



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
SPECIALIZED COMPANIES DIVISION
POLICY, REGULATION AND DEVELOPMENT DEPARTMENT
(MODARABA WING)

Before Tariq Naseem, Registrar Modaraba
In the matter of
First Tri-Star Modaraba, managed by A.R.T. Modaraba Management (Private) Limited

Number and Date of Notice: SC/M.MS/TriStar/42/2022-50 dated February 21, 2022

Date of Hearings: March 11, 2022
March 28, 2022
April 8, 2022
April 12, 2022

Present for Respondent: None

Date of Order May 16, 2022

ORDER

Under Section 32 of Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980

This Order shall dispose of the proceedings initiated against the First Tri-Star Modaraba (the "Modaraba") managed by the A.R.T. Modaraba Management (Private) Limited (the "Modaraba Company") through show-cause notice dated February 21, 2022 (the "Notice") issued under section 32 of the Modaraba Companies and Modaraba (Floatation and Control) Ordinance, 1980 (the "Modaraba Ordinance").

2. Brief facts of the case are that during review of annual audited financial statements of the Modaraba for the year ended June 30, 2021 (the "Financial Statements"), it has been observed that:

- ✓ The Modaraba has reported an investment of Rs.35.88 million in a group company, namely Tri Star Energy Limited (TSEL) and the aforesaid investment, *prima facie*, appears to be in contravention of regulation 10(i) (ii) of the Modaraba Regulations, 2021 (the "Modaraba Regulations").
- ✓ No sufficient explanation has been provided by the Modaraba Company in the Financial Statement regarding auditors' reservation / observation or remarks as required under rule 9 of the Modaraba Companies and Modaraba Rules, 1981 (the "Modaraba Rules") with regard to sale of TSEL shares to one of its directors.
- ✓ The investment was measured at cost instead of fair value, *prime facie*, to be in contravention with the requirements of IFRS 9 and the accounting policy of investment (Fair Value of Comprehensive Income) as adopted by the Modaraba.
- ✓ The Modaraba gave advance of Rs.31.4 million to Habib Jamal & Co, *prima facie*, appears to be in contravention of rule 31 of Modaraba Rules, regulation 9(viii) of Modaraba Regulations and section 17(2) of Modaraba Ordinance.





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The Modaraba Company was asked to provide explanation on the aforesaid observations vide letter dated November 4, 2021 and subsequent reminders dated November 19, 2021 and November 23, 2021 through email, however, the Modaraba Company has failed to provide any justification.

3. Consequently, the Notice dated February 21, 2022 under section 32 of the Modaraba Ordinance for contraventions of regulation 10 (i) (ii) of the Modaraba Regulations, rule 9 & 31 of the Modaraba Rules and section 17(2) of Modaraba Ordinance was served to Chief Executive Officer ("CEO") and all directors of the Modaraba as to why the proceedings should not be initiated under the Modaraba Ordinance and rules and regulations framed its under, and a penalty should not be imposed for violating provisions of section 32 of the Modaraba Ordinance.

4. In response, the Modaraba Company vide letter dated March 4, 2022 requested extension of 3 weeks' time for reply to the Notice, which was granted and hearing fixed for March 11, 2022 was also rescheduled for March 28, 2022. Mr. Jawed Hussain (the "Authorized Representative") vide email dated March 24, 2022 requested two weeks' more time for reply to the Notice, which was granted and hearing fixed for March 28, 2022 was again rescheduled for April 8, 2022.

