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BEFORE APPELLATE BENCH NO. III

In the matter of

Appeal No. 01 of 2011

1. Naseem Saigol , Chief Executive
2. Saeed Ansari
3. Athar Rafiq
4. Shahid Sethi
5. Muhammad Asif Bajwa
6. Azam Saigol
7. Jamal Naseem

(Appellant No. 2 to 7 all directors of the then Azam Textile Mills Limited- Merged and renamed as Ms. Saritow Spinning Mills Limited)

.... Appellants

Versus

Executive Director (Enforcement)

Securities and Exchange Commission of Pakistan .... Respondent

ORDER

Date of hearing 27/06/12

Present:

For the Appellant:
Syed Pervaiz Amjad, S.P. Amjad & Co. Chartered Accountants

Mohammad Shamil, General Manager

Department representative:
Tariq Ahmad, Deputy Director

1. This order shall dispose of appeal No. 01 of 2011 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 21/05/10 (the "Impugned Order") passed by the Respondent.

2. On examination of the annual audited accounts of Azam Textile Mills Limited (the "Company") for the year ended 30/06/08, it was observed that the Company has advanced an amount of Rs.16.735 million (Rs. Nil: 2007) to its associated company namely Kohinoor Industries Limited (the "KIL"), for purchase of textile machinery (Note # 16.6 to the accounts). The Company had advanced an amount of Rs.21.910 million to KIL during the year ended 30/06/07 for purchase of cotton [Note # 20.4 to the accounts]. Further, analysis of subject accounts also revealed that an amount of Rs.5.031 million (Rs.0.120 million: 2007) was due from its associated company namely Kohinoor Power Company Limited (the "KPCL"), on account of advance and its subsequent adjustment against electric bills (Note # 20.4(b) to the accounts). Moreover, it was observed from the accounts of the Company that the maximum amount due from associated undertakings at the end of any month during the year stood at Rs.19.407 million (Rs.23.473 million: 2007) [Note # 36.3 to the accounts]. The examination of quarterly accounts of the Company for the quarter ended on 31/12/08 further revealed that an amount of Rs.28.635 million was due from associated undertakings KPCL and Saritow Spinning Mills Limited [Note # 11.1 to the quarterly accounts]. The aforementioned advances prima facie were not in the nature of normal trade credit and appeared to be in violation of section 208 of the Companies Ordinance, 1984 (the "Ordinance").

3. Show cause notice dated 27/05/09 (the "SCN") was issued to the Appellants under section 208 read with section 476 of the Ordinance. The Appellants filed reply to the SCN and hearing in the matter was held. The Respondent, dissatisfied with the response of the Appellants, passed the Impugned Order and imposed a penalty of Rs. 500,000 on the Chief Executive Officer and Rs. 50,000 on each director. The Appellants were imposed further fine, equivalent to the interest amount calculated by the auditor of the Company, to be reimbursed to the Company in an equal proportionate manner. The Respondent further directed the Company, under section 473 of the Ordinance, to recover and deposit the amount of outstanding receivable from its associated companies within thirty days of the date of the Impugned Order.

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

   a) regarding the transactions with KIL, the amount of Rs. 16.736 million was paid for purchase of textile machinery from KIL. However, due to technical reasons the project was cancelled and the textile machinery was returned to KIL. The amount did not, in any case, represent investment made by the Company in KIL. The amount was advanced clearly to execute a business transaction. Further, the amount was shown as recovered in accounts of the Company for year ended 30/06/09; and

   b) regarding the transactions with KPCL, the Company has been buying electricity from KPCL since the year 2001. In the normal course of business and in compliance with terms of agreement, bills are normally paid in advance and are adjusted against monthly bills. However, due to increase in furnace oil prices it was impossible for

KPCL to supply electricity, hence; the load was shifted to WAPDA. During the course of hearing before the Appellate Bench, the Appellants' counsel admitted that the advance paid to KPCL had remained unsettled and was used to meet day to day expense and make payments for purchase of raw material of KPCL. At present, the outstanding advances and mark-up are settled.

5. The department representative argued that:

a) the annual accounts of the Company for year ended 30/06/08 showed an amount of Rs.16.735 million advanced to KIL for purchase of machinery. The above stated amount was recovered in accounts for the year ended 30/06/09 after a lapse of one year. The Company was required to provide evidence and approval of the aforesaid recovery and it was evident from the documents provided by the Company that the project was abandoned in July 2008. The Company instead of recovering the advance, which was not in the nature of normal trade credit, extended credit during year ended 30/06/09 and the credit was utilized by KIL without requisite approval under section 208 of the Ordinance; and

b) the terms and conditions of the agreement for purchase of electricity dated 04/09/2000 between the Company and KPCL did not allow that in case of non-performance, the funds advanced to KPCL shall be left at its disposal and any interest/mark-up at pre-decided rate shall be charged on the amount. Such open-ended credits without specific purpose cannot be termed as normal trade credit. It was further argued that copies of current accounts of KPCL provided by the Company reveal continuous disbursement of cash from the Company to KPCL to meet day to day expenses and for payments of purchase of raw material. It was, therefore, apparent that the Company has been in the practice of making payments on behalf of KPCL.

a) 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) 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 name called, or any amount, which is not in the nature of normal trade credit.*

Emphasis added

a) regarding the amount of Rs.16.735 million advanced to KIL for purchase of machinery, the project was abandoned in July 2008 due to defective machinery. Instead of recovering the advance from KIL, the Company extended credit during year ended 30/06/09 which was not in the nature of normal trade credit. The explanation provided in section 208 of the Ordinance clearly states that 'investment' includes 'advances' and requires authority of a special resolution. The

Appellants made advance payment and converted the same advance into open ended credit to KIL and failed to recover outstanding receivables. The credit was utilized by KIL without requisite approval under section 208 of the Ordinance; and

b) the explanation to section 208(1) of the Ordinance clearly states that investment includes *loans and advances.* The Company advanced amount to KPCL for purchase of electricity, which became overdue for a long period and also met certain expenses without authorization of the shareholders under section 208 of the Ordinance. Such open-ended credit without specific purpose cannot be termed as normal trade credit. The fact that the parties had an agreement would not make such financial facilities a normal trade credit. The directors utilized funds of the Company (a listed company), to support the operation of their own undertaking i.e. KPCL, without the approval of shareholders. The amount advanced by the Company was adjusted after a considerable time of One (1) year. The Company was, thus, in contravention of section 208 of the Ordinance, as it failed to pass a special resolution authorizing the abnormal credit period.

In view of the above, we do not find any reason to interfere with the Impugned Order. The appeal is dismissed with no order as to costs.

(Mohammed Asif Arif)
Commissioner (Insurance)

(Imtiaz Haider)
Commissioner (SMD)

Announced on: 17th October 2012