SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

Before Tahir Mahmood
Executive Director (Enforcement)

In the matter of

M/s. Sitara Energy Limited

Number and date of Show cause notice:	EMD/233/412/2002-1142-48 dated November 7, 2008
Date of hearing	February 23, 2009
Present on behalf of the Company:	Mr. Niaz Muhammad Tahir-Chief Accountant (Authorized Representative)

ORDER

Under Section 208 read with Section 476 of the Companies Ordinance, 1984

This order will dispose of the proceedings initiated against the directors of M/s Sitara Energy Limited (Company) pertaining to contravention of the provisions of Section 208 of the Companies Ordinance, 1984 (Ordinance).

2. The Company is incorporated in Pakistan as public limited company and is listed in all the stock exchanges in Pakistan. Paid up capital of the Company is Rs. 190,920,000 comprising of 19,092,000 ordinary shares of Rs. 10 each and the Company is engaged in the business of generation and distribution of electricity.

3. In order to decide the matter, brief narration of the background facts leading to issue of show cause notice is necessary. The Enforcement department of Securities and Exchange Commission of Pakistan (Commission) conducted examination of the annual audited accounts of the Company for the year ended June 30, 2008 and previous annual accounts which revealed that the Company had made advances to its wholly owned subsidiary Sitara International (Private) Limited (SIPL) and associate Sitara Fabric Limited (SFL) for the purchase of land in the following order:

Advances given to	2008	2007	2006
SIPL	7,673,125	25,000,000	328,789,631
SFL	18,990,034	55,190,034	55,190,034

The submissions made by the Company in response to our observations, revealed that the Company has made advances to its subsidiary in piecemeal in the year 2006-2007 against which the land was purchased by the Company on June 6, 2007. It was also submitted that the aforesaid purchase of land from the subsidiary and the associate was approved by the Board in July 5, 2005 and June 19, 2006 respectively. It was apprehended that Company has advanced aforesaid amounts to SIPL and SFL without the authority of special resolution and return, which is in contravention to the provisions of Section 208 of the Ordinance. Therefore, a show cause notice dated November 07, 2008 was issued to the directors of the company to explain as to why penalties in terms of Sub-section (3) of Section 208 of the Ordinance may not be imposed on them.

4. The reply to the show cause notice was received from directors vide their letter dated December 01, 2008. The seriatim reply given by the Company is given below:

- An advance of Rs. 328,789,631 to SIPL was made under a sale agreement executed in June 2006 which was subsequently replaced by a fresh sale agreement against which a land of Rs. 297 million was purchased.

- Chief executive of the Company was authorized to negotiate deals and make payments for purchase of land from SIPL and SFL in the normal course of business.

- The Company has made advances to its SIPL and SFL for purchase of land under sale agreements with the rights, title and interest in the land. This fact was duly disclosed in the financial statements. The advances given are in the normal course of business based on market norms under the sale/purchase agreements between the parties and shown as "advances from customer" under current liabilities. Bar contain in Section 208 does not cover cases where the transaction of sale and purchase is entered into. The authority of special resolution was not required. There is no market practice paying of returns on transactions of sale/purchase of land.

- The Company is not providing undue benefit to SIPL and SFL as the transaction were carried out at arms length in the normal course of business. The shareholders of Company in an extra ordinary general meeting held on April 30, 2002 resolved to invest in shares or give loans up to

Rs. 30 million to SFL. However, the transaction referred in your show cause notice was that of sale and purchase of land and would not amount to any investment or loan.

- Based on the facts summarized above, provision of Section 208 of the Ordinance does not apply in our case as the transaction carried out are normal trade credit arising out of transactions entered into as per normal business practice. The Commission by Notification No. 819(1)2007 dated August 10, 2007 ("SRO") exempted investment made in the wholly owned subsidiary from the scope of Section 208 of Ordinance.

5. In order to provide an opportunity of personal hearing to the directors, the case was fixed for hearing on February 23, 2009. On the date of hearing, Mr Niaz Muhammad Tahir- Chief Accountant ("Representative") appeared on behalf of all the directors of the Company and submitted that remedial and curative legislation would always be retrospective in effect and investment in wholly owned subsidiary is exempted by SRO from the scope of 208 of Ordinance. He also referred a case law [2008 PTD 1401 Commissioner of Income Tax versus M/s Ellot Spinning Mills Limited] in support of his argument. Whereas Representative admitted the default regarding advances of Rs.55 million to SFL and requested for taking a lenient view.

