



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department-I

Adjudication Division

Before

Shahzad Afzal Khan, Director/ Head of Department

In the matter of

Crescent Cotton Mills Limited

Show Cause Notice No. & Date CSD/ARN/346/2016-482 dated June 06, 2023
Date of Hearing: August 10, 2023; and September 05, 2023
Present: Mr. Abdul Muqtadir Khan, Advocate (Authorized Representative)

ORDER

Under Sections 176, 205 and 207 of the Companies Act, 2017 read with Section 479 thereof

This Order shall dispose of proceedings initiated by Securities and Exchange Commission of Pakistan (the Commission) through the Show Cause Notice dated June 06, 2023 (the SCN) issued under Sections 176, 205 and 207 of the Companies Act, 2017 (the Act) read with Section 479 thereof to the board of directors of Crescent Cotton Mills Limited (the Company), hereinafter collectively referred to as the Respondents.

2. Facts of the case are that :

- i. As per note 38 of the annual audited accounts of the Company for the year ended June 30, 2022 (Accounts 2022), the Company purchased raw material of Rs. 34 million from its subsidiary company namely M/s Crescot Mills Limited (Crescot).
- ii. Review of the Form A of Crescot dated October 26, 2022 revealed that majority of directors (Interested Directors) of the Company i.e. four out of seven directors have direct interest in Crescot due to common directorship as elaborated in table (Table) below:

| Sr. # | Name of Director | Directorship in Crescot |
|-------|-------------------|-------------------------|
| 1. | Mr. Taimur Amjad | Yes |
| 2. | Mr. Abid Mehmood | Yes |
| 3. | Mr. Adnan Amjad | Yes |
| 4. | Mr. Naveed Gulzar | Yes |



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- iii. The Commission vide letter dated January 03, 2023 advised the Company to submit related minutes of the meeting of Board of Directors (**BoD**) approving aforesaid Related Party Transaction (**RPT**) along with attendance sheet and shareholders' approval. The Company in its reply letter dated January 16, 2023 stated that shareholders' approval was not required and the aforesaid transaction was approved by directors of the Company.
- iv. Review of the information received from the Company revealed that all the concerned/ interested directors despite being interested due to common directorship unanimously approved the aforesaid transaction in BoD held on September 30, 2022 and failed to disclose their interest, *prima facie*, in contravention to the provisions of Section 205 of the Act. Moreover, the interested directors failed to abstain from passing resolution and participating in proceedings of BoD meeting of the Company held on September 30, 2022 approving transactions with subsidiary company, *prima facie*, in contravention of the provisions of sub-section (1) of Section 207 of the Act.
- v. Majority of the directors being interested in the transaction as referred in Para 2(i) above, hence, were not qualified to participate and vote to approve the transaction with Crescot. The transaction, therefore, was required to be laid before the general meeting for approval in terms of provisions of sub-section (2) of section 207 of the Act as *prima facie* the quorum of directors for this resolution was not formed as stated in section 176 of the Act.
- vi. In view of above facts, the interested directors of the Company, *prima facie*, have contravened the provisions of:
 - (i) Sub-section (1) of section 205 of the Act by not disclosing their interest in the transactions despite being concerned and interest due to common directorships and/or shareholding;
 - (ii) Subsection (1) & (2) of section 207 of the Act as the interested directors have participated and voted to approve transactions with Crescot, an associated/related company, despite being concerned and interested and the transactions were not laid before the general meeting for approval.

While all the respondent directors of the Company, *prima facie*, have contravened the provisions of subsection (1) of section 176 of the Act by approving transaction with Crescot in a meeting in absence of quorum.

3. In order to take cognizance of the aforesaid non-compliance, SCN was served on the Respondents for the aforesaid contraventions of Sections 176, 205 and 207 of the Act, requiring them to explain the reasons as to why action should not be taken against them for the aforesaid contraventions.



