

Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH

In the matter of

Appeal No. 11 of 2019

Chakwal Spinning Mills Limited

...Appellant

Versus

Executive Director, Corporate & Supervision Department, SECP

...Respondent

Date of Hearing: 28/11/19

Present:

For the Appellant:

- i. Mr. Abdul Hye, CFO
- ii. Mr. Nadeem Anwar, Company Secretary

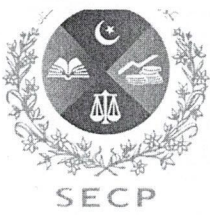
For the Respondent:

Mr. Amir M. Khan Afridi, Director (CSD)

ORDER

1. This Order is passed in the matter of Appeal No. 11 of 2019 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the Order dated 22/02/19 (the Impugned Order) passed by Executive Director, (CSD) (the Respondent).
2. The brief facts of the case are that the Respondent vide letter dated 27/09/18 (the Letter) had allowed Chakwal Spinning Mills Limited (the Appellant) to issue 81,576,000 ordinary shares at par i.e. Rs 5.00 per share, by way of shares other than right under clause (b) of section 83(1) of the Companies Act, 2017 to the following Directors:

i. Mr. Khawaja Mohammad Jawed:	24,841,000 shares
ii. Mr. Khawaja Mohammad Kaleem:	53,135,000 shares
iii. Mr. Khawaja Mohammad Jahangir	<u>3,600,000 shares</u>
Total	<u>81,576,200 shares</u>



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3. The Respondent also noted in the Letter that the loan amounting to Rs. 15,075,000 from Mr. Khawaja Mohammad Kaleem, Director remained unverifiable and, therefore, had not been considered for the aforesaid approval. Furthermore, the aforesaid approval was subject to the following conditions:
- Shares shall be issued within 60 days from the date of the Letter under intimation to the Respondent;
 - The Appellant shall inform the Securities and Exchange Commission of Pakistan (the Commission) within 7 days of the issuance of shares;
 - The aforesaid parties shall not divest their shareholding for a period of three years; and
 - The aforesaid approval for issuance of shares was based on the documents/information provided and relevant laws and regulations, therefore, the Commission bore no responsibility whatsoever for express or implied agreements between the lenders and the Appellant.
4. The Appellant, subsequently, vide letter dated 30/10/18 made an application for permission for waiving off restriction on divestment of shareholding (the Application) keeping in view the circumstances of the case. The Respondent vide Impugned Order communicated to the Appellant that argument for relaxation from the condition of bar on divestment of shares of Directors was unconvincing, based on unrealistic assumptions and contradictory to the previous representations made by the Appellant before the Commission. The Respondent further stated that the Appellant, recognizing all conditions imposed by the Commission, issued shares to the Directors in October 2018. The Respondent held that the Appellant's assumption that they would generate requisite amount of funds by divestment of shares was based on an incorrect average market price of shares, therefore, the condition of the Letter continued to remain enforced.
5. The Appellant preferred the appeal on the following grounds:
- The Appellant made a presentation before the Respondent in which it was submitted that owing to difficult business conditions of the textile industry, the Appellant incurred substantial business losses and eroded its working capital and liquidity to smoothen the operational activities. The Appellant was allowed to convert the amount of Directors' loan of Rs 407,881,000 million into 81,576,200 ordinary shares of Rs 5/- each, however, the Appellant was not able to attract investment opportunities to strengthen its liquidity needed for sustainable operation and profitability. Therefore, in the absence of any other financial opportunities, it was prudently



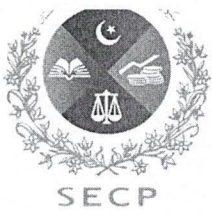
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offered by the Directors of the Appellant to support the Appellant in the shape of loan against divestment of Director's certain portion of equity in the Appellant. The Directors want to give all the funds received against disposition of requested 30% of their respective equity in shape of loan to the Appellant without any mark up and call back option. The amount received by the Appellant will reinforce its liquidity and assist the Appellant in achieving sustainable operating profitability. The Directors currently have 77.98% equity holding in the Appellant and will have 54.58% after proposed 30% divestment of shares which will be sufficient enough to meet the bar requirement. The Directors after divesting their stock will continue to have controlling interest in the Appellant and have given personal guarantee to the financial institutions in their capacity as Directors that they owe fiduciary duties towards the ultimate beneficiaries i.e. shareholders. The Respondent does not mention in his refusal the law under which refusal of Appellant's request for divestment was made and did not give cognizance to the circumstantial nature of the request of the Appellant.

