

# Securities and Exchange Commission of Pakistan

## BEFORE APPELLATE BENCH NO. IV

In the matter of

### Appeal No. 19 of 2012

- (i) Fateh Textile Mills Ltd
  - (ii) Mr. Gohar Ullah
  - (iii) Mr. Humayaun Barkat
  - (iv) Mr. Asad Ullah Barkat
  - (v) Mr Muhammad Saleem
  - (vi) Mr. Maqsood Ahmed Khan
  - (vii) Mr. Soofi Taj Muhammad ... Appellants
- (Appellants No (ii) to (vii) all directors of Fateh Textile Mills Ltd)

Versus

Mr. Ali Azeem Ikram, Head of Enforcement Department  
Securities and Exchange Commission of Pakistan  
Islamabad

...Respondent

Date of Hearing

12/08/15

Present:

For the Appellants:

Ms. Amna Usmani, Associate (Muhammad Masood Khan & Associates)

For the Respondent:

- (i) Mr. Imran Iqbal Panjwani, Executive Director (CSD)
- (ii) Mr. Shahzad Afzal, Director (CSD)

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## ORDER

1. This order is in appeal No 19 of 2012 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order (the Impugned Order) dated 19/04/12 passed by the Respondent.
2. Brief facts of the case are that Fateh Textile Mills Limited (Company) entered into an agreement dated 01/07/06 (the Lease Agreement) with Fateh Petroleum Limited (Fateh Petroleum) for development of coal mines, situated at Lakhra Coalfield leased to the Company by the Government of Sindh, for a period of 30 years. Fateh Petroleum was incorporated in September 2005 i.e. almost one year prior to the signing of the Lease Agreement. Moreover, the Company and Fateh Petroleum had common shareholders/directors making Fateh Petroleum an associated company. The Lease Agreement was approved by the board of directors of the Company on 26/06/06. The following six directors were common on the board of Fateh Petroleum and the Company at the time of signing the Lease Agreement and approval of the same by the board of the Company:
  - i. Mr. Gohar Ullah, Chairman
  - ii. Mr. Humayun Barkat
  - iii. Mr. Asad Ullah Barkat
  - iv. Mr. Maqsood Ahmed Khan
  - v. Mr. Muhammad Saleem
  - vi. Mr. Abdul Razzak Memon
3. Minutes of the aforesaid meeting were sought from the Company to check compliance with the relevant provisions of the Companies Ordinance 1984 (Ordinance) regarding holding of board meetings, disclosure of interest and conduct of directors while considering the business in which they were

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interested. The Company only provided a copy of a resolution approving the Lease Agreement signed by seven directors including six interested directors. It was therefore apprehended that the directors of the Company had failed to disclose their interest in the Lease Agreement as required under section 214 of the Ordinance. Moreover, interested directors who were unqualified under section 216 of the Ordinance to participate in the directors' meeting approved the said Agreement in contravention of the Ordinance. It was further observed that the said resolution was approved in the absence of quorum specified in section 193 of the Ordinance since presence of interested directors was not relevant for the purposes of the quorum. The directors of the Company were not legally empowered under the provisions of the Ordinance to approve and execute the arrangement with Fateh Petroleum and acted beyond their powers under section 196 of the Ordinance.

4. Show Cause Notice (SCN) under sections 193, 196, 214 and 216 was issued on 12/05/11. The directors were also required to furnish the following information:
  - i. Reasons for incorporating a new entity for development of coal mines;
  - ii. Reasons for incorporating a public company with shareholding of directors of the Company instead of forming a wholly owned subsidiary of the Company;
  - iii. The basis used to ensure that terms of the Lease Agreement at arm's length; and
  - iv. Copy of Lease Agreement signed by the Company with the Government of Sindh.
  
5. The matter was fixed for hearing on 03/08/11 wherein no one appeared nor any communication was received in this regard. Subsequently hearing opportunities were provided to the directors of the Company on



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22/12/11, 28/12/11 and 09/01/12 but no one appeared on behalf of the Company.

