Say no to corruption

Before

Shahzad Afzal Khan – Director/Head of Department

In the matter of

Fazal Cloth Mills Limited

Show Cause Notice No. & Date:	No. CSD/233/119/2002-689 dated January 9, 2023
Date of hearing	February 6, 2023, February 22, 2023, March 16, 2023 and March 21, 2023
Hearing attended by:	Mr. Rashid Sadiq as Authorized Representative

ORDER

Under Section 199 of the Companies Act, 2017 and Section 479 thereof read with the Companies (Investment in associated companies) Regulations, 2017

This order shall dispose of the proceedings initiated through the Show Cause Notice No. CSD/233/119/2002-689 dated January 9, 2023 (SCN) issued under Section 199 of the Companies Act, 2017 (**the Act**) and Section 479 thereof read with regulation 5(6) of the Companies (Investment in associated companies) Regulations, 2017 (**the Regulations**) against Fazal Cloth Mills Limited (**the Company**) and its following directors, herein after collectively referred to as the Respondents:

(i) Sh. Naseem Ahmad, Chairman
(ii) Mr. Rehman Naseem, Chief Executive
(iii) Mr. Amir Naseem Sheikh, Director
(iv) Mr. Muhammad Mukhtar Sheikh, Director
(v) Ms. Faisal Ahmed, Director
(vi) Mr. Fahd Mukhtar, Director
(vii) Mr. Babar Ali, Director
(viii) Mr. Masood Karim Sheikh, Director
(ix) Ms. Parveen Akhter Malik, Director
(x) Fazal Cloth Mills Limited through the Chief Executive

2. The brief facts of SCN are that review of the annual audited financial statements of the Company for the year ended June 30, 2020 (**Accounts 2020**) and June 30,2021 transpired that the Company had given long term loan and advance to its associated company, namely Fatima Energy Limited (**FEL**). Accounts of 2021 discloses that total loan disbursement made to FEL was Rs. 3,138.740 Million. Following discrepancies were observed with respect to the loan:

(i) The Company failed to periodically recover accrued mark-up from FEL, accumulated to Rs.

813.882 Million as of June 30, 2021, as per disclosure given in note 19.1 to the Accounts.

(ii) As per note 19.1 and 19.2 of the Accounts – 2020 and Accounts – 2021, the Company has rescheduled the repayment of principal and related markup on the aforesaid FEL Loan, with the approval of directors only. Note 19.2.1 to the Accounts of 2020, *inter alia*, disclosed that:

Pursuant to restructuring of FEL's borrowings with financial institutions along with related subordinated borrowings from sponsors, the Company has entered into a restructuring agreement with FEL for rescheduling the repayment of principal and related mark-up ***as approved by the Board of Directors of both the companies****. As per the revised agreement, principal and markup accrued are subordinated and are now repayable from Financial year 2026."*

Note 19.1.1 to the Accounts 2021, *inter alia*, disclosed that:
19.1.1: pursuant to restructuring of FEL's borrowings with financial institutions along with related subordination of borrowings from sponsors, the Company had entered into a restructuring agreement with FEL for rescheduling the repayment of principal and related mark-up as approved by the Board of Directors of both the companies. As per the revised agreement, principal and mark-up accrued are subordinated and are now repayable from financial year 2027. Accordingly, mark-up accrued from FEL has been classified as non-current.

3. Securities and Exchange Commission of Pakistan (**the Commission**) vide letter dated April 20, 2022 sought necessary explanation from the Company. In reply, the Company through letter dated May 24, 2022, *inter alia*, submitted that:

"The markup on advances to FEL is expected to be recovered periodically which is in line with the terms of the agreement. As per the agreement, markup will be recovered as per the terms of agreement between the Company and FEL along with recovery of principal which is not yet due."

"There has been no change in the terms and conditions of advance/loans provided by the Company to FEL, therefore, no further approval was required to be obtained from the shareholders. You will kindly appreciate that the repayment terms are strictly within the period of 10 years, which is in line with the approval of the shareholders and there is thus no change in the markup rate/terms and conditions."

4. As per available information, the Company, *inter alia*, sought approvals from shareholders for the following loan amounts:

Date of AGM/ EOGM	Approved limits (Rs. in million)	Markup rate	Repayment terms as per statement of material facts
May 30, 2017	500	KIBOR+1% or 1.5% incase borrowing cost exceed in future	Within 10 years of its disburdenment in 20 semi-annually installments. Penalty @1% and 0.5% in case of late payment and mark up, respectively. Will be subordinate favoring FEL's lenders.
October 27, 2018	2,000	KIBOR+1.5%	Within 10 years of its disbursement in 20 semi-annually installments to be due on 30 June and 31 Dec next falling after CoD. Additional markup @ 1% on overdue amount till payment.

November 26, 2020	500	KIBOR+1.5%	Repayable in ten semi-annual installments by FEL after complete discharge of its loan obligations toward its lender' banks and investment will be made till October 15, 2023.

5. Relevant statement of material facts annexed with the notice of AGM of 2017, *inter alia*, disclosed the following for approval of loan facility to FEL: *"Repayment will be made within ten years of date of disbursal. The mark-up which will be charged or accrued at the rate of KIBOR + 1% but not less than the borrowing cost of FCML. Markup will be payable on quarterly basis or otherwise accrued."*

6. Terms of the relevant loan agreements dated May 30, 2017, September 15, 2018, entered by the Company for the purpose of loan facility to FEL, provide that "*markup will be payable on quarterly basis or otherwise accrued with the consent of both the parties*".

7. The term of the loan agreements to the extent it provides that the accrued markup will be repayable on the consent of both the parties, is inconsistent with the provisions of the Act and the Regulations, which explicitly require to recover markup on regular/periodical basis. Therefore, the terms of the aforesaid agreements to that extent is, *prima facie*, void in terms of Section 4 of the Act.

8. Subsequently, the Company through supplemental loan agreement dated June 10, 2020, modified the term of payment of markup. As per available information, the board of directors in its meeting held on June 10, 2020, approved such terms of rescheduling. Relevant terms of the aforesaid agreement are as given below:

> *"C. Pursuant to restructuring of FEL's borrowings with financial institutions along with subordinations of FCML/other group Companies' borrowings and at the request of FEL, FCML is agreed to get repayments of its Loan & Advances from FEL within the original tenor of ten years by way of four annual installments falling due on 31-12-2026, 31-12-2027, 31-12-2028 and 31-12-2029.*
>
> *D. To give effect to the foregoing amendment mentioned in recital-C above, the FCML and FEL have agreed to amend the Loan Agreement accordingly in terms of this 2nd Supplemental Agreement.*
> *2. Mark-up / interest on Loan & Advances shall be paid by FEL at the time of repayments of above installments but not before the date of above installments."*

9. It is, therefore, revealed that the Company has failed to recover accrued markup accumulated to Rs. 813.882 Million as of June 30, 2021, on regular or periodical basis, in contravention to the requirement first proviso to Section 199(2) of the Act read with regulation 5(6) of the Regulations. The contention of the Company regarding rescheduling the repayment of principal as well as related markup on FEL loan only with the approval of directors, is not found to be satisfactory; hence has contravened the requirement of Section 199(4) of the Act, in terms of which any change in the nature of investment or the terms and conditions attached thereto shall be made only under the authority of a special resolution. Both the Company and FEL were associated companies: (i) Year 2020 – due to common directorship and (ii) Year 2021- Mr. Faisal Ahmed Mr. Fahad Mukhtar, both directors of the Company, were also holding directly/indirectly 21.59% and 2.96% shareholding of FEL respectively.

10. In view of the fact the reply of the Company was not found satisfactory, Hence, proceedings were initiated against the Respondents through aforesaid SCN to show cause in writing within fourteen days as to why penalties may not be imposed on them for contravening the afore-referred provisions of Section 199(2) and 199(4) of the Act read with regulation 5(6) of the Regulations for

which penalty is provided in terms of Section 199(6) of the Act.

11. In this regard, reply dated March 15, 2023 was received from the Authorized Representative, which is reproduced as below:

Quote:

We write on behalf of M/s Fazal Cloth Mills Limited (the Company) and its Directors and refer to the show cause notice dated 9th January, 2023 bearing reference No. CSD/233/199/2002-689 (the SCN) issued by the Securities and Exchange Commission of Pakistan (the SECP or the Commission) under Section 199 of the Companies Act, 2017 (the Act) read with Regulation 5(6) of the Companies (Investment in Associated Companies) Regulations, 2017 (the Regulations) which requires a response in writing as to why penalty may not be imposed on the Company and its Directors under Section 199(6) of the Act for perceived contravention of Section 199(2) and (4) of the Act read with Regulation 5(6) of the Regulations in relation to investments by the Company in Fatima Energy Limited (the FEL).

2. Accordingly, please find below submissions made in response to the SCN beginning with submissions made by way of background.

A. Background Facts

3. *FEL was set up to install a bagasse/coal fired IPP of 120 MW to support the Government drive to meet shortfall in the energy requirements of Pakistan as per Cogen Policy 2008 of the Government of Pakistan ('GOP').*
4. *"The Company is one or the main sponsors/ shareholders of the project and holds 19% of the total ordinary share capital of FEL.*
5. *Unfortunately, while determining the project tariff, National Electric Power Regulatory Authority disallowed certain benefits under the Cogen Policy of the GOP. These irregularities were challenged by FEL before the Islamabad High Court which decided in favor of FEL. Since then, FEL is trying from pillar to post for the implementation of the Court judgement, however, NEPRA and GOP delayed the implementation on one pretext or another and filed an appeal against the afore-mentioned judgement which is pending till date.*
6. *In view of the above, FEL could not achieve Commercial Operations Date ('COD') as of to-date in term of the Cogen Policy 2008 of the GOP.*
7. *As a result of delay in the COD, FEL could not service its secured debt obligations towards its bankers and financial institutions and had to get its loans rescheduled.*

Loan Extended to FEL are Subordinated Loans

8. The Shareholders of the Company have granted, though special resolution dated 30th May, 2017, the following authorizations to the Company with respect to FEL:

a. *That the Company will be one of the sponsors of FEL;*
b. *That the Company is authorized to enter into a Sponsor Support Agreement with FEL, its other sponsors and its lenders including Habib Bank Limited, Bank Alfalah Limited and other financial institutions;*
c. *Financial Support to the extent of PKR 9.028 billion in the form of loans or advances for FEL were approved;*
d. *That the Company is authorized to fulfill its commitment to FEL lenders in terms of the Sponsor Support Agreement;*

e. *That the Company is authorized to execute related agreements, documents, undertakings and commitments as required by the lenders of FEL, as may be considered appropriate by the directors.*

9. It may be noted that the Company is under a Sponsor Support Agreement (the 'SSA') with FEL, its other sponsors and its lenders. Pursuant to the SSA, all loans including markup thereon has been subordinated to secured debt obligations of the lenders of FEL. Accordingly, the principal amount of the loans provided by the sponsors as well as markup accrued on these loans cannot repaid by FEL till full payment to the lenders. The sponsors loan and markup thereon, however, can be converted into equity, ordinary or preference, of FEL in terms of the SSA. The shareholders of the Company through special resolution dated 10th March, 2022 have approved, with the permission of the Commission, the conversion of investment of the Company in FEL into preference shares in term of Section 199(4) of the Act.

