



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Adjudication Department-I

Adjudication Division

Before

Shahzad Afzal Khan, Director/Head of Department (Adjudication-I)

In the matter of

Show Cause Notice issued
under Section 199 of the Companies Act, 2017 and Section 479 thereof

Number and date of Show Cause Notice (SCN)	CSD/ARN/87/2015-133 dated April 17, 2024
Date(s) of Hearing:	June 06, 2024
Present at the Hearing(s):	Mr. Iftikharuddin Riaz, Barrister/Advocate Supreme Court, M/s Bhandri Naqvi Riaz Mr. Imran Iqbal, Advocate High Court (Authorized Representatives)

ORDER

This Order shall dispose of the proceedings initiated through the Show Cause Notice No. CSD/ARN/87/2015-133 dated April 17, 2024 (the "SCN") against Mr. Ghazi Khan, Chairman (the "Respondent No. 1"), Mr. Akbar Khan, Chief Executive Officer (the "Respondent No. 2"), Mr. Humayun Akhtar Khan, Director (the "Respondent No. 3"), Mr. Haroon Khan, Director (the "Respondent No. 4"), Mrs. Rasheeda Begum, Director (the "Respondent No. 5"), Mrs. Mobeena Akbar Khan, Director (the "Respondent No. 6"), Mr. Tahir Farooq Malik, Director (the "Respondent No. 7") and M/s Tandlianwala Sugar Mills Limited (the "Company" or the "Respondent No. 8") for their alleged contravention of the requirements of Section 199(1) and 199(2) of the Companies Act, 2017 (the "Act"), under the penal provisions of Section 199(6) of the Act.

2. Brief facts of the case are that an examination of annual audited financial statements of the Company for the year ended September 30, 2023 (the "Accounts") carried out by the Securities and Exchange Commission of Pakistan (the "Commission") transpired that the Company extended a loan/advance to its associated company namely Superior Textile Mills Limited (STML), amounting to Rs.76.3 million approx. Both the Company and STML are associated companies (per the definition of "associated companies" pronounced under Section 2(1)(4)(b) of the Act) on account of the following common directors/management:

- (i) Mr. Akbar Khan;
- (ii) Mr. Ghazi Khan;
- (iii) Mr. Haroon Khan; and
- (iv) Mr. Humayun Akhtar Khan

3. The Commission took up the matter of compliance of Section 199 of the Act with the Company through its letter dated February 19, 2024. The Company through its reply dated March 02, 2023 only provided the minutes of the meeting of the audit committee and minutes of the meeting of Board of Directors, wherein the transaction with STML was approved. The Company through its aforesaid reply, however, did not comment on the compliance with the requirements of Section 199 of the Act.



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4. The following were observed upon examination of the Accounts of the Company:
- a. Note 23.6 to the Accounts disclosed that the amount extended to STML is interest free. The extract is reproduced below for reference purposes:

“23.6: This includes interest free loan receivable from Superior Textile Mills Limited, an associated company, amounting to Rs. 101.2 million (2022: Rs. 30 million) respectively. The maximum aggregate amount outstanding at any time during the year amounts to Rs. 101.2 million (2022: Rs. 30 million).”

- b. Note 41 to the Accounts *inter alia* disclosed that:

Name of party	Relationship	Nature of Transactions	2023 (Rs.)	2022 (Rs.)
Superior Textile Mills Limited	Common Directorship	Advance provided	76,288,000	30,000,000
		Advance received	5,000,000	-

5. The above disclosures indicated that during the year 2022, an amount of Rs.30 million was extended by the Company to STML; whereas in 2023, an amount of Rs.76.288 million was extended out of which Rs.5 million was paid by STML. Accordingly, the Company, in total, extended a loan/advance (net) of the amount of Rs.101.2 million to its associated company/STML, which constitutes investment in terms of Section 199 of the Act.

6. Based on the above facts, it was apparent that the Company has *prima facie*:

- (a) extended the loan/advance of Rs.101.2 million (2022: Rs.30 million) to its associated company STML without seeking shareholder's approval, contrary to the requirements of Section 199(1) of the Act;
- (b) extended the aforesaid loan/advance on an interest-free basis, contrary to the requirements of Section 199(2) of the Act, which mandates that the return on such investment shall not be less than the borrowing cost of the investing company.

