



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

**BEFORE APPELLATE BENCH NO. II**

In the matter of

**Appeal No. 27 of 2007**

1. Mr. Jahangir Elahi
2. Mr. Tanvir Elahi
3. Mr. Ahmed Jahangir
4. Mr. Akhlaq Ali Khan
5. Mr. Nadir Ali Awan
6. Mr. Tariq Latif
7. Mr. Amir Jahangir
8. Mr. Shahrukh Elahi
9. Sh. Muhammad Ashraf

All Directors of Taj Textile Mills Limited, 85-C Model Town, Lahore

..... APPELLANTS

Versus

Executive Director (Enforcement)

Securities and Exchange Commission of Pakistan

NIC Building, Jinnah Avenue, Blue Area, Islamabad

..... RESPONDENT

**ORDER**

Date of Hearing

10 August 2009

**Present:**

**For the Appellants:**

Mr. Muhammad Shoaib, Advocate

**For the Respondent Department:**

Mrs. Maheen Fatima, Joint Director

Mr. Muhammad Anwar Hashmi, Deputy Director



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1. This order shall dispose of appeal No. 27 of 2007 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the Order (the "Impugned Order") dated 03-09-07 passed by the Executive Director, Enforcement (the "E.D Enforcement").
2. The facts leading to the case are that on examination of annual accounts of Taj Textile Mills Limited ("Taj Textile") for the year ended 30-09-01, it was observed that short term borrowings including bank credit facilities of Rupees 246.853 million had been transferred by Elahi Enterprises (Pvt) Limited (the "Elahi Enterprises") to Taj Textile during the years 1998 to 2001. Taj Textile and Elahi Enterprises were associated undertakings at the time of the transfer by virtue of common directors namely: Mr. Jahangir Elahi, Mr. Alamgir Elahi, Mr. Tanvir Elahi and Mr. Akhlaq Ali Khan (the "Common Directors"). Elahi Enterprises suffered a severe set back with respect to its business venture particularly on account of the fact that the long term buyer of its products in France went bankrupt, which caused a liquidity crunch. Elahi Enterprises and the Common Directors were unable to pay back the loans to various banks. The two companies had entered into a conveyance deed dated 21-4-1998 and a supplemental conveyance dated 21-9-98 ( the "Conveyance") through which the loan liability was transferred from Elahi Enterprises to Taj Textile for consideration including: quota for exports of textile products amounting to Rupees 60 million; margin on trading business transfer amounting to Rupees 50 million; goodwill and low rate of interests enjoyed by Elahi Enterprises on refinance scheme which may be availed by Taj Textiles on account of quota already transferred by Elahi Enterprises to Taj Textile.
3. The Commission issued a show cause notice ("SCN") dated 22-11-02 to the directors of Taj Textile ( the "Appellants") and the company secretary to



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explain as to why proceedings should not be initiated against them for violation of section 208(1), 195 (1)(c), 188 (1) (c) (ii) and 189 of the Companies Ordinance, 1984 (the "Ordinance"). The Appellants' counsel submitted reply to SCN dated 23-12-02 on behalf of the directors excluding Mr. Alamgir Elahi, Mr. Umer Elahi and Mr. Muhammad Asif (nominee director of NIT). Mr. Alamgir Elahi and Mr. Umer Elahi in response to SCN stated that they had no access to the record and therefore they are unable to clarify their position in the matter. Mr. Muhammad Asif, nominee director of NIT, submitted a reply dated 15-01-03 stating therein that since he had no beneficial ownership as he was a nominee director and not involved in violating the provisions of the Ordinance.

4. Hearing in the show cause proceedings were held on 28-03-03 and 29-12-03. During the hearing the Appellants' counsel reiterated the grounds taken in the reply to the SCN. The matter remained pending on account of various related aspects of the case. The case was taken up again in the year 2007 and several opportunities were provided to the Appellants but they failed to appear before the Respondent. The other directors namely Mr. Alamgir Elahi and Mr. Umer Elahi were represented by Mr. Fakhar Mahmud Chanda Advocate, who stated that his clients had no access to the record and therefore they are unable to clarify their position in the matter. Mr. Muhammad Asif, nominee director of NIT was represented in hearing by Mr. Shahid Aziz, who reiterated the stance taken in reply dated 15-1-03. ( as stated in para 3 above)
5. The E.D Enforcement decided to proceed on the basis of the record, since the Appellants' counsel failed to appear before him despite numerous opportunities being afforded to him. The E.D Enforcement passed the Impugned Order imposing penalty of Rs 500,000/- each on Appellant No 1 to 5 and Mr. Mr. Alamgir Elahi who were directly involved in the transaction



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under section 208(3) of the Ordinance and penalty of Rupees 100,000/- each was imposed on Appellant Nos. 6 to 9 and Mr. Umer Elahi as they remained on the Board of Directors ("BoD") of Taj Textile but never objected to the illegal transaction. The directors of Taj Textile were ordered to reverse the transaction under section 473 of the Ordinance and further directed to recover the additional financial charges paid on behalf of Elahi Enterprises.

