



Securities and Exchange Commission of Pakistan
Enforcement and Monitoring Division

Before Rashid Sadiq, Executive Director

In the matter of
M/S. ATTOCK REFINERY LIMITED

Number and date of notice	EMD/233/391/2002-2479 dated 16 th October 2002
Date of hearing	October 31, 2002
Present	Mr. Mohammad Raziuddin, Chief Executive Mr. S. Ahmed Abid, Company Secretary
Date of Order	January 14, 2002

This Order shall dispose of the proceedings initiated against M/S Attock Refinery Limited (hereinafter referred to as the “Company”) under Section 265 of the Companies Ordinance, 1984.

2. In order to fully appreciate the issue in hand, it is necessary to glance through the relevant background facts of this case. The Company was incorporated in 1978 under the Companies Act, 1913 (now the Companies Ordinance, 1984) as private company limited by shares and was converted into public company limited by shares in 1979. The shares of the Company are listed on all the three Stock Exchanges in Pakistan. The authorized share capital of the Company is Rs. 350 million divided into 35 million



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ordinary shares of Rs. 10 each. The paid up shares capital of the Company is Rs. 291.60 million divided into 29.16 million ordinary shares of Rs. 10 each. The object for which the Company was established and its powers are contained in its Memorandum and Articles of Association. The Company is principally engaged in refining of crude oil. The refining facility of the Company is located at Morgah, Rawalpindi. It has two major shareholders namely M/S Attock Oil Company Limited and the Government of Pakistan with shareholding of 52.5% and 35% respectively. The Board of Directors of the Company as per its latest annual report for the year ended June 30, 2002 comprises of as follows:

- i) Mr. Bashir Ahmad-Chairman
- ii) Dr. Ghaith R. Pharaon-Director
- iii) Mr. Mohammad Mansoor Zubair-Director
- iv) Mr. Mohammad Iqbal Awan-Director
- v) Mr. Tariq Iqbal Khan-Director
- vi) Mr. Shuaib Anwar Malik-Director
- vii) Mr. Laith Ghaith Pharaon-Director
- viii) Mr. Wael Ghaith Pharaon-Director
- ix) Mr. Abdus Sattar-Director
- x) Mr. Babar Bashir Nawaz-Director



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xi) Mr. Mohammad Raziuddin-Chief Executive

3. The Company is operating under the import parity pricing formula whereby it is charged the cost of crude on 'import parity' basis and is allowed product prices equivalent to the import parity price, calculated under agreed parameters. Under the pricing formula, the Company is entitled to a net of tax return on its paid up capital with a guaranteed minimum of 10% and allowable maximum of 40% in respect of its refinery operations. The Company was, however, allowed to retain surplus profits over the maximum limit of 40% for financing of Refinery Up-gradation and Expansion Project. Any deficit or refund as a result is on account of the Government and adjusted against revenue for the year. The retention of surplus profits over the maximum limit of 40% has been allowed until Rs. 1.500 billion is generated to repay the supplier credit and local loans obtained for Refinery Up-gradation and Expansion Project.

4. During the usual examination of the accounts of the listed companies, the Enforcement and Monitoring Division of the Commission scrutinized the accounts of the Company for the years ended June 30, 1997 to 2001 to check the compliance by the Company and its directors of the various provisions of the Ordinance and it was noticed that the Company has made after tax profits from refinery operations of Rs. 126.219 million



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during the year ended June 30, 1997. This translated into earning of Rs. 6.88 per share. During the next year ended June 30, 1998, the profits from refinery operations were restricted to Rs. 90.0 million being 40% of the paid up capital as per approved import parity formula. The profits earned by the Company from its refinery operations during this year were more than Rs. 90 million and the surplus profits were transferred to reserve for Expansion / Modernization per the pricing formula. During subsequent years, the Company sustained heavy losses from refinery operations due to which the Company had to obtain subsidies from the Government for attaining the guaranteed return of 10% under import parity pricing formula. The total subsidies obtained by the Company during the years 1999 to 2001 amounted to Rs. 1.379 billion. The detail of such subsidies received from the Government is as under:

<u>Year</u>	<u>Rupees</u>
1999	458,360,000
2000	706,690,000
2001	214,640,000

5. It was also noticed from the perusal of the annual audited accounts that the Company has entered into huge transactions with its associated undertakings during the years ended June 30, 1997 to 2001, the detail of



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such transactions as disclosed in audited accounts for the relevant years is as under:

Year	Purchase of Goods and Services	Sale of goods and Services	Trade Debts Receivables	Maximum Receivables
(Rupees in million)				
2001	3,416.62	3,546.92	131.68	238.98
2000	2,333.31	7,945.35	526.57	1,391.07
1999	971.50	5,224.34	289.07	385.53
1998	1,111.58	3,673.03	274.43	520.12
1997	1,322.80	3,427.97	517.54	517.54

6. It was further observed that the names of the related parties from whom the amounts were shown, as receivables in the annual accounts were not disclosed in clear breach of the mandatory provisions of Sub-clause (b) of Clause (C) of Para 6 of Part II of the Fourth Schedule to the Ordinance.

7. It was also noticed from the accounts that the Company has adjusted the outstanding amounts of receivables from the related parties with the outstanding amounts payable to other related parties in the financial



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statements in contraventions of the compulsory requirements of the International Accounting Standards, which require that such balances should be shown separately.

