Corporate Supervision Department
Company Law Division

Before Ali Azeem Ikram – Executive Director (Corporate Supervision Department)

In the matter of

Taha Spinning Mills Limited

Number and date of notice:	EMD/233/202/2002-2770-2776, dated June 20, 2014 EMD/233/202/2002-658, dated November 10, 2014
Date of final hearing:	November 12, 2015
Present:	Mr. Muhammad Afzal Awan, the Authorized Representative Mr. M. Sarfraz, Company Secretary

ORDER

UNDER SECTION 208 READ WITH SECTION 476 AND UNDER SECTION 492 READ WITH SECTION 476 OF THE COMPANIES ORDINANCE, 1984

This order shall dispose of the proceedings initiated against the following directors and the Company Secretary (the "respondents") of **Taha Spinning Mills Limited** (the "Company"):

1.	Mr. Ashfaq Ahmed, Chief Executive	5.	Mr. M. Farooq
2.	Mr. Saqib Ashfaq	6.	Mr. Ikhlaq Hussain
3.	Mr. Amir Ashfaq	7.	Mr. Saleem Abbas
4.	Mr. Niaz Mohammad	8.	Mr. M. Sarfraz, Company Secretary

These proceedings against the respondents were initiated through two show cause notices (the "SCNs") as under:

i. SCN dated June 20, 2014 issued to respondents mentioned above at serial 1 to 7, under section 208 read with section 476 of the Companies Ordinance, 1984 (the "Ordinance"); and

ii. SCN dated November 10, 2014 issued to all the respondents under section 492 read with section 476 of the Ordinance.

2. The brief facts of the case are that examination of annual audited accounts for the year ended June 30, 2013 and quarterly accounts for the period ended March 31, 2014 of the Company, revealed that an amount of Rs4 million was receivable from an associated company HMI Energy (Private) Limited ("HMI"). In response to Commission's letter dated April 16, 2014, the Company provided the requisite information and documents perusal of which revealed that the Company sold generators having market value of Rs15 million for a sale consideration of only Rs13 million to HMI on April 1, 2013. The receivable of Rs4 million was still due from the HMI. Whereas, in case of another party namely Hassan Limited, the Company sold property for Rs124 million on

August 30, 2013 and received sale consideration immediately. It appeared that the Company provided benefit to HMI, by selling generators on credit basis and aforesaid receivable from associated company was without the authority of special resolution and without any return which, *prima facie*, was in contravention with the provisions of sub-section (1) of section 208 of the Ordinance. Consequently, the SCN dated June 20, 2014 was issued to the respondents.

3. In response to the SCN, the respondents submitted reply vide letter dated June 25, 2014. A brief of reply relevant to the contents of the SCN, is given below:

- Machinery was 10 years old and was lying idle since 2008. Its consumption was high and electric yield was low. Average maintenance and unit cost was very high and a huge amount of Rs5 million was required for complete overhauling with no guarantee for satisfactory performance afterwards. Therefore, it was sold to HMI for Rs13 million as there was no other higher offer.
- As per books written down value of generator was Rs12.93 million and forced sale value was Rs10.5 million. The Company still made profit of Rs0.68 million on sale. HMI's bid was higher than others which the HMI further increased by Rs2 million to take it to Rs13 million. Bids from others were for Rs8 million and Rs8.5 million only.
- Mr. Saleem Abbas is not director of HMI. None of the Company's director had any interest in the transaction with HMI. Generator was sold to HMI to pay off Company's liabilities.
- There is no investment in HMI by the Company. The Company in fact received Rs9 million as loan from HMI on January 15, 2012 to meet its commitment with NIB Bank. Generator was sold to HMI on April, 1, 2013 for Rs13 million to reduce debt burden. The balance of Rs4 million is receivable from HMI.
- There was a gain of Rs4 million on sale of generator on credit to HMI vis-à-vis other bidders highest bid being Rs8.5 million.

