



Securities and Exchange Commission of Pakistan

BEFORE THE APPELLATE BENCH NO.III

In the matter of

Appeal No. 37 of 2018

1. Pakistan Mobile Communications Limited
2. Mr. Aamir Ibrahim, Chief Executive Officer,
Pakistan Mobile Communications Limited

...Appellants

Versus

Mr. Mubasher Saeed Sadozai,
Director/Head of Department (CCD), SECP

...Respondent

Dates of Hearing:

11/12/18 & 21/3/19

Present:

For the Appellants:

- i. Mr. Salman Chima, Chima & Ibrahim
- ii. Ms. Saima Kamila Khan, Chief Legal Officer,
- iii. Mr. Shafqat Khan, Company Secretary
- iv. Mr. Asif Ali, Filing Expert

For the Respondent:

- i. Mr. Jawed Hussain, Executive Director (CLD-CCD)
- ii. Mr. Mubasher Saeed, Director (CLD-CCD)
- iii. Mr. Sidney Custodio Pereira, Additional Registrar (CLD-CCD)
- iv. Ms. Sumaira Siddiqui, Additional Director (CLD-CCD)
- v. Mr. Abdul Qayyum, Joint Director (CLD-CCD)
- vi. Ms. Maheen Najmi, Management Executive (CLD-CCD)

ORDER

1. This Order shall dispose of Appeal No. 37 of 2018 filed by Pakistan Mobile Communications Limited (Appellant No.1) and Mr. Aamir Ibrahim, Chief Executive Officer (Appellant No.2) under Section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the



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order dated September 5, 2018 (Impugned Order) passed by the Director/Head of Department, CCD (the Respondent).

2. The brief facts of the case are that as per financial statements of Appellant No.1 for the year ended December 31, 2017, the net profit was Rs. 77,659,466,000/- (*seventy-seven billion six hundred fifty-nine million four hundred sixty-six thousand*). The net profit was inclusive of the gain on transfer of net assets [(Rs. 59,297,894,000/-) *fifty-nine billion two hundred ninety-seven million eight hundred ninety-four thousand*] and the gain on disposal of operating fixed assets [(Rs. 76,448,000/-) *seventy-six million four hundred forty-eight thousand*]. The aforesaid gain arising from transfer of net assets and from disposal of operating fixed assets, encompassed 76% of the net profit. Appellant No.1 transferred and disposed of net assets and operating fixed assets to M/s. Deodar (Pvt.) Limited (Deodar). Appellant No.1 declared Rs. 34,810,000,000/- (*thirty-four billion eight hundred ten million*) as interim dividend for the year 2017. The substantial part of net profit arose out of gains from disposal/transfer of assets, therefore, declaration of interim dividend was *prima facie* violation of Section 240(2) and Section 241 read with Section 502 of the Companies Act, 2017 (Act) that prohibit declaration or payment of dividend from the sale or disposal of immovable property or assets of a capital nature.
3. In view of above, the Respondent issued a Show Cause Notice dated June 6, 2018 (the SCN) to Appellants No.1 and No.2. Hearing in the matter was held on June 21, 2018, which was attended by the Appellants' representatives. The Respondent being dissatisfied with the oral and written submissions of the Appellants, imposed a fine of Rs. 500,000/- (*Five hundred thousand rupees*) on the Appellant No.1 and Rs. 1,000,000/- (*One million rupees*) on Appellant No.2. Appellant No.1 was also directed to stop the payment of the questioned dividend immediately and to recover and deposit the amount of dividend paid earlier, if any. Furthermore, Appellant No.1 was directed to submit compliance report in this regard to the Commission forthwith.
4. The Appellants have challenged the Impugned Order *inter alia* on the following grounds:
 - i. Appellant No.1 entered into a Business Transfer Agreement (BTA) with Deodar whereby, passive infrastructure assets (tower assets) and ancillary contracts were transferred to Deodar. Furthermore, Appellant No. 1 also executed a Master Services Agreement (MSA) with Deodar for provisions of tower related services in future. The



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Impugned Order fails to appreciate that a substantial portion of the sale consideration and gain represents the business intrinsic value rather than the gain on "the sale of immovable property or assets of a capital nature". The MSA also created value in Deodar thus, the total consideration agreed between Deodar and Appellant No.1 included an element by way of premium for this long-term contract, which was not relatable to any transfer of existing assets. Indeed, the amount payable by Deodar to Appellant No.1 would have been lower if only assets and key contracts had been transferred to Deodar without the execution of the MSA.