8. On probing the matter further, it was transpired that the Company sponsored an oil marketing company under the name of Attock Petroleum Limited (herein after referred to as the “Attock Petroleum”) for the marketing of oil/petroleum products. The total cost of setting up of Attock Petroleum was envisaged at Rs. 276.213 million with an issued capital of Rs. 50 million and Rs. 5.973 million as working capital. As per feasibility study submitted to the Government, the Company was expected to achieve sales revenue of Rs. 4.457 billion in the fifth year with net profit before tax of Rs. 120 million. Its capital was to be held by the following:

Pharaon Commercial Investments Group Ltd.	49%
Attock Oil Company Limited	11%
Attock Refinery Limited	10%
Pakistan Oilfield Limited	10%
Public and Employees	20%

9. Admittedly, Attock Petroleum is an associated undertaking of the Company in terms of Clause (2) of Sub-section 1 of Section 2 of the



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Ordinance. It was incorporated in 1995 as a public company limited by shares and commenced business with effect from February 19, 1998. Its authorized share capital is Rs. 500 million divided into five million ordinary shares of Rs. 100 each. Its paid up capital as on June 30, 2001 is Rs 100 million divided into one million ordinary shares of Rs. 100 each. The following shareholders hold the share capital of Attock Petroleum, as per its latest Form 'A' filed with Company Registration Office, Islamabad:

S #	Names of shareholders	%age	Amount (Rupees)	# of shares
1	Pharaon Commercial Investment Group Limited	49	49,000,000	490,000
2	The Attock Oil Company Limited	2.2	2,200,000	22,000
3	Attock Refinery Limited	10	10,000,000	100,000
4	Pakistan Oilfields Limited	10	10,000,000	100,000
5	Attock Cement (Pakistan) Limited	14.8	14,800,000	148,000
6	Attock Petroleum Limited Employees Welfare Trust	7	7,000,000	70,000
7	Mr. Shuaib A. Malik	7	7,000,000	70,000
	Total	100	100,000,000	1,000,000

The Board of Directors of Attock Petroleum, as per latest Form 29 filed with Company Registration Office, Islamabad comprises of the following:



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- i) Dr. Ghaith Rashad Pharaon-Director
- ii) Mr. Laith Ghaith Pharaon-Director
- iii) Mr. Wael Ghaith R. Pharaon-Director
- iv) Mr. Shuaib A. Malik-Chief Executive
- iv) Mr. Farid Djouhri-Director
- vi) Mr. Arif Kemal-Director
- vii) Mr. M. Raziuddin-Director
- viii) Mr. Babar Bashir Nawaz-Director

10. Ministry of Petroleum and Natural Resources approved the setting up of Attock Petroleum in pursuance of Rule 28 (i) of the Pakistan Petroleum (Refining, Blending and Marketing) Rules 1971. The approval granted on February 11, 1997 was, however, subject to several conditions including the following:

- i) Entirely independent infrastructure will be established by Attock Petroleum. Facilities of the Company or other group companies will not be used.
- ii) Competitive marketing will be followed as per Government of Pakistan's policy.



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11. Attock Petroleum, however, did not make any offer to general public/employees for the 20% capital reserved for them on the pretext that the listing regulations required 50% of the capital to be offered to public. The Board of Directors of Attock Petroleum later on issued shares to Attock Petroleum Limited Employees Welfare Trust and Attock Cement Pakistan Limited.

12. The performance of Attock Petroleum, however, surpassed by wide margins all the profitability forecasts made in feasibility submitted to the Government of Pakistan at the time of taking permission to set up oil marketing company. Its profits from the start of its operations as reflected in its annual audited accounts are summarized as follows :

Year	Profit after tax (Million)	Paid up Capital (Million)
30 th June 1998	8.1	1.0
30 th June 1999	95.9	50.0
30 th June 2000	182.9	* 75.0
30 th June 2001	188.3	*100.0

* The paid up capital was increased by the issue of bonus shares as detailed in the succeeding paragraph.



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13. Attock Petroleum also distributed its profits to its shareholders in the form of fabulous cash and bonus dividends since its commencement of operations; the detail of such distributions is as under:

Year	Cash	Bonus shares	Total distribution
1999	50%	50%	100%
2000	125%	33%	158%
2001	150%	-	150%

The cash distributions in three years were five times the amount invested by the shareholders in the form of equity in Attock Petroleum. On the other hand, the performance of the Company since establishment of Attock Petroleum deteriorated resulting in decline in distributions to its shareholders. For ease of reference, the detail of such distributions for the last five years is given as follows:

Year	Cash	Bonus shares	Total distribution
1997	20%	20%	40%
1998	20%	20%	40%
1999	10%	8%	18%
2000	19%	-	19%
2001	25%	-	25%



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14. It is necessary at this stage to look at the key financial ratios of the Company from the year 1997 to 2001:

Key Financial Ratios	2001	2000	1999	1998	1997
Gross Profit/Turn Over	1.80%	3.10%	1.60%	1.60%	2.50%
Profit Before Tax/Turn Over	0.90%	0.90%	1.10%	2.10%	2.90%
Return on Capital Employed	14.30%	11.00%	8.30%	19.90%	33.30%
Interest Coverage (times)	1.70	1.40	3.60	85.70	191.80
Inventory Turn Over (times)	19.70	22.60	22.80	20.20	21.60
Fixed Assets turnover (times)	9.00	6.20	4.10	8.80	24.20
Debt/Equity Ratio	78:22	79:21	80:20	26:74	0:100
Current Ratio	1.04	1.05	1.12	0.78	1.05

It can easily be seen from the above information that the company's financial ratios started deteriorating from the year 1998 onwards i.e., since setting up of Attock Petroleum. Whereas Attock Petroleum prospered giving phenomenal returns to its shareholders, the Company has languished providing reduced returns to its members.

15. In view of the very large number of transactions with associated undertakings / related parties involving Billions of rupees coupled with inadequate disclosure in the successive financial statements and huge losses from refinery operations resulting into payment of subsidies of Rs. 1.379



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billion by the Government since establishment by the Company of Attock Petroleum, it was apprehended that the transactions by the Company with its associated undertakings/related parties were not at arm's length. In fact, due to the huge profitability of Attock Petroleum since commencement of its operations in 1998 and declaration of hefty dividends to its shareholders and on the other hand huge losses sustained by the Company on refinery operations resulting decline in distribution to the shareholders of the Company, it was suspected that establishment of the oil marketing company has adversely affected its profitability. It appeared that this adverse situation for the minority shareholders *prima-facie* was created by the Company by working only in the interest of the related parties. This also demonstrated that the transactions of the Company with its related parties including particularly Attock Petroleum in all these years might have been conducted at the cost of the minority shareholders for the benefits of majority shareholders of the Company who also hold majority stake in Attock Petroleum.

16. In view of the above facts and circumstances, the Enforcement and Monitoring Division vide its letter dated January 08, 2002 asked the Company to provide certain information / documents including particularly the copies of current accounts with its each associated undertakings /



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related parties for the year ended June 30, 2001. The Company vide its letter dated January 28, 2002 replied that the information required by the Ordinance regarding current accounts of associated / related parties have been disclosed in full in the accounts. As the reply of the company was evasive and incorrect, therefore, the Company was directed again to provide the said information vide this Commission's letter dated February 20, 2002. A time period of seven days was provided to the Company to supply the said information/documents. Failure of the Company to supply the requisite information within stipulated time necessitated another reminder to the Company, which was issued on March 01, 2002. The Company, however, instead of providing the relevant information / documents, supplied on March 04, 2002, a statement containing in a summarized form the aggregate transactions with associated undertakings/related parties. The information provided by the Company was examined and found deficient in many ways. The Company was advised through letter dated April 26, 2002 as under:

Quote

“Instead of providing copies of ledger accounts you have provided summarized copies of current accounts with associated companies. Please provide copies of ledger



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accounts of associated companies in books of the company
since July 1997.”

Unquote

Three reminders followed the aforesaid letter on the following dates:

May 06, 2002

May 13, 2002

May 15, 2002

Instead of providing copies of the ledger accounts, the Company vide its letter dated May 17, 2002 posed a question about the purpose for obtaining the said information. The Company was informed through letter dated May 29, 2002 that the information was demanded in exercise of the powers available under the provisions of the Securities and Exchange Commission of Pakistan Act, 1997 and the provisions of the Companies Ordinance, 1984. It was noted with concern that instead of complying with the request, a question was posed by the Company as to the requirement for making such a request. It was, however, informed to the Company that the purpose of requiring the said information is to check the compliance of Section 208 of the Companies Ordinance, 1984 by the Company. A time period of up to May 31, 2002 was allowed to the Company to provide the said information.



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In utter disregard to the directions of the Commission, the Company failed to provide the said information. On September 25, 2002, the Company was again directed to provide the requisite information followed by another letter dated September 27, 2002 wherein the Company was warned that in spite of repeated reminders and after lapse of considerable time the information was not forthcoming. The Company was given another opportunity to provide the information allowing seven days time failing which it was indicated that the proceedings under Section 231 of the Ordinance could be initiated by appointing an officer of the Commission to inspect the books of the Company to extract the requisite information.

17. In response to the aforesaid letter, the Company stated vide its letter dated October 02, 2002 that all the information had been provided. The letter did not even discuss the copies of the current accounts of the associated undertakings, which were repeatedly demanded by the Commission since January 08, 2002 in its various communication to the Company, summarized as under for ease of reference:

January 08, 2002

February 20, 2002

March 01, 2002

April 26, 2002



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May 06, 2002

May 13, 2002

May 15, 2002

May 29, 2002

September 25, 2002

September 27, 2002

The Company was informed vide letter dated October 03, 2002 that the copies of the ledger accounts of associated companies maintained in the books of the Company since 1997 were not provided in spite of repeated directions. The Company, however, did not pay any heed to the repeated directions of the Commission to provide the information, which was necessary to dispel the apprehension that the transactions carried out by the Company with its associated undertakings were not at arms' length and there might be an issue of reduced transfer pricing. The deliberate and intentional disregard to the directions of the Commission for providing the information demanded in exercise of its power under the Securities and Exchange Commission of Pakistan Act, 1997 and the Companies Ordinance, 1984 further strengthened the suspicion that the transactions of the Company with its related parties were not at arms' length.



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18. In the meantime, the Enforcement Division also enquired about the transparency of the transaction of sale of old storage tanks by the Company to Attock Petroleum at scrap price, which could not be justified by the Company. The information regarding quantities involved in products sold (year-wise and for each ruling price during the year) to associated undertakings including particularly Attock Petroleum and companies other than associated undertakings since July 1997, was also demanded vide letter dated April 26, 2002. The Company, however, failed to provide the said information in spite of directions given on several occasions. This also demonstrated that the Company has deliberately withheld the information, which was necessary to finalize the issue of reduced transfer pricing.

19. It is amply clear from the aforesaid discussion that the Company has not complied with the Commission's directions for the provision of necessary information. The successive reminders issued to the Company went unnoticed and the replies of the Company to some of the letters were either evasive or incorrect and incomplete with regard to information provided therein. In view of the aforesaid circumstances, it was apprehended that there could be a serious issue of reduced transfer pricing and the Company was transferring some of its profits to Attock Petroleum and the huge transactions with its associated undertakings might not be at



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arms' length. In the circumstances, it was the duty of the Commission to take appropriate necessary action against the Company as warranted under the law.

20. Consequently, the following show cause notice was issued to the Company on October 16, 2002 under Section 265 of the Ordinance:

Quote

WHEREAS, Attock Refinery Limited (ARL) has established Attock Petroleum Limited (APL) in the year 1995 for marketing of its products. The APL started its business in the year 1997.

2. *AND WHEREAS, it has been observed by the Commission that since commencement of operations of APL, the performance of ARL has declined substantially which is evident from the following:-*

<i>Years</i>	<i>Profit after tax from refinery operations Rupees (M)</i>	<i>Gross Sales Rupees (M)</i>	<i>Paid-up Capital Rupees (M)</i>
<i>30th June 1996</i>	<i>182.3</i>	<i>5,129.9</i>	<i>150.0</i>
<i>30th June 1997</i>	<i>126.2</i>	<i>6,596.4</i>	<i>187.5</i>
<i>30th June 1998</i>	<i>90.0</i>	<i>6,485.9</i>	<i>225.0</i>
<i>30th June 1999</i>	<i>27.0</i>	<i>7,181.6</i>	<i>270.0</i>
<i>30th June 2000</i>	<i>29.1</i>	<i>13,129.0</i>	<i>291.6</i>
<i>30th June 2001</i>	<i>29.1</i>	<i>19,503.7</i>	<i>291.6</i>



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3. *AND WHEREAS, distribution of profits to the shareholders has also declined from 40%- 45% in the years 1996-1998 to 18-25% in the years 1999-2001;*

4. *AND WHEREAS, the Commission has observed that APL since start of its operations has shown tremendous profits as under:*

<i>YEAR</i>	<i>PROFIT AFTER TAX (MILLION)</i>	<i>PAID UP CAPITAL (MILLION)</i>
<i>30th June 1998</i>	<i>8.1</i>	<i>1.0</i>
<i>30th June 1999</i>	<i>95.9</i>	<i>50.0</i>
<i>30th June 2000</i>	<i>82.9</i>	<i>75.0</i>
<i>30th June 2001</i>	<i>188.3</i>	<i>100.0</i>

5. *AND WHEREAS, ARL has entered into huge transactions with its associated undertakings (AU) including APL as follows:*

<i>Particulars</i>	<i>Purchase of Goods and Services Rupees (M)</i>	<i>Sale of goods and Services Rupees (M)</i>	<i>Trade Debts receivable from AU Rupees (M)</i>	<i>Maximum amount outstanding Rupees (M)</i>
<i>2001</i>	<i>3,416.62</i>	<i>3,546.92</i>	<i>131.68</i>	<i>238.98</i>
<i>2000</i>	<i>2,333.31</i>	<i>7,945.35</i>	<i>526.57</i>	<i>1,391.07</i>
<i>1999</i>	<i>971.50</i>	<i>5,224.34</i>	<i>289.07</i>	<i>385.53</i>
<i>1998</i>	<i>1,111.58</i>	<i>3,673.03</i>	<i>274.43</i>	<i>520.12</i>
<i>1997</i>	<i>1,322.80</i>	<i>3,427.97</i>	<i>517.54</i>	<i>517.54</i>
<i>1996</i>	<i>695.25</i>	<i>2,833.47</i>	<i>329.58</i>	<i>331.45</i>



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6. *AND WHEREAS, the Company did not disclose the names of each associated undertaking from which the amount was receivable as required under Sub-clause (b) of Clause (C) of Section 6 of Part-II of the Fourth Schedule to the Companies Ordinance, 1984*

7. *AND WHEREAS, it was apprehended that ARL is passing on some of its profits to APL through transfer pricing and the transactions between APL and ARL were not at arm's length.*

8. *AND WHEREAS, in order to satisfy that APL is not benefiting at the cost of ARL, the following information was called for from ARL vide Commission's letter dated April 26, 2002 and May 29, 2002:-*

- i). *Quantities alongwith amounts involved in products sold (year-wise and for each ruling price during the year) to associated companies including APL and non-associated companies since July 1997*
- ii). *Copies of current accounts with associated undertaking maintained in the general ledger of the Company since July 1997*

9. *AND WHEREAS, ARL did not provide the complete information despite several reminders dated 6th, 13th and 15th May and 25th September 2002 and final reminder dated 27th*



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September 2002 in which seven days time was provided for providing the requisite information;

10. AND WHEREAS, ARL instead of providing the required information replied on 2nd October 2002 and referred to the meeting with officials of E&M and stated that it was agreed that further information for previous years was not required, as it would take lot of manhours;

11. AND WHEREAS, the Commission vide its letter dated 3rd October 2002 informed ARL that it was never agreed between the company and the Commission for non-provision of the information as referred at para 8 above;

12. AND WHEREAS, ARL has still not been able to provide the information as directed by the Commission in its several letters, as aforesaid;

13. AND WHEREAS, non-provision of information provides reasons to believe that the company may not be transacting its business with its associated companies including APL at arm's length basis, which is not in the interest of ARL and its shareholders;

14. AND WHEREAS, in view of the foregoing, the Commission is of the opinion that there are circumstances suggesting that:



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- *the business of the company is conducted in a manner oppressive to its members*
- *the persons involved in the management of its affairs have been guilty of misconduct towards the company and towards its members*
- *the affairs of the company have been so conducted or managed as to deprive the members thereof of a reasonable return;*
- *the members of the Company have not been given all the information with respect to its affairs which they might reasonably expect;*

15. *NOW THEREFORE, in order to ascertain the factual position and to satisfy that circumstances aforesaid do not suggest any action under Section 265 of the Ordinance, the Commission would advise you to please show cause by appearing in person or through your duly authorized representative on 31st October 2002 at 11.00 A.M. in Securities and Exchange Commission Office at 7th Floor, NIC Building, Blue Area, Islamabad, as to why an investigation into the affairs of the company may not be ordered.*

Unquote

21. On the date of hearing, Mr. Raziuddin, Chief Executive of the Company along with Mr. S. Ahmed Abid, Company Secretary appeared before me and argued the case. They also filed a written reply to the show



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cause notice on November 04, 2002. When the Chief Executive was asked as to why the Company has avoided the supply of the requisite information to the Commission for a very long period of time, the Chief Executive promised to provide the requisite information in two weeks time. However, despite promise, the complete information was not made available to the Commission till December 31, 2002.

22. In the written submissions as well as at the time of hearing of this case, the Company vehemently denied the apprehensions raised in the show cause notice. It was averred that all the transactions of the Company with its associated undertakings were at arms' length and at uniform prices for all the customers. It was further stated that the pricing of all regulated petroleum products are according to the Government notified prices as per the import parity pricing formula and the refineries cannot sell the products at prices higher or lower than the notified prices. It was also denied that the performance of the Company has declined since the commencement of operations of Attock Petroleum. It was further stated that the Company has made full and complete disclosure in accordance with the provisions of the Ordinance and the International Accounting Standards and there was no violation in this regard. It was also stated that Attock Petroleum was not formed by the Company. The violations of the Company were discussed at



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length, which were denied by the Chief Executive of the Company. The averments of the Chief Executive would be discussed in the later part of this Order.

23. In accordance with the promise made by the Chief Executive at the time of hearing, the Commission through its letter dated November 06, 2002 confirmed, its directive to provide the following information in writing:

- i) Quantities indicating pricing and total amount involved with regard to each product sold to all associated undertakings except Attock Hospital since 1997 to 2000 on fortnightly basis.
- ii) Copies of the current accounts with associated undertakings maintained in the ledger of the Company since July 1997 till to date.

The Company, however, provided information in piecemeal during the month of December 2002. On the basis of examination of the information made available by the Company, two of the deregulated products, Solvent Oil and Bitumen were selected for detailed scrutiny as the major share of Solvent Oil and whole production of Bitumen was sold to Attock



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Petroleum. Along the revenue generated from sale of Bitumen to Attock Petroleum was more than Rs 1.19 Billion in the years 1998 to 2001. The Company also supplied Solvent Oil to PSO and Shell. The Company was subsequently asked to provide the quantity sold, ex-refinery price and the market-selling price of Regular Motor Spirit, Solvent oil, MTT and Bitumen sold during 1997 to 2001. The copies of current accounts with associated undertakings were provided on November 12, 2002 except Attock Petroleum, which were specifically required by the Commission. The requisite information was finally provided on January 03, 2003 after service of a show cause notice under Section 495 of the Ordinance, which provides penalties for non-compliance with the directives of the Commission.

24. Information provided by the Company for the years from 1998 to 2001 was analyzed and the Commission focused particularly on the information in respect of Solvent Oil in relation to Motor Spirit, which is a regulated product and has observed that the difference in selling prices of Motor Spirit (MS) and Solvent Oil (SO) had been less than Rs. 4/- in the years prior to 1998 whereas the difference soared to Rs. 10/- in the year 1999-2000. This is the same period when the refinery obtained maximum subsidy i.e. Rs. 706 million to attain a profitability level of 10% of its paid



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up capital. It is an eye prick that when the difference in prices of SO and MS was less than Rs. 4/- the refinery was earning huge profits whereas when this gap between the prices of both the products widened the profits from the refinery operations squeezed and resulted in losses from the refinery operations. The Solvent was the only product in respect of which information was collected and analyzed. There are two other main deregulated products i.e. Bitumen and M.T.T in which, due to large transactions with associated undertakings reduced transfer pricing is also suspected.