4. A hearing in the matter was held on September 17, 2014 and the respondents were represented by Mr. Mushtaq Ahmed Vohra and Mr. M. Sarfraz, the Company Secretary. During the hearing it was revealed that the board of directors approved sale of assets only after 8 days of the extraordinary general meeting ("EOGM") held on February 20, 2013. Date of agreement to sell

generators to HMI did not correspond with issue date of stamp paper. The agreement was made on April 1, 2013, whereas, stamp paper was issued by the vendor on November 29, 2012. It is relevant to mention that the Company through its letter dated February 2, 2013 had submitted that the assets will be disposed of through tender offers in newspapers and the same was communicated to shareholders at the time of EOGM. Instead of inviting fresh tenders in newspapers, in line with the information provided to the shareholders in the EOGM and the Commission through the aforesaid letter, the board of directors in their meeting held on February 28, 2013, approved sale of land & building and generators to Hassan Limited and HMI, respectively, on the basis of old quotation offers invited prior to shareholders' approval. The aforesaid transaction suggested that the Company, prima facie, misstated to the commission and to shareholders that sale of assets will be through tender in newspapers, whereas, instead of inviting fresh tenders after the EOGM, the agreement to sell the generators to HMI was reached on the basis of old quotations invited on September 12, 2012 and this material fact was not disclosed to the shareholders at the EOGM. Consequently, through the interim order dated November 7, 2014, the Authorized Officer decided that the SCN dated June 20, 2014 could not be concluded at that time and directed to review the entire matter for initiating fresh proceedings under relevant provisions of the Ordinance, if warranted.

5. Consequently, in line with the direction, the matter was reviewed in its entirety and the SCN dated November 10, 2014 was issued to the respondents, whereof they were called upon to show cause in writing as to why penalties may not be imposed on them in terms of section 492 of the Ordinance for the alleged misstatements and omissions, as stated above. In response to the SCN, the respondents submitted reply dated November 28, 2014. A brief of the reply relevant to the contents of the SCN is given below:

- HMI is a separate private entity and has its separate board of directors with two directors Mr. Amir Zaheer and Mr. Mohammad Nabeel Shahzad at the time of transaction. The Company has its separate board of directors. There are no common directors nor common management as defined in subsection (i) and (ii) (2) of section 2 of the Ordinance. Therefore HMI is not associated company of the Company.
- There is no investment by the Company in HMI. In fact the Company received loan of Rs9 million from HMI on January 15, 2013 to meet its commitment with NIB Bank. Generators

were sold to HMI on April 1, 2013 for Rs13 million to reduce debt burden of the Company. Balance amount of Rs4 million is still receivable from HMI as trade debt.

- The company was facing court cases to settle its liabilities. There was heavy pressure from the court and the creditors to settle their liabilities as early as possible. Shareholders in their EOGM held on February 20, 2013 empower the board to sell the fixed assets. Furthermore, there is no time limit for approval of directors and selling the assets. Sale agreement was executed on April 1, 2013, after shareholders' approval in the EOGM.
- In the statement of material fact at serial no. 6 mode of disposal of fixed assets is also mentioned i.e. (by negotiation/advertisement/tender or calling quotation). Offers were invited through print media. Three bids were received. There was no validity date in these offers. Therefore, sale was made after getting approval from shareholders in the EOGM held on February 20, 2013. Reasons of disposal of assets was informed to shareholders at the time of EOGM, but through tender is not warranted as alleged.
- It is neither mandatory nor binding under the law that stamp paper should be purchased on the date when any deal is to be executed. Under Section 54 of Stamp Act, 1899, stamp paper is valid for six months next preceding the date for execution of any deed. Company advisor had the stamp paper which was used for execution of agreement to sell. After the authorization by shareholders in EOGM on 20th February, 2013, the agreement to sell was executed on April 1, 2013.
- The management was under litigation with the banks and others, therefore, no fresh offers were invited looking the intervention of a person already in litigation with the company. Offers received earlier were conditional that subject to clearance of all liabilities/cases, therefore, clearance took time to accept the offers. Board ultimately accepted the highest offers in their meeting held on February 28, 2013.

6. A hearing in the matter was held on November 12, 2015 and the respondents were represented by Mr. Muhammad Afzal Awan, the Authorized Representative who was accompanied by Mr. M. Sarfraz, the Company Secretary. In the hearing the respondents mainly reiterated their earlier stance, as per their written submissions. It was further argued that fresh tenders for disposal of generators to HMI was not called and those were disposed of based on previous quotations for immediate want of funds by the Company. The Company previously

entered into agreement with a person for sale of machinery excluding generators and that person only made a small payment against the agreement and then initiated litigation with the Company. Therefore, even though the generators were not a part of the agreement with that person, it was difficult for the Company to sell the generator to the outsiders due to their reluctance caused by such litigation. It was further informed that the balance amount of Rs4 million was still receivable from HMI.

