



Corporate Supervision Department  
Company Law Division

Before Ali Azeem Ikram – Executive Director (CSD)

*In the matter of*

**Ali Asghar Textile Mills Limited**

Reference Number of SCN: EMD/233/78/2002-1453-59  
Date of SCN: March 27, 2014

**ORDER**

**UNDER SECTIONS 193, 196, 216, 217 AND 492 READ WITH SECTION 476 OF THE COMPANIES ORDINANCE, 1984**

This order shall dispose of the proceedings initiated against the following directors including chief executive (together referred to as the “respondents”) of **Ali Asghar Textile Mills Limited** (the “Company”):

- |                                      |                                     |
|--------------------------------------|-------------------------------------|
| 1. Nadeem Ellahi Shaikh, Director    | 5. Mr. Raja Ghazanfar Ali, Director |
| 2. Naveed Ellahi Shaikh, Ex-Director | 6. Mr. Sultan Muhammad, Director    |
| 3. Ms. Marium Humayun, Director      | 7. Mr. Muhammad Azad Khan, Director |
| 4. Mr. Muhammad Suleman, Director    |                                     |

These proceedings against the respondents were initiated through show cause notice (the “SCN”) dated March 27, 2014 under the provisions of sections 193, 196, 216, 217 and 492 read with section 476 of the Companies Ordinance 1984 (the “Ordinance”).

2. The brief facts of the case are that the annual audited financial statements (the “Accounts”) of the Company for the year ended June 30, 2012 contained the following disclosure:

*“16,095,372 shares issued to Habib Bank Limited in May 14 1986 have been sold to directors Mr. Nadeem Ellahi Shaikh, 8,045,372 shares and Mr. Naveed Ellahi Shaikh, 8,050,000 shares respectively.”*

In response to the Commission’s requisition for information in this regard, the Company and Habib Bank Limited (the “HBL”) provided the information perusal of which revealed that the directors purchased Company’s shares from HBL at a price of Rs0.05 per share when the market price was around Rs0.55 and breakup value was around Rs7.3 as on December 31, 2011, under the terms of an agreement signed in 1985-86 for restructuring of the outstanding debts of the



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Company obtained from National Bank of Pakistan ("NBP") and HBL. The terms of the agreement, inter alia, included the following:

*"HBL and NBP agree to allow relief on the basis of struck-up debts as on 30<sup>th</sup> September, 1985 by way of conversion of the amount into ordinary shares on the following terms;*

- i. These shares shall not qualify for dividends unless a minimum dividend of 10% is paid to the ordinary shareholders.*
- ii. Issuance of further shares shall require prior written approval of HBL.*
- iii. HBL and NBP shall not exercise any voting rights, which shall be evidenced by standing proxies to be issued in favor of sponsoring directors of the Company which shall be revoked only under following conditions;*
  - Company is not managed properly.*
  - The debt servicing by the Company become unsatisfactory.*
- iv. HBL and NBP reserves the right to dispose of these shares whenever they deem fit. It is expressly provided herein that in case the shares are to be disposed of, the new management shall be given the first right of refusal."*

3. In accordance with the above settlement, 16,095,372 shares were issued to HBL by the Company with proxies issued in the names of Mr. Humayun Ellahi Shaikh, an ex-director and father of Mr. Nadeem Ellahi Shaikh and Mr. Naveed Ellahi Shaikh, or failing him Mrs. Gulnar Humayun Ellahi, an ex-director and shareholder and wife of Mr. Humayun Ellahi Shaikh.

During the year 2011 the Company entered into a settlement agreement with HBL whereby the settlement amount of total liabilities of Rs281.843 million was determined as Rs155.268 million in following manner (HBL's letter dated 2-12-2011):

	<b>Rs in million</b>
Principle of cash finance	45.443
Principle amount of expired limits	94.868
10% of accrued markup	14.153
Against 16,095,372 shares @Rs0.05 per share	0.805
<b>Total</b>	<b>155.268</b>

The Company paid the settled amount and two directors of the Company namely Mr. Nadeem Ellahi Shaikh, Mr. Naveed Ellahi Shaikh purchased 16,095,372 shares of the Company from HBL

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(8,045,372 shares and 8,050,000 shares respectively). In respect of the shares, the Company has been making the following disclosures in its Accounts till year ended June 30, 2011:

*"16,095,372 shares issued to HBL in accordance with restructuring agreement dated May 14, 1986 against their deferred loan converted into ordinary shares. These shares do not qualify any dividends unless minimum of 10% is paid to the Ordinary shareholders and also do not carry voting right."*

4. It appeared that the respondent, prima facie, contravened the following requirements of the law:

- **Section 492 of the Ordinance - Misstatement/omission of material facts:** The Company in its Accounts misstated that the shares issued to HBL do not carry voting rights and hence factual position was concealed from its shareholders. Moreover, the accounts of the Company till the year ended June 30, 2011 did not disclose the following material facts:
  - That voting rights of 16,095,372 shares owned by HBL were given in favor of Mr. Humayun Ellahi Shaikh or failing him Gulnar Humayun Ellahi, through proxy; and
  - The management has first right of refusal whenever the shares held by the HBL are disposed of.
- **Section 193, 196, 214, 216 & 217: Lack of quorum and non-disclosure of interest by the directors and misuse of power by directors:** The aforesaid settlement agreement was approved in BOD meeting held on December 14, 2011. As on June 30, 2011 the shareholding pattern of the Company was as under:

S.#	Name of Directors	Shareholding %age
1	Nadeem Ellahi Shaikh	23.067
2	Marium Humayun	0.092
3	Muhamunad Suleman	0.002
4	Raja Ghazanfar Ali	0.002
5	Sultan Mehmood	0.002
6	Muhammad Azad Khan	0.002
7	Abdullah Moosa	-
8.	Naveed Ellahi Shaikh	26.841
	<b>Name of Sponsors/Shareholders</b>	
1	HBL	36.23 (Voting rights not exercised by HBL.)
2	Others	13.8

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*Handwritten signature/initials in blue ink.*





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In view of the above shareholding structure, majority of the directors on Company's board have been elected or appointed on the voting power of Mr. Nadeem Ellahi Shaikh and Mr. Naveed Ellahi Shaikh, the beneficiaries of settlement with HBL, and their family members. Due to the aforesaid facts, the majority of the board members, being directly or indirectly interested or concerned in the settlement with HBL, were not entitled to consider or vote on the said settlement in terms of section 216 of the Ordinance. Therefore, the quorum prescribed under section 193 of the Ordinance was not present and the board of the Company was not entitled to approve the said agreement. By approving the said agreement the directors have acted beyond their powers specified under section 196 of the Ordinance. Hence, provisions of section 193, 196 and 216 were, prima facie, contravened.

Consequently, the SCN dated March 27, 2014 under sections 193, 196, 216, 217 and 492 of the Ordinance was issued to the respondent whereof they were called upon to show cause, in writing, as to why fines may not be imposed on them for the aforesaid alleged violations of the Ordinance and why they may not be declared to be lacking fiduciary behavior for contravening the provisions of section 216 of the Ordinance.

5. In response to the SCN, the respondents submitted their reply dated May 10, 2014 through their representative Mr. Mansoor Usman Awan of AJURIS, Advocates & Corporate Counsel. A brief of the reply with reference to the contents of the SCN is as under:

- (i) **Section 492:** Disclosure made in the Company's annual accounts with respect to shares held by HBL was based on a misreading of the provisions of the re-structuring agreement and was completely un-intentional. The fact is that HBL shares did have voting rights and HBL continued to exercise its voting rights through proxy. In the absence of any intent of the Board members to cause any loss to the company, invoking penal provisions of the Ordinance is unwarranted. Therefore, we submit that you take a lenient view.
- (ii) **Quorum and contravention of sections 193 and 196:** The meeting of the Board of Directors of the Company, wherein approval for acquiring shares from HBL was granted, was attended by five directors namely: (1) Mr. Muhammad Suleman; (2) Mr. Azad Khan, (3) Mr. Sultan Mehmood, (4) Mrs. Mariam Aftab Butt; and (5) Raja Ghazanfar Ali. Therefore, no contravention of section 193 and section 196 has taken place.