25. The Company was further asked to provide some specific information vide letter dated December 27, 2002. The contents of the same are reproduced hereunder:

Quote

From the information provided for the years 1999-2001, it has been observed that difference in selling prices (the Company's transfer price to OMCs including duties/taxes) of Motor Spirit and Solvent Oil, which was around Rs. 4 in 1997-98 went upto Rs. 10/- approximately in 1999-2000, there from prima facie, it appears that the Company has transferred the profits, which it could have earned had it fixed the selling price of Solvent at a difference of around Rs. 4/- from fixed selling price of Motor Spirit, to other oil marketing companies including Attock Petroleum.



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In order to peruse the information provided by you the same data was called for from PSO in respect of Solvent Oil and Motor Spirit and on examination of the said information it has been noticed that Ex-refinery price of MS and Solvent Oil provided by you are different from the purchase price of PSO for the same period. You are, therefore, advised to bring copies of all invoices of motor spirit and solvent oil for the period January 97 to January 98. Copies of the relevant minutes of the meeting of the Board of Directors wherein decisions regarding fixing of prices particularly Solvent Oil, Bitumen and MTT sold to Attock Petroleum were taken and a detailed comparison of fixed selling prices of Motor Spirit and Solvent Oil for a period of five years previous to the year ended 1997.”

Unquote

The aforesaid information has not been provided by the Company till the writing of this Order. Instead, the Company has asked for more time, which cannot be allowed at this stage in view of the indifferent, unresponsive and heedless attitude of the Company to provide the requisite information to the Commission.

26. Now I revert to the submissions made by the Company at the time of hearing and in the written replies. The main reason given by the Company for the losses from the refinery operations is the import parity pricing



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formula whereby the Company could not charge a price higher or lower than the Government notified price. This argument is illusory, as the prices of deregulated products are fixed by the Company itself. Moreover, the Company is obliged to follow the competitive marketing as per the policy of the Government of Pakistan. In my view, the Company could have fixed the prices of the de-regulated products in such a way that the interest of the Government, which has guaranteed a minimum return to the refinery, is protected. Charging of reduced transfer prices to the associated companies could burden the Government if there are losses on account of regulated products. The charging of uniform prices to other customers do not justify that there was no reduced transfer pricing. In order to benefit the associated undertakings, the Company could have passed some benefits to its other customers, which are not associated undertakings. The Company's argument that its all transactions were at arm's length, therefore, is not sustainable. As regard to the argument regarding fixation of the prices of regulated products, the Commission is concerned about the fixation of prices of de-regulated prices, which the Company is free to fix in the interest of the Company, its shareholders and the Government. The argument of the Chief Executive that the performance of the Company has not deteriorated also do not carry any force, as the Company has obtained subsidies of Billion of rupees in the three years on account of guaranteed



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return under the pricing formula. I am also not convinced with the arguments that the Company has made full disclosure in accordance with the provisions of the Ordinance and International Accounting Standards for the simple reason that some of the statutory disclosures were found absent in the annual accounts of the Company. This issue has also been deliberated at length at some other place in this Order. As regard to the assertion that Attock Petroleum was not formed by the Company, it is on record that the Company has sponsored this associated company although it has got only 10% equity in it. The correspondence of the Company with the Ministry of Petroleum and Natural Resources is also on record, which indicates that the Company made active participation in the process of obtaining license from the Government and representations were made to the Ministry by the Company in this regard. In view of the above, I do not find any merit in the submissions made by the Chief Executive of the Company.

27. I have thoroughly examined by myself the information provided by the Company and have also perused the documents available on record. It has regretfully been observed that:

- i) The Company has intentionally and deliberately avoided supply of information to the Commission, the regulator. The Information



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was demanded in exercise of the powers available to the Commission under the Securities and Exchange Commission of Pakistan Act, 1997 and the Companies Ordinance, 1984. The refusal of the Company to provide information has obstructed the performance of the statutory functions of the Commission.

- ii) The Company has on many occasions made incorrect statements in the information provided to the Commission, which is evident from the letter dated November 27, 2002 wherein the Chief Executive of the Company stated, “ I hope we have provided all the information desired by SECP.” This statement was contradicted in the subsequent letters dated November 27, 2002 and December 31, 2002 wherein the Chief Executive admitted that some of the information required by the Commission was still pending.
- iii) The Company has made misleading statements regarding fixation of prices of its products vide its letter dated January 15, 2002 and May 17, 2002. In the first letter it has been stated that prices of regulated products are determined by the ECC approved import parity formula and the company cannot sell at a price higher or lower than the notified price. Furthermore, regarding the price of deregulated products a “floor” has been given by MPNR and the



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company cannot sell below that formula price whereas in the subsequent letter it was stated that all the sales to marketing companies are made at prices notified by Government of Pakistan. This misleading information may be an attempt to entrap the Commission in unnecessary discussions and to divert its attention from the main issue.

- iv) Maximum balance receivable from the associated companies under the heading “Trade debtors” is shown as Rs. 238.976 million whereas on scrutiny of the ledger account provided by the Company, the maximum balance was Rs. 415.168 million at the end of January 2001.
- v) The Company has provided insufficient and inadequate disclosures regarding associated undertakings in its annual accounts; which is clearly manifest from the fact that the company has changed the classification of items in the financial statements but the amount, nature and reasons for the same has not been disclosed in violation of para 40 of IAS -1. These are as under:-
 - a) The comparative figures under the heading “Trade debtors” for the year ended June 30, 2001 are shown at



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Rs. 100.733 million which is different from the figures appearing in the accounts for the year ended June 30, 2000 which stood at 526.572 million.

b) The comparative figures under the heading Transactions with associated undertakings on account of Sale of goods and services for the year ended June 30, 2001 are shown at Rs. 1,945 million which is different from the figures appearing in the accounts for the year ended June 30, 2000 which stood at Rs. 7,945 million.

c) The comparative figures under the heading “Trade debtors” on account of maximum amount due from associated companies at the end of any month has been shown at Rs. 235.337 million which substantially differ from the amount of Rs. 1,391.07 million shown in the financial statements for the year ended June 30, 2000 under the heading trade debtors.

vi) The Company has adjusted the outstanding amounts of receivables from the related parties with the outstanding amounts payables to other related parties in the financial statements in



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contraventions of the compulsory requirements of the International Accounting Standards, which require that such balances should be shown separately.

- vii) The balances payable to M/S Attock Oil Company, the holding company has not been correctly reflected in the annual account for the year ended June 30, 2001. The balance payable under the heading creditors, accrued and other liabilities is Rs. 140,224,284 whereas on scrutiny of general ledger account, as provided by the Company, it was found that the amount payable to Attock Oil Company was only Rs. 130,454,115.

28. What emerges from the aforesaid discussion is that the company has delayed this enquiry by deliberately withholding information from the Commission and supplying various irrelevant information. On a number of occasions they have been reminded verbally and in writing to supply information some of which has not been given till the date of this order. The data supplied by the Company make it evidently clear that the Company, *prima facie*, has neither safeguarded the company's interest nor obtained the best prices for assets disposal and the management has failed on their prime responsibility for which they were appointed. Instead of protecting the shareholders' and Government's interest, the management



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has engaged in furthering the interest of its major shareholders at the cost of the Government of Pakistan who has by subsidy payments ensured the minimum profitability of Attock Refinery at 10% of paid up capital, under the pricing formula. The aforesaid discussion provides reasonable basis to believe and form an opinion that the Company is a victim of reduced transfer pricing to its associated undertakings. There appears to be a commercial nexus between the two companies, which apparently is one of principal and agent. In such a situation where majority stakeholders are sitting on both side of the decision making process, no consideration is given to the interest of the other stakeholders. This also raises another apprehension as to whether the Company and its associated undertakings have complied with the requirements of Section 214 and 217 of the Ordinance, which deals with the duties of the interested directors. In my opinion the Company has given room for higher margins to Attock Petroleum and other marketing companies by reduced transfer pricing knowing the fact that its own profits are guaranteed at minimum 10% of the paid up share capital under import parity pricing formula. As regards the transactions of the Company with its related parties, one instance is the old storage tanks, which were sold to Attock Petroleum at scrap value. These are very serious issues and a proper study is critical to find out more details and instances regarding transactions between associated companies and



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their effect on subsidies obtained by the Company from the Government. It would be in the interest of all the stakeholders that a fact-finding exercise is conducted through an independent inspector so that correct legal and financial position of the Company and extent of violations committed by the Company and its directors and Chief Executive are ascertained. The inspector would ascertain factual position and whose report can bring to light as to whether the affairs of the Company were managed in conformity with the generally accepted principles and standards of good and efficient management. If the inspector holds that the directors were not responsible for the aforesaid state of affairs of the Company, the report will be helpful to them rather than detrimental to their interests. The Commission can protect the interest of the investors only through timely initiating of a fact-finding exercise.

29. Securities and Exchange Commission of Pakistan has been established under the Securities and Commission of Pakistan Act, 1997 for the beneficial regulation of the capital markets, superintendence and control of the corporate entities and for matters connected therewith and incidental thereto. It is one of its functions to conduct *sue moto* investigations into affairs of the companies, through competent inspectors(s) if in its opinion there are circumstances suggesting one or more of the matters given in sub-



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clauses (i) to (iv) and (vi) of Clause (b) of Section 265 of the Ordinance. The Commission is further empowered to prosecute a company or persons found guilty as a consequence of such investigations. It would also be pertinent to discuss here the spirit of Section 265 of the Ordinance. It is not possible for all the stakeholders to act jointly to protect their interest. Moreover, they are not able to collect evidence where management is acting prejudicial to their interest to bring the same before the appropriate forums for appropriate action. It was because of this difficulty that the legislators have enacted Section 265 of the Ordinance to prevent the managements of companies from acting in a manner prejudicial to the interest of all the stakeholders. The object of this Section, thus, is to safeguard the interest of the stakeholders and those dealing with the company to provide for investigation into its affairs where the affairs of the company are conducted to jeopardize those interests.

30. I am also conscious of the fact that the investigation into affairs of a company is a serious matter. I am, however, of the view that if the reputation of the Company or of a person is kept in view, then on the basis of such apprehension no action could be taken against the persons who violate the provisions of law or who commit an offence. The investigation into affairs of the Company is in the nature of a fact-finding exercise and is



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neither a punishment nor a penalty. It is not a judgment because it is only after the conclusion of the investigation that the Commission could take any action and that too after providing opportunity to the persons responsible for defaults.

31. In view of the above and after carefully examining all the facts and circumstances of the case, I am convinced that the circumstances falls under Sub-clauses (i), (ii), (iii), (iv) and (vi) of Clause (b) of Section 265 of the Ordinance and that substantial and worthwhile basis exist to form an opinion warranting investigation into affairs of the Company. The aforesaid discussion also amply demonstrates that such conditions exist, which fulfills the objectives that form the pre-requisite for ordering an investigation. These circumstances reasonably suggest that the transactions of the Company with its associated undertakings are not carried out at arm's length basis and it is apprehended that the company is transferring some of its profits to its associated company namely, Attock Petroleum Limited.

32. For the forgoing reasons, I, in exercise of the powers conferred on me under Clause (b) of Section 265 of the Ordinance, hereby appoint Mr. Khalid Majid, FCA, of M/S Khalid Majid, Rahman Sarfraz, Rahim Iqbal Rafiq, Chartered Accountants, to act as inspector to investigate into the



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affairs of M/S Attock Refinery Limited to bring into light the actual state of affairs of the Company. He will be paid a remuneration of Rs. 250,000/- (Rupees two hundred and fifty thousands only) to be paid by the Company.

33. Without limiting, in anyway, the scope of investigation, the inspector shall conduct investigation on all aspects of the operations of the Company and shall, after scrutiny of the entire record and books of accounts, furnish report, *inter alia*, on the following matters:

- (a) Whether the transactions with associated undertakings/related parties were at arms' length;
- (b) Reasons for incurring losses on account of refinery operations and justification for subsidy obtained from the government of Pakistan during the years 1997 to 2001. Whether these losses could have been reduced by competitive pricing of products, and whether the losses were due to mismanagement, imprudent policies or some other reasons.
- (c) Investigation of Sales / revenues of the Company with particular reference to procedure for price fixation particularly with related parties/associated undertakings;



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- (d) To check and review the minutes of meeting of Board of Directors or Price Setting Committees to ensure that the prices are not set arbitrarily
- (e) To check and review the suitability of prices on the basis of the geographically segmented markets, customer based market, market's share of the Company, demand for the Company's products, and impact of price elasticity of demand for the products.
- (f) To perform horizontal as well as vertical analysis of the price margins of deregulated products before deregulation and after deregulation
- (g) To check and ensure that the Company is not transferring its profits to its associated undertakings by a detailed review of the transfer price of all products, which are fixed by the Company and in the adverse situation the amount of siphoned funds alongwith supporting evidences and persons responsible for the same, together with recommendations to ensure that such practices does not occur in future.
- (h) Whether or not adequate system of internal controls has existed as to prevent misappropriation and misapplication of Company's assets and resources.



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- (i) To report any lapses or other delinquency detected during the course of investigation.
- (j) In-out record of the Company particularly relating to sales, purchases and stocks movement.
- (k) Any other violation of the Companies Ordinance, 1984 or any other laws.
- (l) Procedure followed by the Company for disposal of storage tanks to Attock Petroleum and to determine if the best price was obtained for those tanks, which are being used for storage of petroleum products by Attock Petroleum.

34. The inspector shall submit his report alongwith supporting documents to the Commission within thirty days from the date of this order. The Commission expects that the report shall be made specifically on each terms of reference along with the names of persons responsible for any irregularities and mismanagement in the affairs of the Company.

35. The inspector shall, if he thinks it necessary for the purpose of his investigation to investigate also the affairs of:

- (a) any other body corporate which is, or has at any relevant time been the company's associated company or subsidiary or



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holding company, or a subsidiary of its holding company, or a holding company of its subsidiary ;

(b) any other body corporate which is, or has at any relevant time been, managed as chief executive by any person who is or was at the relevant time the chief executive of the company;

(c) any person who is or has at any relevant time been the company's chief executive or managing agent or an associate of such chief executive or managing agent;

he shall have power under Section 267 so to investigate and shall report on the affairs of the other body corporate or of the chief executive or the managing agent or an associate of the chief executive or managing agent, as the case may be, so far as he thinks that the results of his investigation thereof are relevant to the investigation of the affairs of the company. In the case of any body corporate or the chief executive referred to in (b) or (c) above, the inspector shall have to follow the requirements of Sub-section (2) of Section 267 of the Ordinance.



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36. The inspector, for the purpose of his investigation, shall have the same powers as are vested in a Court under the Code of Civil procedure, 1908 while trying a suit in respect of the matters enumerated under Section 266 of the Ordinance and every proceeding before the inspector shall be deemed to be judicial proceeding within the meaning of Section 193 and 228 of the Pakistan Penal Code, 1860. Any contravention or non-compliance with any orders, direction or requirement of the inspectors shall entail the consequences under the Code of Civil Procedure, 1908 and Pakistan Penal Code, 1860.

37. It shall be the duty of all the officers, employees and agents and other persons having dealing with the Company to provide all assistance to the inspector in connection with the investigation, and any default whereof shall be punishable under Section 268 of the Ordinance.

RASHID SADIQ

Executive Director (Enforcement & Monitoring)

Announced:
January 14, 2003
ISLAMABAD