7. Before proceeding further, it is necessary to advert to the following relevant provisions of Ordinance:

Section 2 of the Ordinance, inter alia, 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: —*

(i) if a person who is the 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 per cent 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 per cent of the voting power in that company or undertaking; Emphasis Added

Subsection (1) of Section 208(1) of Ordinance provides that *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. Moreover 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."*

Subsection (3) of section 208 of the Ordinance, provides that *if default is made in complying with the requirements of this section or the 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.

Section 492 of the Ordinance stipulates that whoever in any return, report, certificate, balance sheet, profit and loss account, income and expenditure account, prospectus, offer of shares, books of accounts, application, information or explanation required by or for the purposes of any of the provisions of this Ordinance or pursuant to an order or direction given under this Ordinance makes a statement which is false or incorrect in any material particular, or omits any material fact knowing it to be material, shall be punishable with fine not exceeding five hundred thousand rupees.

In terms of the Commission's notification SRO 1003 (I)/2015 dated October 15, 2015, the powers to adjudicate cases under sections 208 and 492 of the Ordinance have been delegated to the Executive Director (Corporate Supervision Department).

8. I have analyzed the facts of the case, relevant provisions of the Ordinance and the arguments put forth by the respondents and my observations are as under:

- Mr. Mohammad Nabeel Shahzad and Amir Zaheer both were directors of HMI and each of them also held 50% shares of HMI. Since, the HMI's shareholding in the Company was 49.914%, therefore, the indirect holding of each of them in the Company was 24.96%. In terms of the definition given in section 2 of the Ordinance, HMI was the associated company of the Company owing to these facts. Therefore, it is established that HMI was associated company of the Company as per section 2 of the Ordinance. Even though definition of *associate* given in International Accounting Standard ("IAS") 28 is not relevant in the context of section 208 of the Ordinance, it must be noted that even in terms of criteria set forth by IAS 28, owing to its substantial shareholding of 49.914% in the Company, the HMI has significant influence and is an associate, unless otherwise is demonstrated.
- The Company sold generators to HMI on April 1, 2013 for Rs13 million, out of which Rs4 million is still receivable from associated company. Whereas in respect of sale of property to another buyer Hassan Limited for Rs124 million on August 30, 2013, sale consideration

was immediately received by the Company. Receivable from HMI is not a normal trade credit and it appears that the Company provided benefit to HMI, by selling generators on credit basis and balance payment has not yet been received despite elapse of more than two and a half years after the sale. Therefore, it cannot be considered as a normal trade credit. Since the amount receivable from associated company is without the authority of special resolution and without any return therefore provisions of section 208 of the Ordinance have been violated. The respondents' have tried to justify the inordinate delay in recovery from associated company HMI by arguing that the generator was obsolete, inefficient and needed substantial amounts for repair. This argument is not tenable because at the time of sale, it was the buyer's responsibility to verify the condition of generator that was sold on *"as is where is basis"*, as per the agreement. Moreover, the agreement clearly mentioned that *it shall not be open to buyer to question the nature and quantity of the generator*. Therefore, delaying payments of balance amount by giving such excuses is not justifiable.

- As per revaluation report dated January 1, 2013 the value of generator set was assessed to be Rs15 million with forced sale value of Rs10.5 million. Therefore, the respondents' plea that even with sale proceeds of Rs9 million the Company earned a profit is not correct.
- In respect of show cause proceedings under section 208 of the Ordinance, respondents' statement that those have been concluded and allegations have been vacated, is based on their misinterpretation of the facts. It is clear that the order dated November 7, 2014 under section 208 of the Ordinance was an interim order and does not concluded the case. This fact has been clearly mentioned in the said order.
- The respondents have referred to the Commission's Appellate Bench's order dated June 5, 2012. In stated case it was held by the Appellate Bench that letting of machinery to associated company for stitching products of a company cannot be termed as investment. Therefore, the case law cited by the respondents bears no relevance to the instant proceedings which are in respect of extending abnormal credit to the associated company.
- The Commission vide its letter dated January 30, 2013 advised the Company to dispose of the undertaking including generators through tender in newspapers in line with the

SRO 1227/2005 dated December 12, 2005. The Company in their letter dated February 2, 2013 had submitted that the assets will be disposed of through tender offers in newspapers. Instead of inviting fresh tenders through newspapers, the board of directors in their meeting held on February 28, 2013, approved sale of land & building and generator to Hassan Limited and HMI, respectively.

