

Before Mr. Tahir Mahmood, Executive Director (Enforcement)

In the matter of

M/S Crescent Steel and Allied Product Limited

(Under Section 208 Read with Section 476 of the Companies Ordinance, 1984)

No. and date of show cause notice	233/420/2002-930-939 dated August 07, 2006
Date of hearing	May 07, 2007
Present:	Mr. Javed Panni, Corporate Advisor.
Date of Order	May 23, 2007

Order

This order will dispose of the proceedings initiated against M/s Crescent Steel and Allied Products 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 company was incorporated on August 01, 1983 as a public limited company under the provisions of the Ordinance and is quoted on all stock exchanges of Pakistan. It has authorized and paid up share capital of Rs.1 billion and Rs.349.96 million respectively, as per its audited Balance Sheet for the year ended June 30, 2006. The Company, is one of the down stream industries of Pakistan Steel Mills, manufacturing large diameter spiral arc welded steel line pipes at Nooriabad (District Jamshoro). The coating plant of the Company commenced commercial production from 16 November 1992. The company acquired a running spinning unit at Jaranwala (District Faisalabad) on June 30, 2000. The cotton spinning activity is carried out by the company under the name and title of "Crescent Cotton Products" a division of the Company. The Company has 1,984 shareholders comprising individuals, financial institutions etc. as per pattern of shareholding annexed to the Directors' Report on the accounts for the year June 30, 2006. Associated companies, directors and their spouses hold around 25.16% of the paid up capital. This indicates that there is sufficient public interest in the shares of this Company.



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3. The Board of Directors of the Company, as per its Financial Statements for the year ended on June 30, 2006 comprises of the following individuals.

Mr. Mazhar Karim	Chairman
Mr. Ahsan M. Saleem	Chief Executive
Mr. Javed A. Callea	Non-Executive Director
Mr. Javed Iqbal	Non-Executive Director
Mr. Mohammad Anwar	Non-Executive Director
Mr. Nasir Shafi	Non-Executive Director
Mr. S.M. Ehtishamullah	Finance Director & CFO
Mr. Zahid Bashir	Non-Executive Director

4. The Company was asked vide letter dated July 05, 2006 to clarify its position with regard to total investment of the Company in the Altern Energy Limited (“Altern”) and evidence of compliance with SRO 865 (1)/ 2000 made under following resolutions tabled before the shareholders:

Date of EOGM	Resolution	Purpose of Investment in accordance with SRO 865 (1)/ 2000	Amount (Rs. in Million)
January 28, 2006	Approval of the Company be and is hereby accorded to make potential equity investment upto Rs.60.4 million in Altern Energy Limited, an eventual associated concern	Balance Diversification	60.40
April 28, 2006	Approval of the Company be and is hereby accorded to make an additional equity investment of Rs. 570.3 in Altern Energy Limited, an associated company, by way of rights subscription of Rs 57.028 million ordinary shares of Rs. 10 each be and is hereby approved.	Balance Diversification	570.30
July 14, 2006	Approval of the Company be and is hereby accorded to make an additional long term equity investment up to Rs.379 million in Altern Energy Limited, an associated company, by way of right subscription of Rs. 37.9 million ordinary shares of Rs. 10 each as per Right Issue announced by the Altern Energy Limited to Finance its own expansion and also to finance the acquisition of Rousch Power (Pakistan) Limited is hereby accorded”	The purpose of present issue is to invest in shares of Altern Energy which in turn will use these funds to acquire 59.984% of shares of an independent power project, Rousch (Pakistan) Power Limited (“RPPL”). RPPL is the owner of a power generation plant with a dependable capacity of 395 MW operating on natural gas. The revenues of RPPL is based on a 30 years take or pay power purchase agreement with WAPDA. Altern Energy itself is also revamping and enhancing company’s assets.”	379.00



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5. The Company vide letter dated July 10, 2006 replied that the investment of the Company in Altern would amount to Rs. 1.047 billion. The Company had already advanced a sum of Rs. 60.4 million against potential equity investment approved in EOGM dated January 28, 2006 and Rs. 34.7 million against Rs. 570 million approved by the shareholders in EOGM dated April 28, 2006. The total investment of the Company would be Rs. 1.047 billion in the Altern, the detail for cost of Rs. 1.047 billion together with the number of Shares and their face value is given as under.