10. You will appreciate that the subordination of the loans provided to associated companies is a normal phenomenon, markup in such cases is always accrued and the associated companies and their sponsors are bound to honor their commitments to the lenders in terms of the underlying sponsor support agreement. In this respect, reference is made to the mark u accrued amounting to PKR 709 million by Fauji Fertilizer Bin Qasim Limited on its loans provided to Fauji Foods Limited.

11. Since the loans and markup thereon are subordinated, FEL is not able to pay markup accrued on sponsors' loans including the loans provided by the Company till the time the secured obligations of lenders are fully settled.

12. That the repayments of the loans provided by the Company to FEL and markup thereon is subordinate to FEL lenders has been duly approved by the shareholders through special resolutions which authorized the Company to execute any related agreements/documents/ undertaking/SBLC/commitment as necessarily required by the FEL lenders on such terms as may be considered appropriate by the directors of the Company.

13. In view of the above, the accrual of mark up and payment of principal by FEL after the settlement of its lenders dues is one of the terms and conditions attached to the special resolutions passed by the shareholders.

14. Through letter the SECP dated 20th April, 2022 bearing reference No. EMD/ 233/ 119/2002-679, the Company was required to furnish information and explanations with respect to long term investment made by the Company in FEL. In response to the observations of the SECP through the abovementioned letter, the Company provided a detailed response through letter dated 24th May, 2022. Subsequently, the SECP communicated further observations through its letter dated 14th June, 2022 to which the Company responded through email dated 7th June, 2022 and letter dated 16th June, 2022 and provided documentation requested. The SECP again sought further clarifications through letter dated 3rd August, 2022 to which the Company responded through its letter dated 26th August, 2022. Further correspondence in the matter was exchanged between the SECP and the Company through SECPs email dated 30th August, 2022 and Company letter dated 31st August, 2022.

15. The above correspondence culminated in the issuance of the SCN where the SECP alleged discrepancies in relation to the long-term loan to FEL approved by the members of the Company through their special resolutions in terms of Section 199 of the Act. The Following are the issues raised in the SCN in relation to the same:

Para 6
".. the term of the loan agreements to the extent it provides that the accrued markup will be repayable on the consent of both the parties, is inconsistent with the provisions of the Companies Act, 2017 and the Companies (Investment in associated companies) Regulations, 2017 which explicitly

require to recover mark up on regular/periodical basis. Therefore, the Terms of the aforesaid agreement to that extent is prima facie void in terms of Section 4 of the Act"

Para 8
"... the Company has failed to recover accrued markup accumulated to Rs. 813.882 million as of June 30, 2021 on regular or periodical basis in contravention to the requirements of first provision to Section 199(2) of the Act read with regulation 5(6) of the Regulations."

Para 9
".. the contention of the Company regarding rescheduling the repayment of principal as well as related markup on FEL loan only with the approval of the directors is not found to be satisfactory; hence has contravened the requirements of Section 199(4) of the Act, in terms of which any change in the nature of investment or the terms and conditions attached thereto shall be made only under the authority of a special resolution."

Para 10
".. both the Company and FEL were associated companies: (i) Year 2020 – due to common directorship and (ii) Year 2021 - Mr. Faisal Ahmed Mr. Fahad Mukhtar, both directors of the Company, were also holding directly / indirectly 21.59% and 2.96% shareholding of FEL."

16. On the basis of the above issues, the SCN issued to the Company and its directors alleged the following violations, which will be addressed in these submissions:

a. *Failure to recover accrued mark up from FEL (associated company) accumulated to PKR 813.882 million as of 30th June, 2021 on periodical basis as required under Section 199(2) of the Act and Regulation 5 (6) of the Regulations;*
b. *The terms of the agreement executed between the Company and FEL to the extent of accrual of mark up and its repayment with the consent of the parties is prima facie void in terms of Section 4 of the Act being inconsistent with the provisions of the Act and the Regulations which explicitly require to recover mark up on regular/periodical basis.*
c. *Change in the terms and conditions of the loan provided to FEL by the Board in their meeting held on 10th June, 2020 without approval of the members through special resolution as required under 199(4) of the Act.*

17. The provisions of law relied on for the issuance of the SCN are reproduced hereunder for convenience:
Section 199 of the Act:

'199. Investments in associated companies and undertaking. – (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, amount of investment and terms and conditions attached thereto.

Explanation: The term 'investment' shall include equity, loans, advances, guarantees, by whatever name called, except for the amount due as normal trade credit, where the terms and conditions of trade transaction(s) carried out on arms-length and in accordance with the trade policy of the company.

2. The company Shall not invest in its associated company or associated undertaking way of loans or advances except in accordance with an agreement in writing and such agreement shall inter-alia include the terms and conditions specifying nature purpose, period of the loan, rate of retum, fees or

commission, repayment schedule principal and return, penalty clause in case of default or late repayments and security, if any. for the loan in accordance with the approval of the members in the general meeting:
Provided that the return on such investment shall not be less than the borrowing cost of the investing company or the rate as may be specified by the Commission whichever is higher and shall be recovered on regular basis in accordance with the terms of the agreement, failing which the directors shall be personally liable to make the payment:
Provided further that the directors of the investing company shall certify that the investment is made after due diligence and financial health of the borrowing company is such that it has the ability to repay the loan as per the agreement.

3. *The Commission may –*
   (a) By notification in the official Gazette, specify the class of companies or undertakings to which the restriction provided in sub-section (1) shall not apply; and
   (b) through regulations, specify such disclosure requirements, conditions and restrictions on the nature, period, amount of investment and terms and conditions attached there to and other ancillary matters.

4. *An increase in the amount or any change in the nature of investment or the terms and conditions attached thereto shall be made only under the authority of a special resolution.*

5. *Every company shall maintain and keep at its registered office a register of investments in associated companies and undertakings containing such particulars as may be specified.*

6. *Any contravention or default in complying with requirements of this section shall be an offence liable to a penalty of level 3 on the standard scale and in addition, shall jointly and severally reimburse to the company any loss sustained by the company in consequence of an investment which was made without complying with the requirements of this section.*

Section 4 of the Act:

"4. Act to override. – Save as otherwise expressly provided herein –

(a) the provisions of this Act shall have effect notwithstanding anything contained in any other law or 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 the coming into force of the said provisions; and
(b) any provision contained in the memorandum, articles, contract, agreement, arrangement or resolution aforesaid shall, to the extent to which it is repugnant to the aforesaid provisions of this Act, become, or be, void, as the case may be. "

Regulation 5(6) of the Regulations:

"5. Restrictions and conditions applicable to a company making investment. –

(6) Interest, mark up profit, fees or commission, as the case may be, shall be recovered periodically by the investing company in line with terms and conditions approved by the members. "

18. *In light of the above background and the requirements of law, the following submissions are made in the matter.*

B. Preliminary Submissions

19. *These preliminary submissions are being made without prejudice to the submission that the Company and its directors have not contravened the provisions of Section 199(2) and (4) of the Act and Regulation 5(6) of the Regulations as alleged in the SCN.*

SCN Issued to Wrong Persons:

20. *It is submitted that the SCN has been wrongly issued to the directors of the Company where the law specifies that the responsibility for compliance with provisions of Section 199 of the Act lies with the 'company' where the provisions expressly provide for investments to be made by a company in the following terms:*

> *"199. investments in associated companies and undertaking. – (1)A company shall not make any investment in any of its associated companies or undertakings except under the authority of a special resolution which shall indicate the nature, period, amount of investment and terms and conditions attached thereto.*
>
> *Explanation: The term 'investment' shall include equity, loans, advances, guarantees, by whatever name called, except for the amount due as normal trade credit, where the terms and conditions of trade transaction(s) carried out or arms-length and in accordance with the trade policy of the company.*
>
> *(2) The company shall not invest in its associated company or associated undertahng by way of loans or advances except in accordance auth an agreement in writing and such agreement shall inter-alia include the terms and conditions specifying the nature, purpose, period of the loan, rate of return, fees or commission, repayment schedule for principal and return, penalty clause in case of default or late repayments and security, if any, for the loan in accordance with the approval of the members in the general meeting:... " (emphasis provided)*

21. *As is evident from the above reproduced law, it is the company that is responsible for ensuring compliance with provisions of Section 199 of the Act and not its directors. In the same vein, penalties to be attracted to non-compliance become the liability of the Company and not individual directors in terms of the aforesaid Section.*

22. *Accordingly, where it is the company that is responsible for ensuring compliance with the provisions of Section 199 of the Act, in any given scenario involving investment in associated companies, it would be the Company that is liable for non-compliance with any provisions of Section 199 of the Act.*

23. *Where the law does not provide for liability of the directors under Section 199 of the Act, the SCN has been erroneously built on faulty structure which violates the constitutionally guaranteed right of the directors to enjoy the protection of the law as per Article 4 of the Constitution of Pakistan, 1973 (the 'Constitution') reproduced hereunder tor ease of reference:*

"4. Right of individuals to be dealt with in accordance with law, etc.

a. *To enjoy the protection of law and to be treated in accordance with law is the inalienable right of every citizen, wherever he may be, and of every other person for the tine being within Pakistan.*
b. *In particular :-*
   i. *no action detrimental to the life, liberty, body, reputation or property of any person shall be taken except in accordance with law;*
   ii. *no person shall be prevented from- or be hindered in doing that which is not prohibited by law; and*
   iii. *no person shall be compelled to do that which the law does not require him to do. "*

