



Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 6 of 2022

1. Syed Nadeem Ahmed
2. Mr. Adnan Asdar Ali
3. Mr. Rashid Abdulla
4. Mr. Ayaz Abdulla
5. Mr. Asad Abdulla
6. Mr. Zubair Razzak Palwala
7. Mrs. Shaista Khaliq Rehman
(All above collectively called "Directors")
8. The Searle Company Limited (Company)

...Appellants

Versus

The HOD, Adjudication Department-I, Adjudication Division, SECP, Islamabad.

...Respondent

Date of hearing:

April 10, 2025

Present:

For the Appellants:

Mr. Yawar Burki, Advocate (through Zoom)

For the Respondent:

1. Mr. Mubasher Saeed Saddozai, Executive Director, Adjudication Division, SECP
2. Mr. Rizwan-ul-Haq, Addition Joint Director, Adjudication Department-I, SECP



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3. Mr. Ehtesham Uddin Ahmed, Deputy Director, Adjudication Department-I, SECP

ORDER

1. This order shall dispose of Appeal No. 6 of 2022 filed by Searle Company Limited, Syed Nadeem Ahmed and six others (the Appellants) against the Order dated September 27, 2021 (the Impugned Order) passed by the HOD (Adjudication-I), SECP (the Respondent) under Section 199 read with Section 479 of the Companies Act, 2017 (the Act).
2. The brief facts of the case are that upon review of the annual audited financial statements of Searle Company Limited (the Company) for the year ending June 30, 2020 (the Accounts), it was observed that the Company had extended short-term interest-free loan and advance to its wholly owned subsidiaries, namely IBL Identity (Private) Limited (IBL) and Searle Biosciences (Private) Limited (SBL) respectively. As per Notes 15, 15.4, and 15.5 of the Accounts an advance of Rs. 972.18 million was given to SBL, while an interest-free loan amounting to Rs. 3.18 billion was extended to IBL. The Securities and Exchange Commission of Pakistan (the Commission) vide its letter dated November 26, 2020 sought an explanation from the Company regarding compliance with the requirements of Section 199 of the Act while executing loan and advance transactions. In response, the Company vide letter dated December 24, 2020, contended that the requirements of Section 199(2) of the Act were not applicable to the transactions, as investments in wholly owned subsidiaries were exempted under SRO 1239(I)/2017 dated December 6, 2017 (the SRO), and consequently, the requirement of obtaining shareholder approval under Section 199(1) of the Act was not triggered. The Company further argued that Section 199(2) of the Act is subservient to Section 199(1) of the Act and could not operate independently, asserting that since shareholder approval was not required under Section 199(1) of the Act under the SRO, it was not necessary to execute written agreements specifying the terms of the loan or advance. Being dissatisfied with the Company's response, the Respondent issued a show-cause notice dated April 29, 2021 (the SCN) for violations of the requirements contained under Section 199 of the Act. Final hearing in the matter was held on August 9, 2021 wherein the above-stated stance was reiterated by the Appellants' representative. The Appellants filed a written reply to the SCN subsequent to the hearing on August 26, 2021. The



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Respondent found the Appellants in contravention of Section 199(2) of the Act for extending loan and advance to wholly-owned subsidiaries without a written agreement and without charging a return, therefore, an aggregate penalty of Rs. 4,500,000/- was imposed on the Appellants under Sections 199(6) read with section 479 of the Act.

3. The Appeal was filed by the Appellants *inter alia* on the grounds that the investments were made in wholly-owned subsidiaries; therefore, under the exemptions provided through the SRO, the requirements of Section 199 of the Act were not applicable. The Appellants stated that Sections 199(1) and 199(2) of the Act are dependent on each other, therefore, the exemptions provided under Section 199(1) of the Act through the SRO are also applicable to the requirements of Section 199(2) of the Act. The Appellants argued that the requirement of a special resolution of Section 199(1) of the Act is exempted through the SRO, therefore, *ipso facto*, the requirement of the written agreement containing the terms and conditions of any investment is also exempted. The Appellants further stated that Section 199(2) requires that the investments should be made through a written agreement containing the terms and conditions of such investments "*in accordance with the approval of the members in the general meeting.*", therefore, if no meeting of the members is required to pass the special resolution then as to how the requirement of a written agreement is applicable in absence of the members meeting. The Appellants reiterated that there is no requirement to have an agreement in writing, and there are no differing interests that the holding company needs to protect.
4. The Appellants stated that it is worth clarifying that because IBL and SBL are wholly-owned subsidiaries of the Company, therefore absence of a written agreement and return on investments has not affected the interest of the Company or its shareholders/members. The Appellants argued that even as a commercial decision whether the advance is provided with high interest or no interest at all, for accounting purposes, the Accounts of the Company, as the holding company, will remain the same. The reasoning for inclusion of the requirement that any loan or advance the "*return shall not be less than the borrowing cost of the company*" is to protect the members of holding company that are not members of subsidiary company, and to ensure that a certain section or class of members of holding company do not unjustly enrich themselves due to their shareholding in a subsidiary company, at the expense of the holding