6. Examination of annual audited accounts for the year ended 30/06/10 revealed that the Company had been incurring niaz expenses for the last many years. A review of the Company's Memorandum of Association (MOA) revealed that there was no clause authorizing such expenses. Therefore, expenses incurred on donations and niaz were, prima facie, ultra vires of the Company's MOA.
7. Show Cause Notice dated 28/12/11 (SCN) under section 496 of the Ordinance was issued whereby the directors of the Company were required to furnish their reply within 14 days i.e. by January 2012. However, no response was received within time and extension until February 2012 was allowed on request of Mr. Gohar Ullah, director/Chairman of the Company. An opportunity of hearing was also provided on 15/2/12 but no one appeared in the hearing nor was any written representation received.
8. In view of the above, notice under section 479 of the Ordinance was served on the Chief Executive and directors of the Company to appear on 21/02/12 along with written reply. It was also specifically stated that in case of non-appearance on the given date, the show cause proceedings will be concluded on the basis of available record. However no one attended the hearing and the matter was again fixed for hearing on 05/04/12. The directors of the Company, except Mr. Muhammad Ayub, nominee director of NIT, neither submitted any reply nor appeared for personal hearing on 05/04/12.
9. It was held by the Respondent that the directors of the Company have violated the provisions of sections 496, 196 and 216 of the Ordinance. The circumstances of the case and non-appearance of the directors to plead their

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case exhibited that the violations have been committed willfully and knowingly. Maximum fine under section 196 and 216 of the Ordinance and a token fine under section 496 of the Ordinance was imposed on each of the directors, except the nominee director, aggregating to a total of Rs.925,000. Furthermore it was advised to investigate Company's transactions with Fateh Petroleum thoroughly to determine any loss caused to the minority shareholders and to suggest suitable action to be taken through a separate order against the directors and other responsible officers of the Company.

10. The Appellants have preferred the appeal against the Impugned Order. The Appellant's counsel at the hearing and written submissions argued that:

- (a) Except for the reason that terms of the Lease Agreement are at arm's length, it is respectfully submitted that reasons for incorporating a new entity for development of coal mines and reasons for incorporating a public company with shareholding of directors of the Company instead of a wholly owned subsidiary of the Company did not result in any breach or violation of any specific provision of the Ordinance and, therefore, could not have been made basis of awarding penalty. The shareholding held by some of the Appellants were only qualification shares and the said Appellants did not actually participated in the said meeting held on 26/06/06 when the said transaction was otherwise approved by the BOD of the Company. The basis of the SCN was on mistaken view of the fact that directors of the Company were legally prohibited not to form or incorporate a public limited company. Fateh Petroleum shareholding was arranged and contributed by themselves through their personal means and not from the funds of the Company. Additionally, the Appellants were not obligated to form or incorporate wholly owned subsidiary of the Company as has been held in the impugned order. Further, it is clarified that Fateh Petroleum was not a private venture of directors of the Company. Further in para 2 of the Reply, it was explained that during the

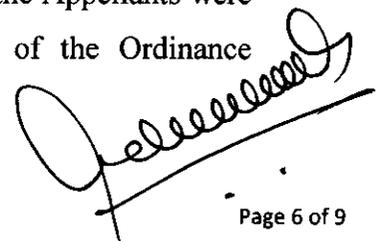


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meeting held on 26/06/06 the requirement of quorum (required for a listed company) was duly met. Therefore, no contravention of section 193 or any other provisions of the Ordinance was made. It is a matter of record that transaction of Agreement was disclosed by the members of FTML as per requirement of the law prior to commencement of any business on 26/06/06 and the resolution was passed through circulation. The directors Mr. Gohar Ullah, Mr. Asad Ullah Barkat and Mr. Humayun Barkat have not participated in the voting for the purpose of operating agreement with FPL. This was specifically explained and clarified by the Appellants in the reply dated 14/07/11, however, the response of the Appellants has been simply discarded by the Respondent. No violation or contravention of section 193, 196 and section 216 was ever made by the Appellants, therefore, awarding penalty imposed by the Respondent under section 196 and 216 of the Ordinance could not have been validly made by the Respondent; and

- (b) The Company unauthorisedly did not make donations and incurred niaz expenses thus purportedly in contravention of section 496 of the Ordinance. Minor charitable contributions were made over a period of so many years and none of the members ever raised any issue as audited accounts of the Company were supplied to them from time to time. Further in any case as is evident, the said charitable contributions or donations cannot be said to be a business carried out ultra vires to its object clause of the Company or for the same reason provisions of section 496 of the Ordinance were contravened. The fact remains that making some meager charitable contributions or niaz expenses were not made for rendering business of the Company, therefore, issue of conducting business in violation of business of company does not arise at all. The Respondents did not appreciate that in view of the facts and circumstances explained in the reply to the SCN, none of the Appellants were in default or any of contravention of any provisions of the Ordinance

  
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including section 193, 196, 214, 216 or 496 of the Ordinance. The Impugned Order as passed is not in accordance with the law.