5. The Authorized Representative submitted reply dated April 6, 2022 along with authorization letters from Mr. Asad Ahmed, CEO and Ms. Marium Ahmad, Director and requested to withdraw the requirement of hearing by taking his aforesaid letter as full and final submission from two directors of the Modaraba Company. The third director namely Mr. Ahmed Khizer Khan neither submitted any response nor authorized any person to represent him in the subject matter. The contentions raised by the Authorized Representative, vide his letter dated April 6, 2022, are summarized below:

- ✓ An offence under the Modaraba Regulations, 2021 is not cognizable/ punishable under section 32 of Modaraba Ordinance. Section 32 of the Modaraba Ordinance does not empower the Registrar Modaraba or the Commission to take cognizance of the violations of the Modaraba Regulations.
- ✓ Sub-section (2) of section 41A of the Modaraba Ordinance provides that "any regulation made under sub-section (1) may provide that a contravention thereof shall be punishable with a fine which may extend to one hundred thousand rupees....". However, the Modaraba Ordinance and the Modaraba Regulations are silent and does not specify/designate any authority for taking cognizance of the alleged violations of the Modaraba Regulations and adjudicate upon it like specific authority under section 32 of the Modaraba Ordinance or section 479(3) of the Companies Act, 2017.
- ✓ The SCN has been issued on the past and closed transactions which, *prima facie*, has already been adjudicated upon in 2008 by the Registrar Modaraba as well as the appellate authority. Regulation 10(ii) of the Modaraba Regulation which is applicable w.e.f. March 5, 2021 cannot be applied retrospectively on the investment in the shares of TSEL made long ago in the year 1996. It is also submitted that the auditor has totally ignored provision of article 12 of the Constitution of the Islamic Republic of Pakistan (Protection against retrospective punishment).

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NIC Building, Jinnah Avenue, Blue Area, Islamabad.
Tele. No. 9195188, email: tariq.naseem@secp.gov.pk



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- ✓ Second Tri Star Modaraba was merged in to First Tri Star Modaraba and the investment in the shares of TSEL appearing in the financial statements is the cumulative investment of both the Modarabas. The same violation of the Modaraba Regulations as reported in the instant SCN , was earlier made part of show cause notice dated April 9, 2008. In the order dated September 16, 2008, all our contentions pertaining to investment in excess of the limits prescribed in Prudential Regulations 7(1), 7(7) and 7(8), were acknowledged/ admitted/ accepted by the Registrar Modaraba in order dated 16.9.2008 as stated in the bold letters in paragraph 3 of the said order in the following terms:

QUOTE

"However, the explanation that the investment was made prior to the promulgation the PRs is accepted, but the management is directed to ensure the compliance of these Regulations as well as all provisions of the PRs latest by 31.3.2009."

UNQUOTE

- ✓ Accordingly, no penalty was imposed by the Registrar Modaraba on the alleged violations of Prudential Regulations 7(1), 7(7) and 7(8). However, the management was directed to ensure compliance to the provisions of the then Prudential Regulations by March 31, 2009. An appeal under sub-section (2) of section 32 of the Modaraba Ordinance was preferred against the order of the Registrar Modaraba dated September 16, 2008 in which the management of the Modaraba took the stance that it would not be possible for the Modaraba Company to withdraw its investments in its associated companies till the aforementioned cut-off date due to financial crunch of the country and that any such step would be detrimental to the certificate holders of the Modaraba. The honorable appellate forum also persuaded to give due credence to the stance of the Modaraba Company in para I(iv)(a) In the following terms:

QUOTE

"For the violations of Regulations 7(1), 7(7) and 7(8) of Part-II (A) of the PRs, it was accepted by the Registrar that said investments were made prior to the issuance of the PRs. Therefore, the questions of their non-compliance do not arise. However, the management was directed to ensure that the investments were brought in compliance to the provisions of the PRs."

UNQUOTE

- ✓ In response to the said direction of the Registrars Modaraba, it is submitted that since TSEL has not yet become operational, it is not possible to take exit. Despite that, one of the directors of the Modaraba has purchased 250,000 shares of TSEL at par value which is more than the breakup value, which is an evidence of the fact that we are cognizant of our responsibility. Hence the investment in TSEL has now been reduced from Rs. 72.711 million to Rs. 35.886 million i.e. reduced by more than 50% which shows our commitment to the issue in hand.
- ✓ We are unable to understand why a past and closed transaction questioned and made part of the instant SCN. The above SCN has been issued in blatant disregard of the decision of appellate forum of





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the Commission announced on August 7, 2009. We consider that the issuance of SCN is unlawful and inappropriate.