- The Company misstated to the Commission that the sale of assets will be through tender in newspapers whereas, the Company sold assets without inviting fresh tenders after the EOGM. The agreement to sell the generators to HMI was reached on the basis of old quotations invited on September 12, 2012. This material fact was also not disclosed to the shareholders in the EOGM that the assets will be disposed of based on old quotations invited on September 12, 2012. Moreover, despite the fact that the generator was being sold to HMI which was an associated company, no disclosure to this effect was given to the shareholders.
- It has been stated by the respondents that the management was under litigation with the banks and others, therefore, no fresh offers were invited due to intervention of a person already in litigation with the company. Perusal of the notice of the EOGM reflects that even this material fact that a person other than the creditors was in litigation with the Company, was not disclosed to the shareholders in EOGM despite knowing it to be material. In any case, the respondents were bound to provide information to the shareholders in case they had plans to dispose of the assets based on previously invited quotations and amounts of quotations so received should have been disclosed to the shareholders to enable them to make a well informed decision.

9. I deem it necessary to make some observations on the importance of adequacy and accuracy of disclosures in notices of the general meetings and directors' duties and responsibilities in this regard. It is of utmost importance that notices of general meetings called to seek approval of the shareholders under various provisions of the Ordinance must contain all the necessary information and give adequate and correct disclosures that are necessary for the shareholders to make a well informed decision in respect of the business to be transacted at the general meetings. The directors have a fiduciary duty to disclose all material information when seeking

shareholders' approval or when a conflict of interest exists. Full and accurate disclosure before a shareholders' vote is required for a well informed decision. It is the duty of directors of a company to see that the disclosures made to the shareholders are adequate and correct and there is no omission of material facts. In view of their fiduciary duties that they owe to the Company, the directors are liable to a higher level of accountability which requires them to be vigilant and perform their duties with care and prudence. It is their primary responsibility to oversee the functioning of the company, to keep it appropriately staffed and organized and ensure due compliance of law. In this context the respondents cannot absolve themselves of their statutory duties regarding misstatements or omissions of material information provided to the shareholders.

10. For the foregoing reasons, I am of the view that the provisions of sections 208 and 492 of the Ordinance have been violated by the respondents. Therefore, in exercise of the powers conferred by section 492 of the Ordinance, I hereby impose an aggregate fine of Rs175,000/- (Rupees one hundred seventy five thousand only) in aggregate on seven respondents. The respondents are directed to deposit the fines in the following manner:

Name of Respondents	Amounts in Rupees
1. Mr. Ashfaq Ahmed, Chief Executive	**25,000**
2. Mr. Saqib Ashfaq	**25,000**
3. Mr. Amir Ashfaq	**25,000**
4. Mr. Niaz Mohammad	**25,000**
5. Mr. M. Farooq	**25,000**
6. Mr. Ikhlaq Hussain	**25,000**
7. Mr. Saleem Abbas	**25,000**
Total	**175,000**

The eighth respondent Mr. M. Sarfraz, the Company Secretary is warned to be careful in future regarding compliance with section 492 of the Ordinance.

In respect of violation of section 208 of the Ordinance, all the respondents are hereby warned to be careful in future and ensure meticulous compliance with the applicable provisions of the law by exercising due care.

The aforesaid fines 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

from the receipt of this order and furnish receipted bank vouchers to the Commission. In case of non-deposit of the penalties, proceedings for recovery of the fines as arrears of land revenue will be initiated. It may also be noted that the aforesaid penalties are imposed on the respondents in their personal capacity; therefore, they are required to pay the said amount from personal resources.

Before parting with the order, I hereby invoke the provisions of section 473 of the Ordinance and direct the respondents, to immediately take all the necessary steps to recover the balance amount of Rs4 million from HMI along with mark up to be charged for the extended period of credit. The rate of markup should not be less than the average borrowing cost of the Company or prevailing bank rate (KIBOR), in case of absence of borrowing cost.

ALI AZEEM IKRAM
Executive Director (Corporate Supervision Department)

Announced:
November 18, 2015
Islamabad