6. I feel it appropriate to quote here the relevant provisions of the Ordinance. Sub-section (1) and Sub-section (3) of Section 208 of the Ordinance provides that:

> *(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.*

7. I have analyzed the written submissions made by the Company, verbal submissions of the representative and relevant provisions of the law. My observations in the case are hereunder:

Advance to SIPL

The Accounts of SIPL were reviewed which revealed that the Company has made advances to SIPL in the financial year 2005 of Rs. 104,588,708 and in 2006 of Rs. 224,200,923 (aggregating Rs. 328,789,631) for the purchase of land, against which land of Rs. 297,000,000 was purchased on June 06, 2007. The principle business of the Company is generation and distribution of electricity. The Company's stance that Section 208 does not cover cases where transaction of sale and purchase is entered into and the authority of special resolution was not required, is not acceptable due to the fact that the company has entered into transaction with SIPL by way of advances which is covered in Section 208 of the Ordinance. Further, it is also noteworthy that the advance was not in normal course of business because there is a span of more than two years between advance given and purchase of land. It is therefore an abnormal trade credit and the Company has given undue benefit to SIPL with out the approval of shareholders and without return.

As regard to SRO, I would like to quote that the provisions of Sec 208 of the Ordinance prior to amendments made by Finance Act 2007 was applicable to investment made in wholly owned subsidiary. Clause (f) of SRO *has exempted a holding company, to the extent of investments made in its wholly owned subsidiary* from the requirement of obtaining the authority of special resolution for making investment in associated companies or undertakings as required under Section 208 of the Ordinance. From the aforesaid it is clear that the holding companies are exempted from the compliance of provisions of Section 208 of the Ordinance for the investments made subsequent to SRO. As the Company has made advances to SIPL prior to the Finance Act 2007; therefore, the Company was obliged to comply with the requirements of Section 208 of the Ordinance.

Advance to SFL

Although the default has been admitted by the authorized representative at the time of hearing, it is pertinent to discuss the violation committed by the Company in light of the submissions made by it. The Company has submitted that it had obtained shareholders approval in EOGM held on April 30, 2002 for the investment in shares or give loans upto Rs. 30, million to SFL. But since the advance referred to in the show cause notice was that of sale and purchase of land it would not amount to any investment or loan. The aforesaid stance of the company is not acceptable due to the fact that investment as defined in Section 208 of the Ordinance includes *loans, advances, equity, by whatever name called, or any amount,*

which is not in the nature of normal trade credit. Since the company has made advances to its associate it comes under the purview of Section 208 of the Ordinance and all the provisions had to be complied with. Moreover, it has been observed that the company has made advances against the resolution passed in the aforesaid EOGM and the advance of Rs. 55,190,034 given to SFL for the purchase of land was appearing first time in the accounts for the year ended June 30, 2006 for which no approval had been obtained from the shareholders. I would like to add here that although, Rs. 36,200,000 have been refunded to the Company by SFL in the year 2008 funds of the Company remained tied up for almost two years for no return and the company has deprived the shareholders of the return.

8. From the above discussion, submissions of the Company and argument put forward by the representative, I am of the considered view that the provisions of Section 208 of the Ordinance have been violated and directors are liable for the penalties as defined in Sub-section (3) of the aforesaid provisions of the Ordinance. However, keeping in view the fact that the SIPL is a wholly owned subsidiary of the Company and that the Commission vide SRO dated August 10, 2007 exempted a holding company to the extent of investment made in its wholly owned subsidiary from the requirement of obtaining the authority of special resolution for making investment in associated undertaking under Section 208 of Ordinance. As the default regarding advance to SFL is admitted by representative, I am inclined to take a lenient view and instead of imposing a maximum fine of Rs. One million on each director hereby impose fine of Rs. 150,000 (rupees one hundred and fifty thousand only) on each director. This will be paid by Chief Executive and directors in the following manner.

Name of Directors	Amount of Penalty (Rs)
Mr Javed Iqbal, Chief Executive	150,000
Mr. Muhammad Adrees, Director	150,000
Mr. Muhammad Anis, Director	150,000
Mr. Imran Gafoor, Dirctor	150,000
Mrs. Naureen Javed, Director	150,000
Mrs. Sharmeen Imran, Director	150,000
Total	**900,000**

The above named Chief Executive and directors of the Company are hereby directed to deposit fine aggregating to Rs 900,000 (rupees nine hundred thousand only) in the designated bank account

maintained in the name of the Commission with MCB Bank Limited within thirty days from the receipt of this order and furnish receipted bank vouchers to the Commission. In case of non-deposit of the penalty, proceedings under the Land Revenue Act, 1967 will be initiated for recovery of the fines as an arrear of land revenue. It may also be noted that the said penalties are imposed on the Chief Executive and directors in their personal capacity; therefore, they are required to pay the said amount from their personal resources.

9. Before departing with the order, I hereby invoke provisions of Section 473 of the Ordinance and direct the Chief Executive of the Company the recover the outstanding amounts from SIPL and SFL with mark up, calculated on a rate which shall not be less than the borrowing cost of the Company, from the date the advance was given till its repayment. The directions are to be complied within 60 days of the date of this order and submit a report to this Commission duly certified by the auditor.

Tahir Mahmood
Executive Director (Enforcement)

Announced On:
March 11, 2009
ISLAMABAD