NO. 19(352)/CF/ISS/74-
SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
(Enforcement & Monitoring Division)
NIC Building, Jinnah Avenue, Blue Area,
Islamabad
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ORDER UNDER SUB-SECTION (5) OF SECTION 208 READ WITH SECTION 476 OF THE COMPANIES ORDINANCE, 1984 - IN THE MATTER OF NAFEES COTTON MILLS LIMITED

Brief facts of the case are that from the annual accounts of the company for the period ended on 30.09.1999 it was noticed that the company during the year 1998-1999 advanced a short term loan of Rs. 38 million to its associated company, namely Legler Nafees Denim Mills Limited (LNDM) carrying mark up at the rate of 18% per annum. It was stated in the published financial statement that the loan would be converted into shares of LNDM and that the plan of the management is to sell these shares during the accounting year 1999-2000 therefore, this loan was grouped under current assets. Since this investment required authorization of shareholders of the company in terms of section 208 of the Companies Ordinance, 1984, the company was asked to furnish a copy of such authorization. In response, the Company submitted a copy of the special resolution of the company passed **seven years ago on 31.03.1992**. The resolution then passed by the company is reproduced as under: -

> “RESOLVED that in terms of Section 208 of the Companies Ordinance, 1984,and/or any other provisions of the laws of the country, the Chief Executive be and is hereby authorized to make long/short term investments, loans and advances, etc., on behalf of the Company, up to the extent of Rs.50,000,000/- (Rupees fifty million) in one or more of its associated, subsidiary and/or other companies, on terms and conditions which are not unfavourabIe as compared to Such

investments, loans, advances, modaraba/ musharaka investments, etc., obtained from commercial banks, and to disinvest, liquidate, reinvest and/or vary the same, and/or change the nature thereof and/or the terms and conditions attached thereto, from time to time."

2. In the process of examining this matter it was further noted that the investee company namely Legler Nafees Denim Limited **was not even in existence at the time of passing of the resolution on 31.03.1992 (as it was incorporated on 20.02.1993).** In last seven years all the directors of the company including Chief Executive had changed except one director. Further the resolution as reproduced above did not meet the requirement of section 208(1) which says that **"resolution which shall indicate the nature and amount of investment and terms and conditions attaching thereto''**.

3. The Finance Act 1995 (1 of 1995) had brought an important amendment in section 208 of the Companies Ordinance, 1984, i.e. the requirement of passing of a "general resolution" was substituted by passing of a "special resolution" by the shareholders. Then to advance the purpose of section 208 ibid, the erstwhile Corporate Law Authority (now SECP), in exercise of its powers, issued an "Order" under section 246 of Companies Ordinance, 1984 on 30th July, 1996 requiring that listed companies shall, while issuing notice of their general meetings, where a special business related to investments in any of the associated companies or associated undertakings is to be transacted, under section 208 of said Ordinance, annex a statement, pursuant to clause (b) of sub section (1) of section 160 of that Ordinance, setting out, among other the following information namely:-

(a) In case of equity investment

(i) Name of investee company or associated undertaking;
(ii) nature, amount and extent of investment;
(iii) price at which shares will be purchased;
(iv) source of funds from where shares will be purchased;

(v) period for which investment will be made;
(vi) purpose of investment; and
(vii) benefits likely to accrue to the company and the shareholders from the proposed investment.

(b) In case of Loans and Advances: -

(i) Name of borrower company and associated undertaking together with the amount of loan and advances;

(ii) rate of interest to be charged on each loan and advance together with particulars of collateral security to be obtained from borrower;

(iii) period to which these loans and advances will be made;

(vi) the terms of repayment or any other terms of loans and advances;

(v) purpose of loans and advances; and

(vi) benefits likely to accrue to the company and the shareholders from loans and advances.

