



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
APPELLATE BENCH REGISTRY

**BEFORE APPELLATE BENCH NO. II**

In the matter of

**Appeal No. 4 of 2010**

1. Muhammad M. Ismail, Chairman
  2. Miftah Ismail, Chief Executive
  3. Maqsood Ismail, Director
  4. Munsarim Saif, Director
  5. Rashida Iqbal, Director
  6. Anisa Naviwala, Director
  7. Nafisa Yousaf Palla, Director
  8. Uzma Arif, Director
- of Ismail Industries Limited. ....

Appellants

Versus

Executive Director (Enforcement)  
Securities and Exchange Commission of Pakistan

.....

Respondent

Date of hearing

02-04-10



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**ORDER**

**Present:**

**For the Appellants:**

Asad Ali Shah

Ghulam Farooq

**For the Respondent Department:**

Amina Aziz

Joint Director, Enforcement

1. This order shall dispose of appeal No. 4 of 2010 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 21-12-09 (the "Impugned Order") passed by the Respondent.
2. On examination of the annual audited accounts for the period ended 30-06-08 (the "Accounts") of Ismail Industries Limited (the "Company"), it transpired that the Company made an equity investment of Rs. 229,724,069 in its associated undertaking Novelty Enterprises (Private) Limited ("NEPL"), for



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which no approval of shareholders under section 208(1) of the Companies Ordinance, 1984 (the "Ordinance") was obtained.

3. Show cause notice dated 15-09-09 ("SCN") was issued to the Appellants calling upon them to show cause as to why penalty under section 208(3) of the Ordinance may not be imposed on them. The Appellants filed reply to the SCN and hearing in the matter was held. The Respondent, dissatisfied with the response of the Appellants, passed the Impugned Order and imposed a penalty of Rs. 200,000 on Appellants 1 to 4 and Rs. 100,000 on Appellants 5 to 8.
  
4. The Appellants preferred the instant appeal against the Impugned Order. It was argued that, on 27-02-08, the Board of Directors (BoD) of the Company decided to invest Rs. 230 million in NEPL and at that time the companies were not 'associated companies' or 'associated undertakings'. The companies' commercial relationship started when the first payment of Rs. 38 million was made on 04-04-08, followed by payment of Rs. 156 million made on 26-04-08, in accordance with schedule of investment approved by the BoD. The relationship of the Company with NEPL as an 'associated undertaking' was established on 26-04-08, when the director of Company was nominated on the board of NEPL. The Appellants' representatives pointed out that the remaining investment of Rs. 25 million made in tranches after 26-04-08, as per the BoD resolution of the Company dated 27-02-08, should be considered as a pre-committed obligation. The investment made after 26-04-08 cannot be construed as fresh investment requiring a special resolution under section 208 of the Ordinance. It was argued that the BoD resolution dated 27-02-08 for the investment in NEPL was passed by all eight directors holding 80% of the voting power in the Company. The BoD resolution in this case was more substantive and



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representative than a special resolution under section 208 of the Ordinance which is required to be passed by a majority of not less than three-fourths (75%) members. The Appellants' representatives further contended that as an abundant caution and without prejudice to the above contention, the Company's shareholders passed a unanimous resolution in an Extra Ordinary General Meeting held on 24-11-09 ("EOGM") to ratify the investments in NEPL. Reliance was placed on *Shahbazuddin Chaudhry and others v Service Industries Textiles Limited cited at PLD 1988 Lahore 1*, where it was held that a company has the choice to regularize the investments made by passing a special resolution with the requisite majority even after the closure of the transaction.

5. The departmental representative argued that advance of Rs. 35, 564, 845 was given to NEPL after the companies became 'associated undertaking'. It was argued that once the relationship, as defined in section 2(1) and (2) of the Ordinance, is established, the provisions of section 208 of the Ordinance come into play. Any investment made thereafter without special resolution would be in violation of the said provisions of law, therefore, the BoD approval held on 27-02-08 would not suffice once NEPL became an associated undertaking of the Company. The departmental representative further argued that the Appellants' representatives' contention that they have ratified the investment made in NEPL by passing a special resolution at the EOGM is not acceptable and is against the provisions of the Ordinance. Reliance was placed on *Gharibwal Cement Limited v SECP* cited at *2003 CLD 131*, where it was held that the phrase '*under the authority*' (of special resolution) used in 208(1) of the Ordinance means having the consent of the shareholders *prior* to investment and not *subsequently*. The authority subsequently acquired cannot be termed as an act '*under the authority*' (of special resolution).



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6. We have heard the parties. Section 208(1) of the Ordinance is reproduced for ease of reference:

*208 Investments in associated companies and undertakings:- (1) 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.*

Further, section 2 of the Ordinance defines 'associated companies' and 'associated undertaking' as follows:

*(2) "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,*



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*holds or controls shares carrying not less than twenty per cent of the voting power in that company or undertaking;*

NEPL became an 'associated undertaking' of the Company on 26-04-08 by way of common directorship but the Company continued to invest in NEPL on the basis of the BoD approval held on 27-02-08. Section 208 of the Ordinance is clear and requires companies to make investments in associated companies only 'under the authority' of a special resolution. The Appellant cannot be allowed to disregard the requirement of section 208 of the Ordinance on the plea that BOD resolution can substitute the special resolution.

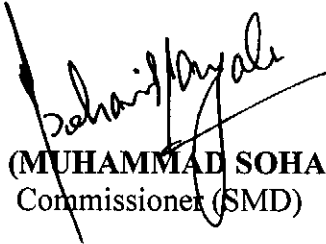
The Appellants should have complied with section 208 of the Ordinance immediately after NEPL became its associated undertaking. The management of the Company has deprived the shareholders to exercise their legitimate right to make a decision to invest in its associated undertaking. We have gone through the case law cited by the Appellants' representatives'; however, the case is distinguishable on facts. *Shahbazuddin Chaudhry and others v Service Industries Textiles Limited cited at PLD 1988 Lahore 1*, deals with the issue of conversion of loan given to an associated company into investment in terms of section 195 and section 208 of the Ordinance. The learned Justice, Mr. Justice Khalil ur Rehman Khan, in the case referred to above, observed that it was open for a lending company either to enforce the repayment of loan under section 195(3) or have the investment made regularized by passing a resolution with the requisite majority under section 208 of the Ordinance. The point whether a penalty can or should be imposed for violation of section 208 of the Ordinance was not an issue before the Court and therefore the judgment cited is not relevant to the issue before us and be relied on by the Appellant's counsel. In the instant case, the Appellant has regularized the investment made in the associated company by passing a special resolution in EOGM. The penalty was,

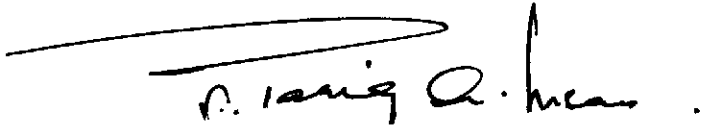


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however, rightly imposed for not seeking prior approval in terms of section 208(1) of the Ordinance. We are of the considered view that neither the BoD approval held on 27-02-08 nor the resolution passed in EOGM can substitute the requirement of a passing special resolution prior to making the investment under section 208 of the Ordinance.

In view of the foregoing, we do not find any ground to interfere with the Impugned Order. The appeal is dismissed with no order as to cost.

  
(MUHAMMAD SOHAIL DAYALA)  
Commissioner (SMD)

  
(S. TARIQ A. HUSAIN)  
Commissioner (LD)

Announced on: 30.04.10