



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH III

In the matter of

Appeal No. 49 of 2012

1. Col (R) Asghar Ali Malik, Chief Executive Officer
2. Mr. Sohail Latif, Director
3. Mr. Foo Chee Mian Micheal, Director
4. Ms Tan Siok Bee, Director

of M/s Petrosin Ravi Industries Ltd

.....

Appellant

Versus

Head of Department (Enforcement)

Securities and Exchange Commission of Pakistan

.....

Respondent

Date of hearing

22/07/13

ORDER

Present:

For the Appellants:

Mr. Tariq Mahmood, Advocate

Department representative:

Mr. Bilal Rasul, Director (Enforcement)

Appellate Bench III

Appeal No 49 of 2012

Page 1 of 8



Securities and Exchange Commission of Pakistan

1. This order shall dispose of appeal No. 49 of 2012 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 29/08/12 (the "Impugned Order") passed by the Respondent.
2. The Enforcement Department of the Commission while examining the annual audited accounts of Petrosin Ravi Industries Ltd ("the Company") for the financial year ended 30/06/10 (the "Accounts") revealed that the Company had outstanding receivables from the associated undertakings in the following manner:

(Rupees)

Head of Accounts	Note	2010	2009
Due from Associated undertaking-unsecured and considered good	Balance Sheet	17,779,902/-	-
Other receivable from associated undertakings	17	60,053,560/-	71,131,623/-
Trade Debtors-considered good- Related Parties	16	60,410,112/-	29,834,020/-

It was also observed from Note 28 (Transaction with Related Parties) to the Accounts that the Company had undertaken transactions with the associated undertakings; therefore, the Company was advised to provide the following documents:

- i) current ledger accounts maintained in the books of the Company for all of the related parties;
- ii) agreements with the related parties with the Company;
- iii) whether the advances given to the associate are in accordance with the provisions of section 208 of the Ordinance; and
- iv) details of markup charged to the aforesaid companies.

The Company failed to provide satisfactory response/documents, hence, an inspection dated 04/10/11 was ordered by the Commission under section 231 of the Companies



Securities and Exchange Commission of Pakistan

Ordinance, 1984 (the “Ordinance”) to inspect the books of accounts, papers and statutory record of the Company. The Company, in response to the inspection order filed a suit in the Civil Court, Sheikhpura due to which the inspection was deferred. The Company withdrew its suit on 08/03/12 and requested the Commission to proceed with the inspection with effect from 15/03/12.

3. The inspection team visited the registered office of the Company on 15/03/12 and reported that:

(i) The Company runs the practice of obtaining *post facto* approval of the shareholders on the outstanding balances due from its associated undertakings as at the year end. (Minutes of Annual General Meetings held on 31/10/09 and 31/10/10);

(ii) The Company has charged mark-up on the outstanding balances (receivable/payables) of the associated undertakings in the year 2010 on the associated companies namely; Petrosin CNG (Pvt.) Limited, Petrosin Gas Pakistan (Pvt.) Limited and Petrosin Edible Oil (Pvt.) Limited and has failed to charge mark-up on balances due from Petrosin Engineering (Pvt.) Limited.

4. Show Cause Notice dated 25/05/12 (“SCN”) was issued to the Appellants under section 208 read with section 476 of the Ordinance. The SCN was not responded by the Company despite various reminders. The Respondent after giving an opportunity of hearing to the Appellants held that the Appellants had violated section 208 of the Ordinance and have not exercised due care while extending credit to the associated companies. However, keeping in view the fact that the Company was charging mark-up on the outstanding balance with the associated companies in the year 2010 and had assured to comply with the provisions of the Ordinance in future, the Respondent took a lenient view and instead of imposing the maximum penalty of Rupees 10 million as provided in section 208(3) of the Ordinance, imposed a penalty of Rs 75,000/- on each Appellant with the total amount aggregating to Rs. 300,000. The



Securities and Exchange Commission of Pakistan

Respondent gave further directions to recover and deposit the outstanding balances from the associated companies and pass a 'special resolution' in accordance with the aforesaid provision of section 208 of the Ordinance.

5. The Appellants have preferred the instant appeal against the Impugned Order. The Appellants' counsel argued that:

- a) the Company obtained a post facto approval for the transactions with associated companies as obtaining special resolution for each and every inter-company transaction was not convenient. It was further argued that the post fact approval is a procedural default only and a lenient view may be taken in the instant case;
- b) the principle condition of charging return on investment is that: i) a company shall have borrowed money from a bank or financial institution and shall have advanced those funds to an associated company; and ii) the transaction shall be a 'loan' as the term 'investment' has not been used, instead the term 'loan' has been used for charging return of investment. Both these conditions are not applicable in the instant case, hence, the Company need not charge mark-up on its transactions with associated companies;
- c) the Commission's SRO 704 (I)/2011 dated 13/07/11 provides exemption of section 208 to wholly owned subsidiaries and private companies which are not a subsidiary of a public company. It was argued that since the Company is a wholly-owned subsidiary of Petrosin Engineering (Pvt.) Limited which in turn is wholly owned subsidiary of Petrosin Corporation of Singapore, the conditions of section 208 are not applicable on the Company; and
- d) there is no designation namely 'Head of Department – Enforcement', in the Commission or in SRO 1061(I)/2005 dated 18/10/05 where the powers of the Commission have been delegated to the officers of the Commission. The Respondent had no power to pass the Impugned Order and the Impugned Order may be set aside on this ground alone.