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4. In response to the SCN, the company secretary of the Company on behalf of the Respondents through letter dated June 26, 2023 made written submission, relevant extracts of which are produced below:

- The Company purchased total Raw Materials of Rs. 4,295.075 Million from various suppliers during the year including purchases of Rs. 34.012 million (0.79% of total raw material purchases) from Cresco made at an arms' length basis using comparable uncontrolled price method. The purchases from Crescot were made without any malice or willful intent of directors and no direct/ indirect benefit or undue advantage whatsoever accrued to either Crescot or any of the directors of the Company.
- The common shareholding and directorship of the directors was categorically disclosed at the Board Meeting while approving the Transaction, in compliance with the provisions of section 205(1) of the Act and it was made clear that none of the directors had any direct or indirect personal interest in the Transaction. Further the Transaction was independently reviewed and approved by the two independent directors of the Company.
- The provisions of section 205(1), 207(1), 207(2) and 176 of the Act are not applicable to any of the Directors of the Company, as none of them has knowingly and willfully defaulted and in discharging their duties as such, have acted at all material times in good faith in accordance with their obligations under law.
- The Transaction is a "related party transaction" covered by Section 208 of the Act, which allows a company to engage in an "arm's length transaction" with a related party and exempts an arm's length transaction like the Transaction, from compliance requirements contained in Section 208(1) of the Act, which inter alia include the requirement to hold a general meeting where the majority of directors are interested and the said exemption would be rendered meaningless if these compliance requirements could be imposed through the invocation(s) of Sections 176, 205 and 207 of the Act. Calling a general meeting of hundreds of shareholders for a Transaction that constitutes only less than a percentage point of raw material purchases is not practical as it involves considerations concerning cost and time. The most efficient manner to approve such transactions in the best interest of the Company is the board meetings. Hence, in the circumstances, the procedural inadequacies relating to quorum (if any) do not imply malice or mal-intent on part of the directors and shall not entail any penal consequences.

5. In order to provide opportunity of personal representation, hearings in the matter were fixed for August 10, 2023 which was adjourned on request of the Respondents. Subsequently hearing was scheduled for September 05, 2023, wherein Mr. Abdul Muqtadir Khan, Advocate, appeared before the undersigned on behalf of the Respondents as their Authorized Representative (AR) and submitted that:

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- Crescot- is a subsidiary of the Company (66.67% shareholding) due to common shareholding & directorship. Both companies are family owned and run , for the last 50 years;
- Company purchased 77,529 kg of viscose fibre for Rs. 34.012 million at an average price of Rs. 374.96/ kg using Comparable Uncontrolled Price Method from Crecot in FY 2022, which constitutes only 0.79% of its total raw material purchases;
- The Board of the Company was duly informed that the RPT with Crescot were executed at arms' length basis and it was disclosed during the said meeting that none of the directors has personal interest in RPT except their common shareholding and remuneration received as director;
- Being conducted on arms' length basis, the RPT attracts second proviso of section 208(1) of the Act;
- RPT was carried out Bona fide as no director had personal interest nor was any malicious intent;
- No shareholder was effected and if EOGM/ AGM is required for such small purchases, it may enhance cost of doing business for the Company;
- Non-compliance, was not intentional and only an interpretational issue and approval of members can be obtained to ratify the same, if so desired; and
- Requested to take lenient view and condone the contravention;

6. Subsequent to the hearing, AR vide email dated September 08, 2023 reiterated the above-stated response and made further written submissions, extracts of which are given below:

- The Transaction was disclosed at BOD held on September 30, 2022 and was approved by entire board without any direct or indirect conflict of interest due to presence of any director. The Respondents, therefore, had the capacity to get the same approved in a General Meeting.
- Violation of section 205 of the Act is not made out as minutes of BoD meeting clearly record that Respondents had no personal interest in the transaction except their common shareholding and remunerations being received as directors.
- Any failure was a bona fide misinterpretation of the law with no underlying malicious intent. The Respondents, if so required, are willing to get the Transaction ratified in the upcoming AGM and also undertake to obtain approval of any/all such future transactions in the AGM.
- The transaction, carried out at an Arm's Length Basis and at a price determined in an uncontrolled manner, is exempted from obtaining approval of the shareholders in terms with the second proviso to section 208 (1) of the Act. A harmonious interpretation of requirements under section 176, 207 and 208 of the Act should be adopted and the exemption available under section 208 should not be made redundant. The interpretation advanced by the Commission would render the exemption granted in the second proviso to Section 208 (1) of the "arm's length transaction" entirely meaningless.



