



**BEFORE APPELLATE BENCH NO. III**

**In the matter of**

**Appeal No. 2 of 2005**

Dawood Fibre Mills Limited

A-57, S.I.T.E

Manghopir Road

Karachi.....Appellants

Versus

Commissioner (Company Law Division), SEC.....Respondents

Date of Impugned Order

December 30, 2004

Date of hearing of appeal

March 09, 2005

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Present:

Khalid Ahmed Tanwari, Advocate for the Appellant

Mubasher Saeed Joint Director (EMD) for the Respondent



## ORDER

1. This appeal No.2 of 2005 has been filed under sub-section (1) of section 33 of the Securities & Exchange Commission of Pakistan Act, 1997 by Dawood Fibre Mills Ltd. ('Company') against the order dated 31-12-2004 ('Impugned Order') passed by the then Commissioner (Company Law Division).

2. Brief facts of the case are that the financial statements of the Company for the year ended 30-09-2003 revealed that accumulated losses of the Company stood at Rs.614.107 million against paid up capital of Rs.119.43 million resulting into negative equity of Rs.494.677 million, and the Company's long term loans stood at Rs.674.253 million. As alleged by the Company Law Division, the auditor's report of the Company was qualified on certain serious issues like drastic reduction in the sales of Company and that the stock in trade which stood as high as Rs.175 million was taken, valued and certified by Chief Executive of the Company. The auditors also emphasized that the Company had failed to pay withholding tax deducted from the parties against payment of purchases/suppliers. The record of the Company maintained with the Commission also revealed that the Company had not shown any signs of improvement in its working results during the previous years. The management of the Company intended to sell some of its assets for which complete information was not made available to the shareholders through statement of material facts under 160(1)(b) of the Ordinance. It was further observed that the Company had not paid any dividend to its shareholders since its listing in the year 1992. The record also showed that proceedings under Section 265 of the Ordinance were earlier initiated in August, 2000 for appointment of inspectors, however, these proceedings were deferred on the assurance of the management that they will improve the financial results of the Company. The accounts of the Company for the



year ended 30-09-2003 were reviewed by the Company Law Division in the above referred background, which indicated that there is drastic decrease in the sales of the Company. The Company again suffered loss of Rs.15.406 million and its accumulated losses increased to Rs.614.107 million. The auditors report was again highly qualified. The stock of furnished goods appeared at Rs.153.708 million as compared of Rs.11.260 million last year indicating an increase of 1365% which was not certified by the auditors of the Company raising doubts about its existence and prima facie indicating that books of accounts do not reflect true and fair view of the state of affairs of the Company. Accordingly, a show cause notice dated 14-10-2003 was served on the Chief Executive of the Company under section 265 of the Companies Ordinance, 1984 ('Ordinance') to explain as to why an inspector may not be appointed to investigate the affairs of the Company. An opportunity of hearing was provided by Commissioner (CLD) to the Company, which made certain contentions against the appointment of inspector. However these contentions were dismissed by the Commissioner who vide the Impugned Order appointed M/s Ijaz Tabussam & Company, Chartered Accountants to act as inspectors.

3. Being aggrieved by the appointment of inspectors, the Company has filed the instant appeal before the Appellate Bench. The hearing in the appeal was held on 09-03-2005 when Mr. Khalid Ahmed Tanwari, Advocate appeared on behalf of the Company. It was admitted that the Company is facing financial problems, including liquidity crunch, adverse market forces, international conditions and immense enhancement of financial liabilities. However it was contended by the counsel that the reasons for these problems were beyond the control of the management. The present management had acquired the project through Sindh High Court in May 1988 and have been trying to revive the project ever since. Mr. Tanwari contended that the difficulties being faced by the management were brought to the notice of the Commissioner who has ignored them. He further contended that the Impugned Order was not a speaking order. He stated that a number of allegations had been



levelled against the management in the Show Cause Notice however most of them were dropped in the Impugned Order. He stated that the Commissioner has based his decision to appoint the inspector on certain doubts that the affairs of the Company are not being conducted in accordance with sound business principles and prudent commercial practices. These doubts have arisen in light of the following observations;

- (a) the continuous decline in the performance of the Company despite huge capital expenditure for BMR (Balancing, Modernization & Rehabilitation);
- (b) tendency of selling assets in repayment of loan liabilities; and
- (c) the qualification of auditors regarding their inability to verify huge stocks of finished goods amounting to Rs.153.708 million as compared to Rs.11.26 million in the last year.