- ✓ The SCN gives an impression that the said investment was made in the financial year ended on 30.6.2021, which is factually incorrect. Further, the new Modaraba Regulations does not provide any timeframe to reduce the investment to the limits specified in the said Regulations. We made strenuous efforts to comply with the direction issued by the Registrar Modaraba to divest the shares of TSEL in the past to bring the investment under the parameters defined in the Modaraba Regulations. However, we could not succeed in divestment due to various factors such as non-availability of any buyer as the shares were of an unlisted company, which was dormant and could not start its business operations. Unfavorable economic conditions, non-grant of requisite licenses/permission by the relevant government departments to kick start the project, litigation on the project in the year 1996 and the absence of any exit mechanism for unlisted shares, were the main reasons which compelled the management not to divest the shares.
- ✓ It is pertinent to mention here that the aforesaid state of affairs was duly communicated by us to the off-site department of the Specialized Companies Division-Karachi/Registrar Modaraba in the past at the time of the scrutiny and periodic financial statements of the Modaraba of the past financial years, which was duly accepted during the last more than a decade, neither any question on non-compliance of the direction of the Registrar Modaraba was ever raised by the Registrar Modaraba/SECP nor any written explanation demanded.
- ✓ Please note that it has been decided by the courts of Pakistan that even when there is no limitation period prescribed by the law, action must be taken within a reasonable time. In this respect, reliance is placed on case Habib Bank Limited vs. Federation of Pakistan and others reported as 2013 PTD 1659.
- ✓ Regulation 10(ii) of the Modaraba Regulations is not at all applicable on the said investment. Moreover, the matter of investment in the shares of TSEL was decided and settled by the order of honorable appellate forum of the SECP announced on August 1, 2009 under sub-section (2) of section 32 of Modaraba Ordinance. Reissuance of a show cause notice on the same transaction for imposition of penalty under section 32 of the Modaraba Ordinance would lead to hit the principal of double jeopardy which is legally restricted. The application of the Modaraba Regulations retrospectively is, illegal, arbitrary and unconstitutional.
- ✓ 250,000 shares of TSEL have been sold to one of the directors of the Modaraba at par value which is more than the breakup value, which is an evidence of the fact that we are cognizant of our responsibility. There is no allegation in the auditor's report as well as in the SCN that the said shares were sold at less than the fair / actual value. Please note that due to typographical mistake, number of shares has been mentioned as 225,000 instead of 250,000 in Note No. 15.3. Hence, the investment in TSEL has now been reduced from Rs. 72.711 million to Rs. 35.886 million i.e. reduced by more than 50% which shows our commitment to resolve the issue in hand.
- ✓ The external auditors of the Modaraba Company have not raised any observation on the transaction of selling of 250,000 shares of TSEL to one of the directors of the Modaraba Company at par value of Rs.10/-. Rather, it is the auditor of the Modaraba who has expressed his inability to determine arm's length price of these shares. It is obviously because of the reason mentioned in this reply and the

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NIC Building, Jinnah Avenue, Blue Area, Islamabad.
Tele. No. 9195188, email: tariq.naseem@secp.gov.pk



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absence of any market mechanism for unlisted shares. He has neither pointed out any irregularity nor has said that the shares were sold at a lower price.

