



# Securities and Exchange Commission of Pakistan

## BEFORE THE LARGER APPELLATE BENCH

In the matter of

### Appeal No. 14 of 2023

Farooq Rahmatullah Khan

...Appellant

versus

Adjudication Department – I, SECP

...Respondent

### Date of hearing:

August 17, 2023

### Present:

#### For the Appellant:

1. Barrister Mohammad A. Qayyum, ASC
2. Mr. Taimur Khan

#### For the Respondent:

1. Mr. Muhammad Anwar Hashmi, Additional Joint Director, Adjudication-I, SECP
2. Raja Farukh Ahmad, Additional Joint Director, Adjudication-I, SECP

### ORDER

1. By a majority of 2:1 (*Commissioner Mr. Abdul Rehman Warraich dissenting*), this Order shall dispose of Appeal No. 14 of 2023 filed by Mr. Farooq Rahmatullah Khan (the “Appellant”), former director of M/s. Hascol Petroleum Limited (the “Company”), under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 (the “SECP Act”).
2. The brief facts of the case are that pursuant to the investigation order dated July 08, 2021 and supplementary investigation order dated August 27, 2021 issued under section 257 of the Companies Act, 2017 (the “Act”), investigation into all aspects of the Company was conducted and the investigation report dated January 12, 2022 *inter alia* revealed that utilization of the right issue of 2017 amounting to Rs. 3.892 billion was not in accordance with the stated purpose. The Appellant was issued a show-cause notice dated June 30, 2022 (the “SCN”) under rule 5(ii) read with rule 11 of the Companies (Issue of Capital) Rules, 1996 (the “Rules”) which was responded by the Appellant vide written responses dated July 06, 2022 and August 25, 2022. Initially, hearing in the SCN proceedings



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was held on August 30, 2021 and the Appellant was advised/allowed to submit within fifteen days his reply along with all supporting evidences to substantiate the fact that he was not involved in alleged violation of the Rules. Thereafter, hearings in the matter were fixed for October 03, 2022 and October 18, 2022, where-after the Respondent, vide order dated October 27, 2022 passed under rule 11 of the Rules (the "Impugned Order"), imposed a penalty of Rs. 300,000/- on the Appellant. Earlier, the instant Appeal was heard by a two-member bench on July 20, 2023, however, on account of divided opinion, the matter is now placed before the larger bench, constituted by the competent authority, for adjudication of the instant Appeal.

3. At the outset, the counsel for the Appellant *inter alia* submitted that the Appellant was an independent and non-executive director on the Board of the Company from 2012 to September 2020 and as per financial statements of the Company for the year 2017, the Appellant owns only 0.23% of the shareholding of the Company. It was submitted that the Appellant, being an independent/non-executive director of the Company, is entitled to protection under section 181 of the Act and also contended that the SCN does not substantiate as to how the said protection is not attracted in case of the Appellant thus, was wrongly held responsible and penalized by the Respondent. The counsel for the Appellant argued that the record clearly demonstrates that the Appellant had no knowledge of the violations alleged in the SCN at the relevant times and subsequently, when the subsidiary company alleged issue of disputed purchases (LCs with Byco) was brought up before the Board of the Company by the then CEO, the Appellant was the only person who strongly supported the action. In support of the argument, the Appellant relied upon the statement of Mr. Waheed Shaikh (then CEO of the Company); Appellant's email to the Board dated April 06, 2020; and minutes of the Board meeting held on April 07, 2020. The Appellant contended that he has been penalized on account of contravention of rule 5(ii) of the Rules which is not applicable in the instant case as the said rule mandates *inter alia* recording by the Board in its resolution, the purpose of the right issue, which the Board did in compliance of rule 5(ii) of the Rules. The counsel for the Appellant argued that the Respondent erred in attracting the *ibid* provision as the instant case is not of non-recording by the Board in its resolution rather use of the proceeds for the purpose other than what was approved by the Board. Further contended, that the Impugned Order fails to establish any of the ingredients of rule 11 of the Rules and is thus liable to be set-aside on this score alone. It was also argued by the Appellant that the Respondent violated the principle of consistency while passing the Impugned Order as one of the members of the Board's Audit

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Committee was not even show-caused whereas the head of the said committee was exonerated by the Respondent after issuing a warning vide the Impugned Order. While summing up the arguments, the Appellant's counsel contended that the Appellant has been exonerated by the Federal Investigation Agency (FIA) after a detailed fact-finding exercise and the said outcome is relevant in the instant matter as well. Lastly, the Appellant argued that the concept of vicarious liability is also not attracted in the instant matter as the Appellant being a non-executive/independent director of the Company was not involved in effectuating the decisions of the Board as the same was the responsibility of the management of the Company, and as such the Appellant cannot be held liable of any knowledge in the hindsight for any wrong-doings on part of the management of the Company.

4. During the course of the hearing, the Respondent raised a preliminary objection on the constitution of the larger Bench and submitted that section 33 of the SECP Act does not envisage constitution of a larger Appellate Bench and in this context rule 17(6) of the Securities and Exchange Commission of Pakistan (Appellate Bench Procedure) Rules, 2003 (the "Appellate Bench Rules"), which deals with the constitution of a larger Bench, is ultra vires of the SECP Act. In support of the said contention, the Respondent has argued that section 41 of the Competition Act, 2010 which deals with the Appellate Bench of the Competition Commission of Pakistan (CCP), expressly allows the constitution of a larger Appellate Bench of the CCP, which is not the case in section 33 of the SECP Act. Moreover, while controverting the arguments of the Appellant, the Respondent *inter alia* contended that the Appellant contravened rule 5(ii) of the Rules due to the reason that he failed to substantiate his stance and failed to provide any acceptable supporting evidence that the proceeds of the right issue of 2017 were utilized for stated purposes. It was contended by the Respondent that the Appellant, having experience in the petroleum sector, was expected to act diligently, as he was a part of the Board of the Company when the resolution pertaining to purpose of the right issue was passed.
5. In rebuttal to the argument of the Appellant with respect to mis-application of rule 5(ii) of the Rules, the Respondent contended that the Appellant was penalised vide Impugned Order under rule 5(ii) of the Rules read with rule 11 of the Rules where the latter provision is a penal clause and thus the Impugned Order does not suffer from any illegality. The Respondent argued that there is nothing on record from the Company which can be seen as an endorsement of the stance of the Appellant and whereas the documents relied upon by the Appellant during the hearing before this Bench, were never

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shared with the Respondent during the SCN proceedings. Lastly, the Respondent submitted that the Company disseminated information through the Pakistan Stock Exchange and the said statement is on record and is sufficient to justify imposition of penalty on the Appellant on account of violation of the relevant provision of the Rules.

6. The Appellate Bench (the "Bench") has heard the parties and perused the record. At the outset it would be apt to deal with the objection raised by the Respondent with respect to the larger bench constituted to decide the instant Appeal. In this regard, it is worthwhile to have a glance at section 33 of the SECP Act and the same is reproduced hereinunder for ease of reference:

*"33. Appeal to the Appellate Bench of the Commission.- (1) Except as otherwise provided any person aggrieved by an order of the Commission passed by one Commissioner or an officer authorized in this behalf by the Commission, may within thirty days of the order, prefer an appeal to an Appellate Bench of the Commission constituted under sub-section (2):*

....

*(2) The Commission shall constitute an Appellate Bench of the Commission comprising not less than two Commissioners to hear appeals under sub-section (1)*

...

*(4) The form in which an appeal is to be filed and the fees to be paid therefor and other related matters shall be prescribed by rules."*

Perusal of the above legal provision transpires that the same *inter alia* provides a right of appeal against an order passed by one Commissioner or an officer authorized in this behalf by the Commission. The said provision also provides about the mandatory constitution of the bench of not less than two Commissioners. Moreover, sub-section (4) of section 33 of the SECP Act provides that the form in which an appeal is to be filed and the fees to be paid therefor and other related matters shall be prescribed by rules i.e. the Appellate Bench Rules. Therefore, the Federal Government in exercise of its powers conferred under section 39(1) read with 33(4) of the SECP Act promulgated the Appellate Bench Rules which prescribe a comprehensive procedure regarding the form and manner of the appeals to be filed and other related matters. With reference to the issue in hand, rule 17 of the Appellate Bench Rules is relevant which provides the procedure for hearing and decisions of the appeals. The same is reproduced hereinunder for ease of reference:

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### *“17. Hearing of appeal and decision of appeal—*

...

*(6) If the Commissioners constituting the Appellate Bench hearing the appeal are divided in opinion, the appeal shall be placed for hearing and disposal before a larger Bench to be nominated by Chairman of the Commission.”*

7. It is a matter of record that the two-member bench heard the instant Appeal on July 20, 2023, however, on account of divided opinion, referred the matter to the Chairman, Securities and Exchange Commission of Pakistan (the “Commission”) for constitution of a larger bench, in pursuance of rule 17(6) of the Appellate Bench Rules. Consequently, a larger bench was constituted by the competent authority for the purpose of hearing of appeal, as there was a division in the two-member bench, and thus there is no ambiguity that the Chairman of the Commission under the Appellate Bench Rules is empowered to constitute a larger bench.
8. As far as the contention of the Respondent that constitution of a larger bench under rule 17(6) of the Appellate Bench is *ultra vires* of section 33 of the SECP Act is concerned, the Bench is of the view that rule 17(6) of the Appellate Bench Rules merely caters the eventuality in case of a divided opinion which in no manner can be regarded as going beyond the mandate of the primary legislation. Had there been a provision in the Appellate Bench Rules requiring constitution of a bench of upto or not more than two Commissioners, only then there would have been a case of subordinate legislation going beyond the scope of the primary law or contradicting the statutory provision. Finally, reliance of the Respondent on section 41 of the Competition Act, 2010 is also misplaced as section 33 of the SECP Act and section 41 of the Competition Act, 2010 are not *pari materia*, needless to mention that sub-section (5) of section 41 of the Competition Act, 2010 also empowers framing of rules *inter alia* for other related matters.
9. Therefore, objection of the Respondent with respect to constitution of a larger bench is hereby turned down as the same has been validly constituted in accordance with law. Needless to mention that in light of the judgment passed by the Hon’ble Supreme Court of Pakistan, reported as 2021 SCMR 321, vires

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of a law can only be challenged by way of a constitutional petition before a High Court on any constitutional and legal grounds.

10. On merits of the instant appeal, it would be apt to first have a glance at the relevant legal provisions of the Act and thus the same is reproduced hereinunder for ease of reference,

*“181. Protection to independent and non-executive directors.—(1) Notwithstanding anything contained in this Act—*

*(a) an independent director; and*

*(b) a non-executive director;*

*shall be held liable, only in respect of such acts of omission or commission by a listed company or a public sector company which had occurred with his knowledge, attributable through board processes, and with his consent or connivance or where he had not acted diligently...”*

11. Bare perusal of section 181 of the Act reveals that a statutory protection is available *inter alia* to independent and non-executive directors of a listed company, and the same shall be held liable only for acts of omission or commission of a company where not only they had knowledge of occurrence but also their consent or connivance or failure to act diligently has been established.

12. The Appellant has been penalized under rule 5(ii) read with rule 11 of the Rules as he was a director of the Company accused of not utilizing the proceeds of the right issue for the purpose mentioned in the announcement of right issue dated September 13, 2017. For brevity, relevant provisions of the said rules are reproduced hereinunder,

*“5. Issue of right shares of a listed company.- A listed company may issue right shares subject to the following conditions, namely:-...*

*(ii) the board of directors of the company while deciding the right issue shall in its resolution clearly record the quantum of the issue, issue price per share, purpose of the right issue, use of the proceeds of the issue, its benefits to the company and the risk factors associated with the right issue, if any; ...”*

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*“11. Penalty. — Whoever fails or refuses to comply with, or contravenes any provision of these rules, or knowingly and wilfully authorizes, abets or permits such failure, refusal or contravention, shall, in addition to any other liability under the Ordinance be also punishable with fine not exceeding five hundred thousand rupees, and in case of continuing failure, refusal or contravention, to a further fine not exceeding ten thousand rupees for every day after the first during which such contravention continues.”*

13. It is the case of the Appellant that being a non-executive director of the Company, the Appellant had no knowledge regarding usage of the proceeds of the right issue for purposes other than what was recorded in the Board resolution. On the contrary, the Respondent's contention is that the Appellant failed to substantiate his claim of not having any knowledge through any supporting documents. In this context, the Appellant's email to the Board dated April 06, 2020 and minutes of the Board meeting held on April 07, 2020 are of significance as the said documentary evidence have not been refuted by the Respondent during the course of the instant Appeal. The Respondent, in its arguments, have stressed that the Appellant having experience in the petroleum sector should have acted diligently. The said contention of the Respondent shows that Appellant has been penalized on a presumption that he had knowledge of usage of the proceeds of the right issue for purposes other than what was resolved and announced, however, nothing has been brought on record by the Respondent in support of the said contention. Even otherwise, issuance of a warning to the head of the Board's Audit Committee and not even show-causing another member of the said committee, casts shadows on the case of the Respondent against the Appellant as he was not a member of the Audit Committee of the Board and not in the same capacity as the other two members of the Audit Committee.
14. Furthermore, neither the Act nor the Rules place the burden of going beyond rule 5 of the Rules, and as such the contention of the Respondent regarding petroleum sector experience and the expectation to act diligently, has neither been mentioned in the SCN nor does it have the backing of law as rule 5 *ibid* only places a very specific condition which appears to have been complied with. Accordingly, the other contention of the Respondent about contravention of rule 5 is also factually incorrect.
15. Moreover, the Respondent's contention that the Appellant failed to act diligently does not correspond with the statement of allegations as mentioned in the SCN as the same has been issued under rule 11 of

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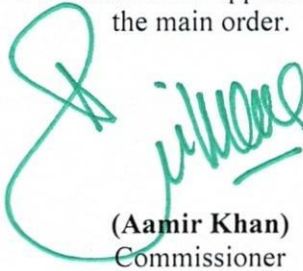
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the Rules and not under section 181 of the Act. However, it is pertinent to mention here that section 181 of the Act being a *non-obstante* clause is a special provision which encapsulates within itself the statutory protection to independent and non-executive directors of a class of companies mentioned therein and also mentions the ingredients which must be fulfilled in order to lift the available protection. This is in line with the overall scheme of the company law and subordinate legislation made thereunder where *inter alia* it is incumbent upon the listed companies to include independent and non-executive directors in their boards who are expected to perform their duties, without any conflict of interest with the company, in the interest of the shareholders of the company.

### ORDER OF THE BENCH

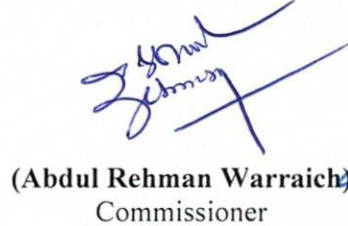
16. In view of the foregoing, the Impugned Order is hereby *set aside* to the extent of the Appellant, and the instant Appeal is accepted.

Decision in note appended with  
the main order.

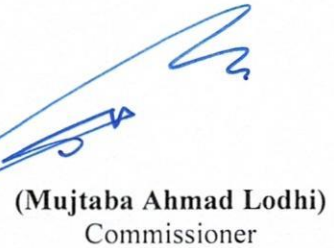


(Aamir Khan)  
Commissioner

I have appended my dissenting  
note with the main order.



(Abdul Rehman Warraich)  
Commissioner



(Mujtaba Ahmad Lodhi)  
Commissioner

Announced on: **15 SEP 2023**



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**Aamir Khan, Commissioner.** – In addition to the reasons provided in paras 10 – 15 of the main order, I am of the view that the SCN, in so far as it relates to the Appellant and the consequent order suffers from serious defects and the level of scrutiny, application of mind, and due diligence expected from a public sector functionary is clearly lacking. The Respondent department must reflect on this Order as a reminder of their responsibility to the general public and regulated sectors and officers/directors working therein, so as to not unfairly place any burden on them owing to their faulty and inadequate interpretation of law.

For foregoing reasons, I hereby *set aside* the Impugned Order to the extent of the Appellant, and accept the instant Appeal. Furthermore, the Respondent is directed to reimburse to the Appellant, cost of litigation pertaining to the instant Appeal.

  
(Aamir Khan)  
Commissioner



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**Abdul Rehman Warraich, Commissioner.** – To the extent of legality of constitution of a larger bench, I agree with the reasons and decision of both my fellow members. As far as the merits of the instant Appeal are concerned, I respectfully disagree due to the reasons explained in the following paragraphs.

2. There are two main questions to evaluate the merits of the instant case.
  - i. whether the Appellant acted diligently in the matter and is entitled to protection available to a non-executive director under section 181 of the Act; and
  - ii. whether the Appellant has been rightly charged under rule 11 read with rule 5 of the Rules.
3. The answer to the first question is 'No'. Section 181 of the Act provides a statutory protection from liability to a non-executive director of a listed company, but not in cases where the acts, attributable to board processes, had occurred with his knowledge, consent or connivance or where he had not acted diligently. The said provision of law is overarching in the sense that it requires independent and non-executive directors to follow the standard set therein in order to enjoy the protection which otherwise shall not be available to them.
4. It is a matter of record that the Appellant remained part of the Board of the Company as a non-executive director till his retirement in September 2020, whereas right issue was announced on September 13, 2017 wherein purpose and benefit of the right issue was stated as follows:

*“The purpose of the Rights Issue is to fund the upcoming projects including development of storage facilities, retail outlets and lube oil and grease blending plant.”*
5. The Appellant has contended that, (a) it was the responsibility of the management of the Company to ensure that the proceeds of the right issue were spent for the purpose for which these were raised; (b) during his tenure as director, the Board was never informed that this was not the case, otherwise he must have taken action to address the lapse; (c) it was unfair to penalize him when he had no knowledge of the lapse during his tenure.
6. The Appellant's contentions are not tenable due to the following:



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- a) It is evident that the Board failed to institute any worthwhile mechanism to monitor the utilization of right proceeds;
- b) The Company was consistently providing wrong information regarding utilization of proceeds of right issue to the stock exchange on quarterly basis for a period of three years, under the watch of the Board;
- c) The Appellant remained part of the Board until 2020 whereas purpose of right of issue was announced in 2017. The submission of the Appellant that the issue pertaining to wrongful use of the proceeds of the right issue never came to the Board till June 2021 when (Mr. Alan Duncan, Chairman of the Board of the Company) issued a statement with regards to whistleblower having identified fake purchase orders, which turned out to be linked to the purchase orders issued to Byco, that he had already asked for at the Board level to be investigated in April 2020, does not correspond with the response of the Appellant dated July 06, 2022 wherein it was stated that, *"I am advised that the Company has already given you a substantive reply which shows that the funds were used for the purposes for which the rights were issued with documents to support it."*

It is evident that the Appellant failed to act diligently despite the fact that he remained part of the Board for almost three years after receipt of proceeds of right issue by the Company and retired upon completion of his tenure.

7. The answer to the second question is 'Yes'. The Appellant contended that, (a) rule 5 of the Rules only requires the Board to specify the purpose of the right issue. It does not require the Board to ensure proper utilization of the right proceeds or to explain the reasons for any deviations, (b) rule 11 of the Rules can only be invoked to penalize non-compliance of rule 5 of the *ibid*.
8. The above contentions of the Appellant are untenable owing to following reasons:
  - a. The interpretation, that rule 5 of the Rules is only concerned with specifying the purpose and not the utilization of right proceeds, is against the intention of the said provision as it defeats the underlying purpose of having such a rule in the first place.

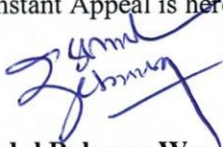


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- b. The mischief that the said rule aims to prevent is misutilization of right proceeds. The correct interpretation is that the Board is responsible for specifying the purpose and ensuring the utilization of right proceeds according to that purpose.

It is concluded that rule 5 and rule 11 of the Rules have been rightly invoked in this case.

9. For above reasons, the instant Appeal is hereby dismissed.

  
(Abdul Rehman Warraich)  
Commissioner