Before Ali Azeem Ikram, Director (Enforcement)

In the matter of

Bestway Cement Limited

UNDER SECTION 208 READ WITH SECTION 476 OF COMPANIES ORDINANCE, 1984

Number and date of notice	No. EMD/233/368/2002-2989-95 dated November 03, 2006
Date of hearing	December 06, 2006
Present	Mr. M. Javed Panni Counsel for the Directors

ORDER

This order shall dispose of the proceedings initiated through Show Cause Notice No. EMD/233/368/2002-2989-95 dated November 03, 2006 against Bestway Cement Limited (BCL) under the provisions of Section 208 of the Companies Ordinance, 1984 (Ordinance).

Background Facts

2. Brief facts of the case are that examination of the notice of the Annual General Meeting of BCL for the year ended June 30, 2006(AGM) revealed that in addition to approval of loans/advances to be given to its subsidiary Mustehkum Cement Limited (MCL) in future, BCL was also seeking approval and ratification from the shareholders in respect of loans/advances already given to MCL. Following agenda was placed before the members of BCL for their consideration and approval:

Quote

"To approve the loans/advances given or to be given to Mustehkum Cement Limited"

Unquote

3. In view of the fact that the provisions of Section 208(1) of the Ordinance require passing a special resolution *before* making any investment by a company in its associated companies or undertakings and do not envisage subsequent ratification of such investments, the matter was taken up

with BCL. Mr. M. Javed Panni of M/s. M. J. Panni & Associates (Counsel), vide his letter dated October 18, 2006 made following submissions:

Quote

> *"The Company had provided short term advance facility to the Mustehkam Cement and started the same in the month of November 2005 of upto with the maximum amount outstanding at any time does not exceed* ***Rs.259 million****. This facility was approved by the Board of Directors. The short term advance balance outstanding on 30th June 2006 was* ***Rs.1,536,785*** *and the mark up charged during the period (on weighted average basis) was* ***Rs.6,586,476****.*
>
> *Being a short term facility, it did not fall under the category of 'Investment", as stipulated in Section 208 of the Companies Ordinance, 1984 and hence did not require shareholders approval.*
>
> *Now a new advance facility of a long-term nature upto* ***Rs.200 million*** *is proposed to be granted to Mustehkam Cement on weighted average borrowing cost of the Company. This advance being of long term nature, approval of the shareholders is proposed to be obtained in the forthcoming AGM in compliance with Section 208 of the Companies Ordinance."*

Unquote

The Show Cause Notice

4. The explanation provided by the Counsel was not found convincing and it was observed that BCL has not complied with the mandatory provisions of Section 208 of the Ordinance while providing advances to MCL. Hence, the directors of BCL were issued a show cause notice on November 03, 2006 to explain as to why penal action may not be taken against them under the penal provisions of Section 208 of the Ordinance for the aforesaid contravention. The directors of BCL failed to respond to this show cause notice within the stipulated time period.

Hearing of the Case

5. In order to provide an opportunity of hearing to the directors of BCL the case was fixed on November 26, 2006 and was adjourned on the request of the Counsel and re-fixed on December 06, 2006. The hearing was attended by the Counsel for the directors who submitted a written reply and argued the case.

Submissions

6. Following submissions were made in the written reply and during the course of hearing;

i. It is agreed that the requirement of Section 208 of the Ordinance is to obtain prior approval of the shareholders before making an investment in an associated company, however, it is emphasized that ex-post facto approvals are absolutely legal because the affected party (the shareholders) has the absolute authority in the matters concerning them.

ii. The amount receivable from MCL has reduced to Rs.1,536,785 as on June 30, 2006. These receivables relates to '*various bills paid on behalf of the subsidiary company*' pertaining to recommissioning of its closed plant. The facility thus extended was not an advance in real terms and was thus classified as receivable. Hence, no violation of Section 208 of the Ordinance has been committed as the amount in question is a '*receivable*' and not an '*investment*'.

iii. The BCL has charged markup on the amount paid on behalf of MCL.

iv. The BCL/directors had no intention to willfully contravene the provisions of the law. Prima facie default, if any, may kindly be condoned.

Issues

7. I have thoroughly considered the arguments presented before me in writing and as well as at the time of hearing and perused the documents on record. I have also examined the relevant provisions of the Ordinance. In my opinion, the following are the issues which require determination before deciding this case:

a) Whether the advances given by BCL to MCL fall under the category of 'investment' as defined in Section 208 of the Ordinance?
b) Whether BCL has committed a default punishable under Section 208 of the Ordinance?
c) Whether ex-post facto approval is valid? and
d) Whether the default has been committed willfully?

Consideration of the Issues

8. After having considered the contentions of the Counsel and the perusal of the documents and information placed on record, I hold on each issue as under:

a). Whether the advances given by BCL to MCL fall under the category of 'investment' as defined in Section 208 of the Ordinance?