- ✓ It is vehemently denied that "No sufficient explanation has been provided by the Modaraba Company in the Financial Statement regarding auditors' reservation/observation as required under rule 9 of the Modaraba Rules". We would like to clarify that note 15.3 of the financial statements of the Modaraba adequately discloses the transaction of selling of 250,000 shares of TSEL to one of the directors at par value, on arm's length basis, with sufficient reasons and explanations for the readers of the financial statements.
- ✓ It is submitted that a show cause notice is a foundational document and must contain all information and evidences. If such evidence or information is incomplete or vague or suffers from any other defect, the SCN cannot be sustained. Reliance in this respect is made on case titled Caretex vs. Collector Sales Tax and Federal Excise and other (reported as 2013 VID 1536).
- ✓ There is no violation of IFRS-9 since the investment of the Modaraba in the shares of TSEL was measured at cost instead of fair value in accordance with the exception available in clause B5.2.3 of IFRS-9.
- ✓ Further, the contents "remaining investment which was measured at cost instead of fair value in contravention with the requirements IFRS-9 and the accounting policy of investment (FVOCI) in the SCN are not referring to any specific investment.
- ✓ It is submitted that the investment of the Modaraba in the shares of TSEL was measured at cost instead of fair value in accordance with the exception available in clause B5.2.3 of IFRS-9 as reproduced below:

B5.2.3 All investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, cost may be an appropriate estimate of fair value. (emphasis added). That may be the case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represent, the best estimate of fair value within that range.

- ✓ The investment of the Modaraba in the shares of TSEL was measured at cost instead of fair value due to the following reasons:
 - (i) TSEL a dormant company since more than two decades. Despite several efforts of the management, no investor had shown interest in acquiring the shares of the company, specially when the project is under litigation.
 - (ii) No mechanism to determine market price of the shares of TSEL was available as such fair value of the shares could not be ascertained.
 - (iii) The management of the Modaraba has been trying to divest the shares of TSEL in the past. To attract a prospective buyer and in the best interest of the Modaraba, the investment in the shares of TSEL was measured at cost in the financial statements of the Modaraba.
 - (iv) The management of the Modaraba is hopeful to divest the shares of TSEL in near future.





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- ✓ An offence under section 17 of the Modaraba Ordinance is not cognizable/ punishable under section 32 of Modaraba Ordinance. Rather it falls under the jurisdiction of the Modaraba Tribunal in terms of section 31 read with section 25(b) of the Modaraba Ordinance. The SCN has been issued without any jurisdiction and liable to be withdrawn on this ground as well. Further it denied that the Modaraba Company or any of its directors/ officers has committed any violation of section 17 of the Modaraba Ordinance.
- ✓ In the transaction with Habib Jamal & Co, none of the directors/ officers or their relatives or the Modaraba Company has obtained any loan, advance or credit from the funds of the Modaraba within the meaning of sub-section (2) of section 17 of the Modaraba Ordinance, as the advance payment of Rs.31.4 M was made to Habib Jamal & Co. as a vendor for the purposes of solar panels as per market norms. The application of this section has been stretched to cover the transaction with Habib Jamal & Co. mentioned in the SCN, illegally and unlawfully.
- ✓ The building in which the office of the Modaraba is situated, is owned by the Modaraba itself and keeping in mind the huge electricity cost and future expectation. The Modaraba has decided to install solar system in the building and has made the advance payment of Rs.31.4 million to Habib Jamal & Co. as a vendor for the purposes of solar panels, as per market norms.
- ✓ Rule 31 of the Modaraba Rules is applicable on loan or contribution by the Modaraba to any of the associated undertakings of the Modaraba Company or political parties or other organization of political nature. Its scope cannot be extended to the advances to the vendors as per market norms for the purpose of purchase of solar panels or any other items.
- ✓ Similarly, regulation 9(viii) prohibits providing finance to associated company/group company/close relatives/directors etc. Its scope cannot be extended to the advances to the vendors as per market norms for the purpose of purchase of solar panels or any other items.
- ✓ In fact, it is a related party transaction in terms of section 208 of the Companies Act, 2017 and necessary compliance of the said provision as well disclosure is made in Note 25 of the Financial Statements for the year ended on 30.6.2021.

