

2012 CLD 2019

[Securities and Exchange Commission of Pakistan]

Before Imtiaz Haider, Commissioner (SMD) and

Mohammed Asif Arif, Commissioner (Insurance)

NASEEM A. SATTAR, CHAIRMAN

and 9 others—Appellants

versus

EXECUTIVE DIRECTOR (ENFORCEMENT),

SECURITIES AND EXCHANGE COMMISSION

OF PAKISTAN—Respondent

Appeal No.42 of 2008, decided on 5th June, 2012.

(a) Companies Ordinance (XLVII of 1984) ---

—Ss. 196, 208, 473 &476—Securities and Exchange Commission, of Pakistan (XLII of 1997), S. 33—Investment in associated company—Securities and Exchange Commission called for the minutes of meeting of the Board of Directors to ascertain, whether or not a resolution was passed to enter into the agreement with the associated company—Company submitted that the transfer of stitching machines from the premises of the company to the premises of associated company being neither an acquisition nor sale of machines in any manner, the approval of the Board was not necessary— Show-cause notice was issued to all the Directors of the company including the Chief Executive Officer of the company— Executive Director (Enforcement) of the Commission, being dissatisfied with, the response of the appellant /company, imposed fine for violation

of ss. 196 and 208 of the Companies Ordinance, 1984—Under provisions of 8.198(2) of the Companies Ordinance, 1984, powers of the company could only be exercised by the Board of Directors through a resolution—In the present case, company and associated company, had common Directors; and in case of 8.196(2) of the Companies Ordinance, 1984, in case of common directorship, the Board, of Directors of the company ought to have passed a resolution allowing the Directors to enter into .the agreement with, the associated company Failure to- pass a resolution of Board of Directors before entering into the agreement with the associated company, was violation of 8.198(2) of Companies Ordinance 1984—Penalty was rightly imposed on the Directors of the company—Argument of the counsel for the company that authority to enter into an agreement was exercised by virtue of powers conferred by the Articles of Association of the company, was not tenable as provisions of S. 196 (2)(g) of Companies Ordinance, 1984, would override the Articles of the Articles of Association- in terms of Ss.6 & 31 of the Companies Ordinance, 1984—Company entered into an agreement, whereby no rental was payable by the associated company to appellant company-- - Agreement, however, was silent with regard to the rental payable to the company—Order to the extent of violation of S. 196 of the Companies Ordinance, 1984 on part of the Directors including the nominee Directors, was upheld—Penalty imposed on Directors including nominee Directors under S.208 of the Companies Ordinance, 1984 and the Direction under S.473 of the Companies Ordinance, 1984, was set aside.

[pp.2022, 2025, 2027] A, B, C &E

(b) Words and phrases—

—'Investment', defined and explained, [p. 2026]D

The Black's Laws Dictionary **rel.**

Mansoor-ul-Arafin for Appellants.

Shahzad Afzal, Joint Director (Enforcement) and Haris Bin Tippo, Deputy Director (Enforcement) Departmental Representatives.

Date of hearing: 20th April, 2012.

ORDER

This order shall dispose of Appeal No.42 of 2008 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the order dated 7-10-2008 (the "Impugned Order") passed by the Respondent.

2. On examining the annual audited accounts of Al-Abid Silk Mills Limited (the "Company") for the year ended 30-6-2007 (the "Accounts"), the Commission sought explanation of note 34 of the Accounts:

Transactions with related parties:		
Associated Company (A1-Abld Exports Private Limited)		
	2007 (Rupees)	2006(Rupees)
Sales	Nil	134,869,770
Confection and packaging availed	83,772,497	63,993.558

3. The Company was required to provide the details of contract made with its associated company, namely Al-Abid Exports (Private) Limited ("AAEPT"). The Company provided the profile of AAEPT and the copy of the agreement dated 8-12-2003 (the "Agreement") made with AAEPT. The Company further informed that machinery having following value was transferred to AAEPT:--

(Amount in Rupees)

Particulars	BOOK VALUE AS ON JUNE 30,2006	Transferred during the year	Total	Depreciation for the Year	Book value as on June 30, 2007
Total 456 machine of various type	9,380.552	2,492.000	11,872,552	1,040.722	10,831.830

