



SECURITIES & EXCHANGE COMMISSION OF PAKISTAN  
APPELLATE BENCH REGISTRY

**BEFORE APPELLATE BENCH NO. II**

In the matter of

**Appeal No. 10, 11, 12, 13,14 of 2008**

1. Razi Kuli Khan Khattak
  2. Mushtaq Ahmed Khan
  3. Ikram-ul-Majeed Shegal
  4. Ali Kuli Khan Khattak
  5. Ahmed Kuli Khan Khattak
- ..... Appellants

Versus

Executive Director (Enforcement) ..... Respondent

Date of Hearing 31-7-2009

**Present:**

For the Appellant:

Mushtaq Ahmed Khan  
Muhammad Afzal Muniff  
Farrukh Junaidy  
M. Moin Khan

For the Respondent Department:

Abid Hussain  
Director (Enforcement)

Alshah Ali Raza  
Deputy Director (Enforcement)



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ORDER

1. This order will dispose of appeals filed by the directors of General Tyre and Rubber Company of Pakistan Limited (the “Appellants”) under section 33 of Securities and Exchange Commission of Pakistan Act 1997 (the “SECP Act”) against the order dated April 23, 2008 (the “Impugned Order”) passed by Executive Director, Enforcement (“Respondent”).
2. General Tyre & Rubber Company of Pakistan Limited (the “Company”) is a public limited company incorporated in Pakistan under the Companies Ordinance, 1984 (the “Ordinance”) and its shares are quoted on the Karachi and Lahore Stock Exchanges. The paid up capital of the Company is Rs.597,713,000/- divided into 59,771,250 ordinary shares of Rs.10/- each as per the annual audited accounts for the year ended June 30, 2007.
3. The facts leading to the case are that while examining the annual accounts of the Company for the year ended June 30, 2007, following issues were highlighted:
  - a) The management of the Company had subscribed 302,100 right shares of one of its associated company namely Ghandhara Industries Limited (“GIL”) and paid Rs.3.021 million as consideration thereof. On perusal of the Company’s record, it was observed that no special resolution was passed in accordance with the requirements of section 208 of the Ordinance. After subscribing the rights of GIL, the Company disposed off the shares to another associated company namely Bibojee Services (Private) Limited (“BSL”) for consideration of Rs.3.074 million, including Rs.0.053 million as mark-up. It was observed that the shares of GIL were sold by the Company to BSL at a lower price than the market price at that time.



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- b) In year 2007, the Company allowed credit period of 42 days to its customers in accordance with its credit policy of 30-45 days. The credit period allowed to its associated companies namely GIL, BSL and GNL stood at 121 days which was approximately three times of credit policy, as is evident from the following analysis:

Amounts in thousands

Years	2007	2006	2005
Total Sales	3,951,145	3,731,994	3,197,717
Sales to Associates	86,000	95,339	75,824
Net Sales (other than Associates)	3,865,145	3,636,655	3,121,893
Trade Debts (other than Associates)	445,839	394,042	319,809
<b>Collection Period (days)</b>	<b>41.53</b>	<b>39.01</b>	<b>36.88</b>
Sales to Associate	86,000	95,339	75,192
Trade Debts to Associates	28,983	20,722	9,384
<b>Collection Period (days)</b>	<b>121.32</b>	<b>78.25</b>	<b>44.93</b>

4. Show cause notice ("SCN") dated 26-2-2008 was issued to the directors of the Company and they were called upon to explain as to why penalties in terms of section 196 (4) and section 208 (3) of the Ordinance may not be imposed on them for the violations mentioned in para 3 above. The Appellants filed response to the SCN. The Respondent not satisfied with the response provided an opportunity of hearing to the Appellants. The Appellants were duly represented in the hearing before the Respondent. The Appellants later submitted additional documents in support of the reply to the SCN. The Respondent after taking into the account the reply to the SCN, the arguments of the Appellants before him and the additional documents filed by the Appellants, passed the Impugned Order and imposed a collective penalty of Rs. 500,000/- on directors for violation of section 196 of the



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Ordinance and collective penalty of Rs. 1,000,000/- on directors for violation of section 208 (1) of the Ordinance.

5. The Appellants preferred the instant appeals against the Impugned Order. The Appellants made the following arguments before us and provided written arguments:

- a) The Company had subscribed right shares of GIL at 3 shares for each share held and paid Rs. 3.021 million as consideration. The Company later disposed off the right shares of GIL to BSL, an associated undertaking for consideration of Rs 3.074 million. Later on 29-8- 2006 it was decided by the Board of Director (“BoD”) of the Company that subscription of right shares of GIL without prior approval of shareholders was inconsistent with the requirements of section 208 of the Ordinance. It was also decided that since no shares have been allotted to BSL, refund of subscription amount with normal profit should be obtained from BSL. In line with the decision, the Company received Rs 3.074 million including Rs 0.053 million as normal markup from BSL. The Company did not incur any loss, instead it reaped a profit of Rs 0.053 million. Respondent without taking into account that no loss was incurred to the shareholders imposed a collective penalty of Rs. 500,000/- for violation of section 196 of the Ordinance.
- b) The Company only sold 2.2% of its total sale of products i.e. tyre, tubes and flaps to its associated companies. The sales were at arms length and on the same terms and conditions on which the sale had been made to other customers. Preferential treatment was not afforded to the associated companies namely GIL, BSL, GNL therefore the Company did not pass special resolution in terms of section 208 of the Ordinance. Sales of tyre



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and tube are under deletion program approved by the Government of Pakistan and the associated companies were under an obligation to purchase the tyre and tube from the Company. The credit period of other customers of the Company also extends beyond 121 days in certain cases. The Respondent failed to take into account that no preferential treatment was given to the GIL, BSL and GNL and decided to impose collective penalty of Rs. 1,000,000/- for violation of section 208 (1) of the Ordinance.