6. The Appellants' preferred the instant appeal against the Impugned Order. The Appellants' counsel as a preliminary objection stated:

- a) The Commission did not provide ample opportunity to the directors of Taj Textile to present their case. E.D Enforcement proceeded ex-parte against the Appellants. It was argued that due process rights have been infringed therefore the Impugned Order should be set aside on this ground alone.

7. The Appellants' counsel on merits argued:

- a) Section 208(1) of the Ordinance is not applicable in the instant case since the Conveyance is not an investment as per the requirements of the said section but is a sale purchase transaction between Taj Textile and Elahi Enterprises. It was contended that the Conveyance clearly identifies a seller; a buyer; transaction at a specific price and at a specific time. The Conveyance contains all the ingredients of a sale purchase agreement. Moreover, details of foreign buyers and quota transferred to Taj Textile was provided to the Commission vide letter dated 23-12-02 wherein the value of the assets transferred to Taj Textile as consideration was measured at Rupees 250 million.



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- b) The E.D Enforcement erred in holding that the price of the assets transferred to Taj Textile as consideration was not determinable as goodwill is an intangible asset. It was argued that the parties transacted at an identified price and goodwill can be sold and purchased and is regarded as property. Reliance was placed on 2008 PTD (Trib), 679 where it has been held that goodwill is an item of balance sheet and shown as an asset though intangible and is subject of sale and other contract, as is any other property of the firm and 1992 SCMR 1755 where it has been held that goodwill is incorporeal property in the class of patents, copyright and trademarks and as such is movable property and therefore, caught within the definition of assets.
- c) It was contended that the annual account of Taj Textile for the year ended 30-09-2001 indicates that the Conveyance was discussed by the shareholders of Taj Textile, therefore the requirements of section 208 of the Ordinance have been fulfilled. Even if the Conveyance is considered as an investment in terms of section 208 of the Ordinance, the requirement to pass a special resolution under section 208(2) of the Ordinance is satisfied. Further the Conveyance was approved by the shareholders of Taj Textile at a meeting held on 31-05-02.
- d) The penalty imposed under section 208(3) of the Ordinance is not applicable as the directors did not act knowingly and wilfully. Reliance was placed on 1984 CLC 2456 and PLD 1966 Lahore 822, where the definition of wilful as defined in Black Law Dictionary is reproduced as an act done with stubborn purpose, but not with malice, as done intentionally, knowingly and purposely as distinct from an act done carelessly, thoughtlessly, heedlessly or inadvertently.



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- e) In the Impugned Order the directors of Taj Textile have been directed to reverse the Conveyance under section 473 of the Ordinance and Taj Textile has been directed to recover the amount paid on behalf of Elahi Enterprises. It was contended that section 208 or section 473 of the Ordinance does not provide for the reversal of Conveyance. Moreover, the direction is unjustified as extensive time has elapsed since the Conveyance and reversal is not feasible.
- f) The Impugned Order imposed penalty of Rupees 500,000 on Mr. Nadir Ali Awan, who was not on the BoD at the time the Conveyance took place. Mr. Nadir acted as CFO in the year 1999 for a period of six months.
8. The departmental representatives, Ms. Maheen Fatima and Mr. Muhammad Anwar Hashmi in response to the preliminary objections stated that:
- a) The Appellants were given several opportunities of personal hearings to explain their conduct. The directors of Taj Textile were represented in the show cause proceedings held in the year 2003. The Appellants' counsel, however, failed to appear before the E.D Enforcement, despite a number of opportunities given to Appellants' counsel to appear on 21-2-07, 1-3-07, 14-3-07, 24-4-07 and 8-5-07. E.D Enforcement passed the Impugned Order ex-parte on the basis of the record available with him as the Appellants as well as their counsel failed to appear.