Securities and Exchange Commission of Pakistan

6. The department representative argued that:

- a) section 208 of the Ordinance requires every investment in an associated company to be made with prior approval of the shareholders. The Company is providing running finance to its associated companies which is not in the nature of normal trade credit and is against the spirit of section 208 of the Ordinance;
- b) section 208 of the Ordinance provides for charging of interest on every investment, by whatever name called. Further, the Company in the subsequent year has charged interest for its transactions which goes on to show that the Company is aware of the requirements of law;
- c) the SRO 704 (I)/2011 dated 13/07/11 exempts a wholly owned subsidiary and private company which is not a subsidiary of a public company. In the instant case, the Company is a public company and the investment is made in associated companies which are not its wholly owned subsidiaries, hence, the exemption is not applicable; and
- d) the Head of Department, vide SRO 706(I)/ 2011 dated 13/07/11, has been empowered to exercise the powers of Executive Director in case the post of the Executive Director is vacant. In fact SRO 1061(I)/2005 dated 18/10/05 has been partially superseded by the SRO 706(I)/2011 dated 13/07/11.

7. We have heard the parties. Section 208(1) of the Ordinance is reproduced for ease of reference:

208. Investments in Associated companies and undertaking.- (1) Subject to sub-section (2A) 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 and amount of investment and terms and conditions attached thereto.



Securities and Exchange Commission of Pakistan

Provided that the return on investment in the form of loan shall not be less than the borrowing cost of investing company.

Explanation: 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.

- a) the argument of the Appellants' counsel that the Company obtained a post facto approval for the transactions with associated companies as obtaining special resolution for each and every inter-company transaction inconvenient, is not acceptable. Section 208 of the Ordinance requires that a special resolution be passed by the Company *before* making investment in its associated company. The requirement of law is unequivocal and cannot be avoided. We place reliance on *Shahbaz-ud-din vs. Service Industries Textiles Limited [PLD 1988 Lahore 1]* where it was held that, applying harmonious reconstruction, where an investment was made in associated companies without a special resolution under section 208 of the Ordinance, the shareholders may either reverse the transaction or regularize the investment by passing a special resolution. It was further held that regularizing the investment does not absolve the shareholders from penalty for non-compliance with section 208 of the Ordinance. The post facto approval of investment made in associated company through a special resolution is not envisaged by the Ordinance and subsequent ratification of the default does not exonerate the Appellants from penalty prescribed under section 208 of the Ordinance;
- b) although there was no borrowing cost incurred by the Company, the Appellants deprived the Company from reasonable return by providing undue benefit to the associated companies. The Company cannot under any circumstances make advances/loans to its associated companies without charging any interest or



Securities and Exchange Commission of Pakistan

return on investment. The word borrowing cost has been used as a benchmark, for computing the interest payable by the associated company to the lending company, as such, the requirement of law is unequivocal and cannot be avoided. Further, the Explanation provided in section 208 of the Ordinance clearly states that 'investment' includes 'loans' and 'advances' and includes any amount which 'is not in nature of normal trade credit'. As such, the contention of the Appellants' counsel that interest can only be charged on 'loan' and not otherwise is not in line with the Explanation given under the said section. The table of the Company's receivables, reproduced in para 2 of this order, which were invested in the associated companies without any return indicates that the Appellants have acted in the interest of associated companies. Moreover, the Company has charged mark-up in the year 2010 at the rate of 18% as resolved (*post facto*) which goes on to show that the Company was aware of the requirements of the provision of section 208 of the Ordinance and was required to charge mark-up in previous years also;

- c) the relevant extract of the SRO 704 (I)/2011 dated 13/07/11 is reproduced for ease of reference:

"The following class of Companies shall be exempt from the requirements of Section 208 of the Ordinance to the extent provided hereunder:

(f) A holding company, to the extent of investment made in the wholly owned subsidiary.....;

(i) A private company which is not a subsidiary of a public company."

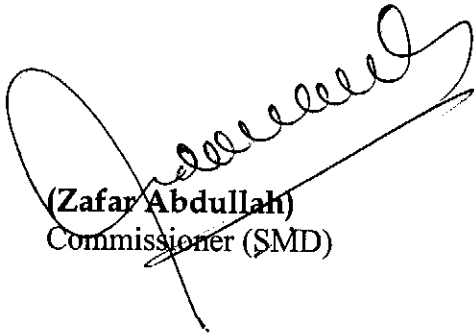
The SRO 704 (I)/2011 dated 13/07/11 exempts a wholly owned subsidiary and a private company which is not a subsidiary of a public company. Since the Company is a public company and the investments made in the associated companies are not wholly owned subsidiaries of the Company, the said exemption is not applicable to the Company; and

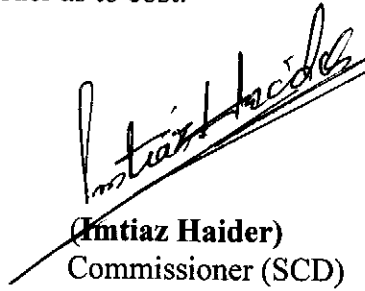


Securities and Exchange Commission of Pakistan

- d) regarding the issue of delegation of powers, we have perused SRO 706(I)/ 2011 dated 13/07/11 , which empowers the Head of Department to exercise the powers of Executive Director in case the post of the Executive Director is vacant. In the instant case, at the time of passing the Impugned Order, the position of Executive Director (Enforcement) was vacant, as such the powers of adjudication was exercised by the Head of Department correctly.

In view of the above, we see no reason to interfere with the Impugned Order.
The appeal is dismissed with no order as to cost.


(Zafar Abdullah)
Commissioner (SMD)


(Imtiaz Haider)
Commissioner (SCD)

Announced on: 22/10/13