6. The departmental representative, Mr. Abid Hussain, Director (Enforcement) in response to the preliminary objections stated that:
- a) It was observed in the minutes of BoD meeting dated 29-8-2006 that right shares of GIL, an associated undertaking were subscribed by the Company without prior approval of the shareholders, which was inconsistent with the requirements of section 208 of the Ordinance and therefore the BoD decided to obtain refund of the subscription amount with normal profit. The Company after subscribing the rights disposed off the shares to BSL, another associated company at throw away price of Rs 3.074 million when the market price of GIL shares stood at Rs 8.594 million. The disposal of shares to BSL caused a loss of Rs 5.520 million to the Company. The common directors of the Company and BSL earned Rs 5.520 million at the cost of the shareholders. Reliance was also placed on letter dated 27-2-2008 and letter dated 26-3-2008, wherein the company secretary of GIL and the chief executive of BSL respectively confirmed that the shares have been allotted to GTR and subsequently to BSL.
- b) With regard to the preferential treatment given by the Company to its associated companies namely GIL, BSL and GNL, the collection period

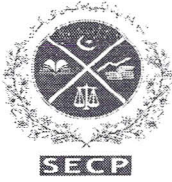


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allowed to associated companies was substantially higher than that of other customers. Reliance was placed on the table mentioned at para 3(b) above. The average collection period of associated companies stood at 121 days against an average of 41 days for other customers. The outstanding amount from the associated companies stood of Rs 28.983 million in the year 2007 which cannot be termed as normal trade credit. The Appellants were in violation of section 208(1) of the Ordinance as making of investment in shape of loans, advances, equity, by whatever name called or any amount which is not in the nature of normal trade credit to the associated companies without passing a special resolution is not allowed.

7. Our para-wise findings on objections, raised by the Appellants' counsel and response by the departmental representative is as under:

- a) The Company after subscribing the rights of GIL at Rs 3.021 million disposed off the shares to BSL at price including markup of Rs 3.074 million. It is not disputed that the market price of GIL shares on 29-8-2006 stood at Rs 8.594 million resultantly the disposal of shares to BSL, at price below the market price caused a loss of Rs 5.520 million to the Company. BSL is a private limited company with directors namely Mr. Ali Kuli Khan Khattak, Mr. Ahmed Kuli Khan Khattak and Mr. Raza Kuli Khan Khattak, who are also on BoD of the Company. The aforesaid directors had a fiduciary relationship with the Company and should have acted in the best interest of the Company instead they acted collusively in their personal interest and sold the shares of the Company to BSL at minimum price and earned profit of Rs 5.520 million at the cost of the shareholders of the Company. The letter dated 27-2-2008 has been perused which confirms the view of the departmental representative that



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the shares were allotted to the Company and were later transferred to BSL. The department has also placed reliance on letter dated 26-3-08 written by Mr. Raza Kuli Khan Khattak, the chief executive of BSL, wherein he has confirmed the allotment of shares to BSL. The Respondent rightly proceeded against the Appellants by imposing fine under section 196(4) of the Ordinance and directing the Appellants to make good the loss of Rs 5.520 million.

- b) On the issue of preferential treatment to its associated companies namely GIL, BSL and GNL. The Appellants have failed to show that the collection period allowed to associated companies was not considerably higher than that of other customers as stated in the Impugned Order. The arguments of the Appellants that the sales to associated companies is 2.2% of the total sales and that the sales were made under a deletion program of GOP are inconsequential as the issue before us is whether or not sales were made to the associated companies on same terms and conditions. The Appellants have failed to rebut the table at para 3 (b) which has averaged out the collection period from associated companies at 121 days against an average of 41 days in case of other customers. The Appellants have relied on Annexure III and IV of the written arguments, which are ledger statements of GIL and GNL. The ledger statements of GIL and GNL provided by the Appellants with the written comments does not provide an accurate account of the collection period of all associated companies. Even, if assumed that other customers have been given credit lines beyond the period specified in the credit policy, does not absolve the Appellants from the violation having committed with respect to its associated companies which have been brought to light and for which they have been penalized. Section 208 of the Ordinance is reproduced for ease of reference



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208(1) *Investments in Associated Companies and Undertakings-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.*

Emphasis added

The preferential treatment given to the associated companies was not a case of normal trade credit and thus falls under the definition of investment given in the explanation of section 208(1) of the Ordinance.

8. The Respondent has already taken a lenient view by imposing fine of Rs 200,000/- for violation of section 208 of the Ordinance when the maximum fine could have been Rs.10 million on each director. We therefore do not find any ground to interfere with the Impugned Order. The appeal is dismissed with no order as to cost.

  
(MUHAMMAD SOHAIL DAYALA)  
Commissioner (SMD)

  
(S. TARIQ ASAF HUSAIN)  
Commissioner (LD)

Announced on: 30 - 10 - 09