SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department- I

Adjudication Division

Before
Amir M. Khan Afridi – Director/Head of Department

In the matter of
The Searle Company Limited

Show Cause Notice No. & Date:	No. CSD/ARN/372/2016/318 dated April 29, 2021
Date of hearing	May 27, 2021, July 27, 2021, August 4, 2021 and August 9, 2021
Hearing attended by:	Mr. Sameer Tayebaly (Authorized Representative)

ORDER

Under Section 199 of the Companies Act, 2017 and Section 479 thereof.

This order shall dispose of the proceedings initiated through Show Cause Notice No. CSD/ARN/372/2016/318 dated April 29, 2021 (SCN) issued under Section 199 of the Companies Act, 2017 (the Act) and Section 479 thereof against The Searle Company Limited (the Company) and its following directors, herein after collectively referred to as the Respondents:

(i) The Searle Company Limited through its Chief Executive
(ii) Syed Nadeem Ahmad, Chief Executive;
(iii) Mr. Adnan Asdar Ali;
(iv) Mr. Rashid Abdulla;
(v) Mr. Ayaz Abdulla;
(vi) Mr. Asad Abdulla;
(vii) Mr. Zubair Razzak Palwala;
(viii) Mrs. Shaista Khaliq Rehman;

2. The brief facts of SCN are that review of the annual audited financial statements of the Company for the year ended June 30, 2020 (Accounts 2020) transpired that the Company had given short term interest free loan and advance to its wholly owned subsidiaries, namely IBL Identity (Private) Limited (IBL) and Searle Biosciences (private) limited (SBL), respectively, as disclosed in note 15, 15.4 and 15.5 to the aforesaid Accounts 2020.

3. The relevant notes to the Account 2020 are given as below:

"15.4 This represents advance to Searle Biosciences (private) Limited – Wholly owned subsidiary amounting to Rs. 972.18 million (2019: Rs. 975.6 million). These advances are provided for the purpose of financial assistance and are settled in the ordinary course of business. The maximum aggregate amounts outstanding at any time during the year was Rs.

975.58 million (2019: Rs. 975.58 million).

15.5 This represents interest-free loan provided to IBL Identity (Private) Limited – wholly owned subsidiary. The maximum aggregate amount outstanding at any time during the year was Rs. 3.18 billion (2019: Rs. 3.45 billion)."

4. Securities and Exchange Commission of Pakistan (the Commission) vide letter dated November 26, 2020 sought explanation from the Company for compliance of requirements of Section 199 of the Act in respect of short-term interest free loan and advance provided by the Company to IBL and SBL respectively. The Company vide a letter dated December 24, 2020, *inter alia*, stated that:

'The Company made investments in its wholly owned subsidiaries namely IBL Identity (Private) Ltd and Searle Biosciences (Private) Limited, as stipulated in the Company's financial statements for the year ended June 30, 2020. Furthermore, since the said companies are in fact wholly owned subsidiaries of the company, any investments made by the Company in such companies fall within the exemption stipulated in SRO 1239(I)/2017 dated December 6, 2017 (the SRO) and consequently do not attract the provisions of Section 199 of the Companies Act 2017. Based on the following, we understand that the said investments does not attract the provisions of section 199 (2) of the Act:

a. While the SRO states that the restriction provided in Section 199(1) of the Act is not applicable in certain circumstances, including investments in wholly owned subsidiaries, we do not agree with the interpretation adopted by the SECP, as the provisions of Section 199(2) of the Act directly emanate from the restriction stipulated in Section 199(1).

b. It is clear from the above that Section 199(1) is a general provision regarding investments in wholly owned subsidiaries and Section 199(2) of the Act details what is required for such investment; consequently, Section 199(2) of the Act is subservient to and cannot be read without the said Section 199(1). It is self-evident from a plain reading of Section 199 of the Act that Section 199(2) is not independent of Section 199(1) of the Act and there can be no situation where Section 199(2) is applicable, but Section 199(1) is not. Resultantly, if the provisions of Section 199(1) of the Act are not applicable, the provisions of Section 199(2) are ipso facto not attracted.

c. This understanding is further clear from the fact that while Section 199(1) of the Act concerns the approval of shareholders for investments in associated companies, Section 199(2) of the Act pertains to the terms for such investments in associated companies in which shareholder approval is obtained. Section 199(2) of the Act specifically states that the agreement in writing must contain the terms for the loan in accordance with the approval of the members in the general meeting.