24. *In addition, the issuance of the SCN to the directors also violates Article 10A of the Constitution of Pakistan (the 'Constitution') which mandates that, 'for the determination of civil rights and obligations or in any criminal charge against him a person shall be entitled to a fair trial and due process.' It is noteworthy that Article 10A was added in the Constitution as a Fundamental Right of every citizen and is recognized as guaranteeing protection against arbitrariness and the unstructured exercise of discretion by authorities.*

25. *Additionally, it may be appreciated that where Section 199(6) of the Act speaks of penalty for default in compliance. there is no mention of penalizing the directors of a company. In contrast one may peruse the comparative provisions of Section 208(3) of the repealed Companies Ordinance, 1984 (replaced by Section 199(6) of the Act) which expressly provided for penalizing directors of the company in the following terms:*

> *"(3) If default is made in complying with the requirements of this section, or regulations, every director of a company who is knowingly and willfully in default shall be liable to fine which may extend to ten million rupees and in addition, the directors shall jointly and severally reimburse to the company any loss sustained by the company in consequence of an investment which was made without complying with the requirements of this section. " (emphasis provided)*

26. *There are many provisions in the Act which specifically provide imposition of fines on the directors and officers in case of default. However, where no such liability is attributable, the intent of the legislature may be gathered from the obligation placed on the company or directors or officers. If the obligation is placed on the Company, the process would be the trial of the company in accordance with the requirement of the Act and not of the directors and officers as no liability can legally be imputed to them.*

27. *In view of the above, the proceedings initiated in terms of the SCN are entirely contrary to requirements of the statutory provisions and rules of interpretation developed by the Courts of Pakistan and by extending liability for perceived violations of Section 199 of the Act to individual directors of a company, the SCN has enhanced the scope of the law by reading into the law that which has not expressly or by necessary implication been authorized by the law.*

28. *The Supreme Court of Pakistan has expounded on the undesirability of importing words into provisions through a judgment reported as PLD 2018 SC 52 in the following terms:*

'It is contrary to all rules of construction to read words into an Act unless it is absolutely necessary to do so' (per Lord Goddard in Renula Bose v Manmath Nath, AIR 1945 Privy Councit 108, 110 column 2), which principle was reiterated by this Court in the case Rashid. Textile v Labour Union

(PLD 1963 Supreme Court 293, page- 295 C). In the case of Zulfiqar Ali Babu v Government of the Punjab (PLD 1997 Supreme Court 11) this Court (per Ajmal Mian, J, page 31) held:

'20. From the above celebrated treatises on the construction of statutes, it is patent that the primary source to ascertain the legislative intent is the language employed in the statute itself. If the legislative intent is clear, plain, unequivocal and capable of only one naming, it is not permissible to have resort to the materials aliunde i.e. outside the statute involved. In such a case, the Court cannot decline to enforce a provision of a statute on the ground that it is harsh, or absurd or contrary to common sense. The Court must give effect to it whatever may be the consequences.

Hamoodur Rahman, CJ, in the case of Mhamnmd Ismail v. The State (PLD 1969 Supreme Court 241, 247 A), expounded how statutes should be interpreted:

'The purpose of construction or interpretation of a statutory provision is no doubt to ascertain the true intention of the Legislature, yet that intention has, of necessity to be gathered from the words used the Legislature itself. If those words are so clear and unmistakable that they cannot be given any meaning other than that which they carry in their ordinary grammatical sense, then the Courts are not concerned with the consequences of the interpretation however drastic or inconvenient the result, for, the function of the Court is interpretation, not legislation. ' (emphasis provided)

29. By issuing the SCN to individual directors, the Commission has acted entirely contrary to the law by creating liability where none has been envisaged by the legislature. The abovementioned judgement instructs against such creation of liability by stating as under:

"18, Judges should not create liability by interpretative techniques. It will be apt to quote lord Diplock (Duport steels Ltd v Sirs, (1980) 1 AER 529, 542):

'It endangers continued public confidence in the political impartiality of the judiciary which is essential to the continuance of the rule of law, if judges, under the guise of interpretation, provide their own preferred amendments to statutes which experience of their operation has shown to have had consequences that members of the court before whom the matter comes consider to be injurious to the public interest. "

Nor should judges try to rectify what they may assume should have been in a statute. Hamoodur Rahman, CJ, writing for this in the case of Muhammad Isnnil v the State (above, 246-7 A) cited with approval of the following extract from Craies on Statute Law, that, 'As a general rule a Court of law is not authorized to supply a cassus omissus, or to alter the language of a statute for the purpose of supplying a meaning, if the language used in the statute is incapable of one even though they may be of opinion that a mistake has been made in drawing the Act'. " (emphasis provided)

30. The Commission, in a number of cases, has ruled on the same point and stated that where the SCN was supposed to be issued to the company, the directors could not be made party to the proceedings and, thus, could not be held liable. The following cases lend credence to the principle:

a. *In the matter of K-Electric Ltd vs Executive Director (CSD), Appeal No. 1 of 2019 dated October 26, 2020, the Appellate Bench of the Commission held as follows:*
   "…. We, however, do not agree with the Respondent…. as show-cause proceedings were initiated under section 132 of the Companies Act which clearly states that penalty will be imposed on the Company for non-holding of AGM and not on the Appellants as directors. Therefore, SCN under section 132 of the Companies Act should have been issued to the Company which was not so in the instant case." (emphasis provided)

b. *In the matter of M/s Agritech Ltd vs E.D. Appeal No. 40 of 2019, another case concerning the failure to convene an AGM, the Appellate Bench cited the decision in K-Electric Ltd referred to above with approval and held as follows:*

"5. The Bench has perused the Impugned Order whereby the directors of the Company have been penalized under Section 132 of the Act for non-holding of the AGM. In our view the Respondent had no power to issue to the SCN to the Appellants under Section 132 of the Act because under the relevant law only the respective company could be held liable for non-holding of the AGM. This Bench has already decided a similar matter in Appeal No.1 of 2019 on October 26, 2020 wherein it was held that under Section 132 of the Act, the Respondent had no power or jurisdiction to initiate proceedings and to impose penalty on directors of the company. In the circumstance we are of the view that analysis of merits and other arguments of the parties may prejudice the rights of parties, therefore, the Bench will not touch upon the merits of the case." (emphasis provided)

31. *In light of the above only the Company could be issued the SC'N for any perceived violation of Section 199 of the Act and the law regarding service of processes on a corporate entity is clear. In light of the above discussed law, it was incumbent on the SECP to issue processes only to the Company, to the exclusion of directors, matters concerning Section 199 of the Act.*

32. *Accordingly, where the SCN has been issued to the directors instead of the Company, it suffers from the fatal flaw of imputing liability on the part of the directors where the law itself does not provide for the same. Accordingly, it is submitted that the SCN was not lawfully issued as result of failure to implead the proper parties.*

33. *The SCN, therefore, is liable to be withdrawn on this count alone without any adverse consequences for the directors. Liability may also not be attributed to the Company where the SCN is based on an erroneous construction of the applicable law as discussed hereinbelow.*

Whether FEL and the Company are Associated Companies:

34. *The Commission has presumed that the Company and FEL are associated in the year 2020 due to common directorship and in the year 2021 due to the fact that two directors namely Mr. Faisal Ahmed and Mr. Fahad Mukhtar hold directly/ indirectly 21.59% and 2.96% shareholding of FEL respectively.*

35. *The Company and FEL will be associated companies only if they fall within the ambit of the definition of associated companies as embodied in Section 2(1)(4) of the Act. The same is reproduced hereunder for convenience:*

(4) – associated companies and – associated undertakings mean any two or more companies or undertakings, or a company and an undertaking, with each other in the following manner, namely; –

a. *if a person who is owner or a partner or director of a company or undertaking or who directly or indirectly holds or controls shares carrying not less than twenty percent of the voting power in such company or undertaking is also the owner or partner or director of another company or undertaking, or directly or indirectly holds or controls shares carrying not less than twenty percent of the voting power in that company or undertaking; or*
b. *if the companies or undertakings are under common management or control or one is the subsidiary of another or*
c. *if the undertaking is a modaraba managed by the company;*

and a person who is the owner of or a partner or director in a company or undertaking or, who so holds or controls shares carrying not less than ten percent of the voting power in a company or undertaking, shall be deemed to be an --associated person of every such other person and of the person who is the owner of or a partner or director in such other company or undertaking, or who so holds or controls such shares in such company or undertaking:
Provided that –

i. *shares shall be deemed to be owned, held or controlled by a person if they are owned, held or controlled by that person or by the spouse or minor children of the person;*
ii. *directorship of a person or persons by virtue of nomination by concerned Minister-in-Charge of the Federal Government or as the case may be, a Provincial Government or a financial institution directly or indirectly owned or controlled by such Government or National Investment Trust; or*
iii. *directorship of a person appointed as an – independent director; or*
iv. *shares owned by the National Investment Trust or a financial institution directly or indirectly owned or controlled by the Federal Government or a Provincial Government; or shares registered in the name of a central depository, where such shares are not beneficially owned by the central depository;*

shall not be taken into account for determining the status of a company, undertaking or person as an associated company, associated undertaking or associated person;

36. *In the matter of Noor Aurangzeb and 2 others v. Executive Director (Corporate Supervision Department) (2019 CLD 1028), the Appellate Bench of the Commission while interpreting the provisions of Section 2(1)(2)(i) of the repealed Companies Ordinance, 1984 (parallel provision of Section 2(1)(4)(a) of the Act) has held that:*

> *"Section 2(1)(2)(i) of the Ordinance presents two instances whereby, associate - relation of two companies or undertakings may be established. Firstly, if a person is either owner or partner or director in two companies or undertakings. Secondly, if a person, directly or indirectly, holds or controls shares carrying not less than twenty percent of the voting power in two companies or undertaking."*

37. *In view of the above ruling of the Appellate Bench, which is binding on the Adjudication Division and its functionaries, there could be no other instances for treating two companies as associated companies or associated undertakings under Section 2(1)(4)(a) of the Act. Therefore, the conclusion drawn in Para 10, on the basis of which SCN has been issued to the Company and its directors, that the Company and FEL are associated companies in the year 2021 due to two directors of the Company namely Mr. Faisal Ahmed and Mr. Fahd Mukhtar holding, directly or indirectly 21.59% and 2.96% shareholding of FEL, respectively is contrary to the aforesaid binding ruling of the Appellate Bench.*

38. *In addition to the aforesaid, neither the mentioned two directors of the Company nor their spouse or minor children held any shares in FEL in 2021 and accordingly attributing any indirect shareholding to these two directors would be against the explicit provisions of the Act.*

