



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

BEFORE APPELLATE BENCH NO. II

In the matter of

Appeal No. 22, 23, 24, 25 of 2008

1. Rafique Dawood & Others
2. AVM (R) S. J. Raza
3. Shamshad Ahmed
4. Safdar Rashid

Directors of First Dawood Investment Bank Limited, 1500-A, Saima Trade Towers, I.I
Chundrigar Karachi

..... APPELLANTS

Versus

Commissioner (Specialized Companies Division)
Securities and Exchange Commission of Pakistan
NIC Building, Jinnah Avenue, Blue Area, Islamabad

..... RESPONDENT

ORDER

Date of Hearing

16 June 2009

Present:

For the Appellant:

Mr. Babar Sattar

Advocate

Mr. Ehsan Ali Qazi

Advocate

For the Respondent Department:

Mr. Umar Hayat Khan, Director (NBFC)

Mr. Asad Haider, Joint Director (NBFC)

Mr. Zia-ul-Haq, Deputy Director (NBFC)



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1. This order shall dispose of appeal No. 22, 23, 24, 25 of 2008 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 against the Order (the "Impugned Order") dated 30-05-2008 passed by the Commissioner (NBFC).
2. The facts leading to the case are that in terms of section 282 I of the Companies Ordinance, 1984 (the "Ordinance") Executive Director, Securities Market Division ("E.D, SCD"), ordered an on site inspection into the affairs of First Dawood Investment Bank Limited ("FDIB") on 10-11-2006 to determine its financial health as on 30-9-2006. The inspectors concluded in the inspection report that FDIB had made equity investment in unquoted shares of four companies without seeking approval of the Commission which was contravention of rule 7(2) (h) of the NBFC Rules 2003 (the "NBFC Rules") and Regulation 6(1) (c) of Part IIA of the Prudential Regulations (the "Prudential Regulations"). The investment made by FDIB is detailed hereunder:
 - a) Rupees 50 million were invested in Jamshoro Joint Venture Limited ("JJVL") on 14-2-04.
 - b) Rupees 5 million were invested in Cybersoft Technologies Limited ("CTL") on 09-1-06.
 - c) Rupees 4.94 million were invested in Caldwell New York Limited Partnership II Units ("CNY") on 16-7-05.
 - d) Rupees 0.3 million were invested in World Bridge Connect Private Limited ("WBC") on 9-8-04 and Rupees 20 million on 10-1-05.
3. The Commission issued a show cause notice ("SCN") dated 31-10-2007 under section 282J read with section 282M (1) of the Ordinance to FDIB and its directors to explain as to why proceedings should not be initiated against them



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for violation of rule 7(2) (h) of the Rules and regulation 6(1) (c) of the Prudential Regulations. In response to the SCN, FDIB submitted its reply dated 17-11-2007 and explained the manner in which investments were made by FDIB in unquoted shares. It was contended as follows:

- (a) At the time of investment i.e. 14-2-04, JJVL was under the process of listing its securities. JJVL later decided not to list the preference shares and informed FDIB that it may withdraw its investment. Letter dated 13-11-2007 from JJVL was submitted in support of the contention and request was made to the Commission that an *ex post facto* approval may be granted to regularize the investment in unquoted shares of JJVL.
- (b) FDIB gave its consent to M/s Liaquat Zaman, Chartered Accountants (the "Consultants") to invest in the preference shares of CTL subject to approval of the Commission. The Consultant construed a letter dated 6-12-05 issued by the Company law Division of the Commission approving investment in CTL securities in place of BRR International Modaraba as the required approval under rule 7(2) (h) of the Rules for FDIB to invest in unquoted preference shares of CTL. The Appellant relied on the representation of the Consultant as such the lapse was inadvertent.
- (c) FDIB failed to seek the Commission's approval before making investment in CNY as required under the law. The investment was, however, done with intention of best return.
- (d) FDIB failed to seek the Commission's approval before making investment on 9-8-04 and 10-1-05 in WBC as required under the law.



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FDIB however, later on 15-11-07 sought *ex post facto* approval from the Commission.