11. The Respondent rebutted the arguments as follows:

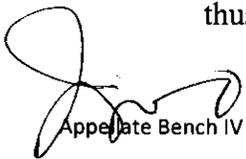
- a) The information regarding reasons for incorporating a new entity for development of coal mines and reasons for incorporating a public company was required to evaluate the real substance of transactions with Fateh Petroleum and how they impacted the operations of the Company, however, no penalty has been imposed under section 193 of the Ordinance. Section 216 of the Ordinance does not grant any exemption to a director holding qualification shares except where such director holds qualification shares on behalf of company approving contract/management and has been nominated by such company. In the instant case, the Company does not hold any shares in Fateh Petroleum, therefore, these directors do not qualify for this exception. The directors made contradictory submissions regarding the mode of approval of Lease Agreement with Fateh Petroleum. On one hand it was submitted that the resolution was passed through circulation while on the other hand it was submitted that disclosure of interest was made in the meeting and requirements of quorum were complied with. This issue could not be clarified as no one appeared to plead the case. However, these directors who hold qualification shares approved the agreement with Fateh Petroleum, as evident from their signatures on the copy of the resolution provided by the Company and thus violated the provisions of section 216 of the Ordinance; and
- b) The Company acted ultra vires the Memorandum of Association of the Company by apportioning the assets in a manner which is not permitted by the charter. The amount of donations and niaz expenses exceeded the amount of dividend paid to the members substantiating that these expenses are being incurred by the directors at the expense of the Company's

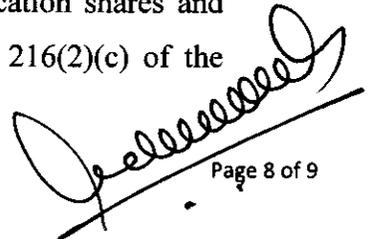


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shareholders. Reliance is placed on the judgment of *Ashbury Ry. Carriage Company v. Riche* (1875) LR 7HL 653, wherein, it was held that, *“it is ultra vires for a company to act beyond the scope of its memorandum. Any attempted departure will be invalid and cannot be validated even if assented to by all the members of the company. By ultra vires it is meant that an act or transaction of a company, which, though it may not be illegal, is beyond the company’s powers by reason of not being within the objects of the memorandum of association. The memorandum is, so to speak, the area beyond which a company cannot travel.”*

12. We have heard the arguments and perused the record of the parties i.e. the Appellant and the Respondent.
13. Section 216 (1) of the Ordinance provides that *“No director of a company shall, as a director, take any part in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into, by or on behalf of the company, if he is in any way, whether directly or indirectly, concerned or interested in the contract or arrangement...”* Further section 216(2)(c) of the Ordinance states *“Sub-section (1) shall not apply to any contract or arrangement entered into or to be entered into with a public company, in which the interest of the director aforesaid consists solely in his being a director of such company and the holder of not more than such shares therein as are requisite to qualify him for appointment as a director thereof...”*. In the instant case, the Appellants have submitted that the three interested directors i.e. Mr. Gohar Ullah, Mr. Asad Ullah Barkat and Mr. Humayun Barkat have not participated in the voting for the purpose of operating Lease Agreement with Fateh Petroleum. Further, Mr. Maqsood Ahmed Khan, Mr. Muhammad Saleem and Mr. Abdul Razak Memon held merely qualification shares and thus were not interested. We are of the view that section 216(2)(c) of the

  
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Ordinance does not grant exemption to a director holding qualification shares except where such director has qualifying shares in the public company requisite for his appointment as a director and has been nominated by the company for approving contract/management with a public company. In the instant case, the Company does not hold any shares in its associated company i.e. Fateh Petroleum, therefore, the said directors do not qualify for the exemption. We are of the view that as a result since majority of the directors were interested who could not have approved the Lease Agreement, therefore, penalty under section 196 of the Ordinance was rightly imposed on the directors.

14. We have reviewed the Memorandum of Association of the Company which does not authorize the Company to make donations and incur niaz expenses and is, therefore, these expenses have been incurred in contravention of section 496 of the Ordinance. The Appellant's contention that minor charitable contributions were made in the past and that there were no objections raised previously holds no merit. The penalty, therefore, has been rightly imposed on the Appellants.

15. In view of the foregoing, we see no reason to interfere with the Impugned Order. The appeal is dismissed with no order as to costs.

( **Fida Hussain Samoo** )  
Commissioner (Insurance)

( **Zafar Abdullah** )  
Commissioner (SCD)

Announced on: **07 SEP 2015**