The company provided the details of quarter wise expenses incurred by AAEP on behalf of, the Company, which were reimbursed by the Company to AAEP:—

Particulars	Amount in Rupees
July - Sept, 2005	Nil
Oct. - Dec 2005	Nil
Jan. - Mar. 2006	Nil
Apr. - Jun. 2006	1,558,286
Jul - Sep. 2006	Nil
Oct. - Dec. 2006	3,225,787
Jan. - Mar. 2007	792. 840
Apr. Jun. 2007	1,688.173
Total	7,265,086

The Commission called for the minutes of meeting of the Board of Directors ("BoD") to ascertain, whether or not, a resolution was passed to enter into the agreement with AAEP. The Company submitted that the transfer of stitching machines from the premises of the Company to the premises of AAEP was neither an acquisition nor sale of machines in any manner; therefore, the approval of the BoD was not necessary.

4. Show cause notice dated 15-5-2008 ("SCN") under sections 196, 208 read with section 473 and section 476 of the Companies Ordinance 1984-(the "Ordinance") was issued to all the directors including, the Chief Executive Officer ("CEO") of the Company. The Appellants' counsel submitted reply to the SCN on behalf of the directors of the Company and hearing in the matter was held. The Respondent dissatisfied with the response of the Appellant passed the B Impugned Order and imposed fine of Rs. 100,000 on each director Including CEO for violation of section 106 of the Ordinance; W 500,000 on the CEO and Appellant No. 2 and Rs 300.000 on Appellant No.3 to Appellant. No. 7 for violation of section 208.and further fine of Rs.400,000 each On both nominee directors. The Respondent further directed the CEO to evaluate the rental value of machinery through the statutory auditors and recover the rent for the years in which the machinery was used by AAEP and to ratify the transaction by passing a special resolution under the provisions of section 208 of the Ordinance.

5. The Appellants preferred to file instant appeal against the Impugned Order. The Appellants' counsel argued that:—

- (a) the Respondent failed to appreciate that the machinery was transferred by the Company to AAEP In order to use the machinery exclusively for the work of the Company through an Agreement. The Company entrusted the work to AAEP in order to get the work done in time. Moreover, the Company by shifting the machinery to 'the premises of AAEP relieved itself from employing labour and other personnel for carrying the work which would have been a burden on the Company The Company also saved on account of day to day maintenance of the machinery, which was the responsibility of AAEP. The authority to transfer the machinery was derived from the Articles of Association of the Company as

such; no action was required from the BoD of the Company in terms of section 196(2) of the Ordinance;

- (b) the machinery is owned by the Company and the machinery was transferred by the Company to AAEP under an Agreement. The transfer of machinery to AAEP does not fall under the ambit of Investment, as such; section 208 of the Ordinance is not applicable in this case. The Appellants' counsel relied on the definition of investment given in Chambers' Twentieth Century Dictionary and Black's Law Dictionary, where the word 'investment' is defined as *any placing of money to secure income or profit' and 'an expenditure to acquire property or assets to produce revenue; a capital outlay'* respectively. Reliance was also placed on *PID 1988 Lahore 1* hi case titled *Shahbazud Din Chaudhry and. 27 others v. Messrs Services Industries Textiles Limited*, where it has been held that *'the term invest and investment used in the Ordinance are to be taken in business sense of laying out of money for earning; income or profit';* and
- (c) the direction of the Respondent to recover the rent of , the machinery is not justified as the Company has gained much more on account of saving storage area, shipment cost of the goods and interest/markup on the outstanding amount payable by the Company to AAEP for rendering services in terms of the Agreement.

6. The department representatives argued that:—

- (a) the Appellant could only have transferred the machinery after complying with the mandatory requirements of section 196(2) of the Ordinance. The machinery was transferred to AAEP in contravention of section 196(2) of the Ordinance as no resolution was passed by the BoD allowing the Company to enter into the Agreement of such nature. The payment of expenses by AAEP on behalf Of the Company for day to day maintenance of the machinery were agreed by the parties

through the Agreement, however, it did not preclude the Appellants from, acting, in accordance with the requirement of section 196(2) of the Ordinance;