4. The directors of FDIB were provided an opportunity of personal hearing on 3-1-2008 by the Commissioner (SCD) to explain their conduct. Mr. Ayaz Dawood representing FDIB and its directors reiterated the grounds taken in reply to the SCN. The Commissioner (SCD) not satisfied with reply to SCN and the contention raised in the hearing passed the Impugned Order imposing penalty of Rupees one million on the Chief Executive Officer ("CEO") and each director serving on the Board of Directors ("BoD") of FDIB under section 282(J) of the Ordinance.
5. The Appellants' preferred appeals against the Impugned Order. The Appellants' counsel made the following preliminary objections to the Impugned Order:
 - a) The process required in passing the Impugned Order was not followed. The Impugned Order was passed pursuant to the SCN issued by the ED, SCD who was exercising the powers of the Commission under SRO 1061 (1)/2007 dated 18-10-05. During the pendency of the show cause proceedings the power to adjudicate was entrusted to Commissioner (SCD) through SRO 1161 (1)/2007 dated 1-12-2007 which did not provide immunity to actions taken by the ED, SCD. SCN should have been re-issued by the Commissioner (SCD) before taking any action against the Appellants. The proceedings initiated by E.D, SCD therefore became void and of no legal consequence and the Impugned Order therefore should be set aside on this ground alone.



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- b) The final Inspection Report was not provided to FDIB in violation of mandatory statutory requirement. The SCN issued on the basis of the inspection report was, therefore, invalid in the eyes of law.
6. The Appellants' counsel on merits relied on the grounds stated in the reply to the SCN which have already been reproduced in para 3 above. In addition, the Appellants' counsel advanced the following arguments:
- a) The Commissioner (SCD) could not have imposed penalty for violations under rule 7(2) (h) of the Rules as it is ultra vires of section 196(2) (e) of the Ordinance. Section 196(2) (e) of the Ordinance authorizes the directors "to invest the funds of the company", whereas Rule 7(2) (h) encumbers the authority of the directors by imposing a condition that prior approval of the Commission is mandatory. No rules or regulations i.e. subsidiary legislation can fetter the power of the directors vested in them by the statute i.e. primary regulation.
- b) Rule 7(2) (h) of the Rules was amended during the pendency of the show cause proceedings and 20% equity investment was allowed in the unquoted stocks without the Commission's approval, whereas the investment made by the FDIB was meager 3%. The amendment in rule 7(2) (h) of the Rules was procedural in nature. Reliance was placed on 2005 SCMR 1785, 2003 SCMR 1017, 2003 PLC (CS) 424 Supreme Court AJK and PLD 1969 SC 187 to show that amendments which are procedural in nature have retrospective effect. It was further contended that rule 7(2) (h) of the Rules was amended by the Commission as it was bad law.



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- c) The Prudential Regulations issued on 21-01-2004 under section 282D of the Ordinance were *ab initio* void. Section 282D of the Ordinance only provides for issuance of directions to the NBFC and the Prudential Regulations could not have been validly issued under it. The Commission was entrusted with the power to issue rules, regulation, directives etc. under section 282B of the Ordinance through the Finance Act 2007. Section 282J of the Ordinance was amended thereafter in order to penalize the violations under the Prudential Regulations. The Prudential Regulations have now been re-issued under section 282 B which shows that the Commission was aware of the fact that the Prudential Regulations were not validly enacted.
- d) The Impugned Order imposed a collective penalty of Rupees 8 million whereas the maximum penalty allowed under 282J of the Ordinance at the time of violation was Rupees 5 million. Section 282J of the Ordinance was amended through the Finance Act 2007 and the maximum penalty was increased to Rupees 50 million. It was contended that section 282J of the Ordinance could not apply retrospectively and reliance was placed on PLD 1969 SC 599 where it has been held that statutes are presumed to be applicable to cases and facts coming into existence after their enactment unless there is clear intention to give them retrospective effect. It was argued that Article 12 of Constitution of Islamic Republic of Pakistan does not allow punishment of a person for an offence by a penalty greater than the one prescribed by law for that offence at the time the offence was committed and therefore the penalty imposed in this case cannot be enhanced retrospectively.



