Appellate Bench Orders

Order in the matter of Appeal No. 8 of 2000 before Appellant Bench No. 1 in respect of Nafees Cotton Mills Limited.

April 26, 2001

Before Appellate Bench No. 1

In the Matter of

Appeal No. 8 of 2000

Mr. Ahmed H. Sheikh,

Chief Executive, alongwith six other Directors of

Nafees Cotton Mills Limited ……Appellants

versus

Commissioner (Enforcement & Monitoring),

Securities and Exchange Commission of Pakistan,

Islamabad …… Respondent

Present:

1. Mr. Ahmed H. Sheikh

2. Mr. Zahid Hamid, Advocate

3. Mr. Hameed Chaudhry, FCA, and

4. Ms. Bushra, Finance Manager

……. on behalf of the Appellants

5. Mr. Ashfaq Ahmed Khan, Director, SECP

...… on behalf of the Respondent

Date of Hearing: 17 April, 2001

ORDER

This is an appeal filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 by Mr. Ahmed H. Sheikh and six other Directors of M/s. Nafees Cotton Mills Limited (Company) against the order dated 19 October, 2000 passed by the then learned Commissioner (Enforcement & Monitoring) of the Securities and Exchange Commission of Pakistan imposing a penalty of Rupees One Million on each of the Directors of the Company.

2. The Appeal came up for hearing on 17 April, 2001 and Mr. Zahid Hamid, counsel for the Appellants, restated the arguments as presented in the Memo of Appeal. The main thrust of his pleading was that the resolution passed by the Company on 31 March, 1992 did not suffer from any legal infirmity and in fact, it provided a blanket power for investment to be made in associated companies upto Rs.50 million. The resolution was passed in accordance with the requirements of section 208 of the Companies Ordinance, 1984 as in force at the relevant time. However, he conceded that there was some deficiencies in the passing of the said resolution and, in order to overcome these shortcomings, a fresh special resolution was passed on 19 August, 2000 after receipt of a show cause notice from the then Commissioner (Enforcement & monitoring). He further took the plea that the special resolution passed on 31 March, 1992 stands ratified/confirmed by the resolution dated 19 August, 2000 whereby the investment in associated companies has been allowed to the extent of 30% of the paid up capital and free reserves of the Company. It was also argued that show cause notices dated 26 July, 2000 and 24 August, 2000 issued by the then Commissioner (Enforcement & Monitoring) do no charge any of the Appellant Company's Directors to have violated section 208 ibid 'knowingly and willfully.' He further proposed that if the Commission feels that any further resolution is required to obtain consent from the shareholders of the Company, the Appellants are willing to do so. He argued that there is a complete absence of "mens rea" and the penalty imposed by the learned Commissioner was not justified unless it is clearly established that the violation was willful and deliberate.

3. The representative of respondent emphasized that the resolution was passed on 31 March, 1992 by the Company and, at that time, the associated company to whom the loan has been advanced was not even in existence. In fact the borrower company, viz, M/s. Legler Nafees Denim Mills Limited, was incorporated on 20 February, 1993. Further, section 208 ibid was amended through the Finance Act, 1995 in July, 1995 i.e., three years after passing of the said resolution whereas the loan in question was advanced in September, 1999 i.e. over seven years after passing of the said resolution and over four years after the changes made in legislation. As regards passing of fresh resolution, it was stated that the 'special resolution' of 19 August, 2000 ratifying/confirming the earlier resolution of 31 March, 1992 was passed after issuance of the show cause notice by the then Commissioner (Enforcement & Monitoring). The Appellant did not bother to pass a fresh resolution when the Auditors' qualified their opinion on the financial statements for the year ended 30 June, 1999. The form and content of both resolutions were similar and the latter resolution could not by any stretch of imagination conform to the strict parameters laid down in the amended provisions of section 208 ibid made through the Finance Act, 1995. This amendment in law envisaged that the investing company was required to disclose additional information to the shareholders while making investment in the associated company, viz. name of the borrower company together with the amount, the rate of interest to be charged together with particulars of collateral security to be obtained from the borrower, the period for which investment will be made, the terms of repayment, purpose of the loan, the benefits likely to accrue to the company and shareholders. Another important change was that the aggregate investment in associated companies, except a wholly owned subsidiary company, shall not exceed 30% of the paid up capital plus free reserves of the investing company and that the return on investment in the form of loan shall not be less than the borrowing co st of the investing company. It was also reiterated that the enabling resolution passed on 31 March, 1992 was never availed of and not even mentioned in any of the annual Directors' report for over six years after which the loan was advanced and, therefore, cannot be treated as a valid resolution especially when substantial amendments have been made in the provisions of section 208 of the Companies Ordinance, 1984.

4. The representative of the respondent further stated that the amount of short-term loan was converted to shareholders' equity by the associated company, viz. Legler Nafees Denim Mills Limited which according to its latest annual accounts has been eroded rendering this investment prejudicial to the interest of the investor company's shareholders and in contravention of the safeguards enshrined in law.

5. We are convinced that the investment in the associated company was made without passing of the requisite special resolution by the shareholders in a meeting called for the purpose. Even the special resolution of 19 August, 2000 obtained by the Appellants by way of post facto approval contravenes the requirements laid down in section 208 of the Companies Ordinance, 1984. Further, since there has been no return on this investment or enhancement of value of the shares in the capital of the investing company, the Chief Executive and the six Directors have prejudiced the rights of shareholders of the Company.

6. After hearing the arguments furnished by counsel of the Appellants and the representative of the respondent at length, we do not find any justification to interfere with the impugned order. The appeal is accordingly rejected.

Announced : 26 April, 2001

(N.K. SHAHANI)
Commissioner
(Securities Markets & Insurance)

(M. Zafar-ul-Haq Hijazi)
Commissioner