



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO. III

In the matter of

Appeal No. 05 of 2011

1. Mr. Javed A. Bhatti, Director
2. Mr. Javed I. Bhatti, Director
3. Mr. Mian Muhammad Ahsan, Director
4. Mr. Muhammad Imran Bhatti, Director
(M/s Stylers International (Pvt.) Limited)

.....

Appellants

Versus

Director (Enforcement)

Securities and Exchange Commission of Pakistan

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Respondent

ORDER

Date of hearing

14/03/12, 5/09/13 and 11/12/13

Present:

For the Appellant:

Mr. Imran Alvi, Advocate

Department representatives:

Ms. Maheen Fatima, Director (Enforcement)

Mr. Shahid Javed, Deputy Director (Enforcement)



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1. This order shall dispose of appeal No. 05 of 2011 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 (the "SECP Act") against the order dated 15/12/10 (the "Impugned Order") passed by the Respondent.
2. Brief facts of the case are that examination of the annual audited accounts of Stylers International (Pvt.) Limited (the "Company") for the year ended 30/06/08 (the "Accounts") revealed that the Company had issued an interest-free loan amounting to Rs. 19.113 million to its associated concern namely; Nexus Fashion (Pvt.) Limited ("NFL"). In response to the query raised by the Commission, the Company vide its reply dated 15/12/09 submitted that the loan was provided to NFL to meet its working capital requirements. The Company further provided copy of the resolution dated 13/07/08 passed by the Board of Directors ("BOD"), wherein, it was resolved that the loan given to associated companies would be interest-free and without consideration of time limit and volume. The Company also furnished copy of the notice dated 12/12/09 for Extra Ordinary General Meeting ("EOGM") held on 12/01/10 in order to regularize the loan issued to the associated undertakings.
3. Show cause notice dated 25/06/10 ("SCN") was issued to the Chief Executive and the directors of the Company under section 208 read with section 476 of the Companies Ordinance, 1984 (the "Ordinance"). The Appellants submitted written reply 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. 50,000 (Rupees Fifty Thousand Only) each on Chief Executive Officer and directors of the Company.



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4. The Appellants preferred to file the instant appeal against the Impugned Order. The Appellants' counsel was partially heard on 14/03/12. Later the case was fixed for hearing on 05/09/13 and 11/12/13, however no one appeared on behalf of the Appellants. The arguments of the Appellant's counsel on 14/03/12 included:

- (a) the Company is a private limited company and its shareholding has always been held by members of the same family. The directors are the only shareholders of the Company; therefore, their approval to provide an interest-free loan to NFL by passing BOD's resolution can be equated with the approval of the shareholders in a general meeting. Reliance was placed on case law cited at 2008 SCMR 615, 2007 SCMR 383, PLD 1989 SC 222, 2008 PLD 243 (L), PLD 1964 SC 536 where the 'doctrine of substantial compliance' has been discussed at length;
- (b) proviso to section 208(1) of the Ordinance requires that the return on investment in the form of loan must not be less than the borrowing cost of the investing company. The Company has no borrowing cost and as a matter of policy, the Company does not procure or provide loan on mark-up basis. No benefit has been given by the Company to NFL by way of providing an interest-free loan at the expense of the shareholders of the Company;
- (c) the inadvertent failure of Appellants in complying with the requirements of section 208(1) of the Ordinance is regretted. The failure of Appellants to obtain prior approval with respect to investment made by the Company in NFL was not willful. The Appellants are only held liable if



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they had failed to comply with the requirements of section 208 of the Ordinance willfully or knowingly; and

(d) in terms of section 208(3) of the Ordinance, the provisions of section 208 can only be invoked if there is a loss to the Company. The Company neither suffered any loss nor any director of the Company enriched himself at the expense of the shareholders, hence, section 208 of the Ordinance cannot be invoked.

5. The Respondent argued that:

- (a) section 208 of the Ordinance requires that the Company shall obtain prior approval of the shareholders through a special resolution before making any such investment in its associated concern. The Company failed to obtain statutory approval in compliance with the provisions of section 208 of the Ordinance;
- (b) the Company has provided an interest-free loan to NFL which is in contravention to section 208 of the Ordinance. Proviso to section 208 of the Ordinance specifically requires that the Company shall provide loan/advance to its associated undertaking at the rate not less than the borrowing cost of the Company;
- (c) the authorized representative of the Company has accepted the default committed by the directors in complying with the requirements of section 208(1) of the Ordinance. The subsequent approval of the loan by BOD in the year 2008 and the regularization of the loan through EOGM shows that the loan was provided/transactions were entered into



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deliberately and intentionally and the Appellants were well aware of the eventual results of their actions; and

(d) section 208(3) of the Ordinance provides penalty for contravention of section 208 of the Ordinance and its enforcement is not dependant on whether or not any loss has been caused to the shareholders.