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9. On merits the departmental representatives stated that:

- a) The argument that the Conveyance is a sale transaction between two parties is not tenable, for a valid sale transaction there must be a identified buyer and seller who agree to transact at an identified price. In the instant case, the transfer of loans and mark-up thereon by Taj Textile on behalf of Elahi Enterprises has been made against assets, the value of which can not be reliably identified. The details of foreign buyers and quota transferred to Taj Textile provided to the Commission vide letter dated 23-12-02 could not measured reliably and cannot be considered as valid consideration. The Conveyance was entered into by the Common Directors of Elahi Enterprises, who were also present on BoD of Taj Textile. The Common Directors entered into the Conveyance when they were unable to repay the loans obtained by Elahi Enterprise to the Bank. It was argued that the Conveyance had caused severe burden on the assets of Taj Textile; the financial charges of Taj Textile increased by 166% in the year 2001 as compared to the previous year and an amount of Rupees 53.086 million was paid by Taj Textile on behalf of Elahi Enterprises to the banks, which caused Taj Textile's profit to plummet. The Conveyance thus falls within the definition of investment in terms of section 208 of the Ordinance.
- b) It has been clearly mentioned in the then applicable IAS 22 – Business Combinations (now IFRS 3), that 'goodwill' can only be accounted for in the accounts as a result of an acquisition or merger and not otherwise. Goodwill, therefore, cannot be considered as an asset in this case when there was neither an acquisition nor a merger. Moreover, para 21 of IAS-38 provides that the intangible assets shall



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be recognized only if the cost of the assets can be measured reliably, where as in the instant case the auditor's qualified the report for the year ending 30-9-02 on the basis that the valuation of goodwill and quota cannot be confirmed

- c) Taj Textile was required under section 208(2) of the Ordinance to obtain the approval of the shareholders by way of a special resolution prior to making the investment in its associated concern. The meeting held on 31-05-02 cannot be termed as having passed a special resolution as it was held after the Conveyance took place. The requirements of section 160(1) (b) of the Ordinance were thus not complied with.
- d) The directors of Taj Textile were fully cognizant of the requirement of section 208 and have argued that the Conveyance was discussed in the AGM, which shows that they were fully aware of the requirements of section 208. The argument of the Appellant that the default was not done knowingly and wilfully is therefore baseless.
- e) Section 473 of the Ordinance empowers the Commission to give direction to make good the default of any provision of the law. Reliance was placed on an order passed by Executive Director (CL), dated 02-09-05, under section 208 read with section 476 of the Ordinance in the matter of Suhail Jute Mills Limited, where direction under section 473 of the Ordinance was given to make good the default.





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- f) As per the minutes of the board meetings submitted by Taj Textile for the years 1998 and 1999, Mr. Nadir Ali Awan was on the BoD of Taj Textile at the time of the Conveyance. He was also the main sponsoring director as per the copy of the Memorandum of Association submitted by Taj Textile.

10. Our findings on the preliminary objection is as under:

- a) The Appellants were given ample opportunities to explain their conduct in the show cause proceedings held in the year 2003. Opportunities for hearings were again provided on 21-2-07, 01-03-07, 14-3-07, 24-4-07 and 08-05-07 but the Appellants' and or their counsel failed to appear before the E.D Enforcement. E.D Enforcement reached the conclusion that the Appellants' have no further arguments to advance other than the response to the SCN and therefore the Impugned Order was passed ex-parte on the basis of the record. We do not see any cogent reasons behind non-appearance of the Appellants and their counsel before the E.D Enforcement. In any case it was made clear to the Appellants' counsel during the hearing of this appeal that we are providing him the right to agitate whatever he desires.

11. Our para wise findings on other arguments of the parties are as follows:

- a) The Common Directors conveyed the loans of Elahi Enterprises to Taj Textile when they were unable to repay the loan to the banks. The question before us is whether the Conveyance was a sale transaction as contended by the Appellants counsel or falls within the ambit of



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investment/loan under section 208(1) of the Ordinance, which is reproduced for reference:

**208(1) *Investments in Associated Companies and Undertakings-***

*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.*

Emphasis added

For a valid sale transaction, the parties must agree to transact at an identified price. In the Conveyance, consideration has not been identified. Quota for exports; margin on trading business and goodwill has been stated as consideration, however none of them can be reliably measured and therefore the price remains un-identified. Taj Textile paid an amount of Rupees 53.086 million on behalf of Elahi Enterprises, which caused Taj Textile's profit to plummet. We do not find any force in the Appellants' counsel's contention that the Conveyance was merely a sale transaction and does not come under



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the preview of section 208 of the Ordinance. The Conveyance was mode of investment and falls within section 208 of the Ordinance and thus a special resolution should have been passed before entering into the Conveyance

- b) We have examined IAS 22 and 38, which were adopted by the Commission vide SRO No 525(I)/2001 dated 18-7-2001 and SRO No 608 (I) /2001 dated 28-8-2001 respectively and are now in force under SRO No 665(I)/2005 dated 28-6-05 – IAS 22 on Business Combinations has been examined to ascertain whether goodwill should have been considered an asset. Para 26 of IAS 22 and para 48 of IAS 38 is reproduced for ease of reference :