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- e) The penalties were imposed on some directors who were not part of the BoD at the time investments were made in unquoted shares. The table along with forms filed with Company Registration Office ("CRO") annexed with the appeal clearly establishes that Mr. Safdar Rashid and AVM (R) S.J Raza were not on BoD during the period in which the violation was committed. Mr. Shamshad Ahmed was acting on the BoD as nominee director of NIT and the penalty of Rs One Million was imposed on him although he was not on the BoD at the time of investment. The penalty was later withdrawn by the Commission. Mr. Rafique Dawood has been penalized twice, once in the capacity of CEO and again as a director. On the other hand United Bank Limited and Shirazi investments co-invested in unlisted securities of WBC without the Commission approval and both were not held accountable.
7. The departmental representative, Mr. Asad Haider in response to the preliminary objections stated that:
- a) The process requirement before passing the Impugned Order was fully complied with. SCN was issued by ED, SCD in exercise of the powers conferred by the Commission under SRO 1061 (1)/2007 dated 18-10-05. During pendency of the show cause proceedings the power to adjudicate was re-delegated and entrusted to Commissioner (SCD) through SRO 1161 (1)/2007 dated 1-12-2007. The Impugned Order was passed by the then Commissioner (SCD) after hearing the parties. Furthermore, the Appellant did not object to the hearing by the then Commissioner (SCD) during the show cause proceedings as such, it cannot be allowed to raise objection at the Appellate forum.

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b) The draft inspection report was shared with FDIB and comments on the inspection report were filed by FDIB on 05-05-2007. It was further contended that sharing of inspection reports is not a requirement of law but was done out of choice. (Copies of correspondence relating to sharing of inspection report were handed over to us for perusal.)

8. On merits the departmental representative argued that the Appellant had accepted its default in the show cause proceedings and therefore the penalty was rightly imposed. On the legal objections the departmental representative stated that:

a) Rule 7(2) (h) of the Rules cannot be termed as ultra vires of section 196 (2) (e) of the Ordinance. It was argued that the rights of directors under section 196 (2) (e) of the Ordinance remained unfettered and directors can decide to invest the funds of the Company. Rule 7(2) (h) of the Rules introduces a requirement of approval from the Commission which does not prejudice the right of the directors to invest the funds of the company. The requirement has been introduced in order to protect the interest of shareholders generally.

b) The amendments in rule 7(2) (h) of the Rules were introduced after the issuance of SCN. Retrospective application of the amendment cannot be allowed as the amendments did not specifically provide for its retrospective application. It was argued that the amendment had the effect of imposing an obligation and creating a disability as such it ought not to have been applied retrospectively. Reliance was placed on *Principles of Statutory Interpretation* by Justice G.P Singh, seventh edition by Wadhwa & Company Nagpurat, page 367; "Every statute, it



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has been said”, observed LOPES, L.J., “which takes away or impairs vested rights acquired under existing laws, or creates a new obligation or imposes a new duty, or attracts a new disability in respect of transactions already past, must be presumed to be intended not to have a retrospective effect”.

- c) The Prudential Regulations issued under section 282D of the Ordinance are not subsidiary legislation. The Commission had been authorized to issue general directions to NBFCs under section 282 D of the Ordinance and the Prudential Regulations were issued as general direction to all NBFCs. The Commission was entrusted with the power to issue regulation under section 282B of the Ordinance through the Finance Act 2007 and thereafter the NBFC Regulations 2007 were promulgated under section 282B of the Ordinance. Moreover, the Prudential Regulations have not been re-issued under section 282B as such the contention of Appellant counsel is baseless
- d) The penalty of Rupees One million was imposed on each director under 282J of the Ordinance for violation of rule 7(2) (h) of the Rules and regulation 6(1) (c) of Part IIA of the Prudential Regulations. At the time of violation the Commission could have imposed penalty up to Rupees 5 million on each director. Section 282J of the Ordinance was amended through the Finance Act 2007 and the maximum penalty was increased to Rupees 50 million. The penalty of Rupees 5 million under section 282J was for each director involved and not on a collective basis; “....if a NBFC [or a notified entity] or its officer (including auditors) fails or refuses to comply with, or contravenes any provision contained in this part..... be also punishable with fine...”. The penalty was not imposed retrospectively and therefore



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the case law cited and Article 12 of the Constitution of Islamic Republic of Pakistan is not attracted in the instant case.