Furthermore, it is submitted that no letter dated November 4, 2021 and subsequent reminders dated November 19, 2021 and November 23, 2021 through emails received.

6. Before proceeding to decide the case, I deem it necessary to advert to the following relevant provisions of Section 32 of the Modaraba Ordinance, which states as under:

32. Penalty.

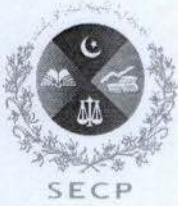
(1) If any person-

(a) refuses or fails to furnish any document, return or information which he is required to furnish by or under this Ordinance; or

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NIC Building, Jinnah Avenue, Blue Area, Islamabad.
Tele. No. 9195188, email: tariq.naseem@secp.gov.pk



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(b) refuses or fails to comply with any condition imposed or made by the Federal Government or direction made or given under this Ordinance or the rules; or

(c) contravenes or otherwise fails to comply with any provision of this Ordinance or the rules other than those referred to in sub-section (1) of section 31, the Registrar, may, if he is satisfied, after giving the person an opportunity of being heard, that the refusal, failure or contravention was willful, by order, direct that such person shall pay to the Federal Government by way of penalty such sum not exceeding one hundred thousand rupees as may be specified in the order and, in the case of a continuing default, a further sum calculated at a rate not exceeding one thousand rupees for every day after the issue of such order during which the refusal, failure or contravention continues.

7. I have assessed, considered and analyzed all the relevant facts of the case, the arguments submitted by the Authorized Representative in the written reply and relevant provisions of the law. As for as contention of the Modaraba Company is concerned that Registrar Modaraba cannot take cognizance of the violations of the Modaraba Regulations under section 32 of Modaraba Ordinance, it may be noted that clause (b) of sub-section of section 32 clearly provide for action where any person refuses or fails to comply with any directions made or given under the Modaraba Ordinance. Since, the Modaraba Company failed to comply with directions of the Registrar Modaraba and appellate forum issued under the Modaraba Ordinance, therefore the Notice has been issued rightly under legal authority.

8. Although the Modaraba Regulations made under sub-section (1) of section 41A of the Modaraba Ordinance, presently do not provide for imposition of penalty, sub-section (2) of the said section 41A stipulate penalty amount that regulations made under sub-section (1) may provide. Nonetheless, non-provision of penalty provision does not mean that the violation of provisions of the Modaraba Regulations is not an offence.

9. It is denied that the Notice gives an impression that the said investments was made in the financial year ended June 30, 2021. It is clearly mentioned in the Notice that this investment was made long ago but the Modaraba Company failed to comply with the direction of the Registrar Modaraba vide order dated September 16, 2008.

10. I would like to clarify that the Authorized Representative stance relating to the appellate forum's order dated August 7, 2009 is not correct. He only quoted paragraph 1 (iv) (a) of the order, whereas in para 7 (i) of appellate forum's order dated august 7, 2009, it is provided that:

"After having heard the arguments of both the Attorney and the Registrar, I am persuaded to give due credence to the fact that the investment made by the Modaraba Company were prior to the introduction of the PRs. Therefore, the Registrar had rightly conceded to the argument of the Attorney and did not impose a fine. In addition, the Attorney has requested this forum to consider the fact that to comply with the direction of the Registrar, to withdraw its investment at such a stage when the





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country is going through a stressful financial situation, it would be detrimental to the certificate holders of the Modaraba. In view of this request, I am of the opinion that the foremost responsibility of the Commission is to protect the rights and interests of the certificate holders of the Modaraba. However, at the same time it is also the duty of this office to ensure compliance of the relevant laws. Accordingly, keeping the interests of the certificate holders of the Modaraba primary and to ensure compliance to the Law, the Modaraba Company is hereby directed to submit a time bound plan to the office of the Registrar for withdrawing the subject matter investments in compliance to the PRs."