***Para 26-*** *The identifiable assets and liabilities acquired that are recognized under paragraph 19 should be those of the acquiree that existed at the date of acquisition together with any liabilities recognized under paragraph 31. They should be recognized separately as at the date of acquisition if, and only if:*

- (a) *it is probable that any associated future economic benefits will flow to, or resources embodying economic benefits will flow from, the acquirer, and*
- (b) *a reliable measure is available of their cost or fair value.*

Emphasis added

***Para 48***

*Internally generated goodwill shall not be allowed as an asset.*

Emphasis added



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Taj Textile had to meet both the conditions in order to treat goodwill as an asset; firstly the goodwill had to be measured reliably. The auditor of Taj Textile had qualified the report for the year ended 30-9-02 on the basis that the valuation of goodwill and quota cannot be confirmed/ measured reliably; secondly, the goodwill had been generated internally. It was not a result of an acquisition or merger and therefore goodwill cannot be considered as an asset in this case.

The case law presented by the Appellants' counsel on the issue of goodwill are; 2008 PTD (Trib) 679 treats goodwill as an asset in case of merger of a company and aids the argument of the departmental representative that goodwill can only be made use of in case of merger and acquisitions and not where the goodwill is generated internally. In 1992 SCMR 1755 goodwill has been treated as incorporeal property and the case is on the issue; whether or not goodwill is taxable. The cases referred to above are distinguishable from this case and cannot be relied upon in deciding the instant appeal.

- c) Section 208(2) of the Ordinance requires the approval of the shareholders by way of a special resolution prior to making the investment in its associated concern and any meeting held by the Appellants after the investment was made would not suffice. The annual account of Taj Textile for the year ended 30-09-2001 indicates that the Conveyance was discussed by the shareholders of Taj Textile after the investment had already been made, which goes to show that the requirements of section 208 of the Ordinance had not been fulfilled.



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- d) The approval of Conveyance by the shareholders on 31-5-02 after making the investment establishes that the Appellants had intentionally and deliberately avoided complying with the mandatory provisions of Ordinance. The Common Directors acted in their personal interest and transferred the liability of bank loan from Elahi enterprises, a private limited company with Common Directors in Taj Textile which is a public limited company to the detriment of the shareholders of Taj Textile, without adequate and reliable consideration which leads us to the conclusion that the default was deliberate and willful.
- e) We have perused section 473 of the Ordinance to ascertain whether the direction to reverse the Conveyance is possible under section 473 of the Ordinance:

**473** *Power of Court, etc., trying offences under Ordinance to direct compliance with the provisions.-- The Court, the Commission, the registrar or other officer trying an offence for a default in compliance with any provisions or requirements of this Ordinance may, at any time during the pendency of the trial or at the time of passing final order, direct, without prejudice to any liability, any officer, auditor or employee of the company in respect of which the default has been committed to comply with the said provisions or requirements within such time as may be specified in the order.*

Emphasis added

The Commission is empowered under section 473 to give a direction to make good the default of any provision of the Ordinance. The Appellants' counsel has failed to point out any provision of the

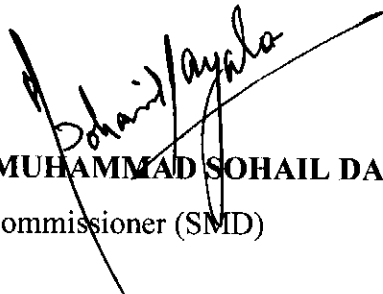


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Ordinance which specifically prohibits the Commission to pass a direction to reverse the Conveyance. Suhail Jute Mills Limited order dated 02-09-05 cited by the department was another case where the Commission had given a direction under section 473 of the Ordinance to make good the default. Moreover, the contention of the Appellants' counsel that the direction is unjustified as extensive time has elapsed since the Conveyance is also not tenable. Lapse of time does not absolve the Appellants of their fiduciary duty towards Taj Textile and the Common Directors are bound to return the benefit to the shareholders of Taj Textile.

- f) Form 29 of Taj Textile was requisitioned from the CRO concerned in order to ascertain whether Mr. Nadir Ali Awan was on the BoD of Taj Textile during the transfer of loans from Taj Textile to Elahi Enterprise. It has transpired from the record that Mr. Nadir Ali Awan was appointed on the BoD on 30-12-1999, whereas he resigned from the office on 16-3-2001 as such, it can safely be concluded that he was on the BoD during the period i.e. 1998-2001 and did not object to the Conveyance as such he is equally liable.

In view of the foregoing, no ground is made out to interfere with the Impugned Order. The appeal is dismissed with no order as to cost.

  
(MUHAMMAD SOHAIL DAYALA)  
Commissioner (SMD)

  
(S. TARIQ ASAF HUSAIN)  
Commissioner (LD)

Announced on: 12-11-09