- ii. It is international trend in telecommunication sector that the telecom companies sell their passive infrastructure assets (tower assets) to a separate company and by doing this, the telecom operators can focus on their core business of providing telecommunication services to its customers rather than managing passive infrastructure. This value proposition results in premiums paid in such acquisitions over and above the stand-alone asset values of the tower assets. This is also reflective in the Appellant No.1's transaction where a substantial portion of the sale consideration and the gain represents the business intrinsic value rather than the gain on sale of tower assets.
- iii. The Respondent had passed the Impugned Order while considering the word "except" appearing in Section 240(2) of the Act, as "and", which is incorrect. The exception placed in Section 240(2) of the Act, i.e. "*except after such profits are set off or adjusted against losses arising from the sale of any such immovable property or assets of a capital nature*" is related to the opening part of this Section i.e. "*No dividend shall be declared or paid by a company for any financial year out of the profits of the company made from the sale or disposal of any immovable property or assets of a capital nature comprised in the undertaking or any of the undertaking of the company*". Furthermore, the word "profits" used in first part of the section 240(2) of the Act and in exception, demonstrate that a company whose business does not consist of buying and selling of immovable property or assets of a capital nature, can also declare dividend from gains resulting from the sale of immovable property or assets of a capital nature, if such profits are set off or adjusted against losses arising from the sale of any such immovable property or assets of a capital nature. Therefore, in our view the Section 240(2) of the Act reads as follows;



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*240. Certain restrictions on declaration of dividend.— (2) No dividend shall be declared or paid by a company for any financial year out of the **profits** of the company made from the sale or disposal of any immovable property or assets of a capital nature comprised in the undertaking or any of the undertaking of the company, ~~unless the business of the company consists, whether wholly or partly, of selling and purchasing any such property or assets, except after such profits are set off or adjusted against losses arising from the sale of any such immovable property or assets of a capital nature:~~*

- iv. Appellant No. 1 had opening accumulated losses of Rs. 3,056M in year 2017. The gain on sale of capital assets in 2017 was Rs. 59,298M which offset all the opening accumulated losses. After such set off, there was Rs. 74,603M profit available with the Appellant No.1 and out of which only Rs. 34,810M were declared as dividends.
- v. The exception of Section 240(2) of the Act is not applicable on the companies engaged in the business of buying and selling of immovable property or assets of a capital nature, therefore, such companies can declare dividend from their *current* year profits, without taking into account any historical losses.
- vi. There are a number of precedents to show that companies have included profits generated from sale of immovable property or assets of a capital nature in their accounting profits, which then form the basis of dividends declared by those companies. Taking this restrictive position would render all those dividends in violation of law. Listed companies in Pakistan have undertaken transactions of disposal of assets comprising businesses and have declared dividends from the gains derived thereof. Some of the examples include sale of business units by Clariant Pakistan Limited (now Archroma Pakistan Limited) in FY 13 and sale of business unit by Clover Pakistan Limited in FY12. In both these instances, substantial gains were recorded by these companies and dividends were declared in subsequent periods utilizing these gains.
- vii. International Financial Reporting Standards (IAS 38- Intangible Assets), prohibit an entity from recognizing/capitalizing any internally generated business/intrinsic assets or their values in its financial statements. Therefore, the intrinsic value realized by Appellant No.1 was not reflected as assets (assets of a capital nature or any other asset) in the financial statements.