- e) The penalties were imposed keeping in view that the directors were representing the BoD of an NBFC. The directors on BoD of NBFCs have greater responsibility than any other company as they are allowed to make investments on behalf of general public. The Commission did not impose maximum penalty on each director which could have been 5 times the penalties imposed in the Impugned Order. The penalties on the directors are in personal capacity and they are required to pay the penalty from their own resources. It was contended that the penalty on Mr. Rafique Dawood was only imposed once and not twice as stated by the Appellants' counsel. On the issue of United Bank Limited and Shirazi investments co-investing in unlisted securities of WBC without the Commission approval it was contended that both companies were not NBFCs as such rule 7(2)(h) of the Rules is not applicable on them.

9. Our para-wise findings on the preliminary objections, raised by the Appellants' counsel on the Impugned Order are as under:

- a) The powers exercised by the Commissioner and Officers of the Commission are delegated under section 10 of Securities and Exchange Commission of Pakistan Act. The notifications delegating the powers are issued by the Commission from time to time, which are published in the Official Gazette. At the time of issuance of SCN the power under section 282J read with section 282M of the Ordinance were delegated to ED, SCD through SRO 1061 (1)/2007 dated 18-10-05, the Commissioner (SCD) could also exercise the powers



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concurrently with the ED, SCD. During the pendency of SCN the power to adjudicate was entrusted to the Commissioner (SCD) through SRO 1161 (1)/2007 dated 1-12-2007 who after hearing the parties passed the Impugned Order. We do not see how the Commissioner (SCD) was not competent to issue the Impugned Order or could have issued the order only after a fresh SCN was issued by him. Furthermore, as correctly pointed out by the departmental representative, the Appellants' ought to have raised this objection at the time of show cause proceedings and not at the appellate stage. Most importantly, the Appellants' have also failed to show any prejudice caused to them as result of the hearing by Commissioner (SCD), therefore the objection is not tenable.

b) The department has shared with the Bench comments filed by FDIB on the draft inspection report dated 05-05-2007 which clearly shows that the inspection report was shared with the Appellants. This was presumably done to ensure that nothing incorrect had crept into the inspection report and to get a feedback if so. Even otherwise the Appellant counsel has failed to point out any provision of the Ordinance which mandates sharing of final Inspection Report with the Appellant. As such we do not find any force in the Appellants' counsel contention.

10. The Appellants' admitted the default in the show cause proceedings and had sought *ex post facto* approval for investment in unquoted shares three years after making the investments and upon the issuance of the SCN by the Commission. With respect to other contentions of the Appellants' counsel our para wise findings are as follows:



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- a) Rule 7(2) (h) of the Rules at the time of issuance of SCN and section 196 (2) (e) of the Ordinance is reproduced for reference:

7 (2) A NBFC shall not

h) make investment in un-quoted shares of any company without the approval of the Commission

196 (2) The directors of a company shall exercise the following powers on behalf of the company, and shall do so by means of a resolution passed at their meeting, namely

(e) to invest in funds of the company;

Rule 7(2) (h) of the Rules clearly provides for approval from the Commission before making investment in unquoted shares of any company, whereas section 196 (2) (e) of the Ordinance authorizes directors to invest the funds of the company by means of a resolution passed in the board meeting. The power to invest rests with the directors and is not taken away by the Rules as the Commission has not been entrusted with the power to take decision on behalf of BoD. The Rules specify a procedure which sets down the requirement of prior approval from the Commission before investment is made in unquoted shares to protect the interest of shareholders and therefore rule 7(2) (h) of the Rules is not ultra virus of section 196 (2)(e) of the Ordinance.

- b) The amendments in rule 7(2) (h) of the Rules were introduced after the issuance of SCN. The question before us is whether or not retrospective application of rule 7 (2) (h) of the Rules can be allowed.



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We have gone through the case law presented by the Appellants' counsel on the issue. In 2005 SCMR 1785, it was held that right of appeal is a not a procedural but a substantive right and any change in law affecting substantive rights has to have prospective effect. In 2003 SCMR 1017 it was held that any amendment made during the pendency of appeal, in a criminal case as regards procedural matters would be applicable to such cases. 2003 PLC (CS) 424 Supreme Court AJK and PLD 1969 SC 187 also supports the view that procedural law is retrospective in nature and includes in the list those matters which relates to procedure such as: matters relating to remedy; the mode of trial; jurisdiction over cause of action; venue; parties pleadings and rule of evidence. We however are of the view that the case law presented by the Appellants' counsel is not relevant to the preposition before us.