7. The aforesaid alleged violations of the Section 199(1) and 199(2) of the Act attract applicability of Section 199(6) thereof. Accordingly, the SCN was served upon the Respondents on April 17, 2024.

8. The Company vide its letter dated April 27, 2024 requested for an extension to reply to the SCN for two (02) weeks. Accordingly, the Commission vide its email dated April 30, 2024 granted an extension up till May 13, 2024. Subsequently, M/s Bhandri Naqvi Riaz (Authorized Representative of the Respondents) vide its letter dated May 10, 2024 requested for another extension in filing of reply to the SCN. Accordingly, in order to accord an opportunity of personal representation to the Respondents, a hearing in the matter was fixed for June 03, 2024, while the Respondents were also advised to submit written response to the SCN within 05 days of the hearing notice dated May 24, 2024. However, the hearing fixed for June 03, 2024 was adjourned and re-fixed for June 06, 2024, which was attended by Mr.



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Iftikharuddin Riaz, Barrister/Advocate Supreme Court and Mr. Imran Iqbal, Advocate High Court (of M/s Bhandri Naqvi Riaz law firm) being the Authorized Representatives on behalf of the Respondents.

9. In the meantime, the Authorized Representative submitted written response to the SCN vide letter dated June 03, 2024, the relevant extracts of which are reproduced below:

"We have been instructed by our clients to respond to the show cause notice, and in the alternative and without prejudice, request for leniency in the imposition of penalties on the basis of the subsequent ratification of the transaction or the return of the amount as may be determined by SECP, as follows:

1 : It is a matter of record that there are common directors of TSML and Superior Textile Mills Limited ("STML") which is wholly owned by them. These shareholders of STML have between themselves previously advanced loans in the sum of PKR 3.635 billion to TSML. When subsequently TSML paid the sum of PKR 101.2 million to STML, it was in effect a repayment to its directors. The directors understood that they were not violating any provisions of the Companies Act, 2017 (the "Act") by paying the amount to STML. The matter was disclosed in the accounts.

2. SECP has the power under section 474 of the Act to enforce compliance of the provisions of the Act and make an order to undo any irregularity or make good any default. If SECP is of the view that there has been some irregularity, since our clients hold amongst themselves 84.95% of the shares of TSML, SECP is requested to grant time to obtain ex post facto approval from the shareholders. For ease of reference, section 474 is reproduced hereinbelow...

3. SECP has shown leniency in cases involving violations of section 199 of the Act. In the matter of Systems Limited, the company obtained ex post facto approval from its members. Acknowledging System Limited's corrective action, by an order dated 28 March 2022, SECP chose not to impose any penalty...

4. It is requested that SECP may grant time to TSML to obtain ex post facto approval from the shareholders in the next annual general meeting, which is to be held in January 2025.

5. However, in the alternative and without prejudice, if SECP is of the view that there is a violation of any provisions of the Act, which is not admitted, then the common directors will cause STML to return the amount with the requisite mark-up to TSML. This payment from STML will be reflected in the upcoming financial statements of TSML for the year ending 30 September 2024.

5.1. SECP has allowed time to the companies in the past and directed them to recover the unauthorized investment, such as in Raja Abdul Aziz v. Executive Director (SECP), 2012 CLD 741 [SECP Appellate Bench]...

5.2 Furthermore, under section 475 of the Act, SECP may direct any officer or employee of the company to undo the irregularity or to unwind the transaction or to comply with the said provisions within a time specified in the order. For ease of reference, section 475 of the Act is reproduced hereinbelow...



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5.3 In the matter of Fateh Textile Mills Ltd., 2010 CLD 36 [SECP] where the directors of the company were in the process of rectifying the default by recovering the balance of trade debts due from its associated companies along with interest, SECP while exercising powers under section 473 of the Companies Ordinance, 1984 (the predecessor of section 475 of the Act) directed the company to recover all the unapproved loans advanced to its associated companies along with interest...