It is clear that both the Registrar Modaraba and the appellate forum directed the Modaraba Company to ensure that the investments were brought in compliance to the provisions of the regulations. Further, the appellate forum also directed to submit the time bound plan to the Registrar Modaraba. However, the aforesaid directions have not been complied with and the Modaraba Company has neither ensured compliance with the stated provisions of the regulations nor submitted the required action plan to the office of the Registrar.

11. The argument of the Authorized Representative that the investment was made prior to the promulgation of the Prudential Regulations was already accepted in the order dated September 16, 2008 and now it is closed transaction is not true. The reason to include this matter in the Notice is that the Modaraba Company has still not complied with the direction of the Registrar Modaraba and the appellate forum. Further, the Modaraba Company had never applied to this office for relaxation from the provisions of Modaraba Regulations, under regulation 35, if it feels that it was difficult to comply with any of the provisions of the Modaraba Regulations.

12. Further, the Modaraba Company's stance that TSEL has not yet become operational and therefore it is not possible to take exit and that in the instance case that Modaraba Regulations does not provide any timeframe to reduce the investment to the limits specified in the said Regulations is not accepted. The Modaraba Company was obliged to comply with provisions of the Modaraba Regulations in light of directions of the Registrar Modaraba and appellate forum or otherwise applied for the relaxation. In absence of both, I am of the considered view that failure to comply with directions of the Registrar Modaraba and appellate forum was willful and therefore hereby impose a penalty of an amount of Rs.50,000/- on the Modaraba Company under section 32 of the Modaraba Ordinance.

13. As regard advance of Rs.31.4 million to Habib Jamal & Co., upon reviewing the office record, it is revealed that necessary disclosure with regard to related party transaction in terms of section 208 of the Companies Act, 2017 has been made in Note 25 of the Financial Statements for the year ended on 30.6.2021. Further, the stance of the Modaraba Company with regard to section 17 (2) of the Modaraba Ordinance and regulation 9(viii) of the Modaraba Regulations is also accepted. The proceedings for alleged violation of section 17 (2) of the Modaraba Ordinance, rule 31 of the Modaraba Rules and regulation 9(viii) of the Modaraba Regulations are hereby dropped.

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NIC Building, Jinnah Avenue, Blue Area, Islamabad.
Tele. No. 9195188, email: tariq.naseem@secp.gov.pk



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14. The arguments submitted with respect to rule 9 and 10 of the Modaraba Rules, considering the inability of the external auditor to determine arms' length price of the shares of TSEL and disclosure made in the financial statements, clause B5.2.3 of IFRS-9 and justification provide by the Modaraba Company to measure the investment at cost instead of fair value, the proceedings under rule 9 and 10 of the Modaraba Rules are hereby dropped.
15. Furthermore, in view of the foregoing, I hereby direct the Modaraba Company, in exercise of powers under section 18A of the Modaraba Ordinance, to submit time bound plan for withdrawing the access investments in TSEL in compliance of the Modaraba Regulations by June 30, 2022. In case of continuing default after that date, the Modaraba Company shall pay a further sum calculated at a rate of Rs.1,000/- for every day during which failure continues.
16. Noting in this order may be deemed to prejudice operation of any other provision of the Modaraba Ordinance providing for the prosecution or imposition of further penalties on the CEO, Directors of the Modaraba Company in respect of any default, omission, violation of the Modaraba Ordinance, Modaraba Rules and Modaraba Regulations by them.
17. The Modaraba Company is hereby directed to deposit within thirty days of the date of the receipt of this Order the aforesaid penalty of Rs.50,000/- (Rupees fifty thousand) in the designated bank account maintained in the name of Securities & Exchange Commission of Pakistan with MCB Bank Limited and furnish original receipted challan to the Commission.
18. Issued under my hand and seal this 16th May, 2022.


Tariq Naseem
Registrar Modaraba

