



**Before Tahir Mahmood
Executive Director (Enforcement)**

In the matter of

The General Tyre & Rubber Company of Pakistan Limited

Number & date of the notice: EMD/233/430/2001-2963-68 dated February 26, 2008

Date of hearing: April 2, 2008

Present: Mr. Ashfaq Ahmed Khan, Corporate Consultant
Ashfaq Ahmed Khan & Associates

Order

Under Sections 196 & 208 read with Section 476 of the Companies Ordinance, 1984

This order shall dispose off the proceedings initiated against The General Tyre & Rubber Company of Pakistan Limited (“the Company”) through show cause notice dated February 26, 2008 under the provisions of Sections 196 and 208 read with Section 476 of the Companies Ordinance, 1984 (“the Ordinance”).

2. The Company is a public limited company incorporated in Pakistan under the Ordinance and its shares are quoted on the Karachi & Lahore Stock Exchanges. The authorized share capital of the Company is Rs.750,000,000/- divided into 75,000,000 ordinary shares of Rs.10/- each and paid up capital of the Company is Rs.597,713,000/- divided into 59,771,250 ordinary shares of Rs.10/- each as per the latest annual audited accounts for the year ended June 30, 2007.

3. Brief facts of the case are that while examining the annual accounts for the year ended June 30, 2007 (“the Accounts”) of the Company, following was observed:

- The management of the Company had subscribed 302,100 right shares of Ghandhara Industries Limited (“GIL”) and paid Rs.3.021 million as consideration thereof. On perusal of the Company’s record, it was observed no special resolution was passed as required under the provisions of Section 208 of the Ordinance;



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department
Company Law Division

Continuation Sheet - 1 -

- After subscribing the rights, the Company disposed off the same to Bibojee Services (Private) Limited (“BSL”), another associated company for consideration of Rs.3.074 million, including Rs.0.053 million as mark-up. However at the date of sale of such shares market price was much higher than the price on which these shares were sold;
- Through such arrangement the Board of Directors (“BOD”) had caused a loss to the Company and its members and such an arrangement falls within the ambit of Sub-section (1) of Section 196 of the Ordinance;
- In year 2007, the Company allowed credit period of 42 days to its customers, other than the associates, which is within 30-45 days of its credit policy. However, credit period allowed to its associates stood at 121 days which was approximately three times of credit policy i.e. 30-45 days, as it is evident from the following analysis:

Amounts in thousands			
Years	2007	2006	2005
Total Sales	3,951,145	3,731,994	3,197,717
Sales to Associates	86,000	95,339	75,824
Net Sales (other than Associates)	3,865,145	3,636,655	3,121,893
Trade Debts (other than Associates)	445,839	394,042	319,809
Collection Period (days)	41.53	39.01	36.88
Sales to Associate	86,000	95,339	75,192
Trade Debts to Associates	28,983	20,722	9,384
Collection Period (days)	121.32	78.25	44.93

- This shows that the Company is giving preferential treatment to its associates namely GIL, Ghandhara Nissan Limited (“GNL”), and BSL which is against the spirit of the provisions of Section 208 of the Ordinance.

4. In view of the foregoing, it was observed that the directors of the Company had violated the provisions of Sub-section (1) of Sections 196 & 208 of the Ordinance, therefore, a show cause notice under the aforesaid sections of the Ordinance was issued to following directors in order to explain as to why penalties in terms of Sub-section (4) of Section 196 and Sub-section (3) of Section 208 of the Ordinance may not be imposed on them:

- (i) Lt. Gen (Retd) Ali Kuli Khan Khattak, Chief Executive;
- (ii) Mr. Ahmed Kuli Khan Khattak, Director;
- (iii) Mr. Ikram-ul-Majeed Sehgal, Director;
- (iv) Mr. Mushtaq Ahmed Khan, Director;
- (v) Mr. Raza Kuli Khan Khattak, Director;



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department
Company Law Division

Continuation Sheet - 2 -

5. In response to the show cause notice, Mr. Ashfaq Ahmed Khan, Corporate Consultant of M/s Ashfaq Ahmed Khan & Associates (“the Counsel”) submitted the following reply on behalf of the aforementioned directors of the Company:

(a) Preferential treatment to associated companies by providing trade credit on softer terms:

- As regards to providing of abnormal trade credit to associated companies, it is submitted that sales of the Company during the year ended June 30, 2007 stood at Rs,3,951 million out of which sales to associated companies stood at Rs.86 million which constitutes only 2.2% of the total sales of the Company. The outstanding amount from associated stood at Rs.28.983 million. The amount of sales to associates and outstanding amount from them are very small when compared to the sales of the Company which runs into billions of rupees;
- It is true that average collection period in case of associated companies is little more yet in view of small amount and slight delay in payment it cannot be concluded that undue preferential treatment has been given in trade credit to associated companies;
- It is amply clear that the Company has neither provided any loan or advance on softer terms to its associated companies as compared to customers. However, there is a slight delay in payment on the basis of which the nature of trade credit has not been changed. The amount due from associated companies is on account of normal trade credit and it cannot be held that the Company has violated the provisions of Section 208 of the Ordinance;

(b) Subscribing right shares of associated company i.e. GIL without the approval of Company’s shareholders and then disposing off the same to another associated company i.e. BSL:

- As regards to subscribing 302,100 right shares of GIL at par value of Rs.10/- each amounting to Rs.3.021 million, it is submitted that during the year, the Company had subscribed the right shares of GIL. As per the requirement of Section 208 of the Ordinance, the Company was required to pass special resolution before subscribing these right shares. The Company however forgets to pass the special resolution. Passing of special resolution requires large number of formalities and considerable amount of money in holding of shareholders meeting and publishing the notice of meeting in at least two daily newspapers. As the number of shares for which shareholders approval was required was quite small, the matter was placed before the BOD of the Company. The BOD in their meeting held on August 29, 2006 considered the matter and observed that subscription of GIL’s right shares without the prior approval of shareholders was inconsistent to the requirement of Section 208 of the Ordinance and therefore decided that the management should obtain refund of subscription amount with normal profit on the subscribed amount as yet shares have not been issued;



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department
Company Law Division

Continuation Sheet - 3 -

- As regards to disposing off right shares to BSL, it is submitted that the BOD of the Company in their meeting held on June 29, 2006 viewed that subscription of right shares of GIL without prior approval of shareholders of the Company was inconsistent with the provisions of Section 208 of the Ordinance. It was therefore decided that management should obtain refund of subscription money with normal profit to avoid default under the provisions of Section 208 of the Ordinance. In view of small number of shares and to save expenditure in calling of shareholders' meeting at this belated stage, the right subscribed were disposed off to BSL for consideration of Rs.3.074 million including Rs.0.053 million as mark-up without causing any loss to the Company.

5. In order to provide an opportunity of personal hearing, the case was fixed on April 2, 2008 on which date the Counsel appeared before me on behalf of all the aforementioned directors of the Company. He reiterated his earlier stance as was given through written submissions in response to the show cause notice. However, he added that the sales made to associated companies were on normal terms and conditions offered to other customers however subsequently delay occurred in recovery of amount from these companies. He further added that no bad debts have ever been recorded on account of transactions with associated companies whereas in other cases the Company has to book provisions against outstanding amounts. However, he admitted that BOD and the Company should have observed the compliance of the provisions of Sections 196 & 208 of the Ordinance respectively at relevant time. Further, he requested to provide more time for submission of additional information / documents which was duly granted and he was advised to submit documents / information in support of his arguments by April 10, 2008. The Counsel vide letter dated April 11, 2008 has reiterated its earlier stance as communicated to the Commission through written submission and verbally on the date of hearing i.e. April 2, 2008. However, the following documents / information have been provided:

- In reference to giving preferential treatment to associated companies by providing trade credit on softer terms, the Counsel provided ledger accounts of associated companies and copies of various letters written by the company for recovery of its outstanding amounts;
- In reference to Company's failure to pass special resolution under the provisions of Section 208 of the Ordinance before subscribing right allotment letters of GIL, it was submitted that GIL had announced right shares on May 19, 2006 whereas the last date for acceptance was July 13, 2006 and the Company made payment for its rights entitlements on July 13, 2006;



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department
Company Law Division

Continuation Sheet - 4 -

- Further, the Counsel confirmed that the Board of the Company had advised the management to obtain refund of the above subscription amount with normal profits on the subscribed amount.

