



Securities and Exchange Commission of Pakistan

BEFORE APPELLATE BENCH NO. I

In the matter of

Appeal No. 41 of 2009

1. Gohar Ullah, Chairman
2. Asad Ullah Barkat, Chief Executive
3. Humayun Barkat, Director
4. Maqsood Ahmed Khan, Director
5. Muhammad Saleem, Director

of Fateh Textile Mills Limited

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Appellants

Versus

Executive Director (Enforcement)

Securities and Exchange Commission of Pakistan

Respondent

Date of hearing

18/09/12

ORDER

Present:

For the Appellant:

Mr. Masood Khan, Advocate

Department representatives:

Mr. Aamir Saleem, Deputy Director

Mr. Rohail Ahmed Abbasi, Assistant Director



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SECP

1. This order shall dispose of appeal No. 41 of 2009 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 02/07/09 (the "Impugned Order") passed by the Respondent.
2. On examination of the annual audited accounts of Fateh Textile Mills Limited (the "Company") for the year ended 30/06/07 (the "Accounts"), it transpired that trade debts amounting to Rs. 81,995,624 were due from the Company's associated companies. The breakup of the trade debts were as under:

	<i>Rupees</i>	<i>Rupees</i>
	2007	2006
<i>Barkat Cotton Mills Limited</i>	29,996,182	32,343,232
<i>Fateh Limited</i>	3,494,801	6,505,801
<i>Fateh Outerwear Limited</i>	11,437,655	11,832,886
<i>Hero Motors Limited</i>	37,066,986	44,986,654
	81,995,624	95,668,573

The ledger accounts of the above mentioned associated companies were reviewed and it transpired that there had been no sale / purchase from the first three associated companies as stated by the Company in Note 19 to the Accounts. It was further revealed that the Company supplied engineering goods to the fourth associated company and the trade credit period allowed to this associated company appeared to be higher than the trade credit period allowed to other trade debtors. Further, the Company financed these associated companies through various payments made to them and had borne expenses on behalf of the associated companies.

3. Show cause notice dated 09/07/08 ("SCN") under section 208(3) read with 476 of the Companies Ordinance, 1984 (the "Ordinance") was issued to



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the Appellants and hearing in the matter was held. The Respondent, dissatisfied with the response of the Appellants, reached the conclusion that the trade debts were open ended credit with no interest charged and were not in the nature of normal trade credit. The Respondent passed the Impugned Order and imposed a penalty of Rs. 500,000 each on the Appellants and Mr. Abdul Razzak Memon (Director). The Respondent further directed the Appellants under section 473 of the Ordinance to recover the abnormal trade debts and unapproved loans advanced to the associated companies. The Appellants were also directed to enter into written agreements with the associated companies specifying the collection period of the trade debts and to recover the interest on previous years' credits which were not in the nature of normal trade credit.

4. The Appellants preferred the instant appeal against the Impugned Order. The Appellants' counsel argued that:
 - a) the trade debts are accumulated from the ordinary sale and purchase transaction between the Company and its associated undertakings. The requirement of export quota (prior to December 2004) for the shipment of export orders necessitated the sale and purchase transaction between the Company and its associated undertakings and the Company having the export quota placed the orders for purchase of merchandise. The sale and purchase transactions were undertaken in this backdrop. The settlement of purchase transaction were effected through realization of export proceeds;
 - b) the maintenance division of the Company having sufficient production facilities to produce sheet metal items, such as small housing, covers for housing, shafts and brackets, were also required by the associated company namely Hero Motors Limited. In order to obtain the optimum

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utilization of the production facilities of the Company, the sale of engineering goods was made at market price to Hero Motors Limited which was more or less within the normal trade credit; and

- c) the advances have been paid back to the Company and no loss has been caused to the shareholders. Reliance was placed on *Executive Director (Enforcement), Securities and Exchange Commission of Pakistan vs Atlas Bakery Limited [2007 CLD 1674]*, where the appellants were let off with warning on the ground that no financial loss was caused to the company. It was further argued that the Appellants availed no personal benefit or material advantage on account of default of section 208 of the Ordinance, hence, the penalty imposed in the Impugned Order may be set aside.