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company. However, this provision was not attracted, as any amount provided by the Company to IBL or SBL is kept with IBL or SBL, will be reflected as an asset of the Company itself, as IBL and SBL are the Appellant's wholly-owned subsidiaries. Hence, there is no reason for a requirement for an agreement in writing when there exists an exemption for compliance with the provisions of Section 199(1) of the Act.

5. It was further submitted by the Appellants that even from a commercial or substantive perspective, there would be no reason for a return to be charged on such loan/advance, as the return amount would increase the liability of the wholly-owned subsidiaries of the Company, thus impacting its consolidated financial statement of the Company. The Appellants stated that the return payable to the holding company would merely be set off against such liability, thus achieving no actual return for the holding company, and placing further financial burden on the wholly-owned subsidiaries. It is also possible that the wholly-owned subsidiaries may need to borrow more funds from the holding company (or third parties) to pay off the return to the holding company, which would defeat the purpose of the arrangement and result in a futile exercise. The Appellants stated that such an interpretation of law would lead to blatant absurdity, even from a practical perspective, which is contrary to the principles of statutory interpretation and even from a taxation perspective, such a return may attract income tax, which would result in a counter-productive position for the holding company. The Appellants argued that if a return is mandatorily payable by a wholly-owned subsidiary against a loan provided by the holding company, the same would completely defeat the purpose of the exemption in terms of the SRO. The Appellants stated that the Respondent has violated the provisions of Section 24-A of the General Clauses Act, 1897 as the powers conferred on the Respondent have not been exercised reasonably, fairly or justly.
6. The Respondent has rebutted the grounds of appeal and arguments put forth by the Appellants' representative during the course of the hearing before the Appellate Bench (the Bench). The Respondent *inter alia* stated that the Appellants have violated the requirements contained under Section 199(2) of the Act because the exemption provided under the SRO is only applicable to the extent of Section 199(1); therefore, the Appellants' presumption that the same is also applicable to Section 199(2) of the Act is a misconceived notion. The Respondent stated that



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the SRO has only provided an exemption of a special resolution, therefore, it cannot be claimed implied or consequential exemption of a written agreement containing terms and conditions of investments i.e. return/ interest/ markup on loan/advance, purpose and period of such investment. The Respondent argued that irrespective of holding and subsidiary relation, financial attachment between two separate legal entities under Section 199 of the Act should have been in a clear and accurate documented form. The Respondent stated that the Appellants' argument that loan arrangements were executed between holding and subsidiaries, therefore, whether the interest was charged or not, the consolidated financial results of the group will remain the same, is fundamentally incorrect because being separate legal entities, the financials of the Company and its subsidiaries should present a true and accurate picture. The Respondent further stated that as per Regulation 5(4) of the Companies (Investment in Associated Companies or Associated Undertakings) Regulations, 2017 (the Investment Regulations) the Company was required to charge markup on loan and advance provided to its subsidiaries, however, it failed to do so, therefore, the Impugned Order has been passed. The Appellants stated that it is a settled principle of jurisprudence that obligations are required to be discharged as per the mechanism provided in law, however, the Appellants failed to adhere to it and violated the express provisions of law. In support of the aforementioned argument, the Respondent relied upon a legal principle: *"If law requires that an act must be done in a particular way, it should be done in that manner as prescribed by law."*