39. *As to what would constitutes 'indirect shareholding' in the context of the definition of associated undertaking or associated undertaking is provided in proviso to Section 2(1)(4) of the Act, which is reproduced hereunder for ease of reference:*

'Provided that –

(i) *shares shall be deemed to be owned, held or controlled by a person if they are owned, held or controlled by that person or by the spouse or minor children of the person.'*

40. *You will kindly appreciate that the only shareholding which can be attributed to a person for the purposes of Section 2(1)(4) of the Act is the shares owned, held or controlled by him and by the spouse or minor children of that person.*

41. *In view of the above submission, the SCN has extended the scope of 'indirect shareholding' beyond what has been provided in Section 2(1)(4) of the Act and interpreted by the Appellate Bench in its ruling and the same violates Article 4 of the Constitution of Pakistan which mandates that, 'To enjoy the protection of law and to be treated in accordance with law is the inalienable right of every citizen' and, 'no person shall compelled to do that which the law does not require him to do.'*

42. *Accordingly, you will appreciate that FEL cannot be classified as an associated company of the Company in the year 2021 on the basis given in Paragraph 10 of the SCN and, therefore, any resultant proceedings initiated on this basis would need to be reconsidered and withdrawn.*

Uniform Application of the Law:

43. *In furtherance of the submissions on fairness in the application of the law and without prejudice to the submissions made hereinabove, you will appreciate that the law administered by the SECP has to be applied uniformly in accordance Section 20(6)(c) of the Securities and Exchange Commission of Pakistan Act, 1997 (hereinafter the 'SECP Act') in order to maintain uniformity in the exercise of powers entrusted to the SECP in cases having similar circumstances. Provisions of Section 20(6)(c) of the SECP Act are reproduced hereunder for ease of reference:*

"20. Powers and functions of the Commission. -
...
(6) In performing its functions and exercising its powers, the Commission shall strive-
...
(c) to achieve uniformity in how it performs those functions and exercise those powers."

44. *This requirement for uniform application of the law is enshrined as a right to which citizens of Pakistan are entitled, Article 25 of the Constitution of the Islamic Republic of Pakistan (the 'Constitution') which provides as under:*

> *"25. Equality of citizens. – (1) All citizens are equal before law and are entitled to equal protection of law.*
> *(2) There shall be no discrimination on the basis of sex.*
> *(3) Nothing in this Article shall prevent the State from making any special provision for the of women and children."*

45. *A different treatment in relation to the Company amounts to unfair, unjust and discriminatory treatment and would contravene the letter and spirit of the scheme envisaged under Section 20(6)(c) of the SECP Act. In this regard, it was held by the Appellate Bench in the matter of ANS Capital (Pvt) Limited v. Director (SMD) reported at 2017 CLD 686 that:*

"15. The Bench has also observed that the Respondents have taken different actions for the same default in the past. This act tentamount [sic] to discrimination. Law requires equal and fair treatment. Further Section 24A of the General Clauses Act requires that fair trail be provided. The Commission should have a uniform approach in exercising powers."

46. *The matter of uniformity was also taken up by the Lahore High Court in the unreported case of Nishat Mills Limited v. SECP Appellate Bench which related to delay in filing certain returns. When presented with precedent developed by the SECP, Shams Mehmood Mirza, J of the Lahore High Court noted as under:*

"4. This Court has gone through 'he orders passed by SECP in a number of cases in which the delay in filing the Form 31 was condoned. The perusal of these orders clearly show that SECP condoned the delay on the assurance and undertaking given by the defaulters for timely filing of the returns in future. The delay in some of these cases was muct more blatant than the appellant's but SECP still condoned the same. This rule was, however, not followed in the case of the appellant which was saddled with the fine of Rs.20,000/-. The case of the appellant is at par with the cases of those companies where delay was condoned and fine was not imposed and as such the appellant was entitled to the similar treatment.

5. In view of orders passed by SECP as well as the law laid down m judgements reported as SECP v. First capital Securities Limited PLD 2011 SC 778 this court has come to the conclusion that the respondent had mechanically passed the impugned order by imposing the penalty on the appellant without first making a determination whether the default was intentional or willful. In the circumstances, the order passed by the respondent is not sustainable in law and facts of the case. This appeal is accordingly allowed and order dated 14.01.2015 is set aside. The fine of Rs. 20.000/- imposed on the appellant is also aside." (emphasis provided)

47. *Similarly, in Appeal No. 29 of 2016 (Mr. Salman Hussain Chawala, Nominee Director, NIT (Paramount Spinning Mills Limited) v Director (CSD), SECP), the Commission, while setting aside the Impugned Order and allowing the appeal, held as follows:*

"10. In the above circumstances it is mandatory for the Bench to follow Principle of consistency in order to maintain balance and the doctrine of equality before law as enshrined in Article 4 and 25 of the Constitution of Islamic Republic of Pakistan, 1973. Therefore, we hereby allow this appeal and set aside the Impugned Order to the extent of Appellant."

48. *The Supreme Court of Pakistan has commented on the need for consistency in application of the law and warned against the danger of inconsistency by reiterating the objective of the law in the matter of Mst. Gul Jan v. Naik Muhammad (PLD 2012 SC 421) through the judgement of Asif Saeed kGan Khosa, J stating as under:*

"The raison detre or object of all laws is to regulate the affairs of a society in uniformity and through such uniformity to establish a just order. However, when in order to achieve and dispense justice in individual cases exceptions are contrived or laws are disregarded that promotes confusion and breeds anarchy which, at the end of the road, disturbs social harmony and contributes towards injustice...."(emphasis provided).

49. *Compliance with the rule of consistency is central to the administration of justice as also noted in the case of Administrator District Council Larkana v Ghulab Khan (2001 SCMR 1320) in the following terms:*

"It is well settled by now that the " Principal object behind all legal formalities is to safeguard the paramount interest of justice---Legal precepts were devised with a view to impart certainty, consistency and uniformity to the administration of justice and to secure same against arbitrariness, errors of individual judgment and mala fides."

50. *The Supreme Court of Pakistan again emphasized the importance of the uniform application of the law through its judgment in the case of Ghulam Murtaza v The State (PLD 2009 Lahore 362) :*

> *"3. The quintessence of the civilization's evolution and growth in the legal field is a progression from dispensation of justice according to the principle of "justice, equity and good conscience" to "justice according to the law". The rationale or raison d'etre for this momentum. easy to discern and comprehend. is that justice ought not to be administered according to the whims, caprice or subjective standards of an individual Judge but it should be dispensed according to some codified or stipulated standards so as to render the outcome and reasonably predictable. Predictability of judicial response to an action or inaction of a person is important because by and large, people living in a community adapt or mould their conduct keeping in view the law of the land and a probable judicial reaction to their actions or inactions. The essence, therefore, is that, proverbially speaking, justice should not vary the size of the Chancellor's foot but a person inviting a legal intervention into his conduct should be able to appreciate in advance as to how he is likely to be treated by a Judge dealing with application of the relevant law to that person's conduct. Uniformity and standardization of judicial response to similar legal situations cannot, thus, be overemphasized.*
>
> *4. Of late it has been noticed by this Court that in the matter of passing sentences in cases of recovery of contraband narcotic substances under the Control of Narcotic Substances Act, 1997 different judges, both at the trial and the appellate stages, have been passing sentences upon convicts placed in similar situations which sentences are quite often hideously variable as they oscillate and fluctuate between unduly lenient and grossly oppressive. Such discrepant and vacillating judicial responses to similar situations not only give rise to confusion and uncertainty but they also encourage unscrupulous litigants and lawyers to try to shop for a suitable ludge.*
>
> *5. We have carried out a survey of all the cases reported in various Law Reports/Journals of the country to find out the sentencing trends of different courts and Judges in cases involving recovery of contraband narcotic substances under the Control of Narcotic Substances Act, 1997 and the information gathered through the said survey shows, and shows quite strikingly, that the sentencing trends in cases of recovery of contraband narcotic substances vary quite sharply and judicial responses in that regard differ quite drastically even in situations which may be similar, if not identical. Such variable approaches clearly underscore the importance of uniformity and standardization in the matter of sentencing in this area and, thus, the efficacy and necessity of adopting a sentencing policy in' that regard cannot be overstated."(emphasis provided)*

51. *In order to avoid the appearance of inconsistency, the SECP must ensure a fair and reasoned application of the law administered by it which demonstrates a consistent approach as noted in the Peshawar High Court case of Zahid Ullah v NWFP Public Service Commission through Chairman, Peshawar (PLD 2010 Peshawar 2) in the following terms:*

> *"Lack of uniformity is an unmistakable indication of tyranny. The more tyrant the ruler, the more numerous the laws, is took known an adage to be reiterated."*

52. *Without prejudice to the submissions made in relation to jurisdictional issues, in light of the instructions of the superior judiciary and the Commission's own determination in similar circumstances, application of the law has to be done in a consistent manner ensuring uniformity and fairness.*

53. *In this regard, reliance is placed on the precedents developed by the SECP with respect to investments in associated undertaking where no fine was imposed by the SECP and operating paragraph of some of such cases are reproduced hereunder:*

a. *In the matter of Kohinoor Power Company Limited through order dated 2nd October,2020 it was held that, "5. The management of the Company has undertaken to settle the outstanding balance in the matter mentioned above vide its letter dated 20th September, 2000. I am of the view that objective of proceeding under Section 208 ibid stand achieved and this arrangement will serve the interest of small shareholders of M/s Kohinoor Power Company Limited better.*
6. In view of the above, the proceedings initiated under Section 208 ibid are dropped. However, if default is made in complying with the undertaking given by the company in its letter dated September 20, 2000 appropriate action will be taken in the matter."

