

Before Tahir Mahmood, Commissioner (CLD)

In the matter of

Zahidjee Textile Mills Limited

(Under Section 496 read with 472 and 476 of the Companies Ordinance, 1984)

Number and date of notice:	No.EMD/233/209/2002/1484-1485 Dated: June 15, 2010
Date of hearing:	September 24, 2010
Present:	Mr. Shahab-ud-din, Company Secretary Mr. Atta Muhammad Khan, Advocate, Legal Counsel
Date of Order:	October 1, 2010

ORDER

This order will dispose of the proceedings initiated against Mr. Muhammad Zahid, the Chief Executive and Mr. Muhammad Asif, Manager Finance (*the "Respondents"*) of Zahidjee Textile Mills Limited (*the "Company"*) under Section 496 read with 472 and 476 of the Companies Ordinance, 1984 (*the "Ordinance"*) which states;

*"If any business or part of business carried on or any transaction made, by a company is ultra vires of the company, every person who acted as a director or officer of the company and is responsible for carrying on such business shall be liable to a fine not exceeding *[five hundred] thousand rupees and shall also be personally liable for the liabilities and obligations arising out of such business or transaction."*

2. The brief facts leading to this case are that the examination of the annual audited accounts of Company for the year ended June 30, 2009 (*the "Accounts"*) revealed that Note 9 (*Other receivable*) to the accounts of the Company disclose receivable against disposal of short term investment in the amount of Rs. 34.264 million (2008: 17.913 million). The Company attributed the aforesaid receivable to the sale proceeds of 467,700 ordinary shares of Askari Commercial Bank Limited (*the "share sale proceeds"*), receivable from the Company's authorized broker M/s Invest Capital and Securities (Pvt) Ltd (*the "Broker"*). The above shares were sold in the open market, from July 24, 2008 to August 20, 2008.



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3. The Company further informed, upon query by the Commission regarding the delay in the repatriation of such share sale proceeds from the broker to the Company, that the share sale proceeds were kept with the broker with the object of reinvestment in more profitable shares to recover the loss as and when the market situation allows. The Company further stated that the aforesaid funds were later on received by the Company from Feb 01, 2010 to March 18, 2010.

4. However, the information called from the broker showed that the share sale proceeds were not remitted/settled by the broker directly to the Company rather they were transferred from the Company trading account No. K 0102 to the trading account maintained in the name of Muhammad Zahid, the Chief Executive of the Company (Account Code No. K 0107). The broker record provided to the Commission divulged that said transfer of share sale proceeds were instructed by Muhammad Zahid, who was the authorized representative/signatory to open and operate the trading account with the broker. It was also noted from the record provided that one of the officers of the Company, Mr. Muhammad Asif, Manager Finance has also advised the broker regarding the transfer of Rs. 17.613 million among the share sale proceeds. The broker further disclosed the following credit ledger balances of the Company's trading account with the Company (i.e. *Amount due from the Company to the broker*);

- a. As on June 30, 2008: Rs. 299,286
- b. As on June 30, 2009: Rs. 399

5. It was noted from the ledger statements received from the broker that Muhammad Zahid, who was paying huge mark up to broker on the debit balances of his personal trading account has benefited himself by transferring and utilizing the Company funds into his personal trading account while unauthorisedly acting on behalf of the Company for doing such business which is prima facie ultra vires of the Company, and that the director and other officer of the Company failed to comply with the mandatory provision of Section 496 of the Ordinance.

6. Consequently, a show cause notice dated June 15, 2010 (SCN) was issued to Mr. Muhammad Zahid, the Chief Executive and Mr. Muhammad Asif, Manager Finance, calling upon them to show cause as to why penal action may not be taken against them under Section 496 read with Section 472 and 476 of the Ordinance for violating the statutory requirements of the Ordinance. The Respondents did not submit their reply in the allowed time of fourteen (14) days and was extended a hearing opportunity vide Commission letter dated July 7, 2010, to be held on July 12, 2010, for submission of representations.