In light of the above, since the approval of the shareholders of the Company was not required to make an investment in its wholly owned subsidiaries in the first place, pursuant to the provisions of the SRO, there would be no requirement to enter into an agreement containing terms in accordance with such approval. Resultantly, the provisions of Section 199(2) of the

Act and its provisos are also not applicable. Any other interpretation would defeat the purpose of granting the exemption of obtaining shareholder approval."

5. In view of the fact the reply of the Company was not found satisfactory, as the Company did not furnish evidence of compliance in terms of Section 199(2) of the Act and the Regulations. The Company extended interest free loans to IBL and financial assistance to SBL in the form of advance, without agreements in writing, and without return, prima facie, in violation of Section 199(2) of the Act. Hence, proceedings were initiated against the Respondents through aforesaid SCN to show cause in writing within fourteen days as to why penalty may not be imposed for contravening the requirements of the Act.

6. In this regard, the Respondents did not submit any written response to the SCN within given time. Subsequently, in order to afford the Respondents an opportunity of personal representation, a hearing in the matter was fixed for May 27, 2021, however, no one appeared on said hearing date. Another hearing opportunity was provided on July 27, 2021. A letter dated July 26, 2021 was received from Mr. Zubair Razzak Palwala and requested adjournment of hearing due to reason cited as COVID-19 pandemic. Hearings in the matter were again fixed for August 04, 2021 and August 09, 2021. On the date of hearing i.e. August 9, 2021, Mr. Sameer Tayebaly appeared as Authorized Representative of the Respondents. He, *inter alia*, submitted that:

(i) Exemption of Section 199(1) of the Act exists and is applicable in case of the Company.
(ii) Holding company advances loans to accommodate subsidiary company. The holding company completely owns subsidiary company. In terms of SRO investments or extension of advances to be made in wholly owned subsidiary company are exempt.
(iii) Section 199(2) of the Act cannot be applied without Section 199(1) of the Act. When no approval of members is required, then how terms and conditions are applicable in given case. There is no reason to enter into agreement when no approval of members is required in given case.
(iv) When holding company advances funds to subsidiary company, there is no impact in consolidated financials of both companies.

He requested to take lenient view and to close the proceedings.

7. A reply dated August 26, 2021 was also received from the Authorized Representative, which is reproduced as below:

"We act on behalf of our clients (i) Syed Nadeem Ahmed; (ii) Mr. Adnan Asdar Ali; (iii) Mr. Rashid Abdulla; (iv) Mr. Ayaz Abdulla; (v) Mr. Asad Abdulla; (vi) Mr. Zubair Razzak Palwala; (vii) Mrs. Shaista Khaliq Rehman (collectively the "Directors"); and (viii) The Searle Company Limited ("Searle") (collectively referred to as "Our Clients"), and write with reference to the Show Cause Notice, bearing No. CSD/ARN/372/2016/318, dated April 29, 2021, issued by yourself under Section 199 and 479 of the Companies Act, 2017 (the "Notice") to our Clients.