4. The above said amendments in section 208 of the Ordinance in 1995 and issuance of “Order” by the erstwhile CLA (SECP) under section 246 ibid in 1996 changed the whole scheme of law relating to transacting business of investments in associated undertakings. Hence, the resolution passed in the year 1992 became in-operative and ineffective. Moreover, from the financial statement for the year 1998-99 it was noticed that Auditors of the company had also qualified their audit report dated 08.03.2000 saying that investment in the associated company was not made on the basis of a valid special resolution. A perusal of directors report published with financial statements for the year 1998-99 indicates that directors had replied to auditors qualification in the directors report dated 08.03.2000, considering the business of advancing loan to the associated company validly transacted. Since it was a clear contravention of Section 208 ibid, a show cause notice dated July 26, 2000 was served upon the Chief Executive of the company for the said default. The management of the company on the other hand having

smelled (from the correspondence exchanged earlier between the Commission and the Company) initiation of proceeding under section 208, promptly scheduled an EOGM on 19th August, 2000 for which a notice of meeting was issued on 26th July 2000 proposing to ratify and confirm its earlier resolution dated 31.03.1992 with enhancement of amount of investment from Rs.50 million mentioned therein to Rs.60 million. The proposed resolution is reproduced as under: -

> "RESOLVED that in terms of Section 208 of the Companies Ordinance, 1984, and/or any other provisions of the laws of the country, the chief executive of the Company be and is hereby authorized to make long/short term investments, loans and advances, etc., on behalf of the company, upto the extent of Rs.60,000,000/- (Rupees sixty million) in one or more of its associated, subsidiary and/or other companies, on terms and conditions which are not un favourable as compared to such investments, loans, advances, modaraba/musharaka investments, etc., obtained from commercial banks, and to disinvest, liquidate, reinvest and/or vary the same, and/or change the nature thereof and/or the terms and conditions attached thereto, from time to time."

5. This special resolution as reproduced above was again in contravention of the provisions of section 208(1) which requires **that resolution shall indicate the nature and amount of investment and terms and conditions attached thereto**. It also violated the Order under section 246 dated July 30, 1995 of erstwhile Corporate Law Authority (Now SFCP) which had categorically laid down the requirements of a statement u/s 160(1)(b). The statement annexed to fresh notice was found to be deficient/defective/false/deceptive to that extent that it mentioned that investment in Legler Nafees Denim Mills Ltd. will be made to the extent of Rs.40 million whereas the resolution as reproduced in foregoing mentions figure of Rs.60 million without making any mention of the name of the

investee company.

6. In the circumstances Commission pointed out deficiencies in the “Notice” under section 160 through its letter dated 11th April, 2000 in the following manner: -

Quote

“a) The proposed resolution intends to ratify the special resolution passed in March 31, 1992 with enhancement of amount from Rs.50 million to Rs.60 million to be advanced/invested in one or more associated/subsidiary companies. The provisions of section 208 of the Companies Ordinance, 1984 do not allow such ratification.

b) The resolution is general in nature and do not conform to the requirements of SRO No.634(l)/96, dated 30.7.1996.

c) There is contradiction between the text of the proposed resolution and para 2 of statement under section 160(1)(b) of the Ordinance enclosed with above referred noticed. The text of the proposed resolution no where mention the investment of Rs.40 million in the equity of Legler Nafees Denim Mills Ltd. (LNDM).

d) The resolution proposes to enhance the authorization of CEO to invest in associates to the extent of Rs.60 million. The company’s total Equity as on September 30, 1999 is Rs. 151.764 million, this would mean that the Chief Executive is being authorized to invest in associates upto the extent of 39.5% of total Equity of the company which is contrary to the provisions of section 208(1) of the Companies Ordinance, 1984.

e) A comparison of financial statements of Nafees Cotton Mills Ltd.

(NCM) and Legler Nafees Denim Mills (LNDM) Ltd. for the years ended September 30, 1999 reveals that the two companies are according different treatments to the said amount. M/s. Legler Nafees Denim Mills (LNDM) Ltd. is treating this amount as “share deposit money (Notes 6 to the accounts) while NCM is treating it as a short term loan (Note 21). Moreover, NCM in note 21.2 of the accounts states that the said loan carries interest of 18% per annum. This position raises serious reservations as to the status of this amount.