Particulars	No. Of Shares	Face Value@ Rs. 10 per share Rs. (in Million)	Cost Rupees in Million	Source of Payment
Acquisition under listed Companies (Substantial Acquisition of Voting Shares and Takeover) Ordinance, 2002. From sponsor shareholders (Sponsors) @ Rs. 12.50 per share	7,735,000	77.40	96.70	Internal Generation of Funds
From 1 % public offering to existing shareholders@ Rs. 12.50 per share	1,295,000	1.20	1.60	-do-
Approved by Shareholders in EOGM dated April 28, 2006	57,030,000	570.30	570.30	Internal Generation of Funds and Realignment of Investment portfolio
Approved by Shareholders in EOGM dated July 14, 2006:	37,900,000	379.00	379.00	-do-
Total	102,794,000	1,027.90	1,047.60	

6. The reply of the Company was not found satisfactory and was asked vide letter dated July 12, 2006 to explain why the Company had given loan to Altern amounting to Rs.95.1 million, when the shareholders never gave any approval to the Company for the aforesaid loan. Moreover, the exact sources of funding for meeting the proposed investments had not been explained at any point of time in the earlier EOGMs. It also appeared from the representation given by the Company that requirements of SRO 865(I)/2000 dated December 6, 2000 for investment in associated concerns has not been complied with regard to the earlier resolutions passed on January 28, 2006 and April 28, 2006. It is required that in case any decision to make investment under authority of a resolution is not implemented till the holding of a subsequent general meeting, its status including the following must be explained to the shareholders in the statement of material facts annexed to the notice of the meeting.



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- Reasons for not having made investment so far; and
- Major change in financial position of Investee Company since date of last resolution.

7. The Company replied vide letter dated July 13, 2006 that 95.1 million has not been given as loan and it has been given as advance for purchase of proposed right shares (to be issued by Altern). This advance carries mark-up of 11% per annum as approved in EOGM held on January 28, 2006. Apart from the initial investment of Rs. 98.3 million already made, investment in right issue of AEL, will be Rs. 949.3 million (570.3 +379) which will be funded as under:

	<u>Rs. (In million)</u>
• Already paid to AEL out of internal generation	95.10
• Acquisition by way of settlement with CSIBL	131.00
• Internal generation and realignment of portfolio / sale of some investment	<u>723.20</u>
Total	<u>949.30</u>

8. The facts and circumstances narrated in the preceding paragraphs shows that the investments of the Company made in its associated undertakings were not in accordance with the resolutions approved by the shareholders. The Company has invested an amount of Rs. 95.1 million as advance while right is yet to be offered by Altern and Rs. 131 million taken over by way of settlement with CSIBL was never approved by the shareholders. It was, therefore, considered necessary to ascertain the extent of violations committed by the Company and loss sustained as a consequence of these investments for which necessary proceeding were initiated under section 208 of the Ordinance. Show Cause Notice dated August 7, 2006 was, therefore, issued to the Company and its Directors highlighting the prima facie violations of Section 208 of the Ordinance.

9. In response to the Show Cause Notice following submissions, on behalf of the Company and the directors, were made by Mr. Javed Panni, Corporate Advisor of the Company;

- a. The advance was for a short-term and was to be adjusted against the subscription of right shares of AEL.
- b. It was originally planned by AEL that it will offer right shares to the shareholders in January 2006 but it was deferred by the Company till March 2006 for want of approval and compliance with certain requirements of Karachi Stock Exchange (KSE). KSE took considerable time to approve the Letter of Right and had given approval on August 28, 2006.