*As a preliminary stance, it is submitted that the averments and allegations against our Clients in terms of the Notice are denied, being incorrect and contrary to the factual and legal position pertaining to the matter. The Securities and Exchange Commission of Pakistan ("**SECP**") has failed to take into account the legal basis on which and no agreement in writing was entered into for the advance off PKR 972.18 Million ("**Advance**") provided by Searle to its wholly*

*owned subsidiary, Searle Biosciences (Private) Limited ("**SBPL**") and for the interest free loan ("**Loan**") provided by Searle to its wholly owned subsidiary, IBL Identity (Private)Limited ("**IBL**"). Moreover, the Notice is based on a complete misinterpretation and incorrect application of the law's stipulation therein. Accordingly, the Notice liable to be withdrawn.*

Without prejudice to the above, we have been instructed to reply to the Notice as follows:

1. *The contents of paras 1 and 2 of the Notice are factual in nature and do not warrant any comment.*
2. *The contents of para 3 Notice are agreed, as it affirms the accurate legal and factual analysis of the present matter and highlights the basis on which the Advance and Loan were provided by Searle to SBPL and IBL, respectively. Further, it confirms the reasoning why there was no legal requirement for our Clients to create any agreement in writing, as given that the SRO 1239(I)/2017 ("SRO") provides for an exemption of Section 199(1) of the Companies Act, 2017 ("Act"), there can be no obligation on our Client to comply with Section 199(2) of the Act, as Section 199 (2) of the Act is entirely dependent on, and follows on from, Section 199(1) of the Act.*
3. *At this stage, it would be useful to explain the reasoning and purpose behind Section 199 of the Act and the reason and purpose behind the exemption for loans and advances to wholly owned subsidiaries, provided for in the SRO:*
   a. *Section 199(1) of the Act places a restriction on companies making investments in their associated companies except under authority of a Special Resolution by the members of the company in a General Meeting. Often, if a certain section or group of members in a company (A) have shareholding in another, associated company (B), providing a loan or advance to the associated company without a Special Resolution could cause prejudice to the members of company A as they have no share in company B, and do not stand to benefit from any preferential loan or advance to company B by company A. Logically, Section 199(1) has been made law to protect the members of companies as a whole and ensure that no investment is made in associated companies without the approval or oversight of all members.*
   b. *Section 199(2) of the Act creates an obligation on companies to only make investments in associated companies with an agreement in writing specifying certain terms and conditions for the loan or advance "in accordance with the approval of the members in the general meeting." Hence, Section 199(2) was created to further protect the members of company A, where if the members of company A agreed to an investment in company B, the terms of conditions of that agreement must be recorded in writing so as to ensure that the members of company A are not prejudiced by an investment in company B that, in some circumstances, will only benefit that section or group of members that are members of both company A and company B. To ensure that some members of company A do not benefit over other members, the terms and conditions of any approval in a Special Resolution, must be recorded to enable members of company A that have no share in company B, to enforce their legal rights.*

c. *However, there is an exemption for Section 199(1) of the Act under the SRO, which stipulates that no approval or Special Resolution is required for a company that is making an investment, providing a loan or an advance, to a wholly owned subsidiary. The reasoning behind this exemption is because all members of the holding company have a beneficial interest in the wholly owned subsidiary, and hence no section or group of members in a holding company can benefit at the expense of other members because any loan or advance made to a wholly owned subsidiary, on any terms, will have the same impact on all the members of the holding company. Hence, there is no requirement to have an agreement in writing and there are no differing interests that the holding company needs to protect.*

d. *Furthermore, it is worth clarifying that because IBL and SBPL are wholly owned subsidiaries of Searle, not only do the Loan and Advance affect all members of Searle in the same way, but even as a commercial decision whether the advance is provided with high interest or no interest at all, for accounting purposes the financials of Searle, the holding company, will remain the same. The reasoning for inclusion of the requirement that any loan or advance the "return shall not be less than the borrowing cost of the company" is to protect the members of company A that are not members of company B, and to ensure that a certain section of members of company A do not unjustly enrich themselves due to their shareholding in company B, at the expense of company A. However, this provision is not attracted, as if any amount provided by Searle to IBL or SBPL is kept with IBL or SBPL, that will be reflected as an asset of Searle itself, as IBL and SBPL are Searle's wholly owned subsidiaries. Hence, even for commercial purposes, there is no reason for a requirement for an agreement in writing when there is no requirement for Special Resolution.*