- (b) the machinery was owned by the Company" and depreciation on the machinery was also charged to the accounts of the Company; The Company had transferred the machinery to AAEP. The transfer of asset from the Company to its associate concern was in the form of an investment. The term investment, as has been defined in section 208 of the Ordinance includes loans, advances, equity, by whatever named called or any other amount which is not in nature of normal trade credit. The arrangement between the Company and AAEP cannot be termed as normal trade credit, as such, it falls under the definition of Investment; and
- (c) the direction of the Respondent to evaluate the rental value of the machinery through the statutory auditor and recovery of the rent for the years for which the machinery was used by AAEP was rightly issued. AAEP has wrongfully gained by not paying the rental value of the machinery to the Company. The direction was issued without prejudice to a remedy, available with AAEP to recover expenses incurred by it on behalf of the Company.

7. We have heard the parties. Our finding on the Issues raised are as under:—

- (a) the Respondent did not question the issue arising out of the Agreement between the parties. The Company should, however, at, all¹ times comply, with the requirements of law. Section 196(f), (2)(g) of the Ordinance are reproduced for ease of reference.

196. Powers of directors.—(1) *The business of a company shall be managed by the directors, who may pay all expenses incurred in promoting and registering the company, and may exercise all such powers of the company as are not by this Ordinance, or by the articles, or by a special resolution, required to be exercised by the company in general meeting.*

- (2) *The directors of a company shall exercise the following powers on behalf of the company, and shall do so by means of a resolution passed at their meeting, namely:--*
- (g) *to authorize a director or the firm of which he is a partner or any partner of such firm or a private company of which he is a member or director to enter into any contract with the company for making sale, purchase or supply of goods or rendering services with the company;*

Emphasis Added

Section 196(2) of the Ordinance states the powers of the Company that can only be, exercised by the BoD through a resolution. In the instant case the Company and AAEP are associated concerns and Mr. Naseem A. Sattar and Mr. Azim Ahmad are common directors on the BoD of both companies. In terms of section 196(2)(g) of the Ordinance, in case of common directorship, the BoD of the Company ought to have passed a resolution allowing the director to enter into the Agreement with the AAEP. The failure to pass a resolution of BoD before entering into the Agreement With AAEP is violation of section 196(2)(g) of the Ordinance, therefore, we are of the opinion that penalty was rightly imposed on the Appellants. The argument of the Appellants' counsel that the authority to enter into an Agreement was exercised by virtue of powers conferred by the Articles of Association of the Company is not tenable, as the provision of section 196(2)(g) of the Ordinance would override the articles of the Articles of Association in terms of sections 6 and 31 of the Ordinance;

(b) and (c) section 208 of the Ordinance is reproduced for ease of reference:--

208, investments in Associated companies and undertaking.—(1)
Subject to subsection (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 name called, or any amount, which is not In the nature of normal trade credit*

The term 'investment' as defined in the explanation to section 208 of the Ordinance includes the words loans', 'advances' and 'equity'. The Black's Law Dictionary quoted by the Appellants" counsel defining the term 'investment' is reproduced for ease of reference:--

'an expenditure to acquire property or assets to produce revenue; a capital outlay'

In the instant case, the Company has lent its machinery to AAEP, an associated concern. The machinery was purchased by the Company, which had book value of Rs. 10.832 million as on 30-6-2007. The Company at the time of purchase of machinery in fact made an investment i.e. *expenditure to acquire property or asset, to produce revenue*; however, letting of machinery to AAEP for stitching products of the Company cannot be, termed as an investment. The machinery is owned by the Company despite it being transferred to AAEP. The Company was bearing the depreciation and major maintenance expenses of the machinery, as such, the Company did not make investment in AAEP.

So far as the terms of the Agreement are concerned, the Company entered into an-arrangement, whereby no rental was payable by AAEP to the Company. The Agreement is silent with regard to the rental payable to the Company, however, the Company saved cost In terms of labour, management, administration, utilities, rents, taxes, government levies, duties etc, which offsets loss Incurred on account of rentals receivable from the Company.

In view of the above, we uphold the order to the extent of violation of section 196 of the Ordinance on part of the directors including the nominee directors (Ra. 100,000 each). The penalty Imposed on directors including nominee directors under section 208 of the Ordinance and the direction under section 473 of the Ordinance is hereby set aside.

HBT/39/SEC

Order accordingly.