5. The department representatives argued that:

- a) there had been no sale / purchase from the first three associated companies as stated by the Company in Note 19 to the Accounts. The sale/purchase transactions were, in fact, abnormal trade credit. In addition to this, the Company was financing these three associated companies through various payments made to it and bearing expenses on behalf of the associated companies as can be seen from their respective ledger accounts;
- b) the Company was supplying engineering goods to Hero Motors Limited and the trade credit period allowed to this associated company was higher than the trade credit period allowed to other trade debtors. At the same time, the Company was also financing Hero Motors Limited through various payments made to it and bearing expenses on


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behalf of it as can be seen in the ledger account of Hero Motors Limited and details provided by the Company; and

- c) the credit facilities extended to the associated companies by the Company were provided without seeking prior approval of the shareholders through a special resolution. The credit facilities were extended for a long period of time without charging any mark-up, therefore, the argument of the Appellants' counsel that no loss had been caused to the Company is baseless. It is pertinent to mention that the Company's paid up capital was just Rs. 12.5 million as at 30/06/07 and 30/06/08 whereas the closing balance of trade debts due from associated companies as at 30/06/07 was Rs. 81.995 million. The said trade debts were far exceeding the paid up capital of the Company. Further, the Respondent, at the time of imposition of penalty, had taken a lenient view as the Appellants were in the process of rectifying the default by recovering the balance of trade debts due from its associated companies along with interest and obtaining the shareholders approval.

6. We have heard the parties. Our para-wise findings on the issues are as under:

- a) the accounts of the Company for the year ended 30/06/07 and 30/06/08 revealed the following balances due from the associated companies

Name of Company	Rupees 2007	Rupees 2006	Rupees 2005	Rupees 2004	Rupees 2003
Barkat Cotton Mills Limited	29,996,182	32,343,232	34,591,581	52,153,850	52,753,850
Fateh Limited	3,494,801	6,505,801	8,651,591	133,340,785	160,204,565
Fateh Sports Wear Limited	11,437,655	11,832,886	16,779,537	77,505,960	80,877,690
Hero Motors Limited	37,066,986	44,986,654	-	-	-
Total	81,995,624	95,668,573	60,022,709	263,000,595	293,836,105



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The balances due to the Company in the form of trade debts from the four associated companies were outstanding since long period of time and fell outside the scope of normal trade credit. The Appellants should have extended the trade debts under the authority of a special resolution under section 208 of the Ordinance. The contention of the Appellants' counsel that export quota for the shipment of export orders necessitated the sale and purchase transaction between the Company and its associated undertakings is no justification for violation of section 208 of the Ordinance;

- b) the maintenance division of the Company produced metal items for Hero Motors Limited and sold it at market rates to Hero Motors Limited. The trade credit period allowed to this associated company was higher than the trade credit period allowed to other trade debtors. The Company provided financial benefit to Hero Motors Limited and such trade credit facilities provided to associated companies with intention to give financial benefit are not in the nature of normal trade credit. Further, the Company's representative submitted additional written submissions, dated 28/03/09, after the SCN hearing before the Respondent, wherein they admitted default of section 208 of the Ordinance. The relevant para has been reproduced for ease of reference:

"As regards the payments (for detail kindly refer Annexure A) released by the Fateh Textile Mills Limited to Hero Motors Limited, it is submitted that we do accept that the transaction has attracted the violation of Section 208 of the Companies Ordinance, 1984. However, the company is in the process to get the transaction approved by the shareholders of the companies as required by the Ordinance. Additionally, the company will



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charge markup at the rate also prescribed by the Ordinance 1984 and will claim from its associated concern."

- c) the Company provided credit facilities to the associated companies without seeking prior approval of the shareholders through a special resolution under section 208 of the Ordinance. The credit facilities were extended for a long period of time [*table in para 6(a)*] without charging any mark-up on the credit given, hence, the argument of the Appellants' counsel that no loss had been caused to the Company is unjustifiable. Even so, loss is not an ingredient for application of section 208 of the Ordinance. The penalty provided under section 208(3) of the Ordinance is imposed when an investment in associated company is made without taking approval from the shareholders and is not dependent on whether or not loss is caused to the shareholders. A separate remedy is provided under section 208(3) of the Ordinance where loss has been caused to the shareholders. Section 208(3) of the Ordinance is reproduced for ease of reference:

208 (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.

Emphasis added

Further, the Appellants' counsel has placed reliance on *Executive Director (Enforcement), Securities and Exchange Commission of*



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Pakistan vs Atlas Bakery Limited [2007 CLD 1674]; the case law pertains to a very nominal amount invested in associated company (Rs. 0.254 million), hence, no penalty was imposed and the directors were let off with a warning and directions to make good the default.

Further, the Respondent had taken a lenient view in the Impugned Order after the Appellants admitted default and undertook to rectify the default by recovering the balance of trade debts due from associated companies along with interest and to obtain the shareholders' approval. The penalty imposed on the Appellants is justified keeping in view that the Appellants extended unauthorized trade debts without mark-up to four associated companies and the Company had been extending trade debts since the year 2003 which is a long period of time.

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

(Muhammad Ali)

Chairman

(Mohammed Asif Arif)

Commissioner (Insurance)

Announced on: 27/11/12