4. *The contents of paras 4 to 6 are quotations of relevant laws and hence warrant no comments.*
5. *The contents of para 7 are denied. It is submitted that the contention of the SECP that the said investments would attract the provisions of Section 199(2) of the Act is incorrect, and any reasonable interpretation of the SRO would determine that it extends to Section 199(2) of the Act, based on the following:*

a. *While the SRO states that the restriction provided in Section 199(1) of the Act is not applicable in certain circumstances, including investments in wholly owned subsidiaries, the interpretation adopted by the SECP is incorrect, as the provisions of Section 199(2) of the Act directly emanate from the restriction stipulated in Section 199(1).*

b. *The provisions of Sections 199(1) and 199(2) are reproduced below for ready reference:*

"(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 ...

(2) The company shall not invest in its associated company or associated undertaking by way of loans or advances except in accordance with an agreement in writing and such agreement shall inter alia include the terms and conditions specifying the nature, purpose, period of the loan, rate of return, fees or commission, repayment schedule for principal and return, penalty clause in case of default or late repayment and security, if any, for the loan in accordance with the approval of the members in the general meeting:
Provided that the return on such investment shall not be less than the borrowing cost of the investing company or the rate as may be specified by the Commission whichever is higher and shall be recovered on regular basis in accordance with the terms of the agreement, failing which the directors shall be personally liable to make the payment ... ". [Emphasis added]

c. *It is clear from the above that Section 199(1) is a general provision regarding investments in wholly owned subsidiaries and Section 199(2) of the Act details what is required for such investment; consequently, Section 199(2) of the Act is subservient to and cannot be read without the said Section 199(1). It is self-evident from a plain reading of Section 199 of the Act that Section 199(2) is not independent of Section 199(1) of the Act and there can be no situation where Section 199(2) is applicable, but Section 199(1) is not. Resultantly, if the provisions of Section 199(1) of the Act are not applicable, the provisions of Section 199(2) are ipso facto not attracted.*

d. *This understanding is further clear from the fact that while Section 199(1) of the Act concerns the approval of shareholders for investments in associated companies, Section 199(2) of the Act pertains to the terms for such investments in associated companies in which shareholder approval is obtained. Section 199(2) of the Act specifically states that the agreement in writing must contain the terms for the loan in accordance with the approval of the members in the general meeting.*

e. *Hence, since the approval of the shareholders of Searle was not required to make an investment in its wholly owned subsidiaries in the first place, pursuant to the provisions of the SRO, there would be no requirement to enter into an agreement containing terms in accordance with such approval. Resultantly, the provisions of Section 199(2) of the Act and its provisos are also not applicable. Any other interpretation would defeat the purpose of granting the exemption of obtaining shareholder approval.*

6. *The contents of paras 8 and 9 are denied. We reiterate the contents of paragraph 3(d) of this Reply. It must be noted that the provision under reply is not attracted, as irrespective of the interest on the Loan given to IBL by Searle, as IBL is Searle's wholly owned subsidiary, all the assets and profits of IBL will be reflected as the assets of Searle in Searle's financial statements. Hence, it is irrelevant whether the Loan was interest free or not, as no section or group of members benefit at the expense of others, and all assets of IBL belong, in effect, to Searle.*
7. *The contents of paras 10 to 12 are quotations of relevant laws and hence warrant no comments.*

8. *The contents of para 13 are denied. It is highlighted that a hearing took place on August 9, 2021, which was attended by the undersigned legal counsel, the authorized representatives of the Respondents, wherein the undersigned addressed all the averments of SECP which have been put in writing in this Reply.*
9. *The contents of paragraph 14 to 20 are formal in nature and warrant no comments.*
10. *In view of the above facts and grounds stated on behalf of our Clients, we request the SECP to consider the Notice to have been satisfactorily responded and the Notice may be withdrawn.*
11. *In the event that further clarification is required by the SECP, our Clients would like an opportunity of further hearing through legal counsel, once the SECP has reviewed the contents of this response."*

8. Before proceeding further, it is necessary to refer to relevant legal provisions are reproduced as under:

Section 199 of the Act provides that:

"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.
(2) The company shall not invest in its associated company or associated undertaking by way of loans or advances except in accordance with an agreement in writing and such agreement shall inter-alia include the terms and conditions specifying the nature, purpose, period of the loan, rate of return, fees or commission, repayment schedule for principal and return, penalty clause in case of default or late repayments and security, if any, for the loan in accordance with the approval of the members in the general meeting:
Provided that the return on such investment shall not be less than the borrowing cost of the investing company or the rate as may be specified by the Commission whichever is higher and shall be recovered on regular basis in accordance with the terms of the agreement, failing which the directors shall be personally liable to make the payment:
Provided further that the directors of the investing company shall certify that the investment is made after due diligence and financial health of the borrowing company is such that it has the ability to repay the loan as per the agreement."

Clause (a) of sub-section (3) of Section 199 of the Act provides that:

"199. Investments in associated companies and undertaking:- (1)...
(2) ....
(3) The Commission may—
(a) by notification in the official Gazette, specify the class of companies or undertakings to which

the restriction provided in sub-section (1) shall not apply;"

S.R.O 1239(I)/ 2017 (SRO), *inter alia,* provides that:
"In exercise of powers conferred by section 510 read with clause (a) of sub-section (3) of section 199 of the Companies Act, 2017 (XIX of 2017) and in supersession of its earlier notification S.R,O. 704(I)/ 2011 dated July 13, 2011, the Securities and Exchange Commission of Pakistan is pleased to specify the following classes of companies to which the restriction provided in sub-section (1) of section 199 of the Act shall not apply to the extent provided hereunder:
(f) A holding company, to the extent of investments made in its wholly owned subsidiary:"

Regulation 5(4) of the Companies (Investments in Associated Companies or Associated Undertakings) Regulations, 2017 states that:
"5. Restrictions and conditions applicable to a company making investment. - (1) ....
(2) ...
(3) ...
(4) The rate of return on loans, advances and debt securities etc. shall not be less than Karachi Inter Bank Offered Rate (KIBOR) for the relevant period or the borrowing cost of the investing company, whichever is higher:
Provided that where a company opts for Shariah compliant mode of financing, the transactions shall be structured in such a way that the rate of return on such facilities is not less than that earned by Islamic Banks or Islamic Financial Institutions in Pakistan on similar facilities during the corresponding time period or the borrowing cost of the investing company, whichever is higher."

Sub-section (6) of Section 199 of the Act provides that:
"(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 and in addition, shall jointly and severally reimburse to the company any loss sustained by the company in consequence of an investment which was made without complying with the requirements of this section."

9. I have examined the submissions made in writing and during the hearing as well as issues highlighted in the SCN. In this connection, it is stated that:

(i) Section 199(1) of the Act clearly stipulates that the company cannot make investment in associated company or associated undertaking except under the authority of special resolution, which shall indicate the nature and the amount of the investment and the terms and conditions thereof. Hence, authority of special resolution of shareholders of a company is mandated by law for making any such investments, loans, advances etc., to associated companies or undertakings. The explanation added to Section 199(1) provides that 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.

The exemption provided by the Commission vide SRO 1239(I)/2017 dated December 6, 2017 is to the extent of a special resolution, wherein the Commission specified the classes of companies to which the restriction provided under sub-section (1) of Section 199 of the Act shall not apply. It has specifically been provided by clause (a) of sub-section (3) of Section 199 of the Act that, "the Commission may be notification in the official Gazette, specify the class of companies or undertakings to which the restriction provided in sub-section(1) shall not apply."

Section 199(2) of the Act provides that the company shall only invest in its associated company or associated undertaking by way of loans or advance in accordance with an agreement in writing and such agreement shall include the terms and conditions, specifying: (i) the nature, purpose and period of loan, (ii) rate of return on loan; (iii) fees or commission; (iv) repayment schedule for principal amount and return; (v) penalty clause in case of default or late repayments; and (vi) security, if any, for the loan in accordance with the approval of the members in the general meeting. Furthermore, the return on such investment shall not be less than the borrowing cost of the investing company or the rate as may be specified by the Commission whichever is higher and shall be recovered on regular basis in accordance with the terms of the agreement, failing which the Company/directors shall be personally liable to make the payment.

