ORDER	
Name of Company:	M/s. Octopus Digital Limited
Show Cause Notice No. & Date:	Adj-I/ARN/26/2022-458 dated September 30, 2024
Respondent:	Octopus Digital Limited
Date(s) of Hearing(s):	December 04, 2024
Case represented by:	(i) Mr. Ahsan khalil (Company Secretary), and (ii) Mr. Faisal Nadeem Sheikh (Chief Financial Officer) (Authorized Representatives)
Provision of law involved:	Section 199 read with Section 479 of the Companies Act, 2017

This Order shall dispose of the proceedings initiated by the Securities and Exchange Commission of Pakistan (**the Commission**) through Show Cause Notice Number Adj-I/ARN/26/2022-458 dated September 30, 2024 (**the SCN**) issued under Section 199 read with Section 479 of the Companies Act, 2017 (**the Act**) against M/s Octopus Digital Limited (**the Respondent/the Company**). The Respondent is a listed company and its principal line of business is to carry out Information Technology enabled services.

2. The brief facts of the case are that the Company was, in terms of Section 199 of the Act, required to make investment in its associated companies or associated undertakings under the authority of a special resolution. As per the explanation clause given with the said section, the term 'investment' includes equity, loans, advances, guarantees, except for the amount due as normal trade credit, where the terms and conditions of trade transaction(s) carried out on arms-length and in accordance with the trade policy of the company.

3. The Commission examined the annual audited financial statements of the Company for the year ended December 31, 2023 (**the Audited Accounts 2023**) and observed that the Company *prima facie* had extended an abnormal credit period *i.e.* more than 180 days (contrary to Respondent's policy on general payment period of 30 days, *reference Note 26*) to its associated companies namely; Avanceon Automation & Control WLL, Qatar *(basis of relationship in both instances: common directorship) and* Avanceon Limited *(basis of relationship: parent company)* in the manner as depicted hereinbelow *(reference: Note 13 and 34 to the Accounts)*:

Description	**Avanceon Automation & Control WLL, Qatar**		**Avanceon Limited**	
	2023 (Rs.)	**2022 (Rs.)**	**2023 (Rs.)**	**2022 (Rs.)**
Not yet due	205,238,305	-	105,103,285	324,000,000
30 days	72,162,079	33,061,301	10,348,385	16,862,757
30-90 days	33,367,720	21,183,721	8,652,391	7,830,610

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90-180 days	40,708,797	169,136,735	25,287,886	8,561,217
Above 180 days	**686,416,303**	**459,949,901**	**319,621,787**	**7,914,626**
Total credit	1,037,893,204	683,331,658	469,013,701	365,169,210

4. Considering the above, the Commission vide letter dated July 18, 2024 sought clarification/explanation from the Respondent with regards to compliance with the requirements of Section 199 of the Act. In response, the Company vide its letter dated August 23, 2024 submitted in the following manner:

> *"the amounts pertain to trade receivables, which arise in the ordinary course of business. A significant portion of this balance is related to international projects, which inherently involved longer timelines. Consequently, these receivables are expected to be realized upon completion of the respective projects, which can span 1 to 2 years or even longer. This variation in project timelines naturally effects the timing of recoverable collection, as it is customary within its industry. Note 26 of the annual audited financial statements addresses debts in a general context, specifically concerning trade debtors for good and services other than the projects. This note reflects the diverse nature of the project timelines and is not applicable to related parties. Regarding note 13.1 of the audited accounts, we have appropriately applied the expected credit loss (ECL) model to account for credit risk. It is pertinent to note that the entities involved are associated companies, which significantly reduces the risk of the default".*

5. Nonetheless, review of the ageing of receivables due from the above-mentioned associated companies/related parties (as disclosed in Note 13.3 and 13.5 to the Audited Accounts 2023) *prima facie* revealed that the credit limit extended to them was not on arms-length basis and contrary to the normal trade policy of the Respondent. The relevant provisions of law are reproduced hereunder:

> ***Section 199 of the Act:***
>
> *"**199. Investments in associated companies and undertaking.**- (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, amount of investment and terms and conditions attached thereto.*
>
> *Explanation: The term 'investment' shall include equity, loans, advances, guarantees, by whatever name called, except for the amount due as normal trade credit, where the terms and conditions of trade transaction(s) carried out on arms-length and in accordance with the trade policy of the company...*
>
> *(6) Any contravention or default in complying with requirements of this section shall be an offence liable to a penalty of level 3 on the standard scale..."*