- c. Out of total advance of Rs.95.1 million, an advance of Rs.60.4 million was paid to AEL in January, 2006. Another amount of Rs.34.7 million, which includes a debit of Rs.700,000 for expenses attributable to AEL, paid/taken in the books as short term advance in June 2006. This amount was paid / taken in the books after CSAPL's EOGM had approved investment of Rs.570 million in AEL on April 28, 2006.
- d. The Company had anticipated that advance towards subscription of AEL Right Shares would stand adjusted as per original plan of right issue. However, due to delay in the completion of formalities and approval of KSE, the total short-term advance of Rs.95.1 million was adjusted on October 31, 2006 (last date of payment of right shares).
- e. In spite of the fact that as per commercial practice no mark-up is charged on short-term advances, the Company did charge mark-up of 11% in the best interest of the Company and its shareholders. This mark-up rate was higher than the average borrowing cost of the Company which during the year ended June 30, 2006 stood at 10.5% on short-term funds.
- f. Short term advance given by the Company to AEL was against subscription of the right shares. It was part of overall investment of Rs. 570 million approved by the shareholders in the EOGM held on April 28, 2006. As such there was no need of separate approval of shareholders under Section 208 of the Companies Ordinance, 1984.
- g. As per original plan the total investment that was to be made in right shares of AEL was Rs.949.3 million. Investment of Rs.570 million was approved by the shareholders in the EOGMs held on April 28, 2006 and another investment of Rs.379 million was approved by the shareholders in the EOGM held on July 14, 2006. However, due to subsequent change in the investment plan among the principal shareholders of AEL, total investment of CSAPL in AEL right shares has been Rs. 606.0 million only.
- h. With regard to providing information to the shareholders about the reasons for not making the investment between the dates of EOGMs in April and July 2006 and whether any changes had taken place in the financial position of the investee Company, it is submitted that these were duly explained to the shareholders in the EOGM held on July 14, 2006, relevant extracts from the minutes are given hereunder:



- “It was further pointed out by the Chairman that the last circulated (unaudited) accounts were available with CSAPL and CSAPL sought and received confirmation from AEL that there was no major change in the financial position of AEL since last EOGM of CSAPL held on April 28, 2006, and
- Mr. Shafiqur Rebman a shareholder of the Company enquired about the reason for delay in making investment in AEL. Mr. Iqbal Sheikh mentioned that Karachi Stock Exchange had not granted approval to AEL so far for issue of Right offer letters to its shareholders”.

10. Moreover, in order to provide an opportunity of personal hearing, the case was fixed for May 7, 2007. Mr. Javed Panni, Corporate Advisor of the Company appeared before me, he reiterated the submissions made in the written reply to the show cause notice. During the Hearing, the Corporate Advisor of the Company admitted the default in respect of investment of Rs. 60.4 million and further submitted that the aforesaid amount is immaterial and interest of the shareholders have not been damaged. Moreover, the default is not willful or intentional.

11. I have considered the reply as well as the submission made during the hearing by the learned Corporate Advisor of the Company. The amount advanced by the Company is loan and this is confirmed by the Auditor of the Altern M/s Yusaf Saeed & Co., Chartered Accountants in their certificate dated June 29, 2006 addressed to the Manager, Karachi Stock Exchange (Guarantee) Limited. The Auditors stated in their certificate that they have reviewed the books of Altern on June 15, 2006 and confirm that cash was received as “LOAN” from Crescent Steel and Allied Product Limited. The reply of the consultants is analyzed and my observations on the issue are as follows:

- a. The company should have made payment at the time of acceptance of right issue and extending the advance at an earlier date was never envisaged.
- b. The time factor is not relevant here, subscribing for right issue do not require any advance payments and the company should have only made payment at the time of acceptance of right issue. In this case, the Company has advanced an amount of Rs.60.4 million for ten months and an amount of Rs. 34.7 million for five months, implying that the Company is acting as financier for Altern, the funding needs of the Altern is met by the Company without respecting the authority of the shareholders.



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- c. The shareholders of the Company approved the transaction to invest in the equity of the shares “*through subscribing the right shares*” issued by Altern in their EOGM held on April 28, 2006 and July 14, 2006. The management abused the authorization of the shareholders by advancing loan in its associated concern at date when no right was announced by the Altern.
- d. The Company should made payment at time of acceptance of right issue and extending advance at earlier date was not at all required.
- e. Charging the mark-up does not correct the situation, investment was made without any consideration of the approval obtained from the shareholders.
- f. The investments in the equity by way of subscribing for the right issue was allowed and that to only at the time of taking up right issue. Advancing loan was definitely not in accordance with the terms approved by the shareholders. Hence, the plea of the respondents cannot be accepted that separate approval was required for investment of short term advance.
- g. The Company is making the investment decisions on the basis of the group needs and has disregarded the authority of the shareholders of the Company. It is also pertinent to mention here that the directors, their spouse and associated concerns hold only 25.16 % shares of the Company and they have invested against the approval of the entire shareholders.
- h. S.R.O. 865 (I)/2000 requires that in case any decision to make investment under authority of a resolution is not implemented till the holding of a subsequent general meeting, its status including the following must be explained to the shareholders through a statement under sub-section (1) of section 160 of the Companies Ordinance, 1984
- reasons for not having made investment so far; and
 - major change in financial position of investee company since date of last resolution.