b. *In the matter of Bestway Cement Limited through order dated 15th April, 2016 it was held that, "7. For the foregoing reasons. I am of the opinion that the provision of Section 208 of the Ordinance has been violated by the respondents as they failed to take approval of shareholders before making investment in subsidiary. However, I have noted that the respondents have admitted oversight on their part and obtained shareholders' approval by providing complete information as required by the law. The self-realization and corrective measures taken for avoidance of future errors are also reassuring. T'he enforcement and regulatory function of the commission is aimed at building a compliant corporate culture, directors have key role in ensuring that seed of this culture grows and is well nurtured. I have also considered the fact that the Company recently took over Pakcem Limited by acquiring up to 87.9% shares; the said transaction was approved by the shareholders. The transaction in question appears to be a consolidation of the aforesaid acquisition which enhances the company's ownership in Pakcem Limited to 88.2%. Therefore, I take a lenient view and hereby warn the respondents to ensure meticulous compliance of law in future"*

c. *In the matter of Systems Limited through order dated 6th July, 2022 it was held that, "....it is stated that non-compliances with Section 199(1) of the Act in the matter of issuing guarantees on behalf of UUS-JV and extending loan to SUS-JV have been established and conceded. Therefore, the Respondents are liable to be penalized under Sub-section (6) of Section 199 of the Act. However, taking cognizance of subsequent ratification of the said non-compliances by obtaining post facto approvals in the matter of UUS-JV and SUS-JV in the EOGM held on December 01, 2017 and the AGM May 29, 2020, respectively, I in terms of the power conferred under sub-section (6) of Section 199 the Act hereby conclude the proceedings initiated through the SCN, without imposing any monetary penalty. The Respondents are, however, directed to ensure compliance with all the applicable regulatory requirements including Section 199 of the Act in the and spirit, in future."*

d. *In the matter of Sitara Peroxide limited through order dated 28th February, 2019 it was held that, "10. In view of the foregoing, I am of the view that although the Respondents have violated the provisions of Section 199 of the Act (Section 208 of the repealed Companies Ordinance, 1984), however, the Authorized Representative during the hearing proceedings gave his firm commitment to recover the balance amount of Rs 11 million. Later on, the Company submitted the evidence of recovery of Rs 11 million, which shows that the Company was serious for recovery of the outstanding amount and have actually recovered the full amount accordingly. I consider it encouraging that the Respondent made serious efforts for recovery of the balance amount and provide documentary evidence to the Commission. I, therefore, take a lenient view and warm the Respondent to be careful in future and observe the compliance of law in letter and spirit."*

e. *In the matter of AKD Capital Limited through order dated 16th April, 2015 where amount was advanced to an associated company and show cause notice was issued under Section 208 and 160 of the repealed Companies Ordinance, 1984 it was held that, '"9. The aforesaid provisions of Law are clear and explicit. It is my considered view that the respondents have failed to comply with the Regulations and Section 160 of the Ordinance. However, keeping in view of the admission of default, assurance of compliance of applicable law and considering recovery of loan and interest from CDPL I, instead of imposing any penalty hereby warn the Respondents of the Company to be careful and ensure meticulous compliance of the law in future."*

f. *In the matter of Jubilee life Assurance Company Limited through order dated 2nd July, 2014, it was held that, "21. ... the default of Section 208 of the Ordinance is established, which has also been accepted by the Company. Therefore, the penalty as provided under Section 208 (3) of the Ordinance can be imposed .... The company's management and its directors have ratified the previous instance of the Company's investment in Packages Limited by obtaining approvals of the company's shareholders ....The Company divested the portion of its investment in shares of M/s Industries Limited, as remedial measure in order to reach out to a level where no further approval of the shareholders in required .. .. The Company contravention has so far not been reported to have affected any of the shareholders of the Company....the Company (its Directors and Chief Executive of the Company) is hereby issued a stern warning that in case of similar non-compliance in future stronger action against the Company will be taken .... The Company is also directed to get the Company's investment in M/s International Industries limited, for the period during which the Company was in contravention of the provisions of Section 208 of the Ordinance, ratified by getting the excess unapproved portion of these investments approved by the Company's shareholders / members."*

g. *In the matter of Khalid Siraj Textile Limited through order dated 28th June 2006 it was held that "15. I have analyzed the facts of the case and observed that the resolution was passed under the provision of Section 208 of the Ordinance in the year 1992. It is therefore viewed that in the above scenario, making of advances in the years 2003 and 2004 on the basis of afore referred resolution cannot be treated as a valid investment. The Chief Executive was authorized to extend advance up to a specified limit to the associated undertaking, and once the amount advanced reached that limit, the said authority extinguished there and then. As construed by the company, the resolution gives all the authority to make investments solely, to the Chief Executive of the Company. This is against the spirit of the law and good corporate governance that requires such transactions to be properly authorized by the shareholders before entering into and making material disclosures to the shareholders regarding any changes in the same. The mandate in respect of making investment in the associated undertaking is with the shareholders and they only delegate the authority after making a well informed decision with unambiguous term and conditions. These facts when highlighted during course of the hearing were acknowledged by the respondents, who accepted the lapse at their part and requested for suggesting of remedial measures. It appears from the written reply and arguments put forward at the time of hearing that it was an honest mistake on the part of the Directors who were under the impression the aforesaid resolution was valid and accordingly, the chief executive had the authority to extend advance to the associated company. On the basis of the aforesaid. I am of the view that the default under Section 208 of the Ordinance is not willful."*

h. *In the matter of Gray Mackenzie Restaurant International Limited trough order dated 31st May 2018 it was held that, "11. I have analyzed the facts of the case, provisions of Sections 208 of the Ordinance, arguments put forth in writing and during the hearings by the Authorized Representatives. I am of the view that the provisions of section 208 of the Ordinance have been violated. However, it is necessary to refer to certain facts of the case before concluding the proceedings. The ultimate owner of both the Company and CPL is the same i.e Cupola Investments*

Limited ("CIL") and that there is no public money invested in the Company. It is further noted that the Company is a closely held entity only shareholders as per the Form A made up to October 31. 2014 and eight of the shareholders hold ten shares or less whereas CIL Holds 95% shares of the Company. There is no complaint on record in the instant matter and it has been submitted that all amounts have been utilized for the operations and closure of CPL and its subsidiaries and it has been assured that the principal amount and accrued interest has been guaranteed by CIL and the Company is expected to be reimbursed by CIL for any amount due from CPL. It has been further submitted that the Company will recover this amount from CIL over next two years.

12. In view of the foregoing, I am inclined to take a lenient view in the matter and conclude that proceedings with a warning to the respondents to ensure meticulous compliance with all applicable provisions of the law in future. Further the Chief Executive is directed to submit report to the Commission after recovering the amount from the associated company as per the commitment given in the hearing."

i. *In the matter of The General Tyre and Rubber Company of Pakistan Limited through order dated 4th January 2017 it was held that "6. Having gone through the relevant provisions of the law, facts of the case and the submission of the respondents, I have concluded that the Company has violated the provisions of section 208 of the Ordinance as it made investment in GIL's shares without approval of the shareholders and also allowed relatively extended credit period to associated companies vis-a-vis other customers. While it is true that the decision to subscribe to the right shares of the GIL was beneficial to the Company, the respondents' plea that they had time constraints is not tenable as no evidence has been provided to substantiate the claim that the Company received the offer for right on the last date. However, the decision was made by Mr. Zuberi, who was chief executive at that time based on the instruction and understanding that the decision would be ratified later on. With regard to the decision by the directors to dispose of the GIL's shares, it appears that complete information was not provided to the board in this regard. However, I am of the firm view that the directors should have been vigilant enough to seek information and documentary evidence with regard to the transaction to avoid being caused to the Company as a result of disposal of GIL's shares. The respondents other than interested directors do not appear to have any interest in the transaction involving disposal of GIL's shares and hence appear to have made the decision in good faith. The interested directors being beneficiaries of the transaction bear the full responsibility regarding violation of section 196 of the Ordinance as a result of loss caused to the Company by disposing of the GIL's shares for consideration below market value. However, since the BSI has paid the amount of Rs. 5,521,105 to the Company to compensate the loss caused to the Company at relevant time as a result of the transaction and keeping in view the fact that the honorable Supreme Court of Pakistan has sent aside the original order, I am inclined to take a lenient view in the matter. Moreover, as stated by the respondents, the Company has revamped its trade credit policy to be uniformly applied to all the trade transactions with customers including the associated undertakings. In view of these facts. I hereby conclude the proceedings against the five interested directors with a stern warning to them to be careful in future and ensure meticulous compliance with applicable legal provisions. The proceedings against other respondents. who did not have interest in the transactions, are hereby concluded without adverse order."*

j. *In Appeal No. 40 of 2013 through order dated 6th July 2015 it was held that "14. The Appellants were penalized for violation of certain procedure and statutory requirement envisaged in section 208 of the Ordinance. The penalty imposed through the impugned order was not based on any loss caused; rather it was invoked for violation of the requirements contained the relevant, section.*

15. In the light of above-stated facts and submission made before the Appellate Bench by the parties on the basis of our analysis on the ground of appeal, it has been established by the conduct of the Appellants that violation of section 208 has been committed. However, in view of the fact that the said violation was ratified by the shareholders of the Company in their general meeting on October 30, 2012 and the fact that LC Commission has always been received from SECL taking a lenient view, We set aside the Impugned Order to the extent penalty."

54. There are many other precedents where relief was granted by the Commission in cases of established default. Such cases may be discussed at the time of hearing of the matter at hand for the sake of brevity of these submissions.

55. It is evident that principles governing the interpretation of penalizing law favor the subject and the SECP has acknowledged this position in the past. Accordingly, it is submitted that where the Company has complied with the law in accordance with the interpretation understood by it, the violations perceived to have been committed by the Company do not justify the imposition of penalties where the penalty would be a harsh consequence where the Company has not intended to violate the law and, as per its interpretation, there has actually been no violation.

56. On this ground alone the SCN is liable to be set aside without any adverse consequences for the Company.

The Company has been deprived of its constitutional right to equal treatment under the law as SECP has acted contrary to its established practice of informing mechanism on receipt and processing of materials/information/documents provided by the companies:

57. The provisions of Section20(6)(e) of the SECP Act are reproduced hereunder for ease of reference:

> *"20. Powers and functions of the Commission. - (1) The Commission shall have all such powers as may be necessary to perform its duties and functions under this Act or any administered legislation*
> .....
> *(6) In performing its functions and exercising its powers, the Commission shall strive-*
> .....
> *(e) to receive, process, and store, efficiently and quickly, the documents lodged with, and the information given to it under this Act, the Ordinance or any other law;"*

58. It is submitted that the Company ensured timely dissemination of pertinent information/ notices as and when required by law, however, it appears that the SECP, despite a number of communications with regard to this matter, neither processed/questioned the proposed transaction nor demanded any further information to be disseminated pursuant to requirements of Section 199 of the Act. Accordingly, it is presumed that the SECP did not find anything objectionable and, therefore, it was considered that the transaction was in order and in accordance with law and the regulations.

59. It is submitted that the SECP has, in many cases, immediately issued directions against filed notices/information/ documents pursuant to the provisions of law where it has assessed that the underlying transaction may not be in accordance with law and that the established practice of the SECP indicates that the SECP employs an informing mechanism which the Company has been deprived of in violation of its constitutional right to equal treatment under the law.