7. Additionally, the Respondent submitted that interest-free loans and advance to IBL and SBL is a blatant violation of Section 199(2) of the Act, therefore, the Appellants cannot be exonerated on the ground that these transactions have not infringed the rights of any person or a set of shareholders. The Respondent stated that as per applicable law the Appellants are not authorized to disburse interest-free loans, therefore, the Impugned Order has been passed. In this regard, in case of 2019 CLD 508 (Shahzada Dawood vs. Appellate Bench), the Sindh High Court has stated that: *"6. On perusal of the exemption in question on which reliance has been placed, it appears that by exercising powers conferred under clause-(a) of the Subsection 2A of Section 208 of the Ordinance it has been notified that the holding Company shall be exempted from the requirement of obtaining the authority through Special Resolution to the extent of investment made in its associated companies or undertakings. This clearly reflects that the exemption is not*



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from the applicability of the entire provision, i.e. Subsection (1), as contended, and it is only limited to the extent of passing of a Special Resolution to that effect. On the other hand, the provision of Section 208 ibid, as observed earlier, is in a manner of restriction in respect of investments to be made in the Associated Companies or undertaking. The arguments of the learned Counsel for the Appellant that exemption from passing of a Special Resolution also applied from the restriction regarding the manner of investment and its return is not correct. Sub section (1) of Section 208 ibid, puts a complete restriction on making any such investment except by a Special Resolution, which in the instant matter has been exempted for the present purposes. However, the Proviso in this case even otherwise qualifies making of investment in the form of loan by putting an embargo that such return on investment shall not be less than the borrowing cost of the investing company. There appears to be a conscious legislation in this situation and the primary objective appears to be and as rightly contended by the Respondents' Counsel is that no holding Company should be permitted to make investment in its wholly owned subsidiary to incur losses on such investment. It must be linked with return on such investment and which must not be less than the borrowing cost of such investment. The exemption under SRO is only in respect of passing of a Special Resolution and has got nothing to do with the restriction otherwise provided in Subsection (1) read with the Proviso thereof as noted earlier it is a restriction within a restriction, and therefore, the contention that the Proviso must be construed strictly and must not be so interpreted so as to make it a substantive law is not appropriate. Here in this matter the Proviso is and must be read together with sub-section (1), failing which it will be redundant, and therefore, literal interpretation of a Proviso as has been contended and done in various citations as relied upon would not apply. In fact, the proviso along with Sub-section (1) has to be read in the following manner; "Investments in associated companies and undertakings [Subject to sub-section (2A) a] company shall not make any investment in any of its associated companies or associated undertakings except under the authority of a special resolution [Provided that the return on investment in the form of loan shall not be less than the borrowing cost of investing company] which shall indicate the nature, period and amount of investment and terms and conditions attached thereto."

8. The Respondent stated that the requirements contained under Section 199(2) of the Act are not subservient to Section 199(1) of the Act and the Appellants failed to ensure compliance with the



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requirements contained in Section 199(2) of the Act, prior to transferring billions of rupees to subsidiary companies as interest-free loans/advance, without a duly approved agreement of members containing terms and conditions of such loan including the rate of interest/ markup to be charged by the Appellant. The Respondent stated that the Appellant also failed to ensure periodic recovery of the loan/advance.

9. The Respondent submitted that the SRO's exemption applied to the requirements of Section 199(1) of the Act only, therefore, the SRO has specifically mentioned Section 199(1) of the Act. Furthermore, a comparison of Sections 199(1) and 199(2) of the Act and analysis of the SRO has made it clear that the exemption of special resolution has been granted, however, the requirements of the general meeting to get the approval of the agreement through ordinary resolution has not been waived. Section 199(1) requires a special resolution, whereas no such requirement has been placed by the legislature in Section 199(2) of the Act.
10. The Respondent stated that the Impugned Order has been passed in accordance with the law and keeping in view all relevant facts of the case, concrete evidence and reasons, therefore, attribution of violation of Section 24-A of the General Clauses Act, 1897 is denied. While rebutting the grounds of appeal, the Respondent stated that upon request made by the Appellants, a lenient view was taken in the matter and instead of imposing a maximum penalty of level three, a minimum scale penalty was imposed, therefore, if the Appellants are of the view that no such request was made by the Appellants' representative, then we request the Appellate Bench to enhance the amount of penalty to a maximum penalty of level three.
11. The Bench has heard the parties and perused the relevant record of the case, including the SRO and noted that the preamble of the SRO has specifically mentioned that it has been issued under Section 199(1) of the Act. In this regard, the Bench believes it is critical to address the Appellants' argument that the exemption granted under the SRO also applies to the requirements outlined in Section 199(2) of the Act, as the latter is subservient to Section 199(1) of the Act and not an independent provision. The Bench is of the view that the requirement of special resolution under Section 199(1) has been exempted through the SRO, hence, the application of