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- viii. The Impugned Order had wrongly held that the revenue generated by Appellant No.1 under the BTA constitutes its capital, which can be realized and distributed to its shareholders only through winding up of any such company. This observation reflects misunderstanding of company law because the Act allows for the reduction of capital. Any gain made by the company from sale of capital assets would be considered “profit” of the company whereas the amount equal to the acquisition/depreciated value would be considered “capital”. In Appellant’s No.1 case, dividend has been declared partially from the “profits” and not to the portion of the sale consideration, which constitutes “capital”.
- ix. There is no illegality for a holding company to transfer its assets and related contracts to its subsidiary therefore, Respondent’s recommendation to initiate independent proceedings against Appellant No.1, and its directors for alleged non-compliance of sections 279 to 282 of the Act is illegal. Furthermore, the Impugned Order imposes substantial penalty on the Appellants which should have only been imposed when someone violates the law with deliberate intent.
5. The Respondent rebutted the arguments of the Appellants on the following grounds:
- i. The gains arising from transfer of net assets to Deodar and from disposal of operating fixed assets, encompassed 76% of the net profit of Appellant No.1. Section 240(2) of the Act, prohibits declaration or payment of dividend by a company from the sale or disposal of any immovable property or assets of a capital nature comprised in the undertaking or any of the undertaking of the company. There is only one exemption under Section 240(2) of the Act that in case a company’s business, wholly or partly, is the sale or purchase of any immovable property or assets of a capital nature. Even in the said exemption, a condition is imposed that the profits arising on such sale or disposal are set off or adjusted against losses arising from sale of any immovable property or assets of a capital nature. Therefore, in case of any other company, dividends cannot be paid out of the gains arising from sale or disposal of any immovable property or assets of a capital nature, and that the accounting treatment reflected in the balance sheet of any such company should clearly reflect the limits entailed under section 241 of the Act.



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- ii. A company is a legal entity, which is separate from its shareholders therefore, the shareholders of the company cannot make any claim against the assets of the company except for the profit declared as a dividend and paid strictly in accordance with provisions of the applicable Company law. The dictum laid by Supreme Court of India has made it clear in *Bacha F. Gulzar vs. Commissioner of I.T. Bombay, cited at AIR 1955 SC 74* that a shareholder in a company acquires a right to participate in the profits of the company but he does not acquire any interest in the assets of the company, and, therefore, he [shareholder] has no right in the property of the company. Any income/proceeds from sale or disposal of capital assets of the company can be distributed to its shareholders only through winding up of any such company.
 - iii. In the instant case, Appellant No.2 has breached the fiduciary duty by declaring dividend in violation of Section 240(2) of the Act. Furthermore, Appellants' argument with regard to the proviso of Section 240(2) of the Act is not related to the case in hand. Transfer of whole or any part of its undertaking to Deodar by the Appellants is against the spirit of Section 279-282 read with Section 285(8) of the Act. The Appellants should have filed application with the Commission to transfer whole or any part of its undertaking to Deodar. The Appellants, by transferring assets of Appellant No.1, to Deodar through the BTA transaction, have defeated the requirements of scheme of reconstruction or amalgamation.
6. The Appellate Bench (the Bench) has heard the parties i.e. the Appellants and the Respondent and perused the record with the able assistance of their representatives. The Bench has observed that while rebutting the alleged violation of Section 240(2) of the Act, the Appellants have argued that the Appellant No.1 had transferred passive infrastructure assets (towers) to Deodar and denied that passive infrastructure assets (towers) are assets of capital nature. (*Para 3.7 of Appeal*). Whereas, on the other hand, Appellants have argued that the dividend has been paid from the profits generated by way of premium through MSA and not from the proceeds of capital assets (towers) transferred to Deodar. Furthermore, premium of MSA or intrinsic value of disposed of assets is intangible, therefore, Section 240 of the Act is not applicable. (*Para 5 of the written arguments*).