60. *It is also submitted that there was full disclosure regarding the proposed transaction in the notices of meeting and the financial statements amongst other documents pertinent for the information of investors and shareholders of the Company. The SECP, as the regulator, never provided any instruction on how to proceed in the matter nor was there any indication that the matter was of a nature that required a treatment different from what was being given it by the Company.*

61. *Accordingly, it is submitted that where the Company has made adequate disclosures at various points in time, the Company cannot be found in violation of Section 199 of the Act about six (6) years after the perceived cause of action first arose especially where the regulator has been aware of the proposed transaction and is entrusted with the duty to implement the law under its administration in accordance with the principles of natural justice and equal treatment.*

Substantial Finding of Guilt and Test of Knowing and Willful Default:

62. *Without prejudice to the above arguments, it is further submitted that penalties may only be imposed upon a finding of guilt on part of the offending party and this would be the case even if the law did not specifically require establishment of guilt as it is an understood position of jurisprudence developed by the courts of law in Pakistan. That there must be a substantial finding of guilt before application of stringent penal provisions has been categorically instructed by the Supreme Court of Pakistan in the case of Securities and Exchange Commission of Pakistan v. First Capital Securities Corporation Limited (2011 PLD 778) in the following manner:*

> *"20. It should also be clarified that since the penal provision is stringent in nature it should be applied in an appropriate manner. In applying such a provision SECP should always bear in mind the importance of determining not merely a technical contravention but a substantial finding of guilt in relation to the person on whom the fine or penalty is being levied. It is not sufficient either in the case of this law, or any other law, merely on the basis of a contravention to arbitrarily impose a fine either the full amount or 50% or 75% or any other arbitrarily chosen figure; a condign punishment is the requirement of law and equity.*
>
> *21. In view of the aforesaid, this appeal has no merits and is hereby dismissed."*

63. *It is also submitted that the fine could only be imposed if the directors are "knowingly and willfully in default". The words "knowingly and willfully" require proof of knowledge, intention and willful action. The term "willfully" as used in different statutes and judicial precedents means "deliberate or intentional act". It connotes conscious act signifying something more than a mere omission, default or inaction or the part of a person who is under an obligation to do something.*

64. *With regards to the requirement for establishing willful non-compliance, the Appellate Bench of the SECP has noted the requirement in Appeal No. 44 of 2014 in the matter of re: Fauji Cement Company Limited vs. Director (MSRD) dated 24 August 2015 that:*

"Moreover, penalty can only be imposed under Section 224(4) of the Ordinance if the failure to commly was willful which has not been established on the facts of the instance case."

65. *Similarly, in re: Next Capital Limited vs. Director (MSRD) Appeal No. 26 of 2015 dated 24 July 2015 it was held by the Appellate Bench that:*

"The word "willful" can be used interchangeably with the word "intentional". Reliance is placed on the Lahore High Court Judgement of Pakistan Indus promoters Limited v. Monopoly Control Authority (1990) CLC 1008, wherein it was held that, the word willful means, "...an act done

Intentionally, knowingly or purposefully as distinct from the one done carelessly, thoughtlessly or inadvertently... "

66. Accordingly, you will appreciate that in accordance with wen-established principles of statutory interpretation, there is a perfectly reasonable interpretation of provisions of Section 199 of the Act which is to be preferred over other stingent and repugnant interpretations which may lead to imposition of penalties. On this basis, the SCN is liable be withdrawn without any adverse consequences to ensure fairness and justice in the application of the law administered by the Commission.

C. Para-Wise Reply To SCN

67. Without prejudice to the jurisdictional, legal and procedural submissions in the preceding sections, the following para-wise reply is submitted to the SCN on merits:

68. That the contents of Paragraph 1 of the SCN, as laid out, are denied and the following submissions are made:

a. As explained in the background facts, the loans extended to FEL and markup thereon are subordinated to the secured obligations of the FEL lenders in terms of the SSA, the execution of which has been approved by the shareholders through special resolution in their meeting held on 30th May, 2017. Accordingly, the loans and markup thereon, subordinated to the lenders' secured debt obligations of FEL in accordance with the special resolution of the shareholders of the Company dated 30th May, 2017, can be paid by FEL only after settlement of financing obtained from its lenders. You will kindly appreciate that the shareholders through their aforementioned special resolution have authorized the Company to fulfill its commitments to FEL lenders in terms of the SSA and to execute the related agreements, documents, undertakings and commitments as required by the lenders of FEL as may be considered appropriate by the directors of the Company. The SCN has conveniently ignored this fact which is the basis for the investment made by the Compony in FEL. In view of the fact that the loan and markup thereon are subordinated in accordance with shareholders' approval in terms of Section 199 of the Act, we respectfully disagree with the allegation that the Company has failed to recover the mark up of PKR 813.882 million from FEL. The markup will be recovered from FEL in accordance with the approval of the Shareholders and the terms of the SSA, as approved by the shareholders.

b. Regulation 5(6) of the Regulations, which prescribes the recovery of interest or mark up being relevant in the context of the present proceedings is reproduced hereunder for ease of reference:

"5. Restrictions and conditions applicable to a company making investment.-

....

(6) Interest, mark up. profit, fees or commission, as the case may be, shall be recovered periodically by the investing company in line with the terms and conditions approved by the members."

c. It may be appreciated that the term 'periodical', for purposes of establishing the intervals at which mark-up or other related payments may need to made in relation to an investment by way of loan under Section 199 of the Act, has not been defined in the Act or the Regulations.

d. You will appreciate that the law has not sought to prescribe parameters for what may constitute 'periodically' which is the term employed in the SCN for purposes of establishing a

violation of Section 199 of the Act. Indeed, the law cannot prescribe parameters for what may constitute periodical for arrangements to be finalized by a corporate entity where the corporate entity may exercise discretion in relation to the periods for repayment. Clearly, what constitutes the norm for a corporate entity is to be determined by the corporate entity itself, as allowed by applicable law, and not by the regulator which may only apply the law and not seek to enhance it by incorporating words into the law that have not been expressly mentioned therein.

e. You will also appreciate that in the absence of defined parameters for the words 'periodically', the length of time shall be calculated in accordance with 'terms and conditions' agreed between the companies in relation to the same and will depend on the circumstances approved by the members of the investing company. For example, if the members of the investing company have decided that interest or markup shall be received yearly then, for the purposes of regulation, the term 'periodically' must be interpreted to mean once a year and not otherwise. Likewise, if the members have decided that interest will be recovered on a quarterly basis, the term 'periodically' will be interpreted to mean four times a year and not once yearly. Conclusively, therefore, the term 'periodically' must be defined in accordance with the terms agreed between the companies and approved by the members of the investing companies and not otherwise".

f. It is further submitted that the provision of Section 199(2) of the Act allows the investing company to agree with terms and conditions including the terms for repayment and penalty in case of default or late payments in accordance with the approval of the members in the general meeting. The above provision being relevant to the case at hand is reproduced hereunder:

> ***"199. Investments in associated companies and undertaking. –***
>
> *(2) The company' shall not invest in its associated company or associated undertaking by way of loans or advances except in accordance with an agreement in writing and such agreement shall inter-alia include the terms and conditions specifying the nature, purpose period of the loan, rate of return, fees or commission, repayment schedule for principal and return, penalty clause in case of default or late repayment and security, if any, for the loan in accordance with the approval of the members in the general meeting"*

g. You will also appreciate that the aforesaid provision of law envisages that the investing company may require, through agreement, the application of penalties for default or delay in payments and that the investment in the associated company can be rescheduled in case of delay or failure to repay the principal and return. This language of the primary law expressly empowers a company to determine every aspect of a proposed investment by way of loan through agreement. The very nature of agreement envisages operation of discretion by parties to the agreement. No Intervention by a third party or regulator is envisaged for the conclusion of the agreement referred to in Section 199(2) of the Act. In this regard, where the SCN seeks to interpret the Regulations in a manner that would prescribe thresholds that would operate to curtail the discretion of a company as expressly provided for in Section 199(2) of the Act, the proceedings are liable to be dismissed as being ultra vires.

h. In light of the above, it is submitted that the loan and markup thereon is subordinated as authorized by the members of the Company. The subordination of the loan is in favour of FEL's lenders against financial facilities availed by FEL as has been approved by the shareholders special resolution dated 30th May, 2017 passed in accordance with the requirements of the Act.

i. *Accordingly, it is submitted that there has been no violation of Section 199 of the Act where the law does not seek to prescribe parameters for what constitutes 'periodically' for purposes of Section 199 of the Act and loan being a subordinated loan, the markup has been accrued to be paid after the settlement of FEL lenders as approved by the shareholders through special resolution dated 30th May, 2017.*

69. *As all investments were made after entering into agreements with FEL, as made mandatory by provisions of Section 199 of the Act, which clearly provides that the markup will be charged or accrued. The term accrued markup means the amounts of money that has been earned but not yet received. It is the amount of money that is going to come in from a customer. It is evident that terms and conditions of the agreement are not repugnant to the provisions of Section 4 of the Companies Act but are exactly in line with the requirements of the Act and Regulations.*

70. *With regards to the terms and conditions attaching to the loans advanced to FEL you will appreciate that all provisioning has been made in the underlying agreements, as approved by the shareholders of the Company to allow variation in the periodical payments of the mark-up and repayments Para 4 of the SCN itself evidences the existence of approvals for periodical payments over ten years. The Company's shareholders of the Company have approved that the loan and markup thereon provided to FEL will be a subordinated loan and will be paid after settlement of FEL lenders.*

71. *In view of the above, it is respectfully submitted that further shareholder approval was not required in the matter at hand as the shareholders of the Company have already approved that the loan provided to FEL will be subordinated and that repayment of principle and interest will be within the 10 years subject to the repayment of loan by FEL to its lenders.*

72. *That the contents of* ***Paragraph 2*** *of the* ***SCN****, as laid out, are not denied, as the same refers to correspondence of the Commission with the Company.*

73. *That the contents of* ***Paragraph 3*** *of the* ***SCN*** *are denied to the extent that the loans provided by the Company to FEL being subordinate to repayment obligations under financial facilities extended by lenders of FEL as approved by the shareholders of the Company through special resolution in their meeting held on 30th May, 2017, has not been mentioned in the list of approvals summarized in this paragraph. The SSA is the basic document for the purposes of extending loans to FEL which has been conveniently ignored by the SCN particularly in Paragraph 3 while summarizing approvals by the shareholders of the Company for investment in FEL.*