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the SRO is limited to the extent of the exemption of special resolution while making investments in associated companies. Furthermore, the Appellants' stance is without substance whereby it has been stated that the phrase used in Section 199(2) of the Act i.e. *"in accordance with the approval of the members in the general meeting."* referred to the meeting in which a special resolution was required to be passed, therefore, exemption of special resolution has also impliedly exempted requirement of any meeting of members to decide terms and conditions of investment through a written agreement. The Bench is of the view that, being separate legal entities, every transaction between associated companies is required to be in writing so that the accuracy of accounts and other related requirements may reflect a true and fair state of the company's affairs. However, the Bench has noted that the Appellants failed to comply with the requirement of the written agreement containing terms and conditions applicable in loan and advance transactions between the Company and associated companies. The Bench is of the view that decisions and approvals of members are made either through ordinary resolution or a special resolution, therefore, if the SRO has exempted the requirement of special resolution under Section 199(1) of the Act then the Company was required to pass an ordinary resolution get the approval of members to invest in associated companies under a written agreement containing terms and conditions of investment. Therefore, the Bench categorically rejects the Appellants' plea that the exemption provided under the SRO in Section 199(1) of the Act is also applicable to the requirements of Section 199(2) of the Act.

12. The Bench finds no substance in the Appellant's argument that the consolidated accounts of the Company and its wholly-owned subsidiaries will remain unchanged, regardless of whether a return on loan or investment is charged or not, levied. The Appellant's argument is profoundly incorrect for the following reason: the financial statements of the holding and its subsidiary companies must be prepared in a manner that accurately and fairly represents the current state of affairs, as they are independent legal entities. Consequently, the Bench is of the opinion that if the Company has violated the requirements of Section 199(2) of the Act under the pretext that the consolidated accounts of the Company and subsidiary will remain regardless of whether a return is charged or not, propriety demands that the Company should have complied with the requirements of Section 199(2) of the Act in order to avoid penal consequences.



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13. The Bench has noted that the Appellants attempt to justify the absence of return on inter-company loans or advances based on commercial and substantive reasoning; however, reliance on this argument is misplaced. Their argument is misconceived in that charging a return on loan or investment in a subsidiary company would lead to no practical benefit due to the consolidation of financial statements and possible tax burdens. The Appellants' claim that requiring return or documentation would be counterproductive due to tax implications is also misplaced. Taxation issues are separate matters governed by tax law, and cannot justify non-compliance of the Act. This argument also fails to acknowledge that compliance with statutory provisions cannot be overridden by commercial convenience or practical considerations. Statutory obligations under Section 199(2) of the Act are clear, mandatory, and not subject to business expediency. The intention of the legislature in enacting this provision is to ensure transparency, accountability, and protection of shareholders' interests through proper documentation and shareholder oversight, irrespective of group structures.
14. The Bench is of the view that the exemption granted under the SRO only extends to Section 199(1) of the Act. Section 199(1) of the Act mandates that a company shall not make a loan or investment to another entity unless a special resolution is passed. The SRO provides relief only from this requirement, recognizing the practical needs of wholly owned subsidiaries. However, Section 199(2) remains fully applicable and it states:

"The company shall not invest in its associated company or associated undertaking by way of loans or advances except in accordance with an agreement in writing and such agreement shall inter-alia include the terms and conditions specifying the nature, purpose, period of the loan, rate of return, fees or commission, repayment schedule for principal and return, penalty clause in case of default or late repayments and security, if any, for the loan in accordance with the approval of the members in the general meeting"

In view thereof, no loan or investment is to be made by the holding company in its subsidiary unless the same is authorized by a resolution of the members and a written agreement setting out the terms and conditions. Failure to comply with the requirements constitutes a clear breach of Section 199(2), which remains operative and binding. Although a holding company is



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exempted from passing a special resolution under Section 199(1) of the Act, however, under Section 199(2) of the Act, it is still required to:

- Execute a written agreement, setting forth the terms and conditions of the loan or investment, and
- Obtain members' approval, which in this case should be through an ordinary resolution (since the special resolution requirement has been waived under the SRO).