5.4 A similar direction was also issued by SECP in the matter of S.G. Power Limited, 2006 CLD 997 [SECP] in exercise of the powers under section 473 of the Companies Ordinance, 1984 to recover the balance receivable as outstanding interest from its associated company and after recovery to submit an auditors' certificate...

In view of the foregoing, SECP is requested to grant time to TSML to recover the amount in question from STML with interest. TSML will provide an auditor's certificate to SECP in due course.

6. In view of the foregoing, it is requested that the show cause notice may kindly be withdrawn. In the alternate and without prejudice, it is requested that SECP may either allow TSML to obtain ex post facto approval from the shareholders in the next annual general meeting, or recover the amount from STML with interest, and no penalty may kindly be imposed against TSML and its directors..."

10. During the course of hearing held on June 06, 2024, the Representative was inquired regarding the contraventions of the law as alleged in the SCN. The Representative reiterated the written submissions made in response to the SCN. Subsequent to the hearing, the Representative submitted another written response vide letter dated June 25, 2024, the relevant extracts of which are reproduced hereinbelow:

"...TSML in its reply and without admission or concession of any liability: to take remedial action concerning the alleged violations of s. 199(1) and (2) of the Companies Act, 2017 (the "Act") committed by TSML in providing a loan (the "Loan to STML") to its associated company, Superior Textile Mills Limited ("STML")...

Reimbursement of loan amount with requisite interest:

1. In compliance with s. 199(6) of the Act, TSML and its directors hereby undertake to recover from STML the net advance amount of Rs. 101.2 million along with the requisite interest, including the interest on the repaid Rs. 5 million.

2. Due to the aforesaid heavy amount, our clients request six (6) months' time to do the needful under s. 475 of the Act.

3. Our clients further undertake to submit at the expiration of this period audited quarterly financial statements of TSML for the first quarter of FY 2024-25, which will reflect repayment of the aforesaid amount by STML before 31 December 2024.



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Obtaining shareholders' approval:

4. In compliance with s. 199(1) of the Act, TSML and its directors hereby undertake to obtain an ex post-facto approval of the Loan to STML from the shareholders through a special resolution, which shareholders include, among others, the aforesaid directors holding amongst themselves 84.95% of the shares of TSML.

5. It is requested that six (6) months' time may kindly be granted to our clients to do the needful as this matter can be taken up in the next annual general meeting estimated to be held in January 2025.

6. Our clients further undertake to submit within this period the relevant Form-26 (Special Resolution) and the relevant statement of material facts annexed with the notice of AGM prepared in accordance with s. 134(3) of the Act and regs. 3 and 4 of the Companies (Investment in Associated Companies or Associated Undertakings) Regulations, 2017.

Execution of agreement in writing:

7. In compliance with s. 199(2) of the Act, TSML and its directors hereby undertake to duly execute an ex post-facto agreement in writing with STML setting out the terms and conditions of the Loan to STML, which will include, inter alia, the following:

- a. Nature and purpose of the agreement.
- b. Loan period of three (3) years.
- c. Applicability of the requisite interest.
- d. Repayment date on or before 24 December 2024. Penalty clause in case of default or late payment.

8. Our clients further undertake to submit a copy of such a duly executed loan agreement within a period of one (1) month.

It is again requested that in light of the aforesaid remedial action proposed to be taken by our clients, SECP may kindly forgo the imposition of penalties on our clients..."

11. Based on the allegations raised in the SCN, written and verbal submissions of the Respondents, and the legal provisions applicable in the instant proceedings, following are the key issues that necessitate addressal:

- a. Whether the Company has obtained shareholder's approval as per the requirements of Section 199(1) of the Act in relation to the loan/advance extended to STML;
- b. Whether the Company has extended the aforesaid loan/advance on an interest-free basis in contravention of the requirements of Section 199(2) of the Act;
- c. Whether the loan/advance extended to STML by the Company can be construed as a repayment of loan to sponsors of the Company; and



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- d. Whether the case laws relied upon by the Respondents are considered relevant to the instant proceedings.
12. I have gone through the facts of the case and considered the written and verbal submissions of the Respondents and evidence available on record, in light of the aforesaid legal provisions and observed that:

A. Investment without authority of Special Resolution:

- a. Section 199(1) of the Act expressly pronounces that 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. The said section further explains that the term 'investment' includes equity, loans or advances etc.