6. I have analyzed the facts of the case, provisions of Sections 196 & 208 of the Ordinance, arguments put forth by the Counsel on behalf of erring directors of the Company and observed as follows:

- (i) The Company has been providing preferential treatment to its associated companies namely GIL, GNL, and BSL for the last two years i.e. 2007 and 2006 as it is evident on the analysis given in para 3 above. It is pertinent to mention here that as on June 30, 2007 credit period allowed to associates stood at 121-days which is more than three times (approximate) of the Company's credit policy. The same has been admitted vide Counsel's letter dated March 17, 2008;
- (ii) The Company had subscribed right shares of GIL, an associated company and paid Rs.3.021 million on July 13, 2006 as consideration thereof. As mentioned in the annual accounts of the Company for the year ended June 30, 2007, the Company after subscribing the rights had disposed off the same to BSL, another associated company, on the instructions of the BOD of the Company for consideration of Rs.3.074 million which also includes Rs.0.053 million as mark-up. Consequently, Company's holdings in GIL had reduced from 1.536% to 0.473%. However, the Counsel in its reply dated March 17, 2008 submitted that BOD in their meeting held on August 29, 2006 considered the above matter and observed that the subscription of GIL's shares without the prior approval of shareholders was inconsistent to the requirement of Section 208 of Ordinance and therefore decided that the management should obtain refund of subscription amount with normal profit on subscribed amount as yet shares had not been issued;
- (iii) If we consider that the Company had disposed off the GIL's right shares on August 29, 2008 at a price of Rs.3.074 million (which also includes Rs.0.053 as mark-up) then loss caused to the Company would be Rs.5,520,745:

Market value of GIL's right shares as on August 29, 2006: Rs.8,594,745
(302,100*28.45)

Amount received from disposal of GIL's right shares: Rs.3,074,000

Loss caused to the shareholders of the Company: Rs.5,520,745

- (iv) It has also been concluded that directors of the Company namely Mr. Ali Kuli Khan Khattak, Mr. Ahmed Kuli Khan Khattak and Mr. Raza Kuli Khan Khattak who are also representing in the Board of BSL, earned Rs.5,520,745 at the cost of Company's shareholders by disposing off the Company's entitlement of GIL's right shares to another associated company wherein they are also directors;



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department
Company Law Division

Continuation Sheet - 5 -

- (v) The above facts while clearly proving that the aforesaid transaction was not carried out prudently and complying with the legal formalities but also raise serious doubts on the validity of the transaction reported by the Company.

7. Before proceeding further, it is necessary to advert to the following relevant provisions of law:

- Provisions of Sub-section (1) of Section 196 of the Ordinance provides that the business of a company shall be managed by the directors, who may 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 the articles, or by a special resolution, required to be exercised by the company in general meeting;
- Provisions of Sub-section (4) of Section 196 of the Ordinance provides that whosoever contravenes any provision of this section shall be punishable with a fine which may extend to one hundred thousand rupees and shall be individually and severally liable for losses or damages arising out of such action.
- Provisions of Sub-section (1) of Section 208 of the Ordinance provides that a company shall not make any investment in any of its associated companies or undertakings except under the authority of special resolution which shall indicate the nature, period and amount of investment and terms and conditions attached thereto provided that the return on investment in the form of loan shall not be less than the borrowing cost of the investing company;

Explanation: The expression “investment” shall include loans, advances, equity, by whatever name called, or any amount which is not in the nature of normal trade credit.

- Provisions of the than applicable Sub-section (3) of Section 208 of the Ordinance provides that if default is made in complying with the requirements of this Section, every director of a company who is knowingly and willfully in default shall be liable to fine which may extend to one million rupees and in addition, the directors shall jointly and severally reimburse to the company any loss sustained by the company in consequence of an investment which was made without complying with the requirements of this Section;

8. The aforesaid provisions of law are clear and explicit. Sub-section (1) of Section 196 of the Ordinance establishes a relationship between directors and company which is being a fiduciary nature and directors shall always to act in good faith vis-à-vis directors could be treated as trustees of money which comes into their hands and on proof of misapplication or misuse thereof, would be held liable to make good the loss. The law gives complete authority to the directors of the Company to use the Company’s funds and does not impose any restriction of taking approval even from the



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department
Company Law Division

Continuation Sheet - 6 -

shareholders or any regulatory authority. Therefore it is the responsibility of the BOD to use this authority with utmost care and decisions should be taken diligently. However, in the case in hand, I have observed that directors had made imprudent decision which caused a loss of Rs.5,520,745 to the Company and its shareholders.