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7. The Bench is of the view that the first argument of the Appellants is not tenable because irrespective of active or passive nature, the towers are fundamental to the running of telecom operations. Before the transfer, towers were owned and controlled by Appellant No.1 and it had installed communications equipment/transmitters to relay telecom signals, therefore, one could easily determine that without the towers Appellant No.1 would not have been able to run its operations. Appellant No. 1 hired the services of Deodar through MSA to provide the towers the facility of telecom transmission. The Bench has observed that in both situations Appellant No.1's reliance on towers is inevitable to run telecom business, therefore, towers and attached devices and associated services are assets of capital nature.
8. The Bench has also minutely analyzed Appellants' other stance with regard to the payment of dividend from the profits realized from the amount of intrinsic value of towers. Appellants stated that the amount payable by Deodar to Appellant No.1 would have been lower if only assets and key contracts had been transferred to Deodar (under BTA) without the execution of the MSA. The Bench is of the view that Appellants' argument that the questioned dividend has been paid from the profits of intrinsic value of the capital assets (towers) is misconceived because in a sale transaction, intrinsic value and fair market value/depreciated value constitutes a complete sale consideration. In this case, the sale consideration received by Appellant No.1 is the actual cost paid by Deodar, to acquire the towers. Therefore, if Appellant No.1 decides to repurchase the same category of towers from Deodar or from some other vendor, then it has to pay the same or higher cost, as paid by Deodar. Furthermore, the sale consideration under the BTA has not categorized the sale transaction into tangible or intangible/intrinsic, therefore, Appellants' plea that they have paid the questioned dividend from the profits and not from the capital is without any substance. Appellants' argument with regard to classification of assets as tangible/intangible and treatment of intrinsic value, under IAS 38 is not relevant to the case in hand.
9. The Bench has also reviewed the plea taken by the Appellants that the Respondent has misinterpreted Section 240(2) of the Act. As a matter of fact, the Appellants have misconstrued and misinterpreted the relevant provision. The exception contained in Section 240(2) of the Act is related to the category of companies whose business is buying and selling of immovable property or assets of capital nature. The treatment of profits from the sale of immovable property or assets of capital nature of such companies is subject to conditions imposed by the



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exception. As Appellant No.1's business does not consist of buying and selling of towers, therefore, it falls under the first category of companies that are not allowed to pay dividends from the profits raised through the sale of immovable property or assets of capital nature.

10. Appellants' have referred certain cases to corroborate their case, however, such cases have their own merits and circumstances. Furthermore, misapplication of law in the past, if any, does not entitle the Appellants' to get any relief. (Reliance is placed on the judgement of Honorable Lahore High Court, Lahore, in the matter of Seeds High School Versus Government of Pakistan cited at 2004 PLD 05).
11. Appellant No.1's case also does not fall under the exception of Section 240(2) of the Act whereby a company engaged in buying and selling of immovable assets or assets of capital nature, can declare dividend from the profits generated from the sale of such assets. Appellant No.1's core business is provision of telecom services to its customers and it is important to understand that said services may not be rendered without availability of complete infrastructure that includes the telecom towers. Therefore, it is not possible for the Bench to consider that Appellant No.1's core business was buying and selling of telecom towers. The Appellant was also unable to demonstrate how distribution of dividend was made after adjusting/setting off any loss arising from sale of such capital assets in the instant case. Furthermore, this is not a case of unrealized gain on investment property, therefore, Appellants' argument with regard to the proviso of Section 240(2) of the Act is not relevant.
12. The Bench is of the view that shareholders' rights revolve around the numbers of shares they hold. The assets of a company represent the underlying value of shares owned by shareholders, however, this value cannot be claimed through disposal of such assets, during the existence of a company. Moreover, reduction of capital is a concept whereby a company reduces its paid up capital or accumulated losses whereas disposal of capital assets does not entitle a company to reduce its paid up capital. Therefore, Appellants' reliance on this point is irrelevant. We concur with the Respondent's finding that income from sale or disposal of capital assets of the company may not be distributed among the shareholders, except through winding up of the company. Furthermore, if Appellant No.1 has disposed of immovable assets then proceeds for such transfer or sale should have not been used except to promote the company's objectives and its core business.



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13. The SCN was issued for the violation of requirements under Section 240(2) and Section 241 of the Act, therefore, Respondent's observation/direction with regard to alleged violation of Section 279 to 282 was unwarranted. The Bench, therefore, holds that the Respondent cannot proceed beyond the scope of the allegations contained in the SCN. However, without prejudice to the observation and direction contained in the Impugned Order, relevant authority may proceed against the Appellants in accordance with law.
14. The violation of Section 240(2) of the Act has been established against the Appellants, therefore, except for Respondent's observation/direction with regard to alleged violations of Section 279 to 282, the Impugned Order is upheld and the Appeal is dismissed without any order as to cost.

(Farrukh H. Sabzwari)
Commissioner (AML)

(Aamir Ali Khan)
Chairman/Commissioner (CLD-CSD)

Announced on: **30 AUG 2019**