It is established from the record that the Company and STML are associated companies, in accordance with the definition of "associated companies" given under Section 2(1)(4)(b) of the Act, since the Respondents No. 1 to 4 are common directors of the Company and STML. It is also evident from the Accounts (particularly note 23.6 and 41 thereof) that the Company has extended a loan/advance to its associated company STML and the outstanding receivable of the said loan stood at Rs.101.2 million (net) as of September 30, 2023.

- b. Upon being inquired about the compliance of Section 199 of the Act on February 19, 2024, the Company through its reply dated March 02, 2023 only provided minutes of the audit committee meeting and minutes of the meeting of Board of Directors of the Company, wherein the aforesaid loan transaction with STML was reportedly approved. However, no documentary evidence was submitted by the Company, even during the course of instant proceedings, in relation to obtaining special resolution from its shareholders as required under Section 199(1) of the Act. The Respondents have instead requested the Commission to grant time to the Company to obtain *ex post facto* approval from its shareholders in the next annual general meeting to be held in January 2025. Hence, non-compliance of Section 199(1) of the Act is established.

B. Return on Investment lower than Borrowing Cost of the Company:

Section 199(2) of the Act *inter alia* mandates 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.

The above-mentioned note 23.6 to the Accounts clearly discloses that the loan extended by the Company to STML was on interest-free basis. During the course of instant proceedings, the Respondents have requested for a lenient view on the basis of proposed ratification of the questioned transaction and/or the return of the amount. The non-compliance of Section 199(2) of the Act is an admitted position and thus stands established.



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C. Advance to STML as Repayment to Sponsors of the Company:

The Respondents have also argued that the shareholders of STML have previously advanced loans in the sum of Rs.3.635 billion to the Company (being its sponsors), and when the Company paid the sum of Rs.101.2 million to STML, it was in effect a repayment to its directors. However, the said argument is not found cogent based on the following reasons:

- a. Note 7 to the Accounts discloses Rs.3.635 billion of interest-free, unsecured loan obtained by the Company from its sponsors, which is repayable at the discretion of the Company. On the other hand, note 23.6 to the Accounts plainly discloses Rs.101.2 million as an interest-free loan receivable by the Company from STML.
- b. It is clearly evident from these disclosures that both are distinct and separate transactions, and the aforesaid disclosures nowhere refer to the repayment of Rs.3.635 billion – in the form of Rs.101.2 million paid to STML – that was reportedly obtained by the Company from its sponsors and not from STML. The extending of loan/advance to STML by the Company cannot be construed as a repayment “in effect”, if the same is not the actual substance of the transaction. The Respondents have erred in muddling the two transactions, as any loan taken from the individual sponsors cannot be repaid back to a company owned by them – plainly due to the existence of a separate legal entity concept.

D. Shareholding Pattern of the Company:

As far as shareholding pattern of the Company is concerned, the Respondents in their written response have stated that *there are common directors of TSML and STML which is wholly owned by them*. However, as a matter of record, it is highlighted that per the pattern of shareholding disclosed in the Accounts of the Company, the identified common directors i.e. Respondents No. 1 to 4 collectively hold approx. 66.56% of paid-up share capital of the Company.

E. Relevance of Case Laws relied upon by the Respondents:

The Respondents have also quoted case laws, based on which leniency in punitive actions and directions to undo the irregularities have been requested. While every case has its own merits, peculiar facts & circumstances, the relevancy of each of the said case law to the case at hand is deliberated in the succeeding paras:

- i. Order dated May 28, 2022 passed in the matter of Systems Limited – the proceedings only related to non-compliance of Section 199(1) of the Act regarding obtaining of shareholders’ approval, and the respondent company had already complied with the questioned requirements of law i.e. well before the initiation of adjudicatory proceedings in 2021. The instant case relates to alleged non-compliances of Section 199(1) and 199(2) of the Act i.e. both the absence of shareholder’s approval and failure to charge & recover interest/return on the loan/advance extended to the associated company, and no rectification of default has been made even till date. Thus, the referred case is not considered relevant to



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the case at hand.

