



# Securities and Exchange Commission of Pakistan

## BEFORE APPELLATE BENCH NO. IV

In the matter of

### Appeal No. 40 of 2009

- (i) Dewan Muhammad Yousuf Farooqui, Chief Executive
- (ii) Dewan Abdul Rehman Farooqui, Managing Director
- (iii) Dewan Asim Mushfiq Farooqui, Director
- (iv) Dewan Abdullah Ahmed Swaleh Farooqui, Director
- (v) Dewan Abdul Baqi Farooqui, Director
- (vi) Mr. Haroon Iqbal, Director

of Dewan Sugar Mills Limited

....Appellants

Versus

Executive Director (Enforcement)

Securities and Exchange Commission of Pakistan

...Respondent

Dates of Hearing: 07/11/12, 20/4/12, 18/09/12, 07/11/12, 20/02/14, 02/01/15,  
15/01/15 and 14/10/15

### Present:

#### For the Appellants 1, 2 and 6:

- (i) Mr. S. M. Abbas Hyder, Advocate
- (ii) Mr. Muhammad Hanif German, Company Secretary, Dewan Sugar Mills Ltd
- (iii) Mr. Syed Maqbool Ali, Senior General Manager, Dewan Sugar Mills Ltd

#### For the Appellants 3, 4 and 5:

Nemo

#### For the Respondent:

- (i) Mr. Ali Azeem Ikram, Executive Director (CSD)
- (ii) Mr. Shahzad Afzal, Joint Director (CSD)

### ORDER



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1. This order is in appeal No. 40 of 2009 filed under section 33 of the Securities and Exchange Commission of Pakistan Commission Act, 1997 against the order dated 30/06/09 (Impugned Order) passed by the Respondent.
2. Brief facts of the case are that examination of the annual accounts of Dewan Sugar Mills Limited (Company) for the year ended 30/09/08 (Accounts) revealed that an amount of Rs.309.704 million (Rs.493.448 million in 2007) was outstanding against advances extended by the Company to its associated undertakings under the toll manufacturing arrangements. Record of the Company available with Respondent reflected that the said advances were extended without obtaining the authority of a special resolution in terms of section 208 of the Companies Ordinance, 1984 (Ordinance) and no interest or markup was charged on the amounts. Consequently, the Company vide Respondent's letter dated 06/03/09 was *inter alia* required to provide the following information with regard to advances to associated undertakings:
  - a) Name(s) of associated undertakings and break up of Rs.309.704 million
  - b) Date since when these undertakings became associated with the Company
  - c) Certified copy of approval(s) authorizing extension of these advances i.e. BOD resolution and Special Resolution of Shareholders passed in a general meeting, with specific reference to the provisions of section 208 of the Ordinance
  - d) Copies of current and ledger accounts of these associated undertakings maintained in the Company's books with effect from 01/10/06 till February 28/02/09
  - e) Certified copies of toll manufacturing agreements and detail of any subsequent changes/amendments
3. In response to the observation of the Commission, the Company vide letter dated 15/04/09 submitted the following information and documents:

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- a) The advances have been extended to associated companies namely Bawany Sugar Mills Limited (BSML) in the sum of Rs.284.700 million and Al-Asif Sugar Mills Limited (ASML) in the sum of Rs 25.004 million
  - b) The companies became associated of the Company on 15/11/06 upon acquisition of majority of shareholdings of BSML and ASML by Dewan Mushtaq Group/Directors
  - c) Provisions of section 208 of the Ordinance are not applicable to these advances as these are for normal trade and do not fall within the definition of 'investment' as per section 208 of the Ordinance
  - d) Copies of current and ledger accounts of BSML and ASML and toll manufacturing agreements were provided
4. Analysis of the documents and reply submitted by the Company reflected that the Company had violated the provisions of section 208 of the Ordinance.
5. Show cause notice dated 24/04/09 (SCN) under section 208(3) read with 476 of the Ordinance was issued to the Appellants. In response to the SCN, Mr. Haroon Iqbal, Director and Mr. Abdul Basit, Company Secretary submitted a response vide letter dated 05/05/09. Hearing in the matter was held on 25/05/09. The Respondent, dissatisfied with the response of the Appellants, passed the Impugned Order and imposed a penalty of Rs.1,000,000 on Dewan Muhammad Yousuf Farooqui, Chief Executive (Appellant No.1) and Rs.500,000 on the rest of the Appellants. The Respondent further directed the Appellants under section 473 of the Ordinance to make good the default by recovering the outstanding amount extended by way of advance to the associated companies without complying with section 208 of the Ordinance and to recover the interest on the aforesaid advances. Further, the Appellants were directed to furnish with the Commission the auditors' certificate regarding final settlement of all the outstanding amounts against advances to associated companies and recovery of markup/interest thereon, within thirty days of the Impugned Order.



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6. The Appellants preferred appeal against the Impugned Order. The representatives of Appellants 1,2 and 6 argued that:

- a) The conclusion regarding violation of the provisions of section 208 of the ordinance has been derived prematurely. Plain reading of the paragraph shows that the inference was drawn even before calling the details and documents which is not permissible under the law. The Appellants complied with the directions of the Respondent in letter and spirit and did not conceal any facts.

In Para 9(i) of the Impugned Order it has been alleged that since the year 2006, the Company has been extending huge amounts of advances which according to the Respondent has surpassed the total amount of charges paid by the Company during the respective years against toll manufacturing facility availed from associated companies. The Respondent has tried to expand the scope of SCN by discussing the issue which has no nexus, connection or relevance with the SCN i.e. matters beyond the scope of SCN. On 30/09/05 the Respondent had erred in referring to the period between 30/09/05 to 30/09/06 as the period admittedly pertains to the tenure when Dewan Sugar Mills Limited and ASML and BSML were not bound by the associate relationship. Therefore, it was legally and factually incorrect to include this period for deriving inference within the meaning of section 208 of the Ordinance which deals with the transactions carried out between associated undertakings. No distinction between and pre and post associate relationship periods has been made either in the SCN or the Impugned Order. The Respondent has acted without jurisdiction in including the pre-associate relationship in his findings as provisions of section 208 of the Ordinance were not applicable in pre-associate relationship period. Therefore, any inference drawn for the purposes of section 208 of the Ordinance on the basis of transactions carried out between the companies during the period prior to establishment of associate undertaking relationship i.e. up to 15/11/06 was totally unwarranted and, therefore, is liable to be set aside.



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- b) In Para 9 (ii), (iii) and (iv) of the Impugned Order, the Respondent by posting yearly and monthly advances in respect of ASML and BSML tried to show that outstanding balances by no means were in the nature of normal trade credit. This has been done without defining the term normal trade credit. The Respondent has erred in assuming that the advances started surging abnormally since the year 2006. The observation is factually incorrect, as is evident for the following table:

Description	Al-Asif Sugar Mills Limited	Bawany Sugar Mills Limited
Balance as on November 15,2006	Rs.223,736,333	Rs.288.858,391
Services received after becoming associated companies	Rs.322,841,018	Rs.562,425,250
Less: Net Payments made	Rs.124,108,921	Rs.541,901,575
Closing Balance	Rs. 25,004,736	Rs.268,434,716

A plain reading of above comparison shows that value of services received after becoming associates was more than the payments made. In the case of ASML payments made after 15/11/06 (the date of establishment of associate relationship) were Rs.124,108,921 whereas services received were to the tune of Rs.322,841,018 i.e. much higher than the payments made. Similarly in the case of BSML payments after 15/11/06 stood at Rs.541,901,575 whereas value of services was at Rs.562,425,250. The facts and figures disprove the allegation that advances started surging abnormally after 2006.