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(iii) **Sections 214 and 216:** The two interested directors, namely, Mr. Nadeem Ellahi Shaikh and Mr. Naveed Ellahi Shaikh wrote to the company secretary on December 10, 2011 disclosing their interest in acquisition of shares from HBL (copies attached) and they also abstained from participating in the aforesaid meeting. By doing so, they duly discharged their duty under section 214 and 216 of the Ordinance. It is further submitted that barring one director, sister of the two interested directors, none of the other four directors is related to the two interested directors. Please note that under the proviso to section 214(1) read with the explanation to section 195(1), a spouse and minor children of a director qualify as interested directors. Under section 214(1), only such directors who have any interest or concern in any contract or arrangement are classified as interested directors. With this legal position, none of the five directors qualifies as an interested director under section 214 read with section 195 of the Ordinance.

Notwithstanding the foregoing, please also take note of the fact that this transaction did not, in any way, cause any prejudice to the other shareholders of the Company nor did the Company suffer any loss due to the purchase of shares from HBO by the two interested directors. Even otherwise, it is the prerogative of the seller to sell its shares on discount. Any loss, as consequence of such discounted sale, is the loss of such seller and does not adversely affect the interests of the other shareholders or of the company. Please also take note of a very important string attached to the HBL shares i.e. the holders of these shares are not entitled to any dividend unless the Company can declare at least 10% dividend. The Company has not declared any dividend since the year 2001 till date, therefore, the two interested directors do not get any benefit from the acquisition of shares from HBL. Moreover, the re-structuring agreement itself provided the right of first refusal to the two interested directors, being members of the new management.

(iv) **Application of Section 217 (Lacking fiduciary behavior):** The respondents have taken due care and have duly discharged their duty towards the company and its shareholders while approving transaction of shares sold by HBL and acquired by the two directors named above. They duly discharged their duty of care towards the company by acting in good faith, in a manner that the respondents reasonably believed to be in the best interest of the company and have taken care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.

For the foregoing reasons, it is evident that the respondents did not contravene the provisions





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of sections 193, 196, 216, 217 and 492 of the Ordinance, and the penal provisions contained in Sections 193, 196, 216, 217 and 492 of the Ordinance are not attracted.

Based on the above submission, the respondents requested to drop the proceedings.

6. Consequently, the issue was discussed with the respondents' representative in a meeting held through video conference facility on January 22, 2015. Subsequent to the meeting, the respondents through letter dated February 28, 2015 submitted information regarding share pricing mechanism for purchase of shares from HBL by the two directors. They submitted that determination of the share price and its basis was completely the decision of the HBL at that time and respondents can only speculate about basis of HBL's decision. They further stated that determination of price might have been influenced by the fact that the shares being off loaded were 'B' or second class with no entitlement for dividend below 9%. Moreover, with average daily volume of hardly 10,000 shares during year 2011 at Rs0.55 per share, comparison of price with 8.08 million 'B' Grade shares is hardly tenable.

7. I have reviewed the facts of the case, respondents' response, relevant documents and provisions of the law. My observations in this regard are as under:

- i. The said share agreement was executed in 1985-1986 for restructuring of Company's debts with the HBL. As stated, the management was given first right of refusal in case HBL decide to dispose of the shares. The shares were issued to the Bank against the debts of the Company under the terms of restructuring agreement. The new 'B' Grade class shares (16,095,372 approximately) were issued in addition to existing capital structure after approval from CLA to HBL in lieu of outstanding debt. The shares were issued with a number of covenant as per restricting agreement of 1986 which also includes express first right of refusal of sponsors directors in case of HBL decision to sell. It is pertinent to mention here that the preferential rights to purchase are found in a diverse range of contracts. Often variously referred to as "pref rights", "preemptive rights" or "rights of first refusal". A preferential right gives the right holder an opportunity to purchase the shares upon the seller decision to sell. The language of a preferential right will specify the terms and conditions of the right holder. The sub clause (iv) of clause 3.02 of the restructuring agreement dated 14.05.1986 states that "*H.B.L and N.B.P reserves the right to*



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*dispose of these shares whenever they deem fit. It is expressly provided herein that in case the shares are to be disposed of the new management shall be given the first right of refusal."*