- ii. Raja Abdul Aziz vs. Executive Director SECP 2012 CLD 741 (Appeal No. 20 of 2006) – this case involved admission of default on part of the appellant company in making an unauthorized investment in its associated undertaking and subsequent ratification in the form of repayment of outstanding principal amount of advance together with mark-up charged. However, in addition to the direction under Section 472 of the erstwhile Companies Ordinance, 1984, the Impugned Order imposed a penalty of Rs.300,000 on each appellant. It is nevertheless important to note that the said appeal was disposed off with a reduced penalty of Rs.100,000 on each appellant, considering subsequent ratification of irregularities by the appellant and the fact that the default was in fact committed. Thus, absolute nullity of penal action cannot be awarded to the Respondents on the basis of this case law alone.
- iii. Fateh Textile Mills Ltd. 2010 CLD 36 – this case also involved admission of default on part of the respondent company who was also in the process of rectifying the same by recovering the balance of trade debts due from its associated companies along with interest. Although the case was concluded with directions under the then Section 473 of the Ordinance (now Section 475 of the Act) to recover the loans and interests thereupon, the respondents were still penalized for Rs.500,000 on each of the 06 respondents for the established non-compliance of the then Section 208 of the Ordinance (now Section 199 of the Act). Thus, as pointed out above, absolute nullity of penal action cannot be awarded to the Respondents on the basis of this case law alone.
- iv. S. G. Power Limited 2006 CLD 997 – this case had similar conclusions as entailed in para (iii) above, and while the adjudicating authority proceeded to issue directions under the then Section 473 of the Ordinance regarding recovery of receivable balance due from associated company along with interest, a penalty of Rs.100,000 was still imposed on each of the 07 respondent directors. Hence, it is abundantly clear that absolute nullity of penal action cannot be awarded to the Respondents on the basis of this case law alone.

The above-mentioned facts, the disclosures made in note 23.6 and 41 to the Accounts of the Company, and the request made by the Respondents themselves to undo the default through proposed remedial actions clearly depict that the loan/advance of Rs.101.2 million (net) was, in fact, extended by the Company to its associated company i.e. STML during the years 2022 and 2023 without obtaining the authority of a special resolution and that too, without levying any sort of interest as a return thereupon. Hence, the contravention of Section 199(1) and 199(2) of the Act is established.

13. In view of the above-stated facts & circumstances, particularly considering the established default of the Respondents in complying with Section 199(1) and 199(2) of the Act, I hereby, in exercise of powers conferred under Section 199(6) of the Act, impose an aggregate penalty of **Rs.1,200,000 (Rupees One Million and Two Hundred Thousand Only)** on the Respondents in the following manner:



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S. No.	Name of the Respondent	Amount of Penalty (Rs.)
1	Mr. Ghazi Khan, Chairman	100,000
2	Mr. Akbar Khan, Chief Executive Officer	100,000
3	Mr. Humayun Akhtar Khan, Director	100,000
4	Mr. Haroon Khan, Director	100,000
5	Mrs. Rasheeda Begum, Director	100,000
6	Mrs. Mobeena Akbar Khan, Director	100,000
7	Mr. Tahir Farooq Malik, Director	100,000
8	M/s Tandlianwala Sugar Mills Limited	500,000
	Total	1,200,000

14. The Respondents are directed to deposit the aforesaid respective penalty, as per para 13 above, in the designated bank account maintained in the name of the Securities and Exchange Commission of Pakistan with MCB Bank Limited or United Bank Limited, within a period of thirty (30) days from the date of this Order, and furnish receipted voucher issued in the name of the Commission for information and record.

15. The Respondent No. 8/the Company is also directed to ensure immediate compliance of Section 199 of the Act in true letter and spirit, and submit an independent auditor's certificate with the relevant department of the Commission within sixty (60) days hereof to reflect recovery of loan/advance made to STML along with the requisite interest/return thereupon.

16. This Order is being issued without prejudice to any other action(s) that may be initiated/taken against the Directors, the Company and/or its officers responsible for the violations of the aforesaid provisions of the law, accordingly.

(Shahzad Afzal Khan)
Director/Head of Department

Announced:
July 4, 2024
Islamabad

