



BEFORE APPELLATE BENCH NO. II

In the matter of

Appeals No. 23 & 24 of 2005

1. Shadab Hassan
2. Musharraf Khan

Former Directors of
Prudential Investment Bank Limited.....Appellants

Versus

Commissioner (Specialised Companies Division), SECRespondent

Date of Impugned Order 27-06-2005

Date of hearing of appeal 13-04-2006

Present:

1. M. Farooq Akhtar, Advocate for the Appellants
2. Imran Hussain Minhas, Joint Director (SCD) & Saima Ahrar, Assistant Director (SCD) for the Respondent



ORDER

1. This order will dispose off appeals No.23 and 24 of 2005 which have been filed under sub-section (1) of section 33 of the Securities & Exchange Commission of Pakistan Act, 1997 by Mr. Shadab Hassan and Mr. Musharraf Khan both former directors of Prudential Investment Bank Limited. Both these appeals are against the order dated 27-06-2005 ('Impugned Order') passed by the Commissioner (Specialised Companies Division).

2. Brief facts of the case are that the Commission examined the audited accounts of the Prudential Investment Bank Limited ("Company") for the year ended 30-06-2004 which revealed that the auditors had indicated various qualifications. Rule 7 of the Non-Banking Finance Companies (Establishment & Regulations) Rules, 2003 ('NBFC Rules') requires that a NBFC shall maintain such books of accounts and other records which depict a true and fair picture of its state of affairs. Consequently, a notice dated 11-03-2005 was served on all directors of the Company calling upon them to show cause why penalties may not be imposed under section 282M(1) read with section 282J(1) of the Companies Ordinance, 1984 ('Ordinance') for violation of Rule 7(1)(a) of the NBFC Rules, and why prosecution may not be filed against them under section 282K of the Ordinance. After providing an opportunity of hearing to the Appellants, Commissioner (SCD) held that the annual accounts of the Company for the year ended 30-06-2004 did not depict true and fair view of the Company's affairs and therefore imposed a fine of Rs.1,000,000/- (Rupees one million) on each of the directors of the Company under sub-section (1) of section 282J.



3. Mr. Farooq Akhtar Advocate appeared before us on behalf of the Appellants. As a preliminary objection, he contended that the Commissioner has not passed an order as to the imposition of penalty. He stated that nowhere in the Impugned Order have the words "impose a penalty" been used, and the Commissioner has straight away directed the Appellants to deposit the fine. He further stated that the qualifications given by the auditors on the audited accounts of the Company for year ended 30-06-2004 had been appearing on the accounts since year 2000. Whereas, Mr. Shadab Hassan was elected as director of the Company on 14-09-2002 and Mr. Musharraf Khan was co-opted as director on 05-01-2004. He contended that holding the Appellants responsible for the said qualifications in the accounts was unfair. He stated that the auditor's qualification related to non-verification of supporting evidence and not non-disclosure, hence it cannot be said that the books of account do not depict true and fair view. He further argued that it was the duty of the chief executive officer (CEO) or the chief financial officer (CFO) to assist in the audit of accounts and the non-executive directors cannot be made liable for such qualifications of by the auditors.

4. The counsel further stated that the Appellants were nominee directors and were representing the First Prudential Modaraba which is a minority shareholder of the Company. He contended that the Appellants were non-executive directors and were not part of the Executive Management. He stated that the policy decisions were made by the "Kitchen Cabinet" and the Appellants were never consulted on these matters. He further argued that contraventions if any, were not committed willfully by the Appellants.

5. Mr. Farooq Akhtar further argued that the Impugned Order has been passed without jurisdiction and is therefore not maintainable. He contended that the Part VIIIA of the Ordinance and the NBFC Rules only apply to NBFCs. An NBFC has been defined as a company that is licenced by the Commission to engage in one or



more of the forms of business in terms of Rule 5. He stated that the Commission has not granted a licence to the Company under the NBFC Rules, and therefore, the Company is not an NBFC and the Impugned Order which has been passed for violation of NBFC Rules, is without jurisdiction. He further argued that the show cause notice dated 11-03-2005 was issued to the Appellants under section 282K of the Ordinance. He stated that the jurisdiction for the above offence lies with the Court of Session and not with the Commission, and hence the Impugned Order is without jurisdiction and attempt to usurp the powers of the court. Mr. Akhtar further informed us that the winding up petition filed by the Commission against the Company was dismissed by the Hon'ble Lahore High Court. While accepting a revival plan presented by the Company, the High Court in its judgment dated 15-09-2005 waived off all penalties relating to the period under previous management. He contended that the order of the High Court also applies to the penalties imposed on the Appellants vide the Impugned Order. Mr. Akhtar prayed that the appeals may be accepted and the Impugned Order be set aside.