9. Considering the circumstances of the case, I am of the view that the directors have failed to clarify their position with respect to compliance with the requirements of Sub-section (1) of Section 196 of the Ordinance at the time of disposing off rights shares of GIL, an associated company, to another associated company i.e. BSL. Due to which, the Company had incurred a loss of Rs.5,520,745 and it is established that by this action, the directors of the Company failed to act in good faith. Accordingly, an action is necessary under Sub-section (4) of Section 196 of the Ordinance which not only provides a fine of one hundred thousand rupees for the responsible directors but also make them individually and severally liable for losses and damages arising out of such action. The fact of the case warrants no sympathy for the directors and requires a stern action against them. I, therefore, impose a fine of Rs.500,000/- (Five Hundred thousand only) in aggregate on the directors including the Chief Executive of the Company for contravening the provisions of Sub-section (1) of Section 196 of the Ordinance.

10. Whereas on the other hand, directors had failed to observe the requisite provisions of law at the time of subscribing right shares offered by its associated company i.e. GIL. The Company had also given preferential treatment to its associated companies namely GIL, GNL, and BSL by allowing abnormal credit period of three times (approximate) of its credit policy. Accordingly, it may be concluded that the stated amount recoverable from associated companies does not comes under normal trade credit. Sub-section (1) of Section 208 of the Ordinance clearly states that no company can make investment in its associated company except under the authority of resolution in the meeting of the members. Whereas, investment includes loans advances, equity, by whatever name called, or any amount which is not in the nature of normal trade credit.

11. For the foregoing reasons, it is evident that the Company has violated the provisions of Section 208 of the Ordinance and had failed to exercise due care while subscribing right shares of its



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department
Company Law Division

Continuation Sheet - 7 -

associated company i.e. GIL and giving preferential treatment to associated companies by allowing abnormal credit period of three times (approximate) of its credit policy. In view of this, I am of the firm opinion that the provisions of Section 208 of the Ordinance have been violated and concerned directors are liable for the penalties as defined in Sub-section (3) of Section 208 of the Ordinance. As the default is admitted, I, therefore, in exercise of the powers conferred impose a fine of Rs.1,000,000/- (one million rupees only) in aggregate on the directors including the Chief Executive of the Company for contravening the provisions of Sub-section (1) of Section 208 of the Ordinance.

12. Directors of the Company are required to deposit the aggregate fine of Rs.1,500,000 (Rupees one hundred and five thousand only) in the following manner:

Directors	Section 196	Section 208	Total
	Amount in Rupees		
Lt. Gen. (Retd.) Ali Kuli Khan Khattak, Chief Executive	100,000	Rs.200,000	300,000
Mr. Ahmed Kuli Khan Khattak, Director	100,000	Rs.200,000	300,000
Mr. Ikram-ul-Majeed Sehgal, Director	100,000	Rs.200,000	300,000
Mr. Mushtaq Ahmed Khan, Director	100,000	Rs.200,000	300,000
Mr. Raza Kuli Khan Khattak, Director	100,000	Rs.200,000	300,000
Total	500,000	1,000,000	1,500,000

The Chief Executive and directors of the Company are hereby directed to deposit the fines in the designated bank account maintained in the name of the Commission with Habib Bank Limited within thirty days from the receipt of this order and furnished receipted bank vouchers to the Commission.

13. Further, all of the above, directors are also directed to make good the loss of Rs.5,520,745 caused to the Company by depositing said amount in the account of the Company within thirty days from the receipt of this order and furnished a receipted bank voucher to the Commission confirming the same.



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department
Company Law Division

Continuation Sheet - 8 -

14. In case of non deposit of the penalty, proceedings under the Land Revenue Act, 1967 will be initiated for recovery of the fine as an arrear of land revenue. It may also be noted that the said penalties are imposed on the directors in their personal capacity accordingly they are required to pay the said amount from their personal resources.

Tahir Mahmood
Executive Director-Enforcement

Announced
April 23, 2008
Islamabad