



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO. IV

In the matter of

Appeal No. 40 of 2013

- (i) Mr. Mohammad Abdullah, Chairman
- (ii) Mr. Shahid Abdullah, Chief Executive
- (iii) Mr. Nadeem Abdullah, Director
- (iv) Mr. Amer Abdullah, Director
- (v) Mr. Yousuf Abdullah, Director
- (vi) Mr. Mohammad Yamin, Director
- (vii) Mr. Naveed-ul-Islam, Director

.... Appellants

Versus

Head of Department (Enforcement), Securities and Exchange
Commission of Pakistan.

.... Respondent

14/05/15

Date of hearing:

Present:

For Appellants:

- (i) Imtiaz Majeed, CEO Hameed Majeed Associates
- (ii) Adnan Akhtar, Senior Consultant

For Respondent:

- (i) Ali Azeem Ikram, Director Enforcement
- (ii) Ms. Ayesha Riaz, Joint Director Enforcement

ORDER

1. This order shall dispose of appeal no. 40 of 2013 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated 13.05.13 ("the Impugned Order") passed by the Respondent.



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2. The facts leading to the case are that during the examination of the annual audited accounts (the Accounts) of the Sapphire Fibres Limited (the Company) for the year ended 30.06.11 it was transpired that the Company had made investments in its associated company namely Sapphire Electric Company (SECL). SECL is an associated company by virtue of common directorship in both the companies. The record reflected that the Company passed various resolutions for making investments in SECL aggregating to Rs. 2,900,000,000/-. The aforesaid enhancement of limit was made in general meeting of shareholders held on 08/09/10, however, no approval was sought for letters of credit despite being in the nature of investments in associated company.
3. The detail and nature of investment made by the Company in SECL is as follows:

Types of investments	Amounts of Investments
Investments made in shares of SECL	Rs. 2,500, 704,020 (2010: Rs. 2,094,410,580)
Advance for issue of shares of SECL	Rs.4,500,000 (2010:Rs. 172,500,920)
Pledge of shares of SECL on behalf of SECL with various financial institutions	172,446,420 shares of Rs. 10 each
Irrevocable Letter of Credit issued in favour of financial institutions and on behalf of SECL	Rs.400,000,000 (2010:Rs.400,000,000)
Stand by Letter of Credits issued in favour of financial institutions and on behalf of SECL	Rs. 600,000,000



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4. The Respondent sought clarification from the Company on compliance of section 208 of the Companies Ordinance 1984 (the Ordinance), vide its letter dated 26.04.12. The Company submitted its reply vide letter dated 19.05.12 and 13.06.12 respectively. The Company replied that all required approvals regarding the investments were placed before the shareholders. Further it was the requirement of the project financing agreement that major sponsors shall sign the share pledge agreement and working capital support agreement. The Company vide its letter dated 13.06.12 further clarified that the Company has to invest up to Rs.2,900,000,000/- in the project as per financing document.
5. In view of the above circumstances and facts a Show Cause Notice (“SCN”) dated 16.07.12 was issued to all the seven directors of the Company (the Appellants) in terms of section 208 of the Ordinance. Mr. Imtiaz Majeed (Authorized Representative), submitted the response to the SCN vide letter dated 11.08.12 and hearing in the matter was held on 13.09.12. Authorized Representative submitted that shares were pledged as per conditions of non-recourse agreements made by SECL and argued that issuance of stand-by letters of credit on behalf of associated company were not investments in associated company in terms of section 208 of the Ordinance. He further stated that financing agreements were placed before the members in meeting, hence there was no need to pass any special resolution for the purpose, however if Commission desires such special resolution may be obtained from the members.
6. The Respondent, being dissatisfied with the response of the Appellants held that standby letters of credit issued on behalf of associated company fall under the ambit of investments in terms of section 208 of the Ordinance. Issuance of standby letters of credit aggregating to Rs. 1,000 million without obtaining sanction of members was, therefore, a violation of section 208 of the Ordinance. Keeping in view of the fact that directors of the Company had proceeded in the general meeting of the members



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of the Company held on 30.10.12 to comply with the requirements of section 208 of the Ordinance, a lenient view was taken and a penalty of Rs. 50,000 was imposed on each of the Appellants with the total amount aggregating to Rs. 350,000.

7. The Appellants, being aggrieved by the Impugned Order filed an appeal before the Appellate Bench on the following grounds and prayed to waive the penalty imposed through the Impugned Order:
- i. SECL is a subsidiary of the Company and it was obligatory on the Company to look after its investments and to support the SECL. Further all the funding agreements were placed before the shareholders of the Company.
 - ii. Standby letters of credit were contingent liability of the Company therefore; it did not fall under the ambit of section 208 prior to issuance of SRO dated 16.01.12.
 - iii. The Commission issued a SRO 27(I)/2012 relating to section 208 by which Companies (Investment in Associated Companies or Associated Undertakings) Regulations 2012 were notified and definition of "Loan and Advances" was clarified wherein a guarantee, indemnity or any other financial engagement which a company may give, issue or undertake on behalf of a borrower was included as part of definition. The aforementioned SRO was not in field when the Company entered into standby letters of credit engagements.
 - iv. The Company in compliance of Companies (Investment in Associated Companies or Associated Undertakings) Regulations 2012 obtained ratification of the standby letters of credit through special Resolution of the members passed in General Meeting held on 30.10.12.
 - v. The hearing in the matter was conducted on 13.09.12 however decision was announced seven months later on 13.05.13 after the date when the Company had obtained approval for ratification of the transaction from the shareholders. This has also been mentioned in para 15 of the Impugned Order. Further there was no justification to imposed the penalty on two following counts :