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6. Taking cognizance of the alleged violation of law, the SCN was served upon the Respondent on September 30, 2024. In response, the Company Secretary vide letter dated October 14, 2024 *inter alia* submitted that:

> *"The Respondent would like to explain its position and state that the company has not extended credit beyond 180 days. Payments are typically due within 30 days after milestone completion and customer acceptance, per the contract(s). Our project-oriented business, involving multiple subcontractors, project delays sometimes face customer disputes. As a result, payment periods range from 1 to 270 days, including advance payments. This is typical for its industry, especially given the challenging macro-economic environment. While the term may seem inconsistent, it aligns with its policy and business practices.*
>
> *Further the Company would like to inform that the following amounts have been settled in the subsequent period:*
>
> *a. Avanceon Automation & Control WLL in HY24: Rs. 115,114,597*
> *b. Avanceon Limited in HY24: Rs. 286,764,277*
>
> *Moreover, we would like to state the fact that the company is actively recovering due balances and plan to clear the backlog. The management is fully aligned with stakeholders to reduce the trade receivables in question while focused on our continuing growth.*
>
> *In view of the foregoing clarifications, we firmly believe that the company has not ccontravened Section 199 of the Companies Act, 2017..."*

7. In order to meet the ends of justice and provide an opportunity of being heard to the Respondent, hearing in the matter was fixed for December 04, 2024, which was attended by Mr. Ahsan Khalil (Company Secretary) and Mr. Faisal Nadeem Sheikh (Chief Financial Officer) being the Authorized Representatives (**the Representatives**) of the Respondent. The Representatives reiterated the above-referred written response and while admitting the delays, the Representatives assured that the Company is actively recovering due balances to clear the backlog.

8. I have gone through the relevant provisions of Section 199 of the Act, and considered the facts of the case along with the written and verbal submissions of the Respondent, and available record of the Company. I have also perused Section 199(6) of the Act, which stipulates penal provisions for contravention of the afore-referred provision of law. I have noted that the objective of Section 199(1) of the Act is to ensure that investments are made by a company in its associated companies or undertakings transparently, responsibly, and duly under the authority of its members being the key stakeholders. In 2011 CLD 1149 *[Appeal No. 37 of 2011, decided on May 26, 2011]*, it was held that *"...it needs to be appreciated that the principle of plain and ordinary meaning from reading of Section 208 of the* [Companies] *Ordinance* [1984] [*pari materia* to Section 199 of the Act] *appears none other than seeking prior permission of ...the shareholders...The words "under the authority" as used in*

section 208 of the Ordinance are much stronger than the word "sanctioned" used in section 374 of the Indian Companies Act...To us, the plain and ordinary meaning of the words "under the authority" means having consent of the shareholders prior to investment."

9. The spirit of the law demands such decisions to be made by the members to ensure that shareholders are aware of and approve investments in associated companies to prevent misuse of the company's financial resources. The mandates of shareholders through the passing of a special resolution, which outlines the nature, period, amount, and terms of the investment is meant to hold the management accountable. The transactions in terms of section 199 of the Act require to be executed on arm's-length basis which eexcludes amounts due under normal trade credit from this provision, provided such transactions are aligned with the company's trade policy, ensuring operational clarity.

10. A bare perusal of Note 26 (Revenue from Contracts with Customers) of the Audited Accounts 2023 shows that in respect of services, *the performance obligation is satisfied over-time and payment is generally due within 30 days of the end of term period;* while in respect of project revenue, the said note explicitly discloses that *the performance obligation is satisfied over-time and payment is generally due within 30 days from reaching a milestone as per contract and acceptance of the customer.* Thus, the contention of the Respondent that note 26 addresses debts in a 'general context' specifically concerning trade debtors for goods and services 'other than the projects' is *ab initio* misplaced, since the said note clearly discloses the normal trade policy for the projects as well. Moreover, the Respondent's contention that the said note reflects the diverse nature of the project timelines and is not applicable to related parties is utterly unfounded and not supported by any legal and/or accounting provision (that would allow, or for that matter, require a distinct trade policy for related parties). Further, the Respondent itself submitted that the amounts in question due from the associated companies pertains to trade receivables that arose in the 'ordinary' course of business. The Respondent has taken another stance that note 26 addresses debts in a 'general context' and is not relevant for the 'projects' in question. It is plainly evident that the Respondent has resorted to two differing arguments – either the amounts arose from normal/ordinary course of business transactions the trade policy for which is expressly catered for under Note 26 or the amounts relate to some 'special' purpose which demanded a deviation from 'normal' credit limit.