As regard the nature of the amount given by BCL to MCL, two contradictory statements were made by the Counsel. Initially, in response to our letter dated October 13, 2006, the Counsel took the plea that the advances being '*short term'* in nature did not fall under the category of '*investment'*, as defined in Section 208 of the Ordinance and hence did not require shareholders approval. Subsequently, in response to the show cause notice it was contended that the amount in question was a *'receivable'* and not an *'investment'*. Regarding the nature of this *'receivable'* it was stated that it related to various bills paid on behalf of MCL and was not an advance in real terms. However, it was admitted during the course of hearing that the *'receivable'* was not in the nature of *normal trade credit*.

In order to determine whether the amount given by BCL to MCL is an investment or not, plain reading of Section 208 of the Ordinance would be sufficient:

> *"A company shall not make any investment in any of its associated companies or associated undertakings* ***except under the authority of a special resolution*** *which shall indicate the nature, period and amount of investment and terms and conditions attached thereto.*
> *Provided that the return on investment in the form of loan shall not be less than the borrowing cost of investing company.*
>
> ***Explanation:*** *The expression* ***'investment'*** *shall include loans, advances, equity, by whatever name called, or* ***any amount, which is not in the nature of normal trade credit****."*

The above quoted provisions of the Ordinance are quite clear and unambiguous. Neither the '*short term'* advances nor the 'receivables' which are not in the nature of normal trade credit, are excluded from the scope of Section 208 of the Ordinance. Thus, it is established that the amount given by BCL to MCL, without regard to its nomenclature, whether being '*short term*' advance or '*receivable*', falls under the definition of 'i*nvestment'* as described in Section 208 of the Ordinance.

b). Whether BCL has committed a default punishable under Section 208 of the Ordinance?

Considering the conclusion drawn in the preceding paragraph, prior approval of the shareholders of BCL was required before making advances to MCL which was not obtained. For the forgoing, I conclude that the directors of BCL have committed a default punishable under Section 208 of the Ordinance.

c). Whether the ex-post facto approval is valid?

In view of the fact that BCL subsequently removed the ex-post facto approval of advances from its agenda, the Counsel stance that ex-post facto approval is valid is not relevant any more. However, since it relates to interpretation of a provision of the Ordinance, I would like to make it clear that the statute does not envisage subsequent ratification of investments made by the companies in their associated concerns. The relevant provisions of law for making investments in associated undertakings, provided as above, make it compulsory to pass a Special Resolution *before* making any investment by a company in its associated companies or undertakings. It has been held by the Appellate Bench of the Commission in case of Gharibwall Cement **(SECP, 2003 CLD 131)** *that investments made in associated company cannot be validated by virtue of subsequent ratification by shareholders and doctrine of substantial compliance cannot be resorted to where there has been a clear violation of mandatory provisions*. The Bench has also defined the expression *'Under the Authority'* in the same case as *'Such words mean having consent of the shareholders prior to investment. Such an authority subsequently acquired cannot be termed as an act 'Under the Authority'*. In view of the aforesaid it is clear that even if BCL has passed a special resolution for subsequent ratification of investment, it would not have undone the default.

d). Whether the default has been committed willfully?

As regards the contention that the directors had no intention to willfully contravene the provisions of the Ordinance, I do not find it convincing. The directors were supposed to be aware of the requirements of the Ordinance and the circumstances of the case shows that they were. So, they must have complied with the provisions of the Ordinance before proceeding for the investment in MCL which they didn't. The aforesaid shows their casual behavior towards compliance with the statute. For the aforesaid, I conclude that the default was committed knowingly and willfully.

Conclusion & Order

9. From the above discussion, I am of the considered view that the provisions of Section 208 of the Ordinance have been violated and directors of BCL are liable for the penalties as provided in Sub-section (3) of the aforesaid provisions of the Ordinance. However, giving the benefit of the fact that BCL has recovered major amount and only Rs. 1.537 million was outstanding at the year ending on June 30, 2006 and that the markup has been charged on the advance, I take a lenient view and instead of imposing the maximum penalty of **Rs. 1,000,000**/- on each director impose a fine of **Rs.100,000/-** only on the Chief Executive of BCL. Other directors are reprimanded to be careful in future and ensure compliance with the requirements of law in letter and spirit.

10. The Chief Executive is hereby directed to deposit the aforesaid fine in the designated bank account maintained in the name of the Securities and Exchange Commission of Pakistan with Habib Bank Limited or pay through a demand draft in the name of the Securities and Exchange Commission of Pakistan within thirty days from the receipt of this order and furnish receipted bank voucher to the Commission, failing which proceedings for recovery of the fines as an arrear of land revenue will be initiated. It may also be noted that the said penalty is imposed on the Chief Executive in his personal capacity; therefore, he is required to pay the said amount from his personal resources.

11. The Chief Executive is further directed under Section 473 of the ordinance to immediately recover the outstanding amount from MCL and furnish an auditor's certificate, within seven days of the date of this order, confirming that BCL has recovered the entire outstanding amount and has charged markup at the rate not less than the borrowing cost of BCL.

Ali Azeem Ikram
Director (Enforcement)

Announced
December 28, 2006
Islamabad.