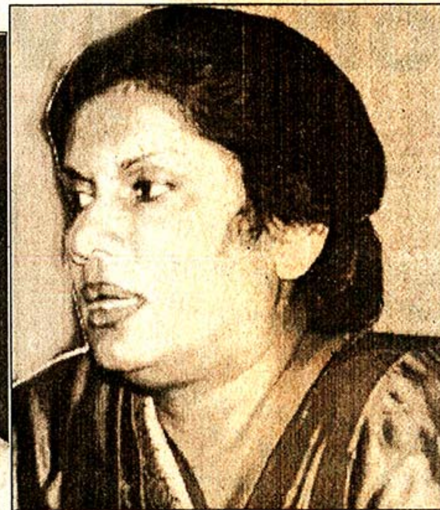
THAWAKKAL REVISITED

Kadirgamar – misled by a classical view?

"Monies had been borrowed in the name of the company, PCL, and appropriated by Thawakkal Group, saddling the company, PCL, with a debt of Rs. 900 million"

Peiris – the issue cannot be re opened



Kumaratunga – that old familiar feeling......?

An analytical exposure, particularly for the benefit of the investing public, from the annual reports of the Merchant Bank of Sri Lanka, focusing upon certain issues of public concern has been made.

Public scrutiny of what people do is probably the most powerful pressure towards probity of conduct – this essentially is the public duty and obligation of a responsible free press, however much those concerned may abhor such scrutiny. Statutes, regulations, rules and standards are not mere niceties in society to make belief that all is ' hunky – dory,' whereas actually things may be rotten to the core.

Pontificating on upholding laws and norms, feigning respectability, would be mere 'bunkum,' if there is lack of commitment to adhere strictly to the laws and norms, by the very persons responsible for enacting the laws and setting the norms and also by the very persons who are entrusted with the responsibility of enforcing such laws and norms.

It would be an even greater tragedy if eminent professionals and those professing intellectuals pay mere lip service to the laws and norms apply their professional skills and academic knowledge to upturn those very norms.

In this context, the spotlight is turned onto one of the most controversial transactions that occupied the national centrestage during the early part of 1996. The much debated Puttalam Cement/ Thawakkal scandal hit the headlines with double page spreads in all the major newspapers.

It was debated for three full days by those who are responsible for enacting the laws after thr exposure of Kadiragamar letters wherein a 20- million rupee bribe to a minister came to be quoted.

Foreign minister Lakshaman Kadirgamar, president's counsel and distinguished alumnus of Oxford and Justice and Constitutional Minister, Prof. G.L Peiris, learned professor of law, Rhodes scholar, also a distinguished alumnus of Oxford, having given their minds to the issues relating to the Puttalam Cement/ Thawakkal scandal, earnestly participated in the parliamentary debate.

Justice Minister Peiris, who only a few months previously had intervened to suspend the implementation of the Hilton settlement agreements that had been executed with the approval of the attorney general, in the case of the Thawakkal agreement, took a completely different stance. He was reported to have stated:

There is no way the contract could be annulled…We are now dealing with a contract which has already finished. The issue cannot be opened again by cabinet. It is a completed contract. Only the courts can revoke this."

Foreign Minister, Kadiragamar, himself a lawyer, was reported to have opined: " I took what I would call a classical view, a strict view in law… we were in a situation where because of a breach of section 55 of the companies act, on which question there is almost unanimity – there is the attorney general's opinion, there is the securities and exchange commission opinion, there is my opinion, there is the opinion of a senior lawyer, a private lawyer, we have all agreed that there was a breach of section 55 of the companies act… it rendered the underlying transaction void in law."

There was much opinion then created, advocated by those affected and interested, that Section 55 is a fossilised provision in our companies act and that developed countries do not have such provision in their statutes and that section 55 be deleted from our statute. On the contrary, what was the factually correct legal position, that both learned men in the law, of the calibre of ministers, Kadirgamar and Peiris could not comprehend or understand?

Section 55 of the companies act makes unlawful the granting of a loan, directly or indirectly, or facilitating the granting of such loan, by a company, to any person, for the purpose of purchasing any shares in the very same company. Section 55 also provides the exceptions to this rule. A company is permitted to give such loans to persons to purchase shares in the very same company, where money lending is the normal business of the company or where such loans are given to employees including employed directors to buy shares in the same company.

In essence, section 55 makes it unlawful for a company to grant loans to persons other than to its employees to purchase shares in the very same company. Even such monies permitted under section 55 to be given by a company are only as loans and would be recoverable by the company, from such borrower. It is the granting of loans by the company that section 55 has specifically made unlawful, except in the case to employees of the company. This is made absolutely clear without any ambiguity whatsoever.

Was the Puttalam Cement/ Thawakkal transaction such a transaction as was deemed by Minister Kadirgamar taking the classical view? What exactly was this transaction? Did not Minister Peiris also agree with this position?