- b) The refusal by the Respondent has restricted the Appellant to do its business freely in an already squeezed economic scenario. The Directors have offered to sell the shares in the best interest of the Appellant and the Commission in parallel cases has put restriction on sale of fresh issue of shares but allowed divestment of previously held shares of Directors. In the instant case, however, the restriction is imposed on previously held shares by Directors.

6. The Respondent rebutted the arguments of the Appellant on the following grounds:

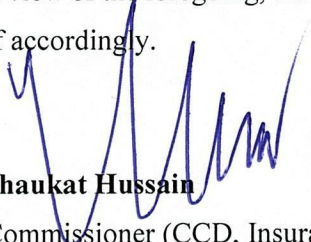
- a) The Respondent is empowered in terms of Regulation 17 of the Companies (Further Issue of Shares) Regulations, 2018 to approve or reject an application in any form for further issue of shares. The basis of declining the Application of the Appellant for waiving one of the conditions of approval i.e. restriction on divestment of shareholding was explicitly provided in the Impugned Order.
- b) The Respondent had approved issuance of shares other than right to Directors on the grounds that such issuance of shares shall be beneficial in the interest of the Appellant and its shareholders and after issuance of shares other than right, the cumulative shareholding of Directors increased from approximately 45% to 78%. The condition of restriction on divestment of shares by Directors was a safety mechanism against any attempts by the Directors to leave the Appellant in a challenging operational and financial position and restrict any attempt on their part to divest their shares in the market for generating returns for their own benefit. The proposal of the Appellant, therefore, to




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allow divestment of shares and then providing the amount raised from sale of such shares as loan to the Appellant is in essence only benefiting the Directors. Furthermore, this also implies that the Directors had not carried out due diligence while proposing to increase capital and after just one month of increasing its shares reverted back to the Respondent negating their own grounds for seeking approval. While the Respondent can place restriction on approval for issuance of shares, it cannot impose conditions on utilization of funds generated from sale of shares owned by Directors as it is their prerogative, therefore, the restriction imposed by the Respondent on divestment of shares was to protect the shareholders. Moreover, the Appellant did not have a convincing business plan. The average price of shares of the Appellant from the date of Application to the date of Impugned Order is Rs 2.56 and not Rs 3.75 as claimed by the Appellant, therefore, their assumption that they would generate Rs 106 million from divestment of shares is fundamentally wrong.

7. We have heard the parties i.e. the Appellant and the Respondent. We are of the view that once the Appellant had accepted the conditions under which approval was granted by the Respondent for issue of further shares to the Directors and also subsequently issued the shares, it is unfair on their part to ask for a relaxation from one of those very conditions i.e. divestment of Directors' shareholding. We concur with the Respondent that the Appellant has not come with any solid argument on how Directors' divestment of shareholding will assist the Appellant's business to achieve sustainable operating profitability and why the Appellant had failed to do their due diligence at the time of approval for issue of further shares. Furthermore, the restriction imposed on divestment of shares is to protect the shareholders as the Respondent cannot impose conditions on utilization of funds generated from sale of shares owned by the Directors. Moreover, the Appellant has not mentioned any specific cases where divestment was allowed by the Commission in similar circumstances.
8. In view of the foregoing, the Impugned Order is upheld with no order as to cost. The Appeal is disposed of accordingly.


Shaukat Hussain
Commissioner (CCD, Insurance)


Farrukh H. Sabzwari
Commissioner (SCD, AML)

Announced on: