BEFORE APPELLATE BENCH NO. I

In the matter of

Appeal No. 32 of 2004

1. Delta Innovations Ltd.
2. Delta Climate Control Ltd.
3. Dewan Motors (Pvt) Ltd.
4. Dewan Mushtaq Motors (Pvt) Ltd.
5. Dewan M. Yousuf Farooqui
6. Heena Yousuf Farooqui

…… Appellants

Vs.

Commissioner (Securities Market Division) …….. Respondent

Appeal No. 33 of 2004

1. Pakland Cement Ltd.
2. Delta Innovations Ltd.
3. Delta Climate Control Ltd.
4. Dewan Motors (Pvt) Ltd.
5. Dewan Mushtaq Motors (Pvt) Ltd.
6. Dewan M. Yousuf Farooqui
7. Heena Yousuf Farooqui

…… Appellants

Vs.

Commissioner (Securities Market Division) …….. Respondent

PRESENT:

For the Appellant

1. Mr. Ijaz Ahmad, Advocate
2. Mr. S Moonis A. Alvi

For the Respondent

1. Ms. Jahanara Ahmad Joint Director (SM)
2. Mr. Ikram Ul Haq Joint Director (Law)
3. Mr. Sajid Imran Deputy Director (SM)

ORDER

1. Since both the appeals No. 32 & 33 of 2004 involve the same issue, we intend to dispose them off through this single order.

2. Brief facts leading to these appeals are that the Commission on 18-05-2004 received a facsimile from the General Manager Finance of Dewan Mushtaq Group containing a letter and a copy of a public announcement published in two daily newspapers on the same day. The said letter revealed that the Dewan Mushtaq Group (the 'Acquirer') had acquired 34,575,502 (approximately 42%) voting shares of Pakland Cement Ltd and 36,175,900 (approximately 19%) voting shares of Saadi Cement Ltd through share purchase agreements. However, the public announcement was with regards to the purchase of Pakland Cement Ltd only. Since Pakland Cement Ltd ('Pakland') was an existing shareholder of the Saadi Cement Ltd ('Saadi'), and held in aggregate 80,000,000 (approximately 43%) voting shares of Saadi, the Acquirer consequently ended up indirectly acquiring 62% of the voting shares of Saadi, and therefore, its control. The Commission issued two notices, both dated 28-05-2004 to the Acquirer through its Chairman to show cause why action may not be taken against it under sub-section (1) of section 25 and sub-sections (1) & (3) of section 26 of the Listed Companies (Substantial Acquisition of Voting Shares & Takeovers) Ordinance, 2002 ('Ordinance') for violating the provisions of sections 5, 7, 9 and 13 of the Ordinance in case of acquisition of Saadi, and sections 7, 9 and 13 of the Ordinance in case of acquisition of Pakland. An opportunity of personal hearing was provided by Commissioner (Securities Market Division) to the Acquirer. On query during the said hearing, the details of the actual six persons who acquired the shares of Pakland and

Saadi were revealed by the representatives of the Acquirer. These are Delta Innovations Ltd., Delta Climate Control Ltd., Dewan Motors (Pvt) Ltd., Dewan Mushtaq Motors (Pvt) Ltd., Dewan M. Yousuf Farooqui and Heena Yousuf Farooqui.

4. Not being satisfied by the arguments presented before him, Commissioner (SMD) passed two separate orders, both dated 30-09-2004. In the case of acquisition of Pakland, he imposed a total penalty of Rs.1 million on the above six acquirers (appellants in appeal No.32 of 2004) in proportion to their shareholding, and further directed them not to dispose of their shares in Pakland for a period of three years from the date of acquisition. In the case of acquisition of Saadi, he imposed a total penalty of Rs.1 million on the above six acquirers, as well as Pakland for acting in concert with the acquirers, (appellants in appeal No.33 of 2004) in proportion to their shareholding, and further directed them not to dispose of their shares in Saadi for a period of three years from the date of acquisition.

5. These two appeals have been filed by the six acquirers and Pakland, against the above two orders under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997. Both these appeals were heard on 22-02-2005 when Mr. Ijaz Ahmed Advocate and Mr. S. Moonis A. Alvi appeared on behalf of the appellants.

6. In appeal No.32 of 2004 filed in the case of acquisition of Pakland, Mr. Ijaz Ahmed stated that approximately 35,000,000 shares of Pakland were acquired by the Acquirer through a share purchase agreement. Further, the Acquirers had made a public announcement of offer for purchase of 7,425,000 shares of Pakland on 18-05-2004. He stated that Pakland was a highly indebted company and had entered into a scheme of arrangement with its creditors. However, Pakland even defaulted under the scheme, and the acquisition by the Acquirers has saved the company and its shareholders from distress sale of assets. He argued that Pakland under the new management appointed

