in a timely manner and prudently once approval is granted by the shareholders under the provisions of Section 208 of the Ordinance. The directors, in the instant case, were required to ensure the completion of legal formalities by the JDMTL for issuance of rights shares before releasing the amount as subscription money. However, in the case in hand, I have observed that directors had not made a timely and prudent decision in the interest of the Company. It is important to point out here that in the JDMTL, the associated company, except for nominee director, rest of the directors namely Mr. Raza Kuli Khan Khattak,

Lt.Gen. (Retd.) Ali Kuli Khan Khattak, Mr. Ahmad Kuli Khan Khattak, Mr. Mushtaq Ahmad Khan, Mrs. Zeb Gohar Ayub, Mrs. Shahnaz Sajjad Ahmad, and Mr. Shaheen Kuli Khan are common directors. Here the above named directors gave an undue benefit to the JDMTL due to which the Company and its members suffered loss in the form of blocked funds for more than one and half years without any return.

12. Considering the circumstances of the case, I am of the view that directors have failed to clarify their position with respect to compliance with the requirement of Sub-section (1) of Section 196 of the Ordinance and the directors of the Company failed to discharge their fiduciary duties prudently. Accordingly, an action is necessary under Sub-section (4) of Section 196 of the Ordinance which not only provides a fine of one hundred thousand rupees for the responsible directors but also make them individually and severally liable for losses and damages arising out of such action. The fact of the case warrants no sympathy for the directors and requires a stern action against them. I, therefore, impose a fine of Rs.500,000/- (Five hundred thousand only) in aggregate on the following directors including the Chairman & Chief Executive of the Company for contravening the provisions of Sub-section 196 of the Ordinance:

Name of Directors	**Amount in Rs.**
Mr. Raza Kuli Khan Khattak, Chairman	100,000
Mr. Muhammad Azhar Khan, Chief Executive	100,000
Lt. Gen. (Retd.) Ali Kuli Khan Khattak, Director	50,000
Mr. Ahmad Kuli Khan Khattak, Director	50,000
Mr. Mushtaq Ahmad Khan, Director	50,000
Mrs. Zeb Gohar Ayub, Director	50,000
Mrs. Shahnaz Sajjad Ahmad, Director	50,000
Dr. Shaheed Kuli Khan, Director	50,000
Total	**500,000**

Besides imposing fines on the elected directors, I hereby also impose a fine of Rs.50,000 (Rupees fifty thousand only) on Mr. Manzoor Ahmad Sheikh, a nominee director from NIT as he, being an independent non-executive director, had failed to discharge his 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.

13. The Chairman, Chief Executive and directors of the Company are hereby advised to deposit their respective fines in the account # 0183089871000097 maintained in the name of Securities & Exchange Commission of Pakistan ("SECP") with MCB Bank Limited within thirty days from the receipt of this order and to furnish a receipted bank vouchers to this office. It may also be noted that the said penalties are imposed on the directors in their personal capacity accordingly they are required to pay their respected fines from their personal resources.

14. Further, in terms of the provisions of Section 473 of the Ordinance, I hereby direct the Chief Executive of the Company:

- To recover the principal amount of Rs.22.818 million from the JDMTL immediately, as the SECP has not allowed the JDMTL to issue shares otherwise than rights to the Company under Section 86(1) of the Ordinance and submit a report to this office not later than October 15, 2008; and
- Appoint the statutory auditors to conduct a special audit to calculate the amount of profit which could have been earned on the amount of Rs.22.818 million if invested with any scheduled bank, on a daily product basis in the relevant period. This amount shall be deposited proportionately, in the Company's account, by the aforementioned elected directors of the Company and a certificate in this regard shall be submitted to this office within thirty days from the receipt of this order.

Abid Hussain
Director (Enforcement)

Announced
September 24, 2008
Islamabad