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- It is trite law that redundancy cannot be attributed to the Legislature. The law clearly emphasizes efficiency gains by exempting transactions carried out at an "arm's length" from the approval requirements contained in the Act. The purported violation, if any, was due to mis-interpretation of statutory requirements and it is trite law that penalty cannot be imposed for unwilful wrongdoings.

7. Relevant legal provisions are reproduced as under:

" 176. Proceedings of the board. – (1) The quorum for a meeting of board of a listed company shall not be less than one-third of number of directors or four, whichever is greater and the participation of the directors by video conferencing or by other audio visual means shall be counted for the purposes of quorum under this sub-section:

Provided that if at any time, there are not enough to form a quorum to fill a casual vacancy, all the remaining directors shall be deemed to constitute a quorum for this limited purpose.

(4) If a meeting of the board is conducted in the absence of a quorum or a meeting of board is not held as required by sub-section (3), the chairman of the directors and the directors shall be liable-

(a) if the default relates to a listed company, to a penalty of level 2 on the standard scale; and

(b)

205. Disclosure of interest by director. – (1) Every director of a company who is in any way, whether directly or indirectly, concerned or interested in any contract or arrangement entered into, or to be entered into, by or on behalf of the company shall disclose the nature of his concern or interest at a meeting of the board:

Provided that a director shall be deemed also to be interested or concerned if any of his relatives, is so interested or concerned.

(6) Any contravention or default in complying with requirements of sub-sections (1) or (2), shall be an offence liable to a penalty of level 1 on the standard scale.

207. Interested director not to participate or vote in proceedings of board. – (1) No director of a company shall, as a director, take any part in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, if he is in any way, whether directly or indirectly, concerned or interested in the contract or arrangement, nor shall his presence count for the purpose of forming a quorum at the time of any such discussion or vote; and if he does vote, his vote shall be void:

Provided that a director of a listed company who has a material personal interest in a matter that is being considered at a board meeting shall not be present while that matter is being considered.

(2) If majority of the directors are interested in, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, the matter shall be laid before the general meeting for approval.

(3)...

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(4) Any contravention or default in complying with requirements under this section shall be an offence liable to a penalty of level 1 on the standard scale."

8. I have gone through the facts of the case, and considered the written submissions made by the Respondents, their AR and the arguments made during the hearings, in light of the aforesaid legal provisions and the record placed before me. The Company, under note 38 of the annual audited accounts for the year ended June 30, 2022 has disclosed the aforesaid transaction as RPT with subsidiary company, namely Crescot. Further the Respondents did not deny the fact that in the Board meeting held on September 20, 2022, RPT with Crescot was unanimously approved by the Board. It is observed that four out of six Respondents were interested in the RPT with Crescot owing to their directorship. With regards to the plea of the AR relating to applicability of second proviso to section 208(1) of the Act in the instant matter, it is noted that the requirements of section 205 and 207 are independent of the requirements of section 208 of the Act and compliance of the former is mandatory. The directors of the company are considered to be knowledgeable and it is amongst their fiduciary duties to be aware of all the applicable legal requirements. The argument of the AR that the non-compliance was not willful holds no merit as even there may not be knowledge or intent, the Directors did not exercise due skill and care required of them as directors of a listed company. Moreover with regards to the aforesaid RPT with Crescot, it is stated that:

(i) Disclosure of interest of directors under Section 205 of the Act:

The Board of Director of the Company in its 192nd meeting held on September 30, 2022 approved the aforesaid RPT with subsidiary company, i.e. Crescot. It is hereby pointed out that Section 205 of the Act provides for disclosure of nature of direct as well as indirect interest in any contract or arrangement entered or to be entered at the meeting of the board. Therefore, in context of the subject Company, the interested directors were required to disclose their interest in the meeting of the BoD held on September 30, 2022 w.r.t. the transactions with Crescot, in terms of the requirements of Section 205 of the Act. It is noted that the minutes of said BoD meeting specifically states that *"the directors of the company expressed that they hold no direct or indirect interest in the above transactions save their shareholdings in and remuneration by the companies."*

It is, therefore, noted that the interested directors had adequately disclosed the nature of their interest in RPT with Crescot during the BoD meeting held on September 30, 2022 wherein the aforesaid RPT was approved.

(ii) Interested director not to participate or vote in terms of Section 207 of the Act:

With regard to the provision of Section 207 of the Act, the Respondents have not disputed the fact that the four interested directors were present in the meeting held on September 30, 2022. Moreover, minutes of the Board's stated meeting did not disclose that the interested directors recused from discussion and voting, when the matter of transactions with subsidiary company i.e. Crescot was being considered and approved. It may be noted that in view of requirements of sub-section (1) of Section 207 of the Act, interested directors of a company are prohibited to participate in discussion and vote on any contract/ arrangement entered or to be entered where



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such director is directly or indirectly concerned. For listed companies, the requirements are further stringent as to the presence of a director having material personal interest is prohibited to be present in such meeting of the board while considering the said matter.

Hence, it is noted that the interested directors had interest in transactions of the Company with Crescot due to their directorship and shareholding therein, and by participating in the consideration and approval of the transaction with Crescot; the interested directors contravened the provisions of Section 207 of the Act and the said fact has also been admitted by the Representative during hearing and submission made vide letter dated June 26, 2023 and email dated September 08, 2023.

(iii) Insufficient Quorum and matter to be placed before general meeting:

Minutes of meeting of the Board held on September 30, 2023 discloses that matter of transaction with subsidiary company i.e. Crescot was placed before the Respondents for consideration and approval. Considering the fact that the interested directors were interested in transactions with Crescot; hence, they were required to refrain from participation and voting in the meeting of the Board and their presence could not be counted for the purpose of forming the quorum while considering the transactions with Crescot. Therefore, the quorum for BoD meeting dated September 30, 2023 in terms of Section 176 of the Act was not formed.

9. In view of the foregoing, I hereby conclude that with respect to the transaction executed by the Company with Crescot, a subsidiary company/ related party:

- a. the interested directors, by not abstaining from participating in the proceedings of the Board meeting relating to the consideration and approval of the transaction by the Company with Crescot had contravened the provisions of Section 207 of the Act and, therefore, are liable to be penalized; and
- b. all the Respondents by obtaining approval during the Board meeting, in the absence of quorum for the Board meeting, dated September 30, 2022, for the aforesaid transaction with Crescot had contravened the provisions of Sections 176 of the Act and are liable to be penalized.

10. Taking cognizance of the aforesaid established contraventions/ non-compliances, I in exercise of the powers conferred under 207 of the Act, hereby impose aggregate penalty of **Rs. 40,000/- (Rupees forty thousand only)** on the Respondents in the following manner and warn all the Respondents on violation of section 176 of the Act to be careful and ensure compliance to the applicable regulatory framework in future in letter and spirit:



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| Sr. # | Name of the Respondents | Penalty (Rs.) for violation of Section 207 |
|-------|-------------------------|--|
| 1. | Mr. Taimur Amjad | 10,000 |
| 2. | Mr. Abid Mehmood | 10,000 |
| 3. | Mr. Adnan Amjad | 10,000 |
| 4. | Mr. Naveed Gulzar | 10,000 |
| | Total: | 40,000 |

11. The Respondents are hereby, directed to deposit the aforesaid penalty in the designated bank account maintained in the name of the Commission with MCB Bank Limited or United Bank Limited within thirty (30) days from the date of this Order and furnish a receipted bank challan to the Commission forthwith. In case of failure to deposit the penalty, the proceedings under Section 485 of the Act will be initiated for recovery of the penalty.

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

(Shahzad Afzal Khan)
Director/ HOD
Adjudication Department-I

Announced:
Dated: September 18, 2023
Islamabad