



# Securities and Exchange Commission of Pakistan

## BEFORE APPELLATE BENCH NO. III

In the matter of

### Appeal No. 08 of 2012

1. Mr. Mussaid Hanif, Chief Executive
  2. Mr. Burhan Muhammad Khan
  3. Mr. Arbab Muhammad Khan
  4. Mr. Gauhar Abdul Hai
  5. Mr. Manzar ul Islam
  6. Ms. Tehniyat Mussaid
  7. Ms. Sabah Burhan
- (Serial No. 2 to 7 all directors of Zephyr Textile Mills Limited) ... Appellants

Versus

Head of Department (Enforcement)

... Respondent

Date of hearing

05/09/13

### **ORDER**

Present:

For the Appellants:

Mr. Usman Akram Sahi (Advocate)

Mr. Furqan Naveed Ch (Advocate)

For the Respondent:

Ms. Amina Aziz, Director (Enforcement)

Mr. Tariq Ahmad, Joint Director (Enforcement)



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1. This order is in appeal No 08 of 2012 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 23/02/12 (the "Impugned Order") passed by the Respondent.
2. The facts of the case are that the Board of Directors ("BOD") of Zephyr Textile Mills Ltd (the "Company"), in their board meeting on 30/09/11, proposed cash dividend of Rs. 1.00 per share, i.e. 10%, for the year ended 30/06/11. The said proposed dividend payment was presented for approval of the shareholder in the Annual General Meeting held on 31/10/11 ("AGM"). Bank of Punjab (the "Bank"), one of the creditors of the Company, vide letter dated 14/10/11 communicated to the Commission its reservations regarding aforesaid decision of the BOD. The Bank informed that the Company had duly signed a rescheduling/restructuring letter dated 30/09/09 (the "Letter") and consequently entered into a rescheduling/restructuring Agreement dated 26/02/10 (the "Agreement"). Both, the Letter and the Agreement, expressly bar the Company from payment of dividend without prior permission of the Bank. Subsequently, the Bank vide letter dated 29/11/11 informed the Commission that it had obtained a stay order from Lahore High Court, Lahore (the "Court") against the payment of dividend by the Company.
3. The Commission sought clarification from the Company regarding restriction on declaration of dividend. The Appellants responded that the BOD, in their meeting on 30/09/11, had declared dividend for the minority shareholders only while the directors holding substantial shares have waived their right to receive said dividend. The dividend is in the interest of the shareholders and declared strictly in accordance with provisions of the Companies Ordinance, 1984 (the "Ordinance"). It was further stated that as the Bank has filed a recovery suit C.O.S No. 8/2011 in the Court, the Letter and Agreement are



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ineffective and the Bank cannot prevent the Company from paying dividend to its shareholders.

4. The examination of the annual accounts of the Company from the period 30/06/09 to 30/06/11 filed with the Commission transpired that material facts related to the restriction on declaration/payment of dividend was not disclosed in the respective notes to the accounts. Rather, the Company in notes to the accounts under head 'issued, subscribed and paid-up capital' stated that all shareholders of the Company are entitled to receive all distribution to them including dividend and other in form of right and bonus as and when declared and all shares carry one vote per share without restriction.
5. Show cause notice dated 16/11/11 ("SCN") under section 492 read with section 476 of the Companies Ordinance, 1984 (the "Ordinance") was issued to the Appellants, calling upon them to show cause as to why penal action may not be taken against them and hearing in the matter was held. The Respondent, dissatisfied with the response of the Appellants, passed the Impugned Order and imposed penalty of Rs. 400,000 on each Appellant.
6. The Appellants have preferred the instant appeal against the Impugned Order. The Appellants' counsel argued that:
  - (a) the Bank filed suit C.O.S No. 8/2011 in the Court for recovery of Rs. 494,400 million on 30/09/10 and an application was also filed by the Bank for stay of payment of dividend to its shareholders. In view of the pendency of the suit/application, any further proceedings by the Respondent or the Appellate authority would amount to pre-empting the adjudication of the



