



**BEFORE
RE-CONSTITUTED APPELLATE BENCH NO. III**

In the matter of

Appeal No. 9 of 2005

Latif Jute Mills Ltd
having its registered office at
Hub Chowki, Village Beirut
Tehsil Hub, Lasbella District.....Appellant

Versus

1. Executive Director (Company Law), SEC

2. Commissioner (CLD)

.....Respondents

Date of Impugned Order

28 March 2005

Date of hearing of appeal

14 February 2007

Present:

1. A.S. Pinger Advocate and M. Tariq Bawany for the Appellant
2. Uzma Hayat, Joint Director & Shoaib Dar, Assistant Director SECP



ORDER

1. This appeal has been filed under sub-section (1) of section 33 of the Securities & Exchange Commission of Pakistan Act, 1997 by Latif Jute Mills Limited ('Company') against the order dated 28-03-2005 ('Impugned Order') passed by Executive Director (Company Law).

2. Brief facts leading to the Impugned Order are that the notice of the annual general meeting (AGM) of the Company scheduled for 22-10-2004 stated that the company intends to pass a special resolution authorizing the chief executive "*to sell the present buildings and land and to organize a suitable project, if available*". However, the statement of material facts required under Clause (b) of sub-section (1) of Section 160 of the Ordinance did not provide any of the following information to the shareholders:

- (i) Description and book-value of land and buildings to be sold;
- (ii) Fair value determined by an independent valuer;
- (iii) Mode of sale of these assets;
- (iv) Utilization of sale proceeds;
- (v) Impact of the sale of assets on the operations of the company; and
- (vi) Identification of suitable project.

4. The Commission vide its letter dated 28-09-2004 advised the Company to provide the aforesaid necessary information to the Commission and that in the presence of material deficiencies in the notice of AGM, the proceedings of the meeting pertaining to the special resolution would be contrary to the provisions of Clause (b) of Sub-section (1) of Section 160 of the Ordinance.



5. In response, the Company vide its letter dated 04-10-2004 stated that the net proceeds from sale of assets after payment of liabilities will be distributed among the shareholders or otherwise as approved by the shareholders. On further inquiry by the Commission, the Company informed that the indicated market price of land & buildings is Rs.55 million, however, it would be sold through advertisement against the highest offer received. It was also proposed that a reserve price may be set at the time of the approval for sale of assets. As regards the identification of suitable project, it was stated that sponsors have not identified any project to be set up in this location and net proceeds of sale of land & building, after adjusting liabilities shall be distributed as approved by the shareholders in the AGM. It was further stated that since the sponsors are the major shareholders, it is in their interest to get maximum price for land and building if sold, or utilising the building for some other project at the soonest possible. These replies were found unsatisfactory by the Commission as the management failed to explain the need of the transaction and utilization of the proceeds and had no clear vision regarding the future of the Company i.e. its revival or winding up. The Commission vide its letter dated 22-10-2004 advised the Company management not to sell the assets unless these are valued by an independent valuer and the proceeds are used for revival of the Company's business. However, if the assets are intended to be sold to pay off liabilities and to close down the business, then the Company should follow the procedure for winding up of the Company as provided in the law.

6. However, the minutes of the AGM provided to the Commission on 30-10-2004 reflected that the special resolution for sale of assets had been approved in the said meeting contrary to the advice of the Commission. The Company vide letter dated 24-11-2004 once again advised the Company not to sell its assets unless a fresh valuation of the property is carried out by an independent valuer. It was again emphasized that in case the Company intends to sell off these assets to pay off



liabilities and to close down its business, then it should follow the legal course of winding up as provided in the Ordinance. Thereafter the Commission examined the past record of the Company and it was revealed that the Company's operations were closed down in August 2003 and since then it has been selling off its assets. The Company had earlier sold its fixed assets for Rs.54.69 million in the year 2004 and a major portion of the funds so generated were utilized to repay loans of directors and associated undertakings. It was also noted that, prima facie, these assets were sold in contravention of the provisions of Section 160 and Section 196 of the Ordinance.

7. Furthermore, the auditors of the Company in their reports to the members for the years ended 30-06-2003 and 30-06-2004 had given an adverse opinion citing the reason that the accounts had been prepared on a going concern basis despite the fact that the Company was no more a going concern. In view of the above, it appeared to the Commission that the sponsors were closing down the Company and selling off the assets for paying the liabilities primarily payable to the directors and associated undertakings. As such it was apprehended that:

- a) The business of the Company is being conducted with intent to defraud its creditors, members in a manner oppressive of its members;
- b) The affairs of the Company are not being managed in accordance with sound business principles and prudent commercial practices;
- c) The affairs of the Company have been so conducted and managed as to deprive the members thereof of a reasonable return; and
- d) The members of the Company have not been given all the information with respect to its affairs, which they might reasonably expect.

8. Due to the aforementioned circumstances proceedings under Section 265 of the Ordinance were initiated through a show cause notice dated 15-12-2004. After hearing the chief executive of the Company, the Executive Director (CLD) vide the Impugned Order, appointed Ijaz Tabussum & Co, Chartered Accountants as



inspector under section 265 on a remuneration of Rs.120,000/- to conduct investigation on all aspects of the operations of the Company and in particular the sale of assets in the past three years.

9. Not being satisfied by the decision of the Executive Director (CLD), the Company filed the present appeal before the Appellate Bench. On the date of hearing of appeal, the chief executive of the Company Mr. Tariq Bawany appeared along with Mr. A. S. Pinger Advocate. As a preliminary objection, Mr. Pinger argued that the Executive Director did not have the jurisdiction to appoint an inspector under section 265 unless two mandatory conditions namely (i) passing of a resolution in a general meeting of a company, or (ii) an order issued by a competent court, to appoint an inspector are fulfilled. He stated that the Commission has no suo moto powers to appoint an inspector. He stated that the appointment of inspector is based on vague and ambiguous grounds, and is in fact a fishing expedition as the inspector has been tasked to investigate all aspects of the Company rather than just focusing on the issue of sale of assets. He argued that the shareholders were competent under the law to approve the sale of assets of the Company and the Commission should not question such decision. He stated that it was an admitted fact that the Company had closed down its business and therefore reliance by the Executive Director on the auditors report that the Company was not a going concern, was of no consequence.

10. Mr. Tariq Bawany apprised the Bench that as per the instructions of the Commission, the asset under question has not been sold by the Company despite approval of the shareholders. He admitted that the Company has been closed down and the management has cleared all the debts of Company. He stated that the proceeds of sale of assets in the past have only been used to pay off the debts owed to the creditors. He apprised us that the directors of the Company had provided interest free loans to the Company which had saved approx. Rs.10 million for the



company. The only liability owed by the Company at the moment was to the directors and the shareholders had therefore decided to pay off this debt also by selling certain assets of the Company. He stated that certain procedural irregularity may have happened while giving notice of the meeting under section 160, however this was neither willful nor intended to deprive the shareholders of any material information. Besides, the sponsors themselves were the major shareholders of the Company and as such they could not be defrauding themselves. He stated that it was in the interest of the sponsors to get the maximum price of the assets. He stated that he had not agreed to the appointment of inspector under section 265 with such wide terms of reference as is recorded in the Impugned Order. However, he had stated that he had no objection to the Commission sending its officer(s) to look into the objections over sale of assets of the Company. He stated that he still had no objection to such inspection. He argued that it in the circumstances where the Company was closed and only bare minimum expenses were being met, it was not reasonable to ask the company to pay Rs.120,000/- as the inspectors fee. Mr. Bawany prayed that the appointment of inspector by the Executive Director be set aside.

11. Ms. Uzma Hayat appearing for the Enforcement Department defended the Impugned Order. In reply to the preliminary objection raised by the Appellant's counsel, she contended that the two pre-conditions mentioned by Mr. Pinger relate to appointment of inspector under section 265(a) and not section 265(b). Whereas, in the instant case, the inspector has been appointed by the Commission in exercise of its suo moto powers under section 265. She stated that the Company failed to abide by the requirements under section 160 of the Ordinance to provide to the shareholders, all material facts regarding the sale of asset. She stated that the auditors report on the accounts for the year ended 30-06-2004 has not been made the ground for the investigation. She contended that a company is expected to generate its income from the operations of its assets and not through sale of all of its assets like in the instant case. The proper process for disposal of assets for the purpose of



payment of debts is winding up, which has not been followed in this case, and the directors are selling the assets to settle debts owed to them.

12. We have heard the matter and perused the record. As a preliminary objection, Mr. Pinger argued that the Commission could only appoint an inspector under section 265 where the two conditions namely (i) passing of a resolution in a general meeting of a company, or (ii) an order issued by a competent court to appoint an inspector are fulfilled. This is not entirely correct. It is quite clear from the plain reading of section 265 that the Commission also has suo moto powers under sub-clause (b) of section 265 of the Ordinance to appoint an inspector and these pre-conditions are not applicable to such appointment. The pre-conditions are applicable where the appointment is made under sub-clause (a) of section 265. The suo moto powers of the Commission to appoint inspector under sub-clause (b) of section 265 have been upheld by the Hon'ble High Court in the case cited at 2002 CLD 1714.

13. The main reason for which an inspection has been ordered by the Company Law Division is the sale of the Company's assets by the management for settlement of debts. It is apprehended that (a) the business of the Company is being conducted with intent to defraud its creditors, and (b) the members of the Company have not been given all the information with respect to its affairs. On the latter issue there seems to be an agreement that the requirements under section 160(1)(b) have not been completely met by the Company. On the former issue too, there is merit in the argument that the appropriate way to settle the liabilities of a company, which is not a going concern, is by winding it up. Where a company has closed its business and there is no foreseeable plan for its revival, then sale of the company's assets by the management for selective settlement of debts is not desirable as it may be seen as an attempt to circumvent the priority of payment among the creditors prescribed by the law. There is therefore a need to rebut these apprehensions. We however feel that



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these apprehensions should be addressed without putting financial burden on an already ailing company. The Department is therefore directed to appoint one of its own officers to investigate on the issues identified by the Executive Director in clauses (i) to (x) of Para 15 of the Impugned Order. The investigation should not be on all operations of the Company but should be restricted to the issue of sale of assets only. On receipt of the Inspector's report, a decision should be made regarding the winding up of the Company.

This appeal is disposed off.

(RAZI-UR-RAHMAN KHAN)
Chairman/Commissioner

(SALMAN ALI SHAIKH)
Commissioner

Announced in Islamabad on 21st March 2007