**Before Dr. Sajid Qureshi, Executive Director (CL)**

In the matter of

**M/S Khalid Siraj Textile Mills Limited**

**UNDER SECTION 208 READ WITH SECTION 472 OF COMPANIES ORDINANCE, 1984**

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| Number and date of notice | No. EMD/233/145/2002-11471-11477 dated June 17, 2005 |
| Date of hearing | July 22, 2005 |
| Present | Mr. Iftikhar-ud-Din, Director<br>Mr. Muhammad Sharif, Chief Accountant |
| Date | June 28, 2006 |

**ORDER**

This order shall dispose of the proceedings initiated through Show Cause Notice No. EMD/145/2002-11471-11477 dated June 17, 2005 against Khalid Siraj Textile Mills Limited (the "Company") under the provisions of Section 208 of the Companies Ordinance, 1984 (the "Ordinance").

2. The Company was incorporated as a public company limited by shares in the year 1988. The shares of the Company are listed on the Karachi and Lahore Stock Exchanges. The paid up capital of the Company is Rs. 107 million divided into 10.7 million ordinary shares of Rs. 10 each. The Company is principally engaged in the manufacture and sale of cotton yarn. Its mills are located in Lahore. The Company has 1,189 shareholders comprising individuals, joint stock companies, private limited companies, insurance companies, financial institutions etc. and as per its pattern of shareholding annexed to the Directors' Report in the accounts for the year September 30, 2004, directors, their spouses and minor children hold 14.12 % of the total shareholding. This indicates that there is considerable public interest in the Company. Board of Directors of the company as per its annual report for the year ended September 30, 2004 comprises of the following persons:

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| 1. | Mian Iqbal Barkat, Chief Executive |
| 2. | Mian Hassan Barkat, Director |
| 3. | Mian Tayyab Iqbal, Director |
| 4. | Ms. Shamim Begum, Director |
| 5. | Mrs. Abida Iqbal, Director |
| 6. | Mrs. Rafia Hassan, Director |
| 7. | Kh.Iftikhar-ud-Din, Director |

3. Brief facts of the case are that during examination of annual accounts of the Company for the year-ended September 30, 2004 it was observed that Rs. 0.792 Million (Rs. 2.189 Million in 2003) have been deducted from financial expenses, being amount charged to M/s Ramzan Buksh Textile Limited, an associated company, against funds used by that company. This offsetting of financial expenses raised concerns about intercorporate financing being undertaken between the group companies. It was also noticed that the company had not disclosed, in the comparative figures for the last year, the loan/advance of Rs. 16.125 million receivable from M/s Ramzan Buksh Textile Mills Limited, an associated company, as required by clause 5(B) (ii) part 2 of the 4th Schedule of the Ordinance in the aforesaid accounts.

4. The Company was asked vide our letter no. EMD/233/145/2002/10150 dated May 11, 2005, to explain the above transaction with the associated company in context of Section 208 of the Ordinance. The Company explained the transaction vide its letter dated May 17, 2005, that:

> ***Quote***
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> *"Markup based temporary loan/advance was given to Ramzan Baksh Textile Mills Limited from time to time during the year and the loan was fully repaid by the loanee company. The said loan was given under the authority of special resolution passed by the members of the Company pursuant to Section 208 of the Companies Ordinance, 1984."*
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> ***Unquote***

5. Copy of current account of M/s Ramzan Baksh Textile Mills Ltd. (the "associated company") in the books of the Company, furnished with the above-referred letter, was examined and it was noticed that at the beginning of the year, an amount of Rs. 4.283 million was shown as principal due to the associated

company and during the year these advances, which though stood repaid at the year end reached a maximum of Rs. 25.330 million.

6. The company also submitted that the advances extended during 2003 and 2004 were under authorization of special resolution passed on June 29, 1992.

7. The submissions of the company were not found cogent and consequently, a Show Cause Notice (the "Notice") was issued to the Chief Executive and directors of the Company on June 17, 2005 as to why a penalty under Section 208 of the Ordinance may not be imposed on them for aforesaid violation. The company replied to the Notice vide its letter dated June 29, 2005. Wherein it was contested that clause 5(B) (ii) part 2 of the 4th Schedule of the Ordinance, which requires the disclosure of names and aggregate amount due by related parties was not applicable in subject case as no such balance was outstanding at the year end. They admitted that no resolution was passed in the years 2003 and 2004 and the investment was made under authority of resolution passed on June 29, 1992, in the general meeting of the Company, which in their view sufficiently satisfies the essential requirements of law. In this context following submissions were made:

- The resolution was passed in the year 1992 and is in line with Section 208 as it then existed. Upon its language the resolution is continuous in operation. There was no bar on passing such resolution. It is not confined to the year 1992 and goes beyond this period. The power delegated to the Chief Executive of the Company there under, clearly authorizes him "to undertake such investment as and when necessary". The expression "as and when necessary" is open ended and not confined to time limit.
- The power exercised by the Chief Executive in pursuance of the resolution, in the year 1992 was not exhausted away. It is well settled that when power is conferred on an authority, such power can be exercised from time to time, when the need arises. There is nothing in the Resolution to the contrary. In view of the language and the spirit of the resolution there is no valid basis, to confine exercise of power by the chief executive to the year 1992 and to preclude him to proceed under the resolution beyond that.
- As regards Section 208, the resolution amply shows that the investment in question is in the nature of loan and its duration is open ended, which in the wisdom of the shareholders has been

left to the Chief Executive. The maximum limit of the loan is specifically mentioned in the resolution as Rs. 27 million.