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- a. The interpretation of loan and advances was issued much after the transactions vide SRO 27(I)/2012.
 - b. Rectifications of the transaction have been carried out by giving opportunity to the shareholders to decide freely.
 - vi. No financial loss was caused to the Company by issuance of standby letters of credit as the commission has always been received from the SECL.
 - vii. The investments were made on energy sector which is at top priority of the government and necessity of the general public. This investment is beneficial for the shareholders of the Company.
8. The Respondent replied to the appeal through para wise comments and rebutted the grounds of appeal and arguments of the Appellants against the Impugned Order. The Respondent reiterated the arguments stated in the Impugned Order and prayed to dismiss the appeal. However, the Respondent rebutted the grounds of appeal in the following manner:
- i. Does not require any comment.
 - ii. Irrevocable standby letters of credits are legal and binding obligations during the validity period the credit. IAS 37 defines contingent liability as:
 - a. A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
 - b. A present obligation that arises from past events but is not recognized because the outflow of resources are not certain or could not be measured reliably.Therefore, contingent liability by definition can be a present obligation as against the argument of the applicant of possible obligation. Further the Company had paid commissions and fees for issuance of the said irrevocable letter of credits, were cash outflows form the Company. Irremovable standby letters of credits are binding loan commitments to the



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associated company, in case of beneficiary's failure to meet the requirements. Due to binding nature of loan commitments, irrevocable standby letters of credits are guarantees, the issuances of which against the assets secured by the Company, require prior authority of members in terms of section 208 of the Ordinance.

- iii. The Company had paid an amount of Rs. 15.7 million as commission against the irremovable letters of credits on behalf of associated company and the same were reimbursed in 2012 as per note 41 to the annual audited accounts for the year ended June 30, 2012. Therefore, there were economic outflows from the Company which were recovered subsequently. Hence, claim of the applicant that the standby letters of credit is contingent liability is not worthy in the instant case, as significant cash outflows from the Company in the form of commission had taken place and the Company has provided its tangible securities for issuance of irremovable letters of credits by the financial institutions. In view of the above said facts the said irremovable letters of credits fall in the ambit of section 208 of the Ordinance and subsequently SRO 27/2012 has very adequately taken its care and included guarantees in the definition of loans and advances. Further, in several cases, it has already been decided by the Commission that guarantees fall in the ambit of section 208 of the Ordinance;
- iv. The proceedings u/s 208 of the Ordinance had been initiated vide SCN dated July 16, 2012, and members of the Company in their general meeting held on October 30, 2012 have authorized in term of section 208 of the Ordinance to issue standby letters of credits on retrospective basis i.e. with effect from July 2009 for L/c of Rs. 400 million and with effect from October 2010 for L/c of Rs. 600 million. Therefore, by obtaining resolution / authority of members on retrospective basis the Company has accepted default in terms of section 208 of the Ordinance and had complied the same in 2012;
- v. The contents require no comments;

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- vi. The Company recovered commissions and fees amounting to Rs. 15.7 million against letters of credits, during the year 2012, and the Company has secured its tangible assets in favor of financial institutions for issuance of letters of credits. Therefore, opportunity loss of financial resources was evident in the said arrangements. Hence, arguments of the applicant that there was no financial loss are not worthy.
9. We have heard the parties i.e. Appellants and Respondent at length and perused the relevant record with the able assistance of the parties.
10. The Respondent never objected the investment of the Company into SECL; however, penalty was imposed through Impugned order for non-compliance of section 208 of the Ordinance while making those investments.
11. The Appellants tried to escape the liability by taking refuge behind SRO 27(I)/2012, however as per legal and interpretational norms secondary legislation cannot go beyond the ambit of primary legislation. Section 208 of the Ordinance is a primary provision whereas Companies (Investment in Associated Companies or Associated Undertakings) Regulations 2012 is a piece of secondary legislation. As matter of fact the Company has violated the section 208 of the Ordinance.
12. The Appellants have stated that the issuance of standby letters of credit has not resulted in any financial loss to the shareholders of SFL as the LC Commission has always been received from SECL.
13. Further, the act has been ratified by the shareholders of the Company in their general meeting on October 30, 2012.
14. The Appellants were penalized for violation of a certain procedure and statutory requirement envisaged in section 208 of the Ordinance. The penalty imposed through

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the Impugned Order was not based on any loss caused; rather it was invoked for violation of the requirements contained the relevant section.

15. In the light of above stated facts and submissions made before the Appellate Bench by the parties on the basis of our analysis on the grounds of appeal, it has been established by the conduct of the Appellants that violation of section 208 has been committed. However in view of the fact that the said violation was ratified by the shareholders of the Company in their general meeting on October 30, 2012 and the fact that LC Commission has always been received from SECL, taking a lenient view, We set aside the Impugned Order to the extent of penalty.

16. Parties to bear their own cost.

(Fida Hussain Samoo)
Commissioner (Insurance)

(Zafar Abdullah)
Commissioner (SCD)-

Announced on:

06 JUL 2015