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However, the Respondents requested, vide its letter dated July 7, 2010, for extension in time line for submitting the reply to the SCN owing to the continued absence of the Company Secretary due to recent expiry of his mother as well as the engagement of the management in preparation of annual accounts due to year end. Mr. Muhammad Asif, one of the respondents, has requested for adjournment of hearing for one month on the plea that he has relocated to Karachi and would appear on his visit to Islamabad. Mr. Muhammad Zahid, the Chief Executive also requested for adjournment as he could not travelled due to strong whether conditions. The hearing was deferred until July 15, 2010, however Mr. Muhammad Zahid, the Chief Executive of the Company informed, vide his letter dated July 14, 2010, that since he wanted to be represented by an authorized representative, who has just returned form his foreign tour and will need at least fifteen (15) days for thorough study of the case. He however further requested for another adjournment after July 30, 2010, vide his letter dated July 23, 2010. The Commission fixed the hearing opportunity on August 16, 2010, on which Mr. Atta Muhammad Khan, Advocate, the legal counsel of the Respondents and Mr. Shahab-ud-din, the Company Secretary appeared and submitted their written representations on behalf of the respondents. The hearing was deferred until September 24, 2010, on which the representatives appeared and put forward the same arguments as were submitted in their written representations, earlier on.

7. The submissions made by the Respondents in their replies to the show cause notice are summarized as under:

- i. The Company sold 545,700 shares from February 26, 2008 to June 20, 2008 and 467,700 shares from July 24, 2008 to August 20, 2008 of Askari Bank Limited through authorized broker and the total amount receivable as per accounts for the year ended June 30, 2009 was Rs. 34.264 million.
- ii. Factually there was no delay in repatriation of sale proceeds of shares form broker to the Company. Sale proceeds of 545,700 shares were kept with the broker with the object of reinvestment. Out of which 50,000 shares of Askari Commercial Bank were repurchased through the broker on June 25, 2008. But in view of unfavorable market situation the management decided to adjust the loan account of Mr. Muhammad Zahid. The loan adjusted was recouped by Mr. Muhammad Zahid form February 01, 2010 to March 18, 2010 as per requirement of the Company.
- iii. Mr. Muhammad Zahid, the CEO as per agreement dated July 02, 2007 has provided interest free loan to the Company in his name as well as in the name of his dependents of which year wise detail is as under;



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Year	Loan provided by Muhammad Zahid and his dependants (Amount in Rs)	Loan provided directly by Muhammad Zahid dependants (Amount in Rs)
2007	200,173,359	82,309,758
2008	182,797,171	59,940,280
2009	180,422,107	56,565,116

- iv. As per clause 6 of the loan agreement, the Company is entitled to re-pay the loan by way of adjustment of its receivable from third party subject to written confirmation by the third party. The Company disposed off shares of Askari Commercial Bank Limited and an amount of Rs. 34.264 million was receivable from broker. The Company instructed the broker to pay the receivable to Mr. Muhammad Zahid against his interest free loan to the Company. The adjustments of balances in the books of account of the Company were subject to written confirmations of the adjustment. The written confirmation of adjustment in terms of loan agreement was received by the Company on October 17, 2009. The balance receivable from broker was accordingly adjusted vide our voucher No. 199 dated October 17, 2009 and transferred to the loan account of Mr. Muhammad Zahid. However, keeping in view the requirements of the Company Rs. 33.949 million was recouped by Mr. Muhammad Zahid in loan account during the period from Feb 2010 to March 2010 in terms of loan agreement.
- v. The difference between the ledger accounts of the Company with the books of Invest Cap was due to the following pending adjustment;

Description	2009 (Amount in Rs.)	2008 (Amount in Rs.)
Balance as per books of account of the Company	34,263,886	17,912,775
<u>Less:</u> Pending transfer to the CEO's loan account due to the pending written confirmation	34,263,388	17,613,388
<u>Less:</u> Credit vide JV 4553 dated June 25, 2008	(100)	(100)
Rounding off difference	1	1
Balance as per books of account of broker	399	299286