Section 6 of the General Clauses Act 1897 deals with the effects of repeal/ amendment; the principle laid down is also attracted in this case as the requirement to obtain approval of Commission before making investment in un-quoted shares of company has been repealed:

6. Effect of repeal. *Where this Act, or any Central Act or Regulation made after the commencement of this Act, repeals any enactment hitherto made or hereafter to be made, then, unless a different intention appears, the repeal shall not*

- a)
- b)
- c) affect any right , privilege, obligation or liability acquired, accrued or incurred under any enactment so repealed; or



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- d)
- e) affect any investigation, legal proceeding or remedy in respect of any such right, privilege, obligation, liability, penalty, forfeiture, or punishment as aforesaid;

and any such investigation, legal proceeding or remedy may be instituted, continued or enforced and any such penalty, forfeiture or punishment may be imposed as if the repealing Act or Regulation had not been passed."

Emphasis added

In our view, the amendment of rule 7(2) (h) of the Rules cannot be termed as procedural as it changed the entire application of the rule and imposed an obligation and created disabilities. The amendment has imposed an obligation by requiring the BoD to carefully analyze the merits and financial impact of the investment; recording the decision in detail in minutes of the meeting; and communicating the decision to the Commission. The amendment has created a disability by declaring that NBFCs cannot make investment in unquoted shares of any company in excess of twenty percent of its equity. Moreover section 6(c) of General Clauses Act 1897 clearly states that the amending act shall not affect any legal proceeding and any penalty or punishment may be imposed as if the repealing Act or Regulation had not been passed. In support of our view, we also place reliance on PLD 1959 Karachi 94, which has upheld the principle stated in section 6 of General Clauses Act 1897. We also agree with the observations cited to us of Lopes L.J, referred to in para 8(b) above.



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- c) We have looked at section 282 D of the Ordinance to ascertain whether the Prudential Regulations were validly issued. Section 282D of the Ordinance stipulates:

282D. Power to issue directions- (1) *Notwithstanding anything contained in any other provision of this Ordinance, where the Commission is satisfied that it is necessary and expedient so to do –*

- (a) *in the public interest; or*
- (b) *to prevent the affairs of any NBFC or notified entity from being conducted in a manner detrimental to the interests of shareholders or unit or certificate holders as the case may be, or persons whose interests are likely to be affected or in a manner prejudicial to the interests of the NBFC or notified entity; or*
- (c) *to secure the proper management of any NBFC or notified entity generally, it may issue directions to NBFCs or notified entities generally or to any NBFC or notified entity in particular to do or desist from doing such acts as the Commission may deem fit and to carry out such changes as are necessary to rectify the situation and the NBFCs or notified entities shall be bound to comply with such directions.*



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(2) The Commission may, on representation made to it or on its own motion, modify or cancel any direction issued under sub-section (1), and in so modifying or canceling any direction may impose such conditions as it thinks fit.

Emphasis added

The Prudential Regulations were issued as general direction to the NBFCs under the aforesaid section, as at the time of issuance of the Prudential Regulations on 21-1-04, the Commission had powers to issue directives only. Prudential Regulations although termed as regulations were in fact general direction for NBFCs. Directives issued by the State Bank of Pakistan ("SBP") in pursuance of section 41 of Banking Companies Ordinance 1962 are also termed as Prudential Regulations. The mere use of the term regulation does not give it another meaning than that envisaged by the section under which such directives were issued. Accordingly the Commission in exercise of its power under section 282D of the Ordinance rightly issued the Prudential Regulations as directives. The directives cannot be declared invalid on the ground that they have been termed regulations. We do not see any merit in the contention of the Appellants' counsel.

The Prudential Regulations, however, have not been re-issued as contended by the Appellants' counsel; they were in fact cancelled through directive dated 23-11-07, after coming into force of NBFC Regulations 2007 on 21-11-07 under section 282(b) of the Ordinance. (amended and re-issued as NBFC Regulations 2008 on 21-12-08).