11. It is imperative to mention here that in pursuance of the aforesaid policy for revenue recognition, revenue (reportedly from the associated companies relating to projects) was recognized over time after reaching particular milestone(s) and satisfaction of performance obligation(s), and accordingly, trade receivables were booked after recognition of revenue by the Respondent. Thus, the receivables recorded by the Respondent itself and shown in the year-end balances indisputably relate to the contracts whose milestones have been achieved and performance obligations have been met, which means that the Respondent's policy (quoted by itself even in response to the SCN) of recovering the debts in 30 days after such achievement of milestones automatically became applicable, and the balances overdue for more than 180 days are due past the 30-day credit limit – thereby clearly demonstrating that the Respondent extended unreasonably long credit limit to its associated companies.

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Further, the trade debts in aggregate due from the associated companies in question stood at approx. Rs.1,506 million as at December 31, 2023 (2022: Rs.1,048 million), which exceeded the Respondent's reported revenue for the year 2023 amounting to only Rs.903 million (2022: Rs.687 million). It shows that the trade receivables of the Respondents as at the year-end included the debts from related parties that have remained irrecoverable and overdue for even more than a year.

12. It is also observed that the trade debts due from the associated companies in question have significantly increased from approx. Rs.1,048 million (2022: Rs.683 million + Rs.365 million) as of December 31, 2022, to approx. Rs.1,506 million (2023: Rs.1,037 million + Rs.469 million) as of December 31, 2023, with Rs.1,006 million (Rs.686 million + Rs.320 million) outstanding for more than 180 days. Out of the total past due balance receivable by the Respondent, only 1.8% is receivable from non-associated companies, while the remaining 98.19% of the balance is receivable from the associated companies. This fact clearly evidences the materiality of transactions of the Respondent conducted with the associated companies, and the crucial need for conducting such transactions on an arms-length basis. It is further noted that a significant portion of the receivables due from the Associates falls under higher aging brackets (i.e. being overdue for more than 180 days), indicating that the credit extended to the associated companies did not, in fact, constitute 'normal trade credit'. Furthermore, the Respondent has not imposed any mark-up on the overdue amounts, thereby highlighting deviation from the mandatory regulatory requirements prescribed under Section 199 of the Act.

13. Another contention put forward by the Respondent is that since the entities involved in the questioned transactions are associated companies, the risk of default is significantly reduced. This contention, however, holds no admissible basis in the eyes of law, particularly considering that the transactions with related parties/associated companies are brought under even stringent scrutiny especially through the provisions of Section 199 of the Act, whereby any investment including extension of an amount on abnormal trade credit constitutes an investment in associated company and warrants necessary compliance of the said provision in true letter and spirit.

14. In 2013 CLD 220 *[Appeal No. 26 of 2008, decided on June 05, 2012]*, the respondent company extended abnormal credit period to its associated companies for making outstanding payments as compared to other trade debtors, and termed it as normal trade transaction. However, it was rightfully observed and held by the Appellate Bench of the Commission that *"The Appellants extended abnormal credit period to* [associated companies] *for making the outstanding payment...the question before us is that whether the abnormal trade credit allowed was an 'investment' in terms of Section 208 of the* [Companies] *Ordinance* [1984]...*The Appellants in fact made investment in the associated companies under Section 208 of the Ordinance and ought to have taken approval from the shareholders before making the said investment. On the basis of above findings, we do not see any reason to interfere with the Impugned Order. The Impugned Order is upheld..."* [Gharibwal Cement v. Executive Director cited at 2003 CLD 131].