The statement under section 160 annexed with the notice of EOGM held on July 14, 2006 did not disclose the aforesaid information, thus the requirement of SRO were not complied with. This has deprived the shareholders of their legitimate right toward access of the information and to take an informed decision. Any subsequent development in the EOGM proceedings does not undo the earlier irregularity.



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12. In view of above and the documents and information placed on record, it is evident that the advance given to the Altern was not in compliance with approval given by the shareholders. Resolutions passed were for the equity investment in Altern Energy Limited and all the resolutions authorized the directors to make equity investments in Altern, by way of rights subscription. Any payment against the said right issue should have been made at the time of acceptance of letter of right, subsequent to the approval of right issue by KSE. Thus the sums advanced as “loan” is in contravention of the resolutions approved by the shareholders. Moreover, as per the information submitted to KSE by Altern, the auditors M/S Yusuf Saeed and Co. Chartered Accountants have also confirmed vide their certificate dated June 29, 2006 that cash amounting to Rs. 95.126 million was received as loan from Crescent Steel and Allied Products Limited. It was also certified that these outstanding liabilities may be taken over as advances against right issue. Through another communication of KSE, Altern was directed by KSE to have the entire issue of right shares underwritten, including the amount of Rs. 303.514 million due from its associates. The Rs. 303.514 million due from its associates included loan of Rs. 95.126 million advanced by the Company, as tabulated below:

Associate	Amount (Rs. In million)
Crescent Standard inv. Bank	182,760,240
Crescent Steel Mills & Allied Product Ltd.	95,126,004
Shakarganj Mills Limited	25,627,746
Total	303,513,990

13. The directors owe fiduciary duties to the Company they serve and its shareholders. They must discharge their statutory obligations in good faith with fairness and honesty. The directors have failed to exercise reasonable care to see that mandatory provisions of law were being violated and have not respected the mandate of the shareholders. Therefore, the directors have breached their fiduciary duties, which they owed to the Company and its shareholders. The Directors made unauthorized transactions out of the funds of the Company. In fact the Company has been acting as a financier by providing funds to the associated concerns to fulfill their financial requirements at the cost of the Company.

14. 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 providing advances to associated concerns. After analyzing the facts of the case and arguments put forward I am of a considered view that these do not carry rationalization and are not acceptable. Violation of section 208 of the Companies ordinance is established and all directors are responsible for the said violation. However, I, instead of imposing maximum penalty of Rs. 1,000,000 on its Chief Executive and each director as prescribed by Sub-section (3) of Section 208 of the Ordinance, take a lenient view of the default by imposing a fine of Rs.100,000 (one lac only) each on the following directors while the Non Executive Directors of the Company are reprimanded to be careful in future;

Name	Designation	Amount
Mr. Mazhar Karim	Chairman	100,000
Mr. Ahsan M. Saleem	Chief Executive	100,000
Mr. S.M. Ehtishamullah	Finance Director & CFO	100,000

15. The Chairman, Chief Executive and the afore-named director are hereby directed to deposit the aforesaid fine totaling to Rs.300,000 (Rupees Three lacs only) in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with Habib Bank Limited within thirty days from the receipt of this Order and furnish receipted vouchers or pay by a DD/pay order issued in the name of Commission for information and record, failing which proceedings under the Land Revenue Act,1967 will be initiated which may result in the attachment and sale of movable and immovable property. It may also be noted that the said penalties are imposed on the Chief Executive and other Directors in their personal capacity, who are required to pay the said amount from their personal resources.

Tahir Mahmood
Executive Director (Enforcement)