- d) The penalty of Rupees one million was imposed on each director under section 282J of the Ordinance for violation of rule 7(2) (h) of the Rules



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and regulation 6(1) (c) of Part IIA of the Prudential Regulations. Section 282J (1) of the Ordinance is reproduced as under:

282J. Penalty for failure, refusal to comply with, or contravention of any provision of this Part.- (1) Notwithstanding anything contained in any other provision of this Ordinance, if a NBFC or the notified entity or its officers (including auditors) fails or refuses to comply with, or contravenes any provision contained in this Part or of any of the provisions of the rules made under section 282 B or regulation, circular or directive or any direction or order passed by the Commission under the provisions contained in this Part or knowingly and willfully authorizes or permits such failure, refusal or contravention, shall, in addition to any other liability under this Ordinance, be also punishable with fine the amount of which shall not exceed fifty million rupees:

Provided that if the failure, refusal, default, contravention is committed by NBFC or the notified entity, every director, manager, or other officer or person responsible for the conduct of its affairs shall, unless he proves that the failure or contravention or default took place or committed without his knowledge, or that he exercised all diligence to prevent its commission, be deemed to be guilty of the offence.

Emphasis Added

The bare reading of section 282J (1) of the Ordinance clarifies the issue at hand as the penalty can be imposed on an NBFC, notified entity or its officers. The word “officers” used in the section may be read as “officer”. If for the sake of arguments, it is assumed that the term “officers” is used



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as plural, the penalty can not then be imposed on individual director, which clearly is not the intent of legislature as an offence can be committed by one officer as well as by several. In reaching the conclusion, we are guided by section 13 (2) of General Clauses Act, 1897, which is reproduced for ease of reference:

S. 13 Gender and number- In all Central Acts and Regulations, unless there is anything repugnant in the subject or context-

(1)

(2) words in the singular shall include the plural and vice versa.

Emphasis added

The proviso to section 282 J of the Ordinance provides that every director, manager, or other officer or person responsible for the conduct of its affairs shall be deemed to be guilty of the offence, which gives strength to the view expressed earlier that every director is liable to pay the penalty. Moreover, the penalty of Rupees one million imposed on each director is far lesser than the maximum penalty of Rupees five million on each director. The argument of the Appellant counsel that the collective penalty of Rupees eight million on all directors was greater than maximum threshold is therefore not tenable. The question of retrospective application of penalty does not arise in this instance.

- e) The Impugned Order imposed a penalty of Rupees One million on Mr. Rafique Dawood as CEO and his name was again mentioned in the list of directors giving an impression that the dual penalty has been imposed on him. The departmental representative has however clarified that the penalty of Rupees One million was imposed on Mr. Rafique Dawood, both as the Chief Executive and director of FDIB. The forms filed with Company Registration Office ("CRO") annexed with the appeal





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clearly establishes that Mr. Safdar Rashid was appointed as director on 25-2-04 and was not serving on BoD at the time of investment in JJVL. AVM (R) S.J Raza was appointed as director on 9-9-05 and was on BoD at the time of investment in CTL and not when the investment was made in JJVL, CYN and WBC.

Mr. Abdul Samad Khan was appointed as nominee director of NIT on the board of directors of FDIB on 25-6-04 and was therefore liable as much as other directors on the board at the relevant time. The nominee directors on the BoD have a fiduciary relationship with the company on whose board they sit. The Impugned Order imposed the penalty on Mr. Shamshad Ahmed as nominee of NIT instead of Mr. Abdul Samad Khan, which was later set aside in the review Order. We are however not inclined to look at the penalty on nominee director of NIT as neither a SCN was issued to Mr. Abdul Samad Khan nor did the Impugned Order impose any penalty on him.

In view of the foregoing, we hereby modify the Impugned Order passed by the then Commissioner (SCD) to the extent that penalties imposed on Mr. Safdar Rashid and AVM (R) S.J Raza stands reduced to Rupees 0.8 Million and Rupees 0.2 million respectively as they were not on the BoD at the time of investment in securities mentioned in paragraph 10 (e) above. The rest of penalties imposed in the Impugned Order, except the one on Mr. Shamshad Ahmed are upheld.


(MUHAMMAD SOHAIL DAYALA)
Commissioner (SMD)


(S. TARIQ ASAF HUSAIN)
Commissioner (LD)

Announced on: 31.8.09