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- vi. The provisions of section 496 are not attracted in this case as Mr. Muhammad has not benefited himself by transferring and utilizing the Company's funds into his personal trading account but the Company has repaid his loan by issuing instructions of adjustment. Factually the Company is benefited from the huge amount of interest free loan granted by Mr. Muhammad Zahid in his personal name and in the name of his dependents.
 - vii. That the instructions to the broker on behalf of the Company were issued in terms of loan agreement.
 - viii. That the director and other officer of the Company have acted in good faith to comply with the terms of loan agreement and as per scope of the object clauses of the Memorandum of Association. Clause 19 of the Memorandum of Association of the Company authorized the Company to deal in the shares and clause 31 of the Memorandum of Association of the Company authorized the Company to borrow money and use its assets to repay the borrowed money. Since the dealing in shares, borrowing of money and appropriation of Company's assets toward repayment of borrowing are specifically included in the object clauses of the Company, therefore, instructions issued by the director and other officer on behalf of the Company are not ultra vires of the Company.
 - ix. The Company has not provided undue benefits to Mr. Muhammad Zahid as the transactions were carried out in the normal course of business.
 - x. The business conducted by the Company and transactions of sale proceeds of Askari shares is neither ultra vires nor can be termed against the interest of the Company and the shareholders. Therefore there is no violation at all on the part of the Company or its officers for violating the provisions of section 496 of the Ordinance.
8. I have considered the facts and record of the case, relevant provisions of the Ordinance, written submissions made in response to SCN and presented during the hearing, however, I do not find myself convinced with the arguments raised by the Respondents. My observations on the issue are as follows:
- a. The Company, first in its letter dated April 5, 2010, attributed the receivable from the broker in the amount of Rs. 34.264 million, to sale proceeds of ordinary shares of Askari Commercial Bank Limited, sold during July 24, 2008 to August 20, 2008. The Company further explained in its letter dated April 23, 2010, upon enquiry by the Commission regarding the reason and position of this outstanding receivable, that the funds were kept with the broker with the object of reinvestment in more profitable shares to recover the loss. It has also informed that the said funds



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were received by the Company through crossed cheques during Feb 1, 2010 to March 18, 2010, while attaching the copy of bank statements showing the said recovery.

- b. However, when the Company was called upon for the supporting documents to verify their position with regard to the sale of shares and receipt of funds including the bank vouchers and broker ledger statements vide Commission letter dated May 21, 2010, the same were not provided until July 14, 2010, much after the date of aforesaid show cause notice issued dated June 25, 2010, when the Company appeared with a different position than before. The Respondents presented a loan agreement dated July 2, 2006 executed between Mr. Muhammad Zahid, the CEO (*the Lender*) and the Company (*the Borrower*) and stated that the said receivables were utilized for adjusting the loan of Muhammad Zahid towards the Company in accordance with clause 6 of the Loan Agreement, which states that the borrower i.e. the Company is entitled to repay any amount by way of adjustment of its receivables from third parties.. The said loan adjustment was stated to be recouped by Muhammad Zahid during the period from Feb 01, 2010 to March 2010.
- c. However, when the copy of the aforesaid loan agreement was sent for verification of issue of underlying stamp paper (*bearing No. 9456 issued on 20-6-2006*), its particulars could not be verified from the Stamp Issue Register that was submitted to the General Record Room, Faisalabad, proving this agreement to be an invalid/fake document with regard to its execution at the declared date of agreement. The negative verification of loan agreement has disproved the fundamental argument presented by the respondents that the said transfer of funds were in compliance of and hence fully justified by a so called loan agreement, the very un-authorized transfer of such funds belonging to the Company to the personal trading account of the Chief Executive is an ultra vires transaction and business of the Company. The clause 19 and 31 of the Memorandum of Association referred above become irrelevant as a consequence of aforesaid disproof of acclaimed loan agreement, as the matter in question is not that of dealing in shares or borrowing and repaying the money.
- d. More importantly, in the instance case Mr. Muhammad Zahid is the Chief Executive of the Company who has instructed this un-authorized transfer of funds from Company's trading account maintained with the broker to his personal trading account with the same broker, which otherwise has a serious impact due to the involvement of the Chief Executive of the Company.



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9. The respondent's representatives, during the hearing, after witnessing the evidence to the above discussion, also admitted the default and requested for a lenient attitude.

10. From the above discussions, the submissions put forward by the Respondents and the vital information available on record, I am of the considered view that Section 496 of the Ordinance has been violated and the Respondents are liable for the penalties as defined in aforesaid section of the Ordinance. However, since substantial amounts of interest free loan have been provided by the respondent director to the Company and that Muhammad Asif has only been acting as employee and had also left the employment of the Company, I therefore impose a penalty aggregating to Rs. 250,000/- (Rupees Two hundred and fifty thousand only) only on Mr. Muhammad Zahid, the Chief Executive.

11. The Chief Executive of the Company is hereby directed to deposit the aforesaid fine of Rs.250,000/- (Rupees Two hundred and fifty thousand only) in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with MCB Bank Limited within thirty days from the receipt of this Order and furnish receipted vouchers or pay by a DD/pay order issued in the name of Commission for information and record, failing which proceedings under the Land Revenue Act,1967 will be initiated which may result in the attachment and sale of movable and immovable property. It may also be noted that the said penalties are imposed on the Chief Executive in his personal capacity who is required to pay the said amount from his personal resources.

Tahir Mahmood
Commissioner (CLD)

Announced:
October 1, 2010, Islamabad