by the Acquirer, was on its way to recovery, and the improvement in the price of its shares reflects this change. He stated that a large number of Pakland shares traded through the stock exchange were not transferred to the purchasers since 1998 despite judgments and orders of Hon'ble High Court of Sindh and the Commission. The present management after the acquisition has transferred majority of these shares and is in the process of transferring the remaining shares. These facts he argued, proved that the acquisition of Pakland has resulted in the benefit of the company and the minority shareholders. He stated that the objective of the Takeover law is the protection of minority shareholders and therefore, Acquirers had not violated the spirit of the law. He stated that a large portion of the Ordinance has been left to the Rules to be prescribed under the Ordinance, however as yet no Rules have been framed by the competent authority and therefore meaningful compliance with the provisions of the Ordinance is not possible. He referred to sections 9(2) and 10 of the Ordinance which provide that the information to be provided and contents of public announcement and public offer shall be prescribed by the Rules. He argued that the Ordinance although in force was not in effect. He stated that even then the Acquirers had complied with the requirement of making a public offer and notably none of the minority shareholders have come forward to sell their shares. This, he argued meant that the minority shareholders were happy with the acquisition of Pakland. He contended that no willful default had been established on part of the Acquirers. In such circumstances, the penal provisions of the Ordinance should not have been given effect and the Acquirers may have been given a warning instead, by the Respondent.

7. In the case of acquisition of Saadi, in addition to the above arguments, Mr. Ijaz Ahmed contended that the Acquirer had only acquired 19% of its shares and therefore section 5 of the Ordinance was not attracted to the case. He stated that the shares of Saadi already held by Pakland should not have been counted along with the 19% shares acquired by the Acquirers. He referred to clause (l) of section 3 of the Ordinance, which

provides that the provisions of the Ordinance do not apply to existing shares held by a person on the date of commencement of the Ordinance. He further argued that in any case, Pakland being the target company cannot be said to have acted in concert with the acquirers and therefore should not have been penalized. He informed the Bench that the Acquirers had deposited the fine imposed by the Respondent under protest. However, on the grounds given by him, he prayed that both the orders be set aside and the fine may be refunded to the Acquirers.

8. Ms. Jahanara Ahmad, Joint Director appearing on behalf of the Respondent contended that it was wrong to argue that Commissioner (SMD) had not taken into consideration the improved financial position of Pakland and Saadi. This fact, she stated had been recorded in the impugned orders and the Commissioner had consequently taken a lenient view by not ordering disinvestment in the shares of Pakland and Saadi. However, any improvement in the financial position of the companies cannot exonerate the acquirers from complying with statutory requirements. She stated that a number of violations of the Ordinance had been committed by the Acquirers. In the case of acquisition of Pakland, these *inter alia* included failure to, (a) appoint a manager to the offer as required under section 7(1); (b) submit a copy of the public announcement to the Commission and stock exchanges within the stipulated time under section 9(3); (c) send a copy of the proposed offer letter within the stipulated time period to the stock exchanges and the Commission under section 13(1); (d) specify a cut-off date in the public announcement to determine the eligible shareholders who are to be sent the offer letter under section 13(2); and (e) deposit security and make financial arrangement for fulfillment of obligations as stipulated under sub-sections (8) & (9) of section 13. In the case of acquisition of Saadi, these further included failure to make a public announcement of offer to acquire voting shares or control of the Company as required under section 5 of the Ordinance, and before making such

announcement, failure to make a disclosure in the manner as mentioned under Section 4.

9. Mr. Ikram Ul Haq also appearing on behalf of the Respondent contended that the Ordinance was in force and in effect from the day it was promulgated as mentioned in sub-section (3) of section 1, and it was untenable to argue that since the Rules had not been prescribed, the Ordinance itself was not in effect. Besides, it was clear from the impugned orders that the acquirers had been penalized for violating the provisions of the Ordinance itself and not for those requirements, which are still to be prescribed under the Rules. On the issue of willfulness, it was contended that the Acquirers knew well that they were required to fulfill the requirements of law, which is apparent from the public announcement made by them on 18-05-2004 of offer to acquire 9% voting shares. Therefore there was nothing stopping them from fulfilling the remaining requirements. With regards to the argument that the Acquirers had only acquired 19% shares of Saadi and not 62%, it was contended that section 5 of the Ordinance covers the situation where the shares are acquired directly or indirectly. In the present case, the acquirers had proceeded to acquire 62% shares of Saadi indirectly by acquiring the shares of Pakland and therefore were required to fulfill the requirements of law. On the issue of culpability of Pakland, Ms. Jahanara contended that the Ordinance covers acquisition made by the Acquirer itself or through another person acting in concert. In the case of acquisition of Saadi, Pakland had acted in concert with the Acquirer and therefore was in violation of the Ordinance.

10. We have heard the arguments presented before us and also examined the available record. Mr. Ijaz has presented before us, details of the improvement in the financial, managerial and administrative condition of both Pakland and Saadi. The appalling condition in which these two companies were before their acquisition is in public knowledge. It cannot, therefore, be denied that the acquisition of these

companies has been for the benefit of the companies as well as its shareholders. This is the reason why Commissioner (SMD) has not ordered disinvestment of those shares which have been acquired in violation of the Ordinance.