74. *That the contents of* ***Paragraph 4*** *of the* ***SCN****, as laid out, are not denied as the same reproduces an excerpt from the notice of the shareholders meeting of the Company. It is, however, submitted that the same refers to the statement of material facts in relation to the approval of SSA pursuant to which the loans provided to FEL and markup thereon are subordinate to secured obligations of the lenders of FEL and this fact has not been mentioned in Paragraph 4 of the SCN. In accordance with the approval of shareholders in terms of SSA, the mark up could not be paid, the same will have to be accrued to be paid after settlement of the FEL lenders secured debt obligations.*

75. *That the contents of* ***Paragraph 5*** *of the* ***SCN*** *are denied to the extent that the special resolution was passed by the shareholders for execution of SSA, executed between the Company, FEL and its lenders, pursuant to which the loans to FEL and markup thereon are subordinated and the same cannot be paid until cull payment of secured obligations of the lenders of FEL. Accordingly, the terms of the agreements are as per the approvals granted by the shareholders as the question of payment of principal and markup will arise after the repayment of secured debt obligations by FEL to its lenders.*

76. That the contents of **Paragraph 6** of the **SCN** are denied as the loans provided to FEL are subordinated loans. Accordingly, the terms of the agreements may not be considered inconsistent with provisions of the Act where the Act itself allow the discretion in fixing the terms and conditions including defining the parameters of agreements to be executed by the Company, as approved by the shareholders. There is, thus, no violation of Regulation 5(6) of the Regulations where such regulation can only be read harmoniously with the enabling provisions of the authorizing law which expressly empower the Company to determine what constitutes periodical payments along with ancillary terms and conditions. Accordingly, the declaration that the 'aforesaid agreements [are] to that extent are, prima facie, void in terms of Section 4 of the Act' is entirely misconstrued and misapplication of the law. You will also appreciate that irrespective of the subordination of the loans provided by FEL, the repayment of the Company loan and markup thereon has been agreed to be paid in ten years' time.

77. That the contents of **Paragraph 7** of the **SCN** are denied that there has been any requirement for additional special resolutions terms of Section 199(4) of the Act where the existing special resolution clearly mentioned that the loans are subordinate to repayment obligations arising under finance facilities extended to FEL by lenders and authority was granted to the authorized persons to negotiate and execute necessary agreements and any ancillary matters thereto.

78. That the contents of **Paragraph 8** of the **SCN,** as laid out, are vehemently denied as provisions of Section 199(2) of the Act allow incorporation of penal clauses in any agreements to be executed in relation to investments by way of loans Moreover, the loans and mark up are subordinate to FEL lenders and shall be paid only after the lenders of FEL are fully discharged. There is, thus, no contravention of Section 199(2) of the Act and Regulation 5(6) of the Regulations.

79. That the contents of **Paragraph 9** of the SCN, as laid out, are denied and the contents of the previous paragraphs are reiterated. There have been no changes which would require approval of the shareholders as stipulated in Section 199(4) of the Act as the authorized signatories of the agreement were fully empowered to make requisite to FEL repayment obligations in view of the subordination of the loans in favor of FEL lenders in accordance with the approval of the shareholders through special resolution dated 30th May,2017.

80. That the contents of **Paragraph 10** of the **SCN,** as laid out, and the contents of the previous paragraphs are reiterated which adequately explain that the conclusion drawn in this paragraph is not based on the factual position with regard to year 2021 and no calculation has been provided for attributing indirect shareholding to the mentioned two directors which may form the basis for assessment of FEL as an associated company of the Company in the year 2021.

81. That the contents of **Paragraph 11** of the **SCN,** as laid out, are a reproduction of Section 199 of the Act and relevant regulations, hence need no response.

82. That the contents of the remaining paragraphs of the SCN are acknowledged, however, it is reiterated and reasserted that the SCN has been issued on the basis of a repugnant interpretation of the law which has resulted in establishment of liability where none exists in the law and the Company and its directors have not violated the provisions of the Act as alleged in the SCN. Accordingly, the SCN is liable to be withdrawn without any adverse consequences for the Company or the Directors.

83. Without prejudice to above submission, it is stated that the sponsors hold 87% shares of the Company due to which it was not difficult to pass a special resolution as is evidenced from the passing of such special resolutions in the past. However, in view of the loan being subordinated to FEL

Lenders, the Company genuinely understand that no further approval is required from the shareholders."

Unquote:

12. In order to provide opportunity of personal representation, hearing in the matter was fixed for February 6, 2023 and February 22, 2023. In this regard, Mr. Rashid Sadiq, through email dated February 21, 2023, sought two weeks adjournment. Hearing in the matter was later fixed for March 16, 2023 and March 21, 2023. On the date of hearing, Mr. Rashid Sadiq and Mr. M. Azeem Rashid appeared as Authorized Representatives. They reiterated their stance as was given in writing through letter dated March 15, 2023.

13. Subsequent to the hearing, the Authorized Representative through letter dated March 29, 2023 submitted a copy of letter dated March 27, 2023, in terms of which the Company stated that:

"This is in regards to the show cause notice dated 9th January 2023, bearing reference no. CSD/233/199/2002-689 (SCN) issued to Fazal Cloth Mills Limited (Company) and hearings held in relation thereto on 16th March 2023 and 21st March 2023.

As advised at the aforesaid hearings, the Company hereby conveys the following actions to be taken in terms of the accrued mark up on the subordinated loan provided by the Company to Fatima Energy Limited (FEL). It may be noted here that the markup thereon is also subordinated to the secured debt obligations of Fatima Energy Limited as per the Sponsor Support Agreement duly approved by the shareholders in terms of Section 199 of the Companies Act, 2017 (the Act).

1. *The entire markup amount shall be converted into equity as per the Sponsor Support Agreement by obtaining approval of shareholders of the Company by way of Special Resolution;*
2. *FEL will be seeking the Securities and Exchange of Commission of Pakistan's (SECP) approval in terms of applicable law and regulations for issuance of shares otherwise than right.*
3. *Subject to approval of the SECP, the Company hopes that the above should be completed by 30th June 2023.*
4. *The Company is also seeking fresh approval from shareholders for investment in FEL for satisfaction of the SECP though in the considered view of the Company the same is already approved by the shareholders in terms of Section 199 of the Act and regulations issued thereunder.*

The above are without prejudice to our argument that the loan provided to FEL is subordinated to its secured lenders as per the Sponsor Support Agreement that was approved by the shareholders through special resolution in their meeting held on 30 May, 2017.

Accordingly, the Sponsor Support Agreement specifying the subordination of the said loan is one of the terms and conditions approved by the shareholders and all loan agreements entered into by the Company are subject to the subordinated aspect, as has been approved by the shareholders. You are, therefore, requested to please take into account the fat that the shareholders were always aware and approved the matters in relation to the said loan advanced to FEL. The Company is strictly complying with the special resolutions passed by the shareholders which provided accrual of markup being subordinate to the FEL secured debt obligations. The principal amount of the loan has already been converted into equity and mark-up will also be converted into equity of FEL. This letter may be treated as component of the submissions made by the Company in its defense with regards to the SCN."

14. Before proceeding further, it is necessary to refer to relevant legal provisions, which are reproduced as under:

Section 199(2) of the Act

"(2) The company shall not invest in its associated company or associated undertaking by way of loans or advances except in accordance with an agreement in writing and such agreement shall inter-alia include the terms and conditions specifying the nature, purpose, period of the loan, rate of return, fees or commission, repayment schedule for principal and return, penalty clause in case of default or late repayments and security, if any, for the loan in accordance with the approval of the members in the general meeting:

Provided that the return on such investment shall not be less than the borrowing cost of the investing company or the rate as may be specified by the Commission whichever is higher and shall be recovered on regular basis in accordance with the terms of the agreement, failing which the directors shall be personally liable to make the payment:

Section 199(4) of the Act:

"(4)An increase in the amount or any change in the nature of investment or the terms and conditions attached thereto shall be made only under the authority of a special resolution.

Regulation 5(6) of the Regulations:

5(6) Interest, mark up, profit, fees or commission, as the case may be, shall be recovered periodically by the investing company in line with the terms and conditions approved by the members.

Section 199(6) of the Act:

(6) Any contravention or default in complying with requirements of this section shall be an offence liable to a penalty of level 3 on the standard scale and in addition, shall jointly and severally reimburse to the company any loss sustained by the company in consequence of an investment which was made without complying with the requirements of this section.

15. I have reviewed the submissions made in writing and during the hearing as well as issues highlighted in the SCN. In this connection, it is stated that:

(i) As per available information, an amount of Rs. 813.882 million (2020: 552.664 million) is due from the associated company namely FEL. In this regard, the Respondents in their representation has stated that: *"FEL could not achieve commercial operations date (COD) as of to-date in terms of the Cogen Policy 2008 of the GOP. FEL could not service its secured debt obligations towards its bankers and financial institutions and had to get its loans rescheduled".*

Moreover, the Respondents have submitted that: *"It may be noted that the Company is under a Sponsor Support Agreement (the SSA) with FEL, its other sponsors and its lenders. Pursuant to the SSA, all loans including markup thereon has been subordinated to the secured debt obligations of the lenders of FEL. Accordingly, the principal amount of the loans provided by the sponsors as well as markup accrued on these loans cannot be repaid by FEL till full payment to the lenders. The sponsors loan and markup thereon, however, can be converted into equity, ordinary or preference, of FEL in terms of the SSA. The shareholders of the Company through special resolution dated 10th March 2022 have approved, with the permission of the Commission, the conversion of investment of the Company in FEL into preference shares in terms of Section 199(4) of the Act".*

The Respondents have relied on authorization of members as was allowed in general meetings held on May 30, 2017, to enter into Sponsors Support Agreement (SSA). In this regard, relevant authorization is given as below:

"Resolved that the Company, as sponsor, be and is hereby authorized to enter into a sponsor support agreement with Fatima Energy Limited, an associated undertaking (FEL) and its lenders including Habib Bank Limited, Bank Alfalah Limited and other financial institutions (FEL's lenders) along with other sponsors, and to make investment up to Rs. 1,000 million in FEL in the form of loan or advance in lumpsum or in parts at markup chargeable in parts at mark-up chargeable at a rate of KIBOR + 1% in terms of section 208 of the Companies Ordinance, 1984 subject to occurrence of default by FEL in repayment of its obligations/liabilities towards the FEL's lenders, in such case the Company is hereby authorized to fulfill its guarantee/commitment/stand by letter of credit/undertaking to FEL's lenders in terms of the Sponsor Support Agreement."