(ii) As per available information, the Company has extended an amount of advance of Rs. 972.18 million (2019: 975.6 million) and interest free loan of the amount of Rs. 3.18 billion (2019: Rs. 3.45 billion) to IBL and SBL respectively. The aforesaid transpires that an amount of Rs. 4.426 billion was extended to wholly owned subsidiary companies without charging any interest thereof and without any agreement in writing. I am of the view that the Company cannot extend 'loan' or 'advance' to its wholly owned subsidiary companies without any return thereon. In view of the aforesaid, the Respondents have contravened the requirements of Section 199(2) of the Act.

(iii) The Respondents are of the view that all members of the holding company have a beneficial interest in the wholly owned subsidiary company, and hence, no section or group of members in a holding company can benefit at the expense of other members because it will have same impact on all the members of the holding company. I am of the view that holding company and subsidiary companies are separate legal entities. The Respondents have highlighted that the principal of set off of transactions of holding company and subsidiary company exists, and resultantly no loss to any shareholder incurs. I am of the view that mutually exclusive nature of holding and subsidiary companies makes it liable that interest or mark-up be charged and recovered as per legal requirements i.e. Section 199 of the Act read with the Regulations. The Respondents, however, failed to comply with the given requirements as highlighted through SCN in true letter and spirit and extended material amounts of loans and advances to subsidiary companies, without charging any return on the loan amount.

(iv) In terms of Regulations 5(4) of the Regulations, the rate of return on loans, advances may not be less than Karachi Inter Bank Offered Rate for the relevant period or the borrowing cost of the investing company, whichever is higher, and rate of return or interest or mark-up at rate to be determined, as specified, on such amounts from the date of transfer of funds was not

charged. The aforesaid regulation and the requirements provided in terms of Section 199(2) of the Act make it obligatory on the part of the Respondents to charge and recover mark-up periodically.

(v) The Respondents have not placed before me any documentary evidence of any compliance of the requirements of Section 199(2) of the Act and regulation 5(4) of the Regulations.

10. From the above discussion and after careful consideration of all the facts of the case, I am of the view that provisions of Section 199(2) of the Act have been contravened and for this contravention, the Respondents are liable under sub-section (6) of the Section 199 and Section 479 of the Act. In exercise of the powers conferred under the said provision, I hereby impose aggregate penalty of **Rs. 4,500,000/- (Rupees four million and five hundred thousand only)** on the Respondents in the following manner:

S. No.	Name of the Respondents	Penalty (Rs.)
1.	The Searle Company Limited	1,000,000/-
2.	Syed Nadeem Ahmad, chief executive	500,000/-
3.	Mr. Adnan Asdar Ali	500,000/-
4.	Mr. Rashid Abdulla	500,000/-
5.	Mr. Ayaz Abdulla	500,000/-
6.	Mr. Asad Abdulla	500,000/-
7.	Mr. Zubair Razzak Palwala	500,000/-
8.	Mrs. Shaista Khaliq Rehman	500,000/-
	Total	**4,500,000/-**

11. The aforesaid fines must be deposited in the designated bank account maintained with MCB Bank Limited in the name of the Securities and Exchange Commission of Pakistan within thirty days of the date of this order and furnish receipted bank vouchers to the Commission. In case of non-deposit of the said penalty, proceedings under Section 485 of the Act will be initiated for recovery of the same as arrears of land revenue. It may also be noted that the said fines are imposed on Respondents in their personal capacity, therefore, they are required to pay the said amount from their personal resources.

12. Nothing in this Order may be deemed to prejudice the operation of any provision of the Act providing for imposition of penalties in respect of any default, omission or violation of the Act.

(Amir M. Khan Afridi)
HOD - Adj. Department-I

Announced:
Dated: September 27, 2021
Islamabad