BEFORE APPELLATE BENCH NO. III

In the matter of

Appeal No. 03 of 2011

1. Fawad Ahmad Mukhtar, Chief Executive
2. Fazal Ahmad Sheikh, Director
3. Faisal Ahmad Mukhtar, Director
4. Ambreen Fawad, Director
5. Fatima Fazal, Director
6. Farrah Faisal, Director
7. Fadia Kashif, Director

of Reliance Fabrics Limited ..... Appellants

Versus

Director (Enforcement)
Securities and Exchange Commission of Pakistan ..... Respondent

Date of hearing 27/02/11

ORDER

Present:

For the Appellant:
Mr. Basharat Hashim , Manager
Departmental representative:
Mr. Shahid Javed, Deputy Director (Enforcement)
Mr. Malik Asim Pervez, Deputy Director (Enforcement)

1. This order shall dispose of appeal No. 03 of 2011 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 15/12/10 (the "Impugned Order") passed by the Respondent.

2. Examination of the annual audited accounts of Reliance Fabrics Limited (the "Company) for year ended 30/06/09 (the "Accounts") revealed that the Company had provided interest-free loans and advances amounting to Rs.10.604 million (2008: Rs. 10.604 million) to various associated companies without the authority of special resolution passed by the shareholders of the Company. Consequently, the Commission vide its letter dated 25/03/10 advised the Company to clarify the position with regard to compliances of section 208 of the Companies Ordinance, 1984 (the "Ordinance"). In response, the Company vide its letter dated 11/05/10 furnished the copies of relevant documents and stated as follows:

> *"Rs.12,837,000 million ("Advance") was received from the Company sponsors ("Sponsors") for the promotion and setting up of the Company and its intended business. At the time it was provided, the Sponsors had made their intension clear through letter dated 24 July 2003 (copy enclosed) that should the Company not commence business, the Advance was to be utilized in accordance with the instructions of the Sponsors. Any amounts extended/advanced were to be interest free and to be returned by the Company within 30 days of written demand by the Sponsors. Rs. 12,000,000 of the Advance was put in the Company's account ("Account Money") kept with Meezan Bank Limited at its Multan Branch on 24 September 2003 by the Sponsors (copy of bank statement attached), and the remaining Rs. 837,000 was provided for the preliminary expenses of the Company.*
>
> *Of the Account Money, Rs.11,500,000 was transferred by the Company to Reliance Commodities (Pvt.) Limited (RCL) (copy of board resolution*

authorizing payment attached), an associated company, on 06 October 2003, on the express instructions of the Sponsors (through letter dated 2 October 2003-copy enclosed).

Rs.10,604,400 in aggregate was then provided by RCL to the following associated companies on 30 June 2004 on behalf of and as instructed by the Sponsors:

	Rs.
Reliance Cottons (Pvt.) Ltd .	*1,837,428*
Gadoon Packing (Pvt.) Ltd.	*1,129,080*
Fatima Fibers Ltd.	*800,870*
Fatima Trading Company (Pvt.) Ltd.	*2,421,661*
Mukhtar Trading Company (Pvt.) Ltd.	*2,207,680*
Farrukh Trading Company (Pvt.) Ltd.	*2,207,681*

In the light of the above, it is submitted that 208 resolutions were not required as the Advance was paid out to the aforesaid companies in accordance with the instructions of and at the risk of the Sponsors."

3. Show cause notice dated 12/10/10 ("SCN") under section 208 of Ordinance was issued to the Appellants. The Appellants filed reply to the SCN and hearing in the matter was held. The Respondent, keeping in view the fact that the authorized representative has admitted the default, passed the Impugned Order and taking a lenient view imposed penalty of Rs. 10,000 each on the Appellants and gave directions under section 473 of the Ordinance to regularize the transactions by presenting the matter before the shareholders of the Company and accordingly get the approval by way of special resolution containing the nature, terms and condition for making loans and advances to associated companies. Further to submit to the Commission the acknowledged copy of special resolution. (Form 26/30) from the concerned Company Registration Office.