6. We have heard the parties. Section 208 of the Ordinance has been reproduced for ease of reference:

208. Investment in associated companies and undertakings.-

(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:

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 named called, or any amount which is not in nature of normal trade credit.

Emphasis added

- a) there are two requirements of section 208 (1) of the Ordinance. *Firstly*, the companies are prohibited from making investment in any of its associated companies or undertakings without passing a special



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resolution indicating the nature, period, amount of investment and the terms and conditions attached thereto and; *secondly* the return on any such investment made by the companies in an associated company should not be less than borrowing cost of the investing company. In the instant case, the Company has made an investment by providing interest-free loan to its associated concern without obtaining *prior approval* from the shareholders as required under section 208 of the Ordinance. The contention of the Appellants' counsel regarding the '*doctrine of substantial compliance*' and the cases relied upon by the Appellants are not attracted in the instant case as the Appellants only passed a BoD resolution and did not substantially comply by failing to pass a special resolution and failed to ensure return on investment;

- b) the loan provided by the Company to NFL was without charging any return which is violation of the requirements of section 208(1) of the Ordinance. The intent of legislature is to prohibit the provision of mark-up free loans to associated companies so that shareholders may not suffer and companies receive return on their investments in associated companies. To attain this objective, the bench mark set for charging cost to the associated company is '*borrowing cost*' as providing loans or making investments without any return results in passing of undue benefit to the associated company which is a loss to the lending company and its shareholders;
- c) the BoD of the Company passed resolution dated 13/07/08 stating that the loan given to associated companies would be interest-free and without consideration of time limit and volume, which was clear violation and disregard of the requirement of section 208(1) of the Ordinance. The Company later regularized the loan issued to NFL through the EOGM.



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held on 2/01/10. The act of the Appellants were willful, as they despite been cognizance of the requirement of section 208(1) of the Ordinance failed to substantially comply with the requirements and only ratified their actions after issuance of SCN by the Respondent. 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.”

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.”

- d) the Appellants were penalized for violation of section 208(1) of the Ordinance and incurring of loss is not an ingredient of the aforementioned section. Section 208(3) of the Ordinance is reproduced for ease of reference:

(3) If default is made in complying with the requirements of this section, or the regulations, every director of a company who is knowingly and wilfully in default shall be liable to fine which may extend to ten million rupees and in addition, the directors 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.



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Section 208(3) of the Ordinance provides a penalty up to Rs 10 million for violation of section 208(1) of the Ordinance and does not set any pre-condition as to loss incurred by the investing company.

Be that as it may, we would like to observe that the Commission vide its notification SRO No 704(I)/11 dated 13-07-11 has exempted a private limited company, which is not subsidiary of a public limited company from the application of section 208 of the Ordinance. It is a trait law that the effect of beneficial enactment is also available in the pending cases. Reliance is placed on the case titled *Commissioner of Income Tax vs. Shahnawaz Ltd and Others* cited at 1992 SC 920 reported in *Complete Supreme Court cases on Income Tax (1947-1997), Volume II, published by S.A. Salam Publications, 1997/ [(1992) 66 Tax 126 (S.C. Pak)]*, wherein, Crawford's *statutory construction* has been cited and it is stated that a statute relating to remedial law may properly, in several instances, be given retrospective operation. In the aforementioned judgment, the honorable judge of the Supreme Court also quoted the judgment of the High Court in the same matter, wherein, it was observed that the retrospective operation could extend only to such:

"cases which were pending at the time of amending law was enacted i.e. cases which had not been finally determined or processing(')s which had not attained finality. The retrospective effect of the amending law would therefore, apply only to those cases where assessment had not been made by the I.T.Os or where an appeal was pending before the Tribunal or reference was sub-judice before the High Court, at the time the amending law was enacted. The cases which had finally been determined or had attained finality i.e. which were past and closed transactions, could not be reopened under amending legislation as there are no express words to that effect employed in the amending law."



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In light of the above cited judgment, the benefit of the notification SRO No 704(I)/11 dated 13-07-11 should also to be given to the Appellant. In view of the above, we taking a lenient view set aside the order to the extent of the penalty under section 208(3) of the Ordinance and the direction under section 473 of the Ordinance.

(Mohammed Asif Arif)
Commissioner (Insurance)

(Imtiaz Haider)
Commissioner (SCD)

Announced on: 30/1/14