(f) There are large number of complaints from the shareholders, Karachi Stock Exchange, and a creditor of the company namely Union Leasing Limited who have requested the Commission to intervene and ask the company to refrain from proceeding the proposed business.

g) As regards benefits arising out of this investment, the company has stated that it would benefit in terms of dividend and capital gain where as from the financial statements of Legler Nafees Mills Ltd., it has been noticed that accumulated losses of Legler Nafees Mills Ltd. stand at Rs.374 million which have eroded the equity of the company completely and the Legler Nafees Mills Ltd. has not paid any dividend since its listing in the year 1996.”

You are expected to keep in view the matters pointed out in foregoing before proceeding further in the matter.

Un-quote

7. The above mentioned letter, warning the company’s management to keep in view the legal position and concern of Stock Exchanges, creditors and shareholders was written by the Commission on 11th August 2000 and on 12th August, 2000, a letter from the Director Finance of the company which was dated 5.8.2000 was received in the Commission through which it was

reiterated that investment in the associated companies had been made on the basis of valid special resolution and further that the company was holding an extra-ordinary general meeting to pass a “special resolution” to ratify and confirm the powers vested in the Chief Executive vide earlier resolution dated 31.3.1992. The reply was totally unsatisfactory and indicated the mood of the management of the company totally disagreed the legal position, therefore, immediately on the same day a notice of hearing was issued fixing hearing on 24.8.2000. The Commission thereafter, never received any response from the company to its warning letter dated August 11, 2000 mentioned above. No body bothered to appear on the date of hearing and at this juncture of time with the purpose to meet the ends of justice, the Chief Executive was provided another opportunity to explain his position fixing hearing on 11.9.2000 and Show Cause Notices to other 6 directors of the company who had joined hands in this deliberate violation of law with the chief executive of the company were also issued. The other directors of the company through their separate letters dated September 4, 2000 also stated that the resolution passed in 1992 was valid, that company had already ratified and confirmed powers vested in the Chief Executive vide earlier special resolution and consequently if there was any irregularity before it then stood ratified. It was further argued that powers under section 208 could be exercised by the Commission only if the contravention of the provision of law was found to be knowingly and willfully committed. It was further stated that at the most, the violations, could be stated as “inadvertent”. They also pleaded the absence of “means rea” or knowing/willful and criminal intent.

8. It is pity that directors of the company who had violated law on every step and continued with their illegal move in their letters were taking a position that even if there was default, it was not knowing and willful.

9. Different dates for hearing were fixed but the hearing finally held on 3.10.2000 when Mr. Ali Kazim, Advocate alongwith Ms. Bushra Naz, Finance

Director of the company appeared and case was argued.

10. The whole of the arguments advanced by the counsel of the Company centered round the following points: -

1. That the Resolution passed under section 208 of the Companies Ordinance, 1984 on 31.3.1992 had been without any legal defect because it had been submitted to the concerned Company Registration Office and that no objection whatsoever had ever been pointed out by the Registrar concerned since then.

2. That even if there was any violation of law it was not intentional and willful.

3. That the Resolution dated 31.3.1992 stands ratified by the Resolution dated 19.8.2000 whereby authorization has been enhanced from Rs. 50 million to Rs.60 million.

4. That the Commission cannot impose the heavy penalty provided under section 208 because the default is neither willful nor intentional.

5. That the Show Cause Notice are defective because these do not spell the amount of the penalty

11. The Counsel in support of his arguments that penalty may be imposed only if default is found to be willful and intentional submitted the following case law of foreign origin because in his view the whole of the present corporate statute is an extension of the Anglo-Saxon Laws: -

i) AELR, February 19, 1953
LONDON 7 COUNTRY COMMERCIAL PROPERTY INVESTMENTS, LTD. Versus.
ATTORNEY - GENERAL

ii) AELR, May 12, 1939
GAUMONT BRITISH DISTRIBUTORS, LTD.
Versus
HENRY.

iii) AELR
TUCK & SONS Versus PRIESTER

iv) AELR, January 14, 30, 1948.
HARING Versus PRICE

v) February 25, 1957
R. Versus HALLAM.