Thawakkal Group agreed to Purchase 90% of the shares of Puttalam Cement Co. Ltd. (PCL) from the treasury secretary, who held such shares on behalf of the government. Thawakkal Group agreed to pay the full purchase consideration of Rs. 2028 million to the treasury secretary for such shares. Consequently, Thawakkal Group, the buyer, paid part of such purchase consideration, a sum of Rs. 1128 million to the seller the treasury secretary.

The Company, PCL, thereafter borrowed Rs. 900 million from banks and other lenders, and paid the treasury secretary, the so borrowed Rs. 900 million., which was the amount of the balance purchase consideration that had to be paid by the buyer, Thawakkal Group, to the seller, treasury secretary, for the purchase of the shares of PCL by Thawakkal Group.

It is clear that the company PCL borrowed the money, whereby such monies belonged to the company; and thereafter paid such monies belonging to the company, to the treasury secretary, on behalf of Thawakkal Group, as the balance payment due from Thawakkal Group to the treasury secretary, whereby the Thawakkal Group purchased in their names the 90% shareholding of the company, PCL.

NO BASIC ACCOUNTING

The receiving of such loan monies, that belonged to PCL, by the company to the treasury secretary, on behalf of the Thawakkal Group, however, has apparently not been recorded in the books of accounts of the company, PCL, in violation of the basic requirements of book keeping under the law, as stipulated in section 143(1) of the companies act no 17 of 1982, whereby all sums of monies received and expended by a company have to be recorded in proper books of account.

Curiously, what has been recorded appears to have been this.

The company, PCL, re-valued its fixed Assets and credited the surplus on such re-valuation to a capital re-serve, which is the normal practice. Thereafter by an innovative and ingenious method of accounting the blatant abnormality was perpetrated.

Part of such capital reserve created, appears to have been simply restated to be read as the loan repayable of Rs. 900 million, to represent the monies that had been borrowed by the company and paid to the treasury secretary, for and on behalf of the Thawakkal Group. How could this be possible, under basic principles of accounting, let alone under the much talked of accounting standards?

The company, PCL was to repay this loan of Rs. 900 million with interest, to the lenders, from the future profits of the company, which also belonged to the other 10% shareholders, none other than the poor employees of the company.

In the final analysis, the employees are called upon to contribute from their share of future profits towards the purchase consideration of Thawakkal Group. Let alone the question of legality, what about the issue of morality?

MISAPPROPRIATION ?

It is patently clear that this was definitely not a loan to the Thawakkal Group from the company, PCL, as contemplated under section 55 of the companies act. There was no intention, no commitment, no record in the books of accounts of the company for the repayment of such monies by Thawakkal Group to the company, PCL.

It was quite simply, that monies had been borrowed in the name of the company, PCL and appropriated by Thawakkal Group, saddling the company, PCL with such debt of Rs. 900 million, to be repaid to the lenders, together with interest thereon, by the company.

Would this not amount to misappropriation of company funds? Would this not be an expropriation of the assets of the minority shareholders, grounds on which, the courts of law can entertain litigation by the minority to prevent such expropriation?
Ten per cent of the PCL shares now belong to the employees, and at the relevant time was held on their behalf by the government of Sri Lanka. Can a government ever be a party to such a transaction or compromise?

STRINGENT CLAUSE

On the other hand, the Agreement with the Thawakkal Group entered into by the government for the sale of the shares, *inter-alia*, provided that the 10% shareholding of the employees will not be diluted in any way.

Such stringent clause even prevented any reduction of the 10% shareholdings of the employees, even by legitimate means, through issues of new shares or a rights issue or otherwise.

Contrary to the opinion expounded, the Puttalam Cement/ Thawakkal transaction has nothing whatsoever to do with section 55 of the companies act. Even without section 55 in the statute, could such misappropriation of funds of a company by such ingenious method of innovative accounting and the expropriation of the assets of the majority thereby, be permitted under common law?

SECTION 55 OF THE COMPANIES ACT

(1) Subject as provided in this section, it shall not be lawful for a company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of, or for any shares in, the company, or where the company is a subsidiary company, in its holding company;

Provided that nothing in this section shall be taken to prohibit-

(a) where the lending of money is part of the ordinary business of a company, the lending of money by the company in the ordinary course of its business;

(b) the provision by a company, in accordance with any scheme for the time being in force, of money for the purchase of, or subscription for, fully-paid shares in the company or its holding company, as the as the case may be, being a purchase or subscription by trustees of or for shares to be held by, or for the benefit of, employees of the company, including any director holding a salaried employment office in the company;

(c) the making by a company of loans to persons, other than directors, bona fide in the employment of the company with a view to enabling those persons to purchase or subscribe for fully-paid shares in the company or its holding company, as the case may be, to be held by themselves by way of beneficial ownership.

2. Where a company acts in contravention of the provisions of this section, the company and every officer of the company who is in default shall be guilty of an offence and shall be liable to a fine not exceeding one thousand rupees.

The section in question – a fossilised provision in the companies act or a very relevant one?

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