11. We have noted the difficulty being caused by lack of Rules in implementing the Ordinance in an effective manner. However, we are not inclined to agree that the Ordinance in the absence of the Rules is not in force or effect. What needs to be appreciated is that the appellants have been penalized for not complying with those requirements which are laid down in the Ordinance itself, and not any such requirements which are supposed to be prescribed by the Rules. As for the argument that the Acquirers had only acquired 19% shares of Saadi and therefore did not fell foul of section 5, the relevant section 5 is quite clear and self explanatory.

> "5. **Additional acquisition of voting shares. —** (1) No person shall, directly or indirectly, acquire—
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> a) voting shares, which (taken together with voting shares, if any, held by such person) would entitle such person to more than twenty five per cent voting shares in a listed company; or
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> b) control of a listed company,
>
> unless such person makes a public announcement of offer to acquire voting shares or control of such company in accordance with this Ordinance.
>
> (2) Before making announcement under sub-section (1), such person shall make disclosure in the manner specified in section 4."

12. The acquirers have fallen foul of both sub-clauses (a) and (b) of section 5 as they had acquired voting shares of Saadi, which taken together with the voting shares held through Pakland entitled them to more than 25% voting shares. In addition, they had also acquired the control of Saadi. Section 5 also clearly provides that such shares may be acquired directly or indirectly as in the present case. We also do not agree that the

shares of Saadi held by Pakland would be exempted under sub-clause (l) of section 3, which provides,

> "**3. Ordinance not to apply to certain transactions.-** Nothing contained in this Ordinance shall apply to -
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> …
>
> (l) existing shares held by a person on the date of commencement of this Ordinance. "

13. The above exemption is for voting shares held by a person when no new acquisition is made by that person in addition to the existing shares. Where any new acquisition is made by a person, than the existing shares held by that person are to be counted along with the new acquisition to see if he has crossed any of the thresholds mentioned in sections 4, 5 and 6, as is clearly laid down in section 4(1) and section 5(1)(a), where its says, "…*voting shares, which (taken together with voting shares, if any, held by such person) would entitle such person to more than…*".

14. It is also not correct to argue that the shares held by Pakland should not be counted. The words "directly or indirectly" have been used in section 5(1) as well as the definition of the term "acquirer" given in section 2(1)(a) of the Ordinance to cover situations such as the present one. Otherwise, it would leave a loophole in the law to be utilized for acquisition of listed companies indirectly, by acquiring the holding companies of such listed companies. Similarly, the Ordinance covers the situation where the acquirer acts in concert with any other person to acquire a listed company as in the present case. The shares of Saadi held by Pakland have therefore been rightly counted along with the shares acquired directly by the Acquirers. However we do not agree with the Commissioner on the culpability of Pakland in the acquisition of Saadi. Although the acquirers have acted in concert with Pakland and have therefore

indirectly acquired control of Saadi, we are unable to see how Pakland, which was in fact the target company, could have willfully violated the provisions of the Ordinance. Pakland did not have a choice in the present case.

15. The Acquirers have argued against the restriction imposed by the impugned orders, on disposing of the shares acquired by them for a period of 3 years. However, we believe that it is a reasonable restriction in the interest of the companies and its minority shareholders. The Acquirers have themselves relied upon the refusal of the minority shareholders to sell their shares pursuant to the public offer, to contend that, the minority shareholders are pleased with the takeover. They have further declared that the intention behind the takeover is the rehabilitation of these sick companies. If the Acquirers have created a legitimate expectation in the minds of the minority shareholders and the investors, then they should not be allowed to make a quick profit by selling the companies in rapid succession.

16. Notwithstanding the above legal findings, however we consider that keeping in mind the benefit which has accrued from the acquisition of these sick companies, a maximum fine should not have been imposed upon the Acquirers. In fact, in our view, the Takeover law should provide for certain exemptions, particularly for the acquisition and takeover of sick companies, where the intention behind the acquisition is rehabilitation of those companies. Where the acquisition is in the greater public benefit in addition to the benefit of the minority shareholders, penalizing the acquirers would amount to defeating the purpose of the Takeover law. It would also be against the Government's policy of rehabilitation of sick industrial units in the country. The Securities Market Division should, with assistance from the Policy Department of the Commission, consider proposing amendments in the Takeover law so that the spirit of this law is clarified. Further it should hasten the framing of the Rules so that the Takeover law can be implemented effectively.

17. For reasons stated above, we consider that a lenient view should be taken in the matter. Therefore the penalties imposed on the Acquirers in the acquisition of both Pakland and Saadi are hereby set aside. However, the Acquirers, including Pakland are directed not to dispose of their shares for a period of three years from the date of acquisition. Both the appeals No.32 and 33 of 2004 are disposed off.

(ETRAT H. RIZVI)
Commissioner

(SALMAN ALI SHAIKH)
Commissioner

Announced in Islamabad on May 5, 2005