4. The Appellants have preferred the instant appeal against the Impugned Order. The Appellants' representative argued that:

a) the Company started the business in adverse circumstances faced by the domestic textile industry with surging competition from countries with low cost production. The sponsors of the Company put faith in the Company and invested a sum of Rs 12,837,000 only for promotion and setting up of the Company and its business. The sponsors of the Company also informed that in case the business of the Company does not commence, the advance was to be utilized in accordance with the directions of the sponsors. The sponsors vide letter dated 02/10/03 advised the Company to transfer a sum of Rs. 11,500,000 to RCL which was later transferred from RCL to six associated companies on the instruction of the sponsors. The requirement of section 208 of the Ordinance was not applicable as the advance was paid out in accordance with the instructions and at the risk of the sponsors;

b) attention was drawn to section 208(3) of the Ordinance, which provides that if default is made in complying with the requirements of this section, or the regulations, every director of the Company who is knowingly and willfully in default shall be liable to fine which may extent to ten million rupees. The Respondent, failed to establish that the acts of the Appellants were done 'knowingly and willfully'. The failure to comply with section 208 of the Ordinance by the Appellants was not done knowingly and willfully as the money was transferred on the instructions of the sponsors.

5. The department representative argued that the Respondent stance that no advance was given to associated companies is not supported by the evidence in the Accounts. The instructions of sponsors to withdraw the sponsors money should have reduced the liability of sponsor's advance, which was not reduced. The Appellants provided interest free loans to associated companies in contravention of section 208 of the Ordinance, which requires that the Company should provide loan/advances to its associated undertaking at the rate not less than the borrowing cost of the Company. The accounting treatment of the sponsor money by the Appellants in the accounts shows that the Appellants acted willful, as such, the penalty was rightly imposed on the Appellants.

6. We have heard the parties and have gone through the record. Our para-wise findings on the issue are as under:

a) the contention of the Appellant that the amount was extended by the Company to the associated companies on the instructions of sponsors. The contention that sponsors had put the money in the Company, with a conditions that in case Company is unable to start its operations, the sponsor money shall be paid as per the instructions of sponsors is not acceptable. Had it been the case the Company would have refunded the money back to the sponsors, who could then pass on the money to associated companies. As a matter of fact the Company was established on the amount of advance extended by the sponsors, which is evident by the accounting entries made, whereby, advance from sponsors had been accounted for as the Company's liability and onwards advances to its associated companies as receivables. The advances made by the Company to the associated companies cannot be

deemed to have been advanced by the sponsors. The Appellant cannot be allowed to argue that section 208 of the Ordinance is not applicable, since the money was advanced by the Company without charging any interest to the associated companies and also without passing a special resolution as required by the said section;

b) the act of the Appellants was willful, as they despite been cognizant of section 208(1) of the Ordinance failed to comply with its requirements. We place our reliance *on Jalaluddin F.C.A vs. Commissioner SEC, 2005 CLD 333*, where the meaning of willful has been discussed and it was held that:

> *"whereas intent is a necessary ingredient of willfulness, impropriety is not (1960) 30 Com cases 523. It is therefore not necessary to prove that the default committed by the Appellant was mala fide."*

From the above case law it is clear that the Respondent need not show that failure to comply with the requirements of section 208 of the Ordinance was *mala fide*, it was sufficient to show that the act of the Appellant was done stubbornly and in an unseemliness manner despite the express provision in the law. We would also rely on case titled City Equitable Fire Insurance Co Ltd Re, 1925 Ch 407, referred to in 2005 CLD 333:

> *"that a default, in case of breach of duty, will be considered 'wilful' even if it arises out of being recklessly careless, even though there may not be knowledge or intent."*

The Appellants were recklessly careless as they made investment in associated companies without complying with the requirements of section 208 of the Ordinance. 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
(OED and TMF& CD)

(**Imtiaz Haider**)
Commissioner (SMD)

Announced on: 14/03/13