15. The bench is of the view that it is a settled principle of corporate law that each company, even within a group structure, is a distinct legal entity (as established in *Salomon v. A Salomon & Co. Ltd.*). Therefore, any inter-company transaction, such as loans or investments, must be documented through formal agreements to:

- Establish clear legal obligations,
- Ensure enforceability of terms,
- Provide transparency to auditors, shareholders, and regulators, and
- Comply with statutory provisions such as Section 199(2) of the Act.

This is especially critical because members' approval of the transaction (through an ordinary resolution in this case) can only be meaningfully given if the terms are set out in writing. The notion of "approval" under the Act assumes knowledge of the terms, which is only possible through written documentation.

16. In Bench's view the Appellants' argument that the charging of return would "defeat the purpose" of intra-group arrangements and be commercially absurd ignores the legal structure imposed by the Act. Allowing companies to bypass documentation and member approval requirements would:

- Undermine corporate governance standards,
- Lead to lack of shareholder oversight,
- Result in regulatory circumvention, and



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- Encourage arbitrary inter-corporate transactions, possibly to the detriment of creditors or minority shareholders.

17. The Appellants' allegation that the Respondent violated Section 24-A of the General Clauses Act, 1897, by not exercising its powers reasonably or justly is misplaced, as the Respondent's action is merely enforcing the clear and unambiguous requirements of Section 199(2) of the Act. The enforcement of express statutory provisions cannot be deemed unreasonable or unjust. Furthermore, the Sindh High Court's judgment cited as 2019 CLD 508 (Shahzada Dawood vs. Appellate Bench) had made it clear that the exemption provided under the SRO is related to a special resolution; however, it cannot be extended to an exemption of return on loan or investment. In view thereof, the absence of a written agreement containing the terms and conditions, including the rate of return on loan or investment made in wholly-owned subsidiaries, has established a violation of Section 199(2) of the Act.
18. The Bench has noted that it is an admitted fact that the Company made an investment by extending short-term interest-free loan of Rs. 3.18 billion and advance of Rs. 972.18 million to its wholly-owned subsidiaries, without executing a formal written agreement as mandated under Section 199(2) of the Act. Furthermore, no return, benefit, or interest was charged on such investment, thereby causing not only a non-compliance with the statutory requirements but also a disadvantage to the interests of the shareholders. The said provision is mandatory in nature and the requirements contained thereunder are not optional but a statutory obligation, non-observance of which is liable to penal consequences.
19. The record reveals that the Appellant, despite being fully aware of the statutory requirements, invested the said sum without execution of a formal agreement and without charging any return, thereby acting in violation of Section 199(2) of the Act. Statutory compliance cannot be dispensed with merely because non-compliance is argued to have caused no direct loss. The legislative intent is to ensure corporate governance, transparency, and protection of minority interests, regardless of the financial effect claimed by management. Moreover, consolidated financial statements present an aggregated view for reporting purposes but do not negate the

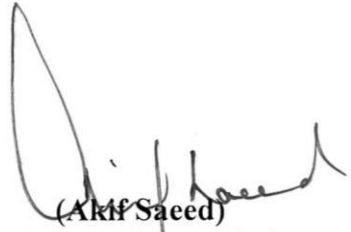


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legal requirement of arm's length dealings and financial discipline at the individual entity level. It must also be emphasized that directors owe fiduciary duties not merely to the majority but to all shareholders, including potential minority interests that may arise, particularly in cases of future de-consolidation or restructuring. Non-receipt of returns impairs the intrinsic value of investments and undermines corporate governance standards, which the Commission is mandated to safeguard.

20. In view of the above, the Bench concludes that investment in a subsidiary company is subject to a written agreement and return on investment is a necessary element to ensure that resources of the holding company are deployed prudently and in accordance with shareholders' expectations. In view thereof, the defense raised by the Appellant are found to be untenable both in fact and in law. The violation of Section 199(2) of the Act stands established beyond cavil.
21. In view of the foregoing, we find no infirmity or illegality in the Impugned Order. The appeal, therefore, stands dismissed without any order as to cost.


(Abdul Rehman Warraich)
Commissioner


(Akif Saeed)
Chairman/ Commissioner

Announced on:

03 JUN 2025