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aforementioned suit. It is established law that if a matter is pending adjudication before a higher forum, then the forum below should await the decision of the higher forum. The Respondent has passed the Impugned Order without taking into account the judicial propriety. The Impugned Order would also cause prejudice to the Appellants and is against the interests of justice. Further, PLA No. 87-B/2011 of the Appellants before the Court in suit C.O.S No. 8/2011 has been accepted and the Appellants have been granted unconditional leave to defend vide order dated 13/03/12. The Impugned Order, therefore, is liable to be set aside as the matter is sub judice before a higher forum;

- (b) it is evident from the minutes of the BOD meeting held on 30/09/11 that *'directors of the company unanimously decided to forfeit their right to receive dividend in the best interest of the company. The directors recommend cash dividend to all categories of shareholders except directors' shareholding.'* The suit had already been filed prior to BOD meeting on 30/09/11 and the Company at this point was not under any obligation to seek permission of the Bank before declaring the dividends. The Company, therefore keeping in view its profitability in the preceding fiscal year, approved payment of dividends in the AGM. Furthermore, the restriction on payment of dividend was imposed through the Letter after closing of the financial year 2009, as such; no disclosure was required in the accounts for the year 2009. In the year 2010, the Company was in loss and, as such, no disclosure on restriction of payment of dividend was required in the accounts for the year 2010. Moreover, the



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Company had also disclosed to its shareholders, the existence and pendency of the suit C.O.S No. 8/2011 filed by the Bank in the accounts for the year 2011 which itself was a sufficient disclosure; and

- (c) the allegation of not concealing of material facts from the shareholders is not true and devoid of any merit. *Mens rea* is an ingredient of the offence of section 492 of the Ordinance which needs to be established before imposition of penalty. In the instant case, there was neither any malafide on part of the Appellants, nor was there any intention to mislead or defraud the public or any of the investors. The Impugned Order fails to take the same into account and is liable to be set aside on this ground.

7. The department's representatives argued that:

- (a) the proceedings under section 492 of the Ordinance against the directors was initiated for, prima facie, withholding of material information from shareholders/stakeholders in the accounts for 2009-11 i.e. the payment of dividend by the Company is restricted as a result of the Agreement. On the other hand, the Bank has initiated a suit for recovery of Rs. 494,400 million against the Company. The nature of both the proceedings i.e. by Commission and in Court is different;
- (b) the fact that directors waived off their right to receive dividend does not relieve the Appellants of their statutory responsibilities. The Company in the accounts for the year 2009 and 2010



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incorporated the financial effect of the Letter and Agreement. The argument of the Appellants that the said Letter/Agreement was not in effect, therefore, does not hold any merit. Furthermore, the Company deliberately chose to avoid disclosure of restrictive clause regarding dividend in the notes to the accounts. Instead, the Company stated in its notes to the accounts that shareholders are entitled to all distribution including dividend as and when declared and all shares carry one vote per share without restriction. This note, in itself, is enough to establish misstatement by the Company. Moreover, the shareholders were kept in dark about the consequences of declaring dividend in presence of restrictive clause in the Agreement; and

- (c) section 492 of the Ordinance states that whoever in any form of return including statutory documents, information or explanation makes a statement which is false or incorrect in any material particular, or omits any material fact knowing it to be material is liable for penalty. The act of the Appellants by omitting and misleading the facts in the accounts for the year 2009-11 was intentional and mens rea need not be proved in the instant case.