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15. In 2011 CLD 614 *[J.K. Spinning Mills Ltd.]*, a similar violation was discussed at length and it was held that *"...in the context of arguments put forth, the first and the foremost question to be addressed, among others, is whether the funds advanced to...which remained outstanding in. the following years are in the nature of the normal trade credit or not. Although the words trade credit' could be of widest scope in general legal usage, I am of the view that the context in which these words have been used in the aforesaid provisions of law has limited meaning' In my opinion, "Normal Trade Credit' has been used with reference to investing company and refers to the credit allowed by the investing company to its customers in the ordinary course of business...In fact, merely a quick look on the abnormally stretched credit period for which these funds remained outstanding and then their recovery in the form of purchase of finished fabric which is not covered by their main line of business, sufficiently demonstrate that there did not exist a normal trade relationship between the Company and its associate...This practice, evidently cannot be covered by the term 'Normal Trade Credit' in accordance with requirements of section 208 especially in view of the fact that the expression "investment" has particularly been defined which provides that "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" In view of the foregoing discussion and the account analysis shows that the outstanding amount due from J.K. Sons by the Company is not in the nature of normal trade credit as explained in the particular context of the expression...It is a mandatory requirement of section 208 of the Ordinance that the funds can only be invested in the associated/ subsidiary company under the authorization of the shareholders. It has been established that the Respondents have violated the mandatory requirements of section 208 of the Ordinance. The management of the Company has deprived the shareholders to exercise their legitimate right to make a decision to invest in its associate...The directors owe fiduciary duties to the Company they serve and its shareholders. They must discharge their statutory obligations in good faith with fairness and honesty. In fact, the Company has been acting as a financier by providing funds to the associated concerns to fulfil their financial requirements at the cost of the Company. They have breached their fiduciary' duty by providing unnecessary benefits to its associated undertakings...The directors have failed to exercise reasonable care to see that mandatory provisions of law were being violated and have not respected the mandate of the shareholders..."*

16. In another case cited as 2010 CLD 1210 *[Appeal No. 02 of 2010, decided on April 30, 2010]* wherein the company made investment in associated company by allowing abnormal credit terms, it was held by the Appellate Bench that *"...the term 'investment' has been defined in explanation to Section 208(1) of the Ordinance. The term 'investment' does not necessarily involve transfer of money...in the instant case, the trade credit granted by the company to [associated company] cannot be termed as normal trade credit...in our view, the abnormal trade credit given to [associated company] caused loss to the company..."*

17. Based on the aforementioned facts, it is evident that the Respondent cannot deny having extended credit periods to the associated companies in contradiction with the Respondent's stated policy of 30 days. This action indicates that undue benefits were extended to the Associates by providing

interest-free funds for an extended duration. The explanation as stated in sub-section (1) of Section 199 of the Act clearly stipulates criteria for determining what qualifies as an investment in associated companies/undertakings; and a clear exception has been made only for amounts due as normal trade credit, where the terms and conditions of trade transaction(s) carried out on arms-length and in accordance with the trade policy of the company. In the instant matter, the trade credits extended to the associated companies in question clearly neither qualify as normal trade credit nor were such credit limits extended on arms-length in accordance with the trade policy of the Respondent; thereby qualifying them to be investment in associated companies/undertakings that warranted authority of the special resolution.

18. After careful consideration of all the facts of the case in light of the relevant provisions of the law, and the written and verbal submissions made by the Respondent, I am of the considered view that the Respondent has contravened the provisions of sub-section (1) of Section 199 of the Act and is liable to penalty under Section 199(6) read with Section 479 of the Act. I, therefore, in exercise of the powers conferred upon me under Section 199(6) of the Act vide S.R.O. 1545(I)/2019 dated December 06, 2019, hereby impose a penalty of **Rs.500,000 (Rupees Five Hundred Thousand only) on the Respondent** on account of the aforesaid established default.

19. The Respondent is, hereby, directed to deposit the aforesaid amount of penalty in the designated bank account maintained in the name of the Commission with MCB Bank Limited or United Bank Limited within thirty (30) days from the date of this Order and to furnish a receipted bank challan to the Commission forthwith. In case of failure to deposit the penalty, the proceedings under Section 485 of the Act will be initiated for recovery of the fines as arrears of land revenue pursuant to provision of Section 42B of the Securities and Exchange Commission of Pakistan Act, 1997.

05-03-2025

Sohail Qadri
Director/ HOD
Adjudication Department-I

Announced:
March 5th, 2025
Islamabad