The Respondent has also admitted that advances made as on September 2005 were Rs.160,562 million as against cost of toll manufacturing was higher than the advances made.



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In para-9 (v), (vi), (vii) of the Impugned Order, it has been maintained that profitability, liquidity and overall financial position of the company has deteriorated. The real factors which are other than the advances made, leading to decrease, if any, in profitability and liquidity have not been taken into account by the Respondent. The Respondent has erred in restricting the scope of the findings to the factum of advances only. There were several other factors responsible for decrease, if any, in profitability and liquidity.

In para-9 (viii) of the Impugned Order it has been maintained that provisions of section 208 of the Ordinance has become applicable on entering into associate relationship between DSML and ASML and BSML irrespective of the fact that the toll manufacturing arrangement already existed between them. The assertion is misconceived as provisions of section 208 of the Ordinance were only applicable on signing of new arrangement. It was not attracted retrospectively on the transactions already concluded between the associated companies prior to 15/11/06. Since there was no change in the nature of transaction or terms and conditions, the question of applicability of section 208(1) of the Ordinance does not arise;

- c) The Respondent has attempted to unnecessarily expand the scope of the SCN by discussing issues and matters having no nexus, connection or relevance with the SCN. The observations of the Respondent in paragraph 11 of the Impugned Order have been made without specifying and quantifying the amount of loss allegedly incurred to the Company due to advances made to the associated companies or the benefits accrued to the associated companies. The conclusion drawn is without substance and general in nature. The Respondent has erred in law and on the facts of the case and penalized the Appellants with harsh penalties. The Impugned Order has been passed without affording the Appellant the opportunity of being heard, i.e. the maxim audi alteram partem has been violated. The conclusion drawn is without substance and general in nature. The Respondent has erred in law and on the facts of the case and penalized the



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Appellants with harsh penalties. The Impugned Order, therefore, is not sustainable in the eyes of the law; and

- d) Penal provisions under the Ordinance are quasi-criminal in nature and, therefore, it was mandatory to establish mens rea before levying penalty. The Impugned Order does not establish the guilty intent or mens rea. As there is no allegation against the Appellants that they acted with criminal intent or made any personal gains or benefits from the alleged contravention or default, penal provisions of section 208 of the Ordinance were not attracted, nor could be applied to them..

7. The Respondent rebutted the arguments as follows:

- a) Paragraph 9 of the Impugned Order includes analysis of the facts and figures and is purely based on the information provided by the Company and as such it cannot be termed as irrelevant to the case and proceedings initiated against the directors of the Company. Reference to the period between 30/09/05 to 15/11/06 i.e. the period prior to establishment of associate relationship between the Company, ASML and BSML, is made only to highlight the trend of outstanding advances allowed vis-a-vis and value of services acquired from ASML and BSML in pre and post associate relationship period. It has been demonstrated that before establishment of associated relationship, the amount of advances outstanding at the beginning of the year were in excess of the value of services obtained during the year. This clearly demonstrates that after establishment of associate relationship, the associated companies i.e. ASML and BSML were passed on benefit by allowing excessive advances without any mark up or interest.

It is pertinent to mention that Para 9 (viii) of the Impugned Order provides that the provisions of section 208 of the Ordinance become applicable to the Company with effect from 15/11/06 and any loan or advances made by the Company to ASML and BSML subsequent to that date without the authority of special resolution of shareholder of the Company, constitutes

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violation of these provisions. The directors have been penalized for the violation of the provisions of section 208 of the Ordinance for the aforesaid period i.e. after establishment of associate relationship between the Company, ASML and BSML. Reference to the period prior to establishment of associate relationship is merely to highlight facts and figures and to show trend analysis and no inference in the pre-associate relationship period has been made to establish violation of provisions of section 208 of the Ordinance by the Appellants. The Appellants' plea, therefore, is untenable;

- b) The term trade credit/normal trade credit is very well understood in the accounting and business circles and due to this reason no need was felt by the legislators to define the term in the Ordinance. It is a well understood principle that the trade credit in the normal course of business has specific repayment period and it is not an open ended credit without specific repayment period. In the instant case, the Company has extended huge amounts to ASML and BSML, the associated companies without any specific repayment period and sporadic adjustments against the advanced amounts have been made without any clean out period. As such the advances are in the nature of running finance or an ever green line of credit but without any interest or mark up. The same facts have been highlighted in Para 9(ii) to 9(iv) of the Impugned Order. The Appellants have wrongly stated that the Respondent has erred in assuming that the advances started surging abnormally since the year 2006. In fact, the Respondent at Para 9(i) in the Impugned Order has stated that average number of days of repayment/adjustment against the said advances started surging abnormally since the year 2006 and the same fact has been demonstrated based on the following calculations, as per figures reported in the annual audited accounts of the Company:

Year ended Sep 30	2004 (Million Rs.)	2005 (Million Rs.)	2006 (Million Rs.)	2007 (Million Rs.)	2008 (Million Rs.)
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Total Toll Mfg. Charges paid	-	199.737	248.847	284.733	426.210
Total Outstanding Advances	-	160.562	440.980	493.448	309.704
Avg. Days of Repayment/Adjustment	-	147	441	599	344

The Appellants have presented the following data in the appeal in favour of their arguments:

Description	ASML	BSML
Balance as on 15/11/06	233,736,333	288,958,391
Services received after being associated	(322,841,018)	(562,425,250)
Less: Net Payments made	124,108,921	541,901,575
Closing Balance	25,004,736	268,434,716

The Appellants have stated that the above comparison shows that the value of services received after becoming associates were more than the payments made. It is stated that the Appellants have tried to manipulate the data by giving comparison of figure of outstanding advances on a specific date i.e. 15/11/06 against the value of services obtained during the subsequent period of 22 months and sixteen days with effect from 16/11/06 till 30/11/08. In our view only a year to year comparison in the subject case can reflect the true picture by comparing the value of services obtained during a year against the advances which were outstanding at the beginning of that year.

Period Nov.15, 2006 to Sept, 2007	Rs.in millions		
	ASML	BSML	Total
Balance as on 15/11/06	223.736	288.958	512.964
Further amounts Extended	129.998	179.306	309.304

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during the year			
Adjustment against services	123.927	204.623	*328.550
Balance as on 30 Sept 07	229.807	263.641	493.448

(This figure is based on ledger accounts provide by the Company. The audited accounts show a figure of Rs.284.733 million as total toll manufacturing charges during the year ended on Sep. 30, 2007)

The above table demonstrates that services worth Rs.328.550 million (ASML: 123.927 + BSML: 204.623 M) were obtained from the associated companies during the period from 15/11/06 to 30/09/07 against the outstanding advances of Rs.512.694 million (ASML: 223,736 + BSML: 228.958) which were outstanding as on 15/11/06. In other words, the Company instead of adjusting the outstanding advances against the value of services obtained during the period so as to bring down the outstanding amounts, further extended Rs.309.304 million to associated companies, therefore, huge balance of Rs.493.448 million was still outstanding on 30/09/07. Furthermore, the average month and balance outstanding against advances to associated companies from 16/11/06 to 30/09/07 was Rs.480.398 million. The minimum month end balance never went below Rs.400.311 million. The above figures are taken from the ledger accounts provided by the Company. There cannot be any justification for the huge amounts of outstanding advances vis-à-vis value of services obtained during the period.

Period October 1, 2007 to Sept 30, 2008		Rs.in millions	
	ASML	BSML	Total
Balance as on 30/09/07	229.807	263.641	493.448
Further amounts Extended during the year	73.977	312.286	386.263
Adjustment against services	198.914	291.228	79.866
Balance as on 30 Sept 08	