4. With regards to the first observation, Mr. Tanwari repeated the contention that the reasons for constant decline in the performance of the Company were beyond the control of management. On the second observation, he argued that the Commissioner has wrongly used the word 'tendency' as there was only one instance where the Company had sold a piece of land to repay loans acquired from Habib Bank Ltd. As for the qualification of auditors, Mr. Tanwari produced before us the Auditor's Report to the Shareholders for the year ended September 2004, which shows that the Auditors have not qualified their opinion. He stated that the auditors were in the process of verifying the stock of finished goods when the Impugned Order was passed, and since then the stocks have been verified. He argued that the decision to appoint an inspector under section 265 of the Ordinance cannot be made on basis of doubts. He stated that the circumstances or observation on the basis of which the inspector has been appointed by the Commissioner do not necessarily lead to the inference that the affairs of the Company are not being conducted in accordance with sound business practices, or are being conducted in a manner oppressive to its members. He referred to certain judgements where the Superior



courts have observed that some sort of prima facie evidence or material was required on the basis of which an inspection into the affairs of the company can be ordered, which he argued were absent in this case. He prayed that the Impugned Order be set aside and the appointment of inspector be cancelled.

5. Mr. Mubasher Saeed Joint Director appearing on behalf of the Commissioner reiterated the grounds and observations contained in the Impugned Order. He argued that the Company has suspended its business and there is no production. The losses have been increasing every year resulting in negative equity of Rs.494.677 million. He alleged that the Company's stock has been sold at a lower price. He argued that the Company was highly indebted and has had to sell its assets to repay its loans. He informed the Bench that the Company has not paid any dividend since 1992. He was adamant that the Auditors have qualified their report for the year ended September 2004. All these factors necessitated the appointment of inspector to find out the real causes of the problems being faced by the Company. In support of his contentions, he referred to a decision of Divisional Bench of Sindh High Court in the case cited at PLD 1995 Karachi 132.

6. We have heard the arguments presented by both sides and also perused the documents on record. The Commissioner (CLD) has appointed the inspector under section 265(b) for circumstances which suggest that (i) the affairs of the Company are not being conducted in accordance with sound business principles and prudent commercial practices; (ii) are being conducted in a manner oppressive to its members; (iii) with an intent to deprive them of the reasonable return on their investment; and (iv) may lead to ultimate closure of the project. The counsel for the Company has sought to argue that the above circumstances do not exist, and even if they do, it is not the fault of the present management. We are afraid however, that the financial position of the Company tells a different story. It has not paid any return to its shareholders by way of dividend for the last 12 years. Its accumulated



losses have increased to Rs.614.11 million in year 2004 and the negative equity has increased to Rs.494.681 million in the same period. Although the long term loans have come down in the same period, however they still stand at a massive Rs.577.039 million. In any case, this reduction is due to sale of assets of the Company and not because of any business returns. The Company is no longer in business and has closed down its production, which means that there is no immediate prospect for reversing the situation. We are unable to agree with the counsel that these facts do not constitute the circumstances, as provided in section 265, which suggest that the affairs of the Company are not being conducted in accordance with sound business principles and prudent commercial practices. The Commission is not required under section 265 to come to a definite conclusion that any of situations contained in sub-clauses (i) to (vii) of clause (b) actually exist. This is the job of the inspector to be appointed thereunder. The Commission only has to form an opinion based on some circumstances which suggest that any of these situations may exist. And in our opinion, the facts stated above clearly suggest that.

7. If the situation in which the Company is, is allowed to carry on, there is every likelihood of the closure or insolvency of the Company. We have to remember that this is a listed company and the Commission in this regard has a dual role of beneficial regulation and control of the corporate sector as well as the protection of investors. It cannot be expected to sit idle while listed companies slide into liquidation. The authority to carry out inspections has been provided to the Commission by law for entirely this reason. Additionally, the appointment of inspector by the Commission is supported by the decision of the Hon'ble High Court in the case cited at PLD 1995 Karachi 132 as the facts and the grounds therein are nearly identical to this case.

8. The counsel for the Appellants is right that the auditors have not qualified their opinion in year 2004, and in this regard we do not agree with the view point of



the Department. However, this does not change the situation which is depicted by the annual accounts. The counsel's argument that the present management is not responsible for the quagmire faced by the Company cannot be made a reason not to inquire into the affairs of the Company. In fact if it is true that the reasons for the predicament are beyond the control of the management, it should welcome such an inquiry which would prove their innocence. The management of the Company has already been given an opportunity in the past when similar proceedings under section 265 were deferred in year 2000 on the representation that the financial situation of the Company would be improved and dividends would be paid to the shareholders. Besides, the intention behind the inspection is not witch hunting, rather it is to find reasons for the bad state of affairs of the Company. For the reasons stated above, we find no reason to interfere in the order passed by the Commissioner (CLD). The appeal is accordingly dismissed.

**(Shahid Ghaffar)**  
Commissioner

**(Etrat H. Rizvi)**  
Commissioner

Announced in Islamabad on May 30, 2005