6. Mr. Imran Hussain Minhas, Joint Director (SCD) & Ms. Saima Ahrar Assistant Director (SCD) appearing on behalf of the Department contended that it was immaterial if the exact words "impose a penalty" have not been used in the Impugned Order. Mr. Minhas argued that in Para 21, the Impugned Order specifically states that "the directors of the company have made themselves liable for the penalties provided under sub-section (1) of section 282J of the Ordinance", which is sufficient for the purpose. He further argued that the Appellants have been directors of the Company for considerable time and cannot argue that they had no role or responsibility in the working of the Company. Equally, they cannot argue that the contravention is not willful as they have been directors of the Company for the period of time when the default occurred. He contended that there was no difference between the legal responsibility of nominee directors and ordinary directors. He informed the Bench that although no new licence has been issued by the Commission to the Company, its existing licence is deemed valid under Rule



5(6), for the purpose of the NBFC Rules as long as its application for a fresh licence is pending with the Commission. Therefore the Appellants argument that the Company is not an NBFC for the purpose of NBFC Rules is untenable. He stated that Appellants have only been penalized under section 282J and not section 282K therefore the issue of usurpation of powers of the court does not arise. On the issue of waiver of penalties by the High Court, Mr. Minhas apprised the Bench that the Commission has filed an Intra Court appeal against the order of the High Court and the same has been suspended by the Divisional Bench.

7. We have heard the arguments presented by both the parties in detail. In our view the Appellant's arguments regarding the Impugned Order being without jurisdiction are untenable. As has been pointed out by the Department, under Rule 5(6) of the NBFC Rules, the Company is an NBFC for the purposes of the NBFC Rules as long as its application for renewal of licence is not rejected by the Commission. In the present case, the application of the Company for renewal of licence under the NBFC Rules has admittedly not been rejected by the Commission as yet. The Department is also correct to point out that the issue of usurpation of powers of the court does not arise as the Commissioner has not imposed a penalty under section 282K of the Ordinance but under section 282J. It is clear from the Impugned Order that the issue of filing criminal prosecution against the management under section 282K was put on hold by the Commissioner. Also, the counsel's argument regarding non-imposition of penalty is erroneous. Lack of one word "impose" cannot be made a ground for setting aside the judgment when the entire judgment makes it amply clear that the Appellants have been found in violation of the law and penalized under section 282J.

8. We also cannot agree with the counsel that nominee directors or representatives of the minority shareholders should be exempted from their fiduciary responsibilities as directors. Particularly in cases such as the present one



where the Company is a listed entity, and has been so blatantly mismanaged over an extended period of time. In such circumstances, it is the duty of every member of the board, whether he or she is a non-executive director, nominee director or a minority director, to raise concern and have his views recorded in the meetings if nothing else. Although the extent of their responsibility may vary according to their position, the members of the board are overall responsible for the affairs of company and the violations if any, occurring during their tenure.

9. Keeping in view the above principle, in our opinion Mr. Musharraf Khan who was co-opted as a director on 05-01-2004, should not be held liable for the qualifications given by the auditors in the accounts for the year ended June 2004, particularly if these qualifications have been appearing since year 2000. His appeal is therefore accepted and the penalty imposed upon him is set aside. The Department is directed to refund the 25% penalty deposited by him as provided in section 282J(4) of the Ordinance.

10. Mr. Shadab Hassan on the other hand cannot plead the same defence as he has been a director of the Company since year 2002. Although he has not provided any document to prove that he had raised his concern over the auditor qualifications appearing in the accounts since year 2000, we take a lenient view keeping in mind his position as a non-executive director representing the minority shareholders. The penalty imposed on him is reduced to Rs.50,000/-. The Department is directed to refund Rs.200,000/- out of the 25% penalty deposited by him under section 282J(4) of the Ordinance.

11. As far as the waiver of penalties by the High Court is concerned, since the order of the High Court deals with a revival plan for the Company, the waiver in our opinion applies to the penalties on the Company itself, and not the ones imposed upon the management for innumerable contraventions committed by them. Besides,



the penalties imposed on the management are required to be paid by them from their own pocket and not by the Company. Having said that, however, we believe this decision should be put off till the outcome of the Intra-Court appeal filed by the Commission against the order dated 15-09-2005 of the Lahore High Court. Consequently, the order of imposition of penalty on Mr. Shadab Hassan shall remain suspended till the outcome of the Intra-Court appeal.

The appeal is disposed off in the above manner.

(Razi-ur-Rahman Khan)
Chairman/Commissioner

(Rashid I. Malik)
Commissioner

Announced in Islamabad on 22 June 2006