- So far as the terms and conditions of the loan are concerned, it is given on mark up basis, to be charged at the prevalent bank rate. The essential requirements of Section 208 thus stand satisfied materially.
- Likewise, the resolution also substantially fulfils the main requirements of the SRO, such as the name of the loanee, the amount of the loan etc. It is noteworthy that through Form 30, copy of the Resolution was filed with the joint Registrar of Companies, Lahore and no objection regarding alleged violation of Section 208 was ever raised.

8. In order to give an opportunity to the management of the Company to clarify their position, a hearing was fixed on July 22, 2005.

9. On the date of hearing Mr. Iftikhar-ud-Din, Director, and Mr. Muhammad Sharif, Chief Accountant appeared on behalf of the Chief Executive and directors of the Company.

10. During the hearing, it was submitted that since the Company has passed a resolution for making investments in associated company, there is no contravention of Section 208 of the Ordinance. It was argued that the language of the resolution was continuous and thus the authorization was not confined to any time limit. It was further stated that the advances were made in the ordinary course of business from time to time in order to fulfill the working capital requirements of the associated company. It was also mentioned that the Company had always charged return on these advances equal to the company's own borrowing cost.

11. In order to examine the Company's claim that these advances are legitimately authorized by the shareholders vide the resolution passed in the Annual General Meeting (AGM) of the Company on November 26, 1996, it would be appropriate to examine the contents of the afore-referred resolution:

***Quote:***

*"Resolved that the company be and is hereby authorized to make investment upto Rs. 27 million in Ramzan Buksh Textile Mills Ltd. by way of loan/ advance*

*Further resolved that the Chief Executive be and is hereby authorized to undertake such investment as and when necessary and mark up on loan/advance be charged on the amounts outstanding at prevailing bank lending rate as mutually settled between the parties."*

***Unquote***

12. The resolution referred to by the Company, was inappropriately worded and thus wrongly interpreted as allowing continuous authorization to the Chief Executive for making advances. The statute does not provide for such an authorization, but rather requires that each and every transaction be undertaken only under concrete approval of the shareholders obtained after adequate disclosure of full and complete facts about the transaction. It is also clear from the requirements of SRO 865(I)/2000 dated December 6, 2000 which requires that the shareholder be updated on the status of any investment authorized by them under Section 208 of the Ordinance. Moreover, while justifying the extending of advances on the basis of resolution passed in the year 1992 the Company's stance that decision to make investments was left in the wisdom of the shareholders to the Chief Executive is also not acceptable, as such a delegation of authority cannot be made. The provisions of Section 208 of the Ordinance are designed to ensure that every investment in associate whether equity or advance would be made with the approval of the shareholders who will make such a decision after being fully informed of the risk, return and benefits of such an investment. Such an authority is not perpetual and expires after execution of that particular transaction. Accordingly every new transaction in the nature of investment in associate must be made with specific approval of the shareholders. Thus the resolution was a transaction specific authorization that expired after completion of that particular transaction, its extension to any subsequent transaction was not justified as any subsequent investments should have been undertaken only after seeking fresh approval from the shareholders.

13. In the year 2000, the statutory requirements in respect of investments in the associated undertakings were changed and the companies were required to comply with SRO 865(I)/2000 dated December 6, 2000. It was stipulated therein that in case any decision to make investment under authority of a resolution is not implemented till the holding of a subsequent general meeting, its status including the following must be explained to the shareholders through a statement under sub-section (1) of section 160 of the Companies Ordinance, 1984:

i. reasons for not having made investment so far; and

ii. major change in financial position of investee Company since date of last resolution.

It was observed that the aforesaid requirements were never complied with.

14. It is clear from the contents of the resolution that normal terms and conditions relating to these kinds of transactions were also not mentioned in the aforesaid resolution and stipulations like period for which loan/ advance is to be extended and significant terms of the financing arrangement have not been explicitly defined. Time period for extension of the loan facility is a fundamental component of any financing arrangement, and its exclusion from the aforesaid resolution shows that it suffered from serious defects. It is also apparent from the contents of the resolution that no material information regarding the associated company has been provided to the shareholders. As has been held by the superior courts in the case [Munir A. Sheikh, J. , M Shahid Saigol V. Kohinoor mills Limited reported as PLD 1995 Lah. 264 (g)] *resolution must indicate the nature of investment to be made in the associated company and terms and conditions attaching thereto.*

15. I have analyzed the facts of the case and observed that the resolution was passed under the provisions 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 terms 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

and deliberate and has risen due to misinterpretation of legal provisions. Further, the Company has also been charging mark up on these advances and the balance also stands recovered at the year end, I, therefore do not impose a penalty as provided under Sub-Section (3) of Section 208 of the Ordinance. However the Chief Executive and directors are directed, in terms of Section 472 of the Companies Ordinance, 1984 to recover all the outstanding balances, if any, from the associated undertaking by June 30, 2006 and pass a fresh resolution under Section 208 and SRO 865(I)/2000 dated December 6, 2000 before making any such advances in future.

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***Dr. Sajid Qureshi***
Executive Director (C.L)