8. We have heard the parties. Our para-wise findings are as under:

- a) the suit C.O.S No. 8/2011 filed in the Court under section 9 of the financial Institution (Recovery of Finances) Ordinance, 2001 for recovery of Rs. 494.400 million as on 30/09/10 pertains to breach of Agreement between the Bank and the Appellants,



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whereas, the proceedings by the Respondent is the basis of an alleged omission and misstatement in the accounts under section 492 of the Ordinance. The subject matter of the Impugned Order is not the contractual dispute between the parties in respect of the Agreement, rather the Impugned Order deals with the negligence of directors for non-disclosure of restrictive clauses of the Letter/Agreement in the annual accounts for the year 2009-11 and an alleged misstatement in the notes to the said accounts. In view of the facts discussed, the argument of the Appellants that the suit filed by the Bank is pending before the Court, therefore, proceedings against them should be stayed until the outcome of the case, holds no merit;

- (b) the Company chose to disclose in its annual accounts for the year ended 30/06/09 that the management of the Company has applied for restructuring of long term financing from the Bank. In light of the foregoing, the Appellants opted not to show maturity of the loans amounting to Rs. 34.00 million, Rs. 41.172 million and 50 million under the head of current maturity of long term liabilities. The Company, however, did not disclose the fact that owing to the Letter, the Company had accepted the restriction on payment of dividends subject to No Objection Certificate from the Bank. The rescheduling effects of these loans were also incorporated in the accounts for the year ended 30/06/10. We are privy to the fact that the Company was in loss in the year 2010, hence, no dividend was declared. As such, the Company was not required to disclose the restriction on payment of dividend in the accounts for the year ended 30/06/10. The Company in its annual accounts for the year ended 30/06/11 disclosed that the Bank had



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filed a suit C.O.S 8/2011 for recovery of amount due against long term loans. The restriction of dividend, however, was not disclosed. Further, in notes to the accounts for the years 2009, 2010 and 2011, under the head '*issued, subscribed and paid-up capital*', it was categorically stated that shareholders of the Company are entitled to receive all distribution to them including dividend and other in form of right and bonus as and when declared and all shares carry one vote per share without restriction, which was a misstatement in terms of section 492 of the Ordinance. It is pertinent to mention that for the year ended 30/06/12, the above mentioned statement that the Company is entitled to receive all distribution including dividend was not mentioned in the notes to the account, as such, the Appellant by their conduct acknowledged the misstatement made in the annual accounts for the year 2009-11.

We are not convinced with the argument of the Appellants that the directors should be absolved from the responsibility to shareholders as they waived off their right to receive dividend. It was incumbent upon the directors to have fully disclosed in the accounts the restriction on right to receive dividend; and

- (c) Section 492 of the Ordinance is reproduced for ease of reference:

**492. Penalty for false statement.** - *Whoever in any return, report, certificate, balance sheet, profit and loss account, income and expenditure account, prospectus, offer of shares, books of accounts, application, information or explanation required by or for the purposes of any of the*





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*provisions of this Ordinance or pursuant to an order or direction given under this Ordinance makes a statement which is false or incorrect in any material particular, or omits any material fact knowing it to be material, shall be punishable with fine not exceeding five hundred thousand rupees*

Emphasis Added

We place our reliance on *Principle of Statutory Interpretation*, by Justice G.P. Singh (7<sup>th</sup> edition, Chapter 11, page 653 & 659, published by Wadhwa & Company Nagpur) to expound on the issue of *mens rea* that; “.....existence of a guilty intent is an essential ingredient of a crime at common law and the principle is expressed in the maxim- *Actus non facit reum nisi mens sit rea*” ..... “penalty imposable under an Act for breach of civil obligation by an adjudicatory proceeding which is not criminal in nature does not attract the rule that *mens rea* is essential before a penalty could be imposed”. In the instant case the default has been committed under section 492 of the Ordinance, which is a civil and not a criminal offence, as such, *mens rea* need not be established. The Appellants have not been charged with malafide or intention to defraud, however, from the facts of the case, it is established that the Appellants knowingly committed the default.



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

(Mohammad Asif Arif)  
Commissioner (Insurance)

(Intiaz Haider)  
Commissioner (SCD)

Announced on: 31/10/13