I have reviewed the grounds and of the view that the Company sought approval of extending loans in the associated company. Moreover, through the SSA the authorization was conditional and was subject to occurrence of default by FEL in repayment of its obligations/liabilities towards the FEL's lenders and in that case the Company was authorized to fulfill its commitments to FEL's lenders in terms of the SSA. As per available information, the Company disbursed an amount of Rs. 3,138.740 million to associated company FEL and there against a mark-up of Rs. 813.882 million was outstanding as of June 30, 2021.

As per available information disclosed in note 19.2.1 to the Accounts of 2020, FEL entered into restructuring arrangement with the lenders in terms of which loans were repayable starting from 2026. In this regard, I am of the view that the provisions of the Act and of the Regulations require periodical and regular recovery of mark-up for the amounts invested in the associated companies and the aforesaid legal requirements do not allow open ended credit terms, and non-recovery of mark-up on regular basis, for the investments in associated companies. Given the available information, and the stance of the Respondents, the principle and mark-up due from the associated company FEL is subordinated, hence, the same cannot be repaid before 2026; the said position is contrary to the provisions of the Act and of the Regulations and is not in the interest of the investors of the Company who hold shares prior to the realization of this arrangement. Therefore, I am of the view that the stance taken by the Respondents and their Authorized Representatives is not cogent.

(ii) As per available information both the Company and FEL were associated companies in the year 2020 due to common directorship. The Respondents have not contended this position. Moreover, during the year 2021, Mr. Faisal Ahmed and Mr. Fahad Mukhtar, both were holding directly/indirectly, 21.59% and 2.96% shareholding of FEL respectively. The Respondents have not denied the aforesaid indirect shareholding of Mr. Faisal Ahmed and of Mr. Fahad Mukhtar. In this regard, Section 2(1)(4) of the Act states that:

*"associated companies" and "associated undertakings" mean any two or more companies or undertakings, or a company and an undertaking, interconnected with each other in the following manner, namely – (a) if a person who is owner or a partner or director of a company or undertaking, or who, **directly or indirectly**, holds or controls shares carrying not less than twenty percent of the voting power in such company or undertaking, is also the owner or partner or director of anther company or undertaking, or directly or indirectly, holds or controls shares carrying not less than twenty percent of the voting power in that company or undertaking."*

The aforesaid provisions take into account both direct and indirect shareholding of a person in case of associated companies. I am of the view that both the Company and FEL are associated companies in terms of Section 2(1)(4)(a) of the Act due to the fact that two directors of the Company namely Mr. Faisal Ahmed and Mr. Fahad Mukhtar were indirectly holding 21.59% and 2.59% shares of FEL respectively. The aforesaid reflects that the ownership in FEL were **controlled** by the mentioned directors to the extent of the aforesaid shareholdings. Mr. Faisal Ahmed and Mr. Fahad Mukhtar were indirectly holding 21.59% and 2.59% shares of FEL respectively, hence, the director having 21.259% shareholding was having control over twenty percent shareholding of the FEL, through the indirect shareholding of FEL. Due to the cited fact, both the Company and FEL are associated companies in terms of the aforesaid provision of the Act and reliance of the Respondents on the precedent case which is based on the provision of erstwhile Companies Ordinance, 1984 is not cogent.

Moreover, it is important to mention here that the board of directors in its meeting held on June 10, 2020 modified the term of payment of markup through supplemental loan agreement dated June 10, 2020. In view of the aforesaid, it is evident that both the Company and FEL were associated on June 10, 2020, owing to the common directorship of Mr. Faisal Ahmad and Mr. Fahad Mukhtar as both were on board of the Company and as well as on the board of FEL. Hence, the provisions of Section 199 of the Act were duly applicable on the Company. Therefore, any change in the nature of investment or the terms and conditions attached thereto by the board was contrary with the provisions of Section 199(4) of the Act.

(iii) The Respondents are of the view that there is no requirement for additional special resolutions in terms of Section 199(4) of the Act where the existing special resolution clearly mentioned that the loans are subordinate to repayment obligations arising under finance facilities extended to FEL by lenders and authority was granted to the authorized persons to negotiate and execute necessary agreements and any ancillary matters thereto, in accordance with the approval of the shareholders through special resolution dated 30th May, 2017. In this regard, as per available information, the board of directors in meeting held on June 10, 2020 deliberated that:

"The loan investment which has been made and will be made in future in terms of approvals already sanctioned by the Company's shareholders in Fatima Energy Limited (FEL), will be repaid by FEL within already approved tenure of ten years but repayable in four annual installments starting from December 31, 2026 ending to December 31, 2029. Mark up on this investment will also be recovered accordingly at the time of repayment of these installments".

Relevant terms of the aforesaid agreement are as given below:

"C. Pursuant to restructuring of FEL's borrowings with financial institutions along with subordinations of FCML/other group Companies' borrowings and at the request of FEL, FCML is agreed to get repayments of its Loan & Advances from FEL within the original tenor of ten years by way of four annual installments falling due on 31-12-2026, 31-12-2027, 31-12-2028 and 31-12-2029.

D. To give effect to the foregoing amendment mentioned in recital-C above, the FCML and FEL have agreed to amend the Loan Agreement accordingly in terms of this 2nd Supplemental Agreement.

2. *Mark-up / interest on Loan & Advances shall be paid by FEL at the time of repayments of above installments but not before the date of above installments."*

In this regard, the loan agreements dated May 30, 2017 and September 15, 2018 clearly stated that:

> *"Markup will be payable on quarterly basis or otherwise accrued with the consent of the both parties."*

Whereas, second supplemental agreement to loan agreements dated June 10, 2020, *inter alia*, stated that:

> *"Mark-up / interest loan & advances shall be paid by FEL at the time of repayments of above installments but not before the date of above installments."*

Considering above, I am of the view that the board of directors of the Company in board meeting held on June 10, 2020 changed the terms and conditions of loans due from the associated company by amending the clause C of the loan agreement in terms of which mark-up/interest on loan and advances be paid by FEL at the time of repayments. The Respondents, however, did not seek approval of the members for the said change in terms and conditions of the investments made in associated company. As per available information, the said repayments to start from 2026. The Respondents, being directors, has amended the terms and conditions of the investments made in associated company in violation of Section 199(4) of the Act and arguments made in this regard are neither cogent nor tenable.

(iv) As regard to the stance of the Respondents that it is the company that is responsible for ensuring compliance with provisions of Section 199 of the Act and not its directors; it is hereby stated that first proviso of Section 199(2) of the Act provides that: *"Provided that the return on such investment shall not be less than the borrowing cost of the investing company or the rate as may be specified by the Commission whichever is higher and shall be recovered on regular basis in accordance with the terms of the agreement, failing which the directors shall be personally liable to make the payment."*

It is also provided under second proviso of Section 199(2) of the Act that: *"Provided further that the directors of the investing company shall certify that the investment is made after due diligence and financial health of the borrowing company is such that it has the ability to repay the loan as per the agreement."*

Moreover, Section 199(6) of the Act enjoins that: *"Any contravention or default in complying with requirements of this section shall be an offence liable to a penalty of level 3 on the standard scale and in addition, shall jointly and severally reimburse to the company any loss sustained by the company in consequences of an investment which was made without complying with the requirements of this section."*

The aforesaid provisions of the Act therefore, placed responsibility on the directors of the company for recovery of return/mark up on regular basis and also enjoin on the directors to conduct due diligence for making investments in associated company. The legal provision further emphasizes that any loss sustained in consequences of an investment

which was made without complying with the requirements of this section **shall be** jointly and severally **reimbursed to the company**.

I am, therefore, of the view that the directors of the Company, having prior obligation to conduct due diligence for making investments, are also liable for the cited default of the given provisions of Section 199 of the Act read with the Regulations, hence, proceedings were initiated against the Respondents for default of the afore stated legal provisions.

(v) I am of the view that in the instant matter an amount of mark-up of Rs. 813.882 Million (2020: 552.664 million) was overdue from the associated company FEL. The aforesaid amount is material and significant, hence, violation of Section 199(2) of the Act read with the regulation 5(6) of the Regulations is attracted in the given matter.

(vi) I am of the view that the term of the loan agreements to the extent it provides that the accrued markup will be repayable on the consent of both the parties, is inconsistent with the provisions of the Act read with the Regulations, which explicitly require to recover markup on regular/periodical basis. Therefore, the terms of the aforesaid agreements to that extent is void in terms of Section 4 of the Act. In this regard, the stance taken by the Respondents is not cogent.

(vii) The Respondents pursuant to the hearing held on March 16, 2023, through another letter dated March 29, 2023, *inter alia*, submitted that: *"Accordingly, the Company has communicated that it seeks to convert the markup amount on the loan extended to Fatima Energy Limited, amongst other things"*. The Company has submitted that subject to the approval of the Commission, the process would be completed by June 30, 2023.

In this regard, I am of the view that the amount of markup of Rs. 813 million is recoverable from the associated company for over two years period till date and any subsequent conversion of the said amount, however, does not exonerate the Respondents for the said non-compliance of Section 199(2) of the Act read with the Regulations.

16. In view of above and after careful consideration of all the facts of the case, I am of the view that aforesaid requirements of Section 199 of the Act read with the Regulations have been contravened and for this contravention, the Respondents are liable under Section 199(6) of the Act. In exercise of the powers conferred under the said provision, I hereby impose an aggregate penalty of **Rs. 500,000/- (Rupees Five Hundred Thousand only) on Fazal Cloth Mills Limited**. I also warn the Respondent directors to ensure meticulous compliance of the legal provisions of the law.

17. The aforesaid fine must be deposited in the designated bank account maintained with MCB Bank Limited in the name of the Securities and Exchange Commission of Pakistan within thirty days of the date of this order and furnish receipted bank vouchers to the Commission. In case of non-deposit of the said penalty, proceedings under Section 485 of the Act will be initiated for recovery of the same as arrears of land revenue.

18. Nothing in this Order may be deemed to prejudice the operation of any provision of the Act/the Regulations providing for imposition of penalties in respect of any default, omission or violation of the Act/the Regulations.

Shahzad Afzal Khan
Director / Head of Department
Adjudication Department-I

Announced:
Dated: June 27, 2023,
Islamabad