- ii. The purchasing of shares from the HBL is transaction between the bank and its directors. According to section 214 directors have duty to disclose their interest. The letters dated 10.12.2011 issued by Mr. Naveed Ellahi and Mr. Nadeem Ellahi Shaikh regarding the disclosure of interest under section 214 of the Ordinance was written to company secretary of the Company. The aforesaid transaction was approved by the Board of Directors (the "BOD") in meeting held on 14.12.2011 which reveals that necessary disclosure was made. The section 216 of the Ordinance states that interested director not to participate or vote in proceedings of directors. The minutes of the board meeting reveals that Mr. Naveed Ellahi and Nadeem Ellahi Sheikh did not participate in the board meeting which approved the said transaction. From the aforesaid facts, it appears that there was no breach of section 216 of the Ordinance.
- iii. The provisions of section 193(1) of the Ordinance require that the quorum for a meeting of directors of a listed company shall not be less than one third of their number or four, whichever is greater. The minutes of BOD held on 14.12.2011 reveals that five directors namely Mr. Azad Khan, Mr. Sultan Mahmood, Mrs. Mariam Atif Butt, Mr. Raja Ghazanfar Ali and Mr. Muhammad Sulman participated in the aforesaid meeting. Therefore, in the absence of any evidence to the contrary, it appears that the quorum was formed for the meeting. The section 196(1) of the Ordinance requires that the business of a Company shall be managed by the directors, who pay all expenses incurred in promoting and registering the company, and may exercise all such powers of the company as are not by this Ordinance, or by a special resolution, required to be exercised by the company in general meeting. If the meeting of the directors is convened and quorum is formed, the decisions taken by such meeting are valid, if those are not specifically required to be taken by the members.
- iv. That as per clause 4.1 of the Annual Report 2011 of the Company *"This includes 16,095,372 shares issued by HBL in accordance with restructuring agreement dated 14.05.1986 against the deferred loan converted into ordinary shares. These shares do not qualify for any dividend unless minimum 10% is paid by ordinary shareholders and also don't carry any voting rights"*, which clearly reveals that said transaction was shown in the audit reports. It is pertinent to





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mention here that Company mentioned the restructuring agreement in the audit report, so that shareholder can get further information regarding the said transaction if they required. While it is understood that it is not practically possible to include all the terms and conditions of restructuring agreement in the audit report, it is important that material information that is necessary for the shareholders to understand the agreement are correctly disclosed in the Accounts. It is clear that the Company did not make correct disclosure and it was incorrectly stated in the Accounts till the year ended June 30, 2011 that the shares held by HBL do not carry voting rights.

8. In view of the aforementioned facts, it appears that the respondent were not in violation of provisions of section 193, 196 and 216 of the Ordinance and, therefore, are not liable for fines prescribed for violation of these sections or action under section 217 of the Ordinance. However, it is evident that the Company in its Accounts till the year ended June 30, 2011 made incorrect disclosure in respect of the shares issued to IIBL by stating that those did not carry voting rights despite the fact that actually those share carried the voting rights. Moreover, the aforesaid Accounts also did not disclose the following material facts:

- That voting rights of 16,095,372 shares owned by HBL were issued in favor of Mr. Humayun Ellahi Shaikh or failing him Gulnar Humayun Ellahi; and
- The management has first right of refusal whenever the shares held by the HBL are disposed of.

Para 17-C of International Accounting Standard IAS 1 requires an entity to provide additional disclosures when compliance with specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events or conditions. Para 79 of IAS-1 requires an entity to disclose, for each class of share capital, the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital. Therefore, the Company being a listed company that prepares its Accounts in compliance with IFRS, was required to make the disclosures of aforementioned material facts in its Accounts as those were essential to enable users to understand the impact of aforesaid transaction with HBL.

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9. Having analyzed the facts of the case, provisions of the law and submissions of the respondents, I have concluded that the respondents have not violated the provisions of sections 193, 196 and 216 of the Ordinance and, therefore, the proceedings under these sections are concluded without any adverse order. However, in respect of violation of section 492 of the Ordinance, I have concluded that the respondents have failed to meticulously comply with these requirements as improper and inadequate disclosure was made in the Accounts till the year ended June 30, 2011 with regard to shares issued to HBL. However, taking cognizance of the fact that the respondents have admitted the non-compliance and have stated that it was unintentional and inadvertent, I hereby conclude the proceedings under section 492 with a warning to the respondents to be careful in future.

**Ali Azeem Ikram**

Executive Director (CSD)

**Announced:**

December 1, 2015

Islamabad