I have gone through the cases cited in the above and feel that circumstances in these cases were different than in the matter in hand.

12. Before dilating upon the real issue, it is appropriate to mention that mere filing of a return with the Registrar does not absolve the directors from the consequences of violations of law committed by them. This argument that default was not intentional or willful is falsified by the fact that even on pointing out the same by the Auditors vide their report dated 8.3.2000, directors did not prefer to exercise care about he legal position which they are to observe as a mandate of the law. Instead of keeping themselves within the confines of the restraints the Board continued with its obdurate practices even when Commission vide its letter dated 11th August, 2000, warned them to keep in view the legal position which is a clear reflector of their collective mind of continuing with violation of law.

13. The directors, therefore, knowingly, willfully and with an ulterior motive continued an act not warranted in law by making investment in associated company and then enhancing the authorization limit of investment

of the Chief Executive from Rs.50 million to Rs.60 million by passing another unlawful and invalid Resolution on 19.08.2000.

14. Here it is pertinent to mention that in the case of this company Chief Executive and directors (other than one director) were different persons on the date of passing of the earlier resolution (of 1992) and on the date of making investment (year 1998-99). The resolution passed seven years ago had empowered a different individual namely Mr. Naseer A. Shaikh who ceased to be the Chief Executive and in the year 1998-99, a different individual namely Mr. Ahmed H. Shaikh, with different board except one director made the subjected investment. The position of law is that even if an individual is re-elected as director/chief executive for a subsequent term after expiry of the earlier term, he cannot be treated a deemed to continue with past such authorization under section 208 because brain child of law is different from earlier one though the human being is the same. In this case even the individual originally authorized ceased to hold the office. A resolution passed seven years ago, never enforced and not even ever mentioned in any of the directors report cannot be considered to be alive and binding upon hundreds of new shareholders who have purchased shares in last seven years. Specially when the requirements of law have been changed materially.

15. Such a conscious, deliberate and unlawful departure from law is likely to even disqualify the board of directors because ignorance of the corporate laws dis-entitles an individual to hold the office of either director or of chief executive. A clear legal presumption is that all the directors and the Chief Executive are well aware of their duties and obligations under the law and desertion of law by them is alien to the concept of corporate legislation.

16. In view of the circumstances mentioned above, each of the following directors who have been found knowingly and willfully in deliberate, continuing as well as recurring default with the mandatory requirements of

section 208 ibid read with section 476 of the Companies ordinance, 1984 are made liable to pay a fine of Rs. 1,000,000/-(Rupees one mill ion only): -

1. Mr. Ahmed H. Shaikh, Chairman/Chief Executive.
2. Mr. Aehsun Shaikh, Director
3. Syed Abid Husain, Director
4. Mr. Muhammad Ashiq, Director.
5. Mr. Abdus Sattar, Director
6. Mr. Naeem Yousaf Qureshi, Director
7. Mr. Shahid Aslam, Director

17. The latest half yearly financial statements of the investee company for the period ended 31.03.2000 indicate that break up value of shares of the company is only Rs. 0.09. If the directors of the company fail to protect the investment of Rs.38 million in that company or convert the loan into shares having negligible break up value, they may, in addition to above penalty be made liable to reimburse to the company any consequential losses on this account as provided in sub-section (5) of section 208 ibid.

18. The amount of penalty total Rs.7,000,000/- (Rupees seven million) i.e. Rs.1,000,000/- (Rupees one million) shall be paid by the Chief Executive and each director from their own resources in the following head of account within 30 days of the issue of this Order.

"Account No.75010-6
Habib Bank Ltd., Centre Branch,
102/103, Upper Mall,
Lahore."

(M. Zafar - ul - Haq Hijazi)
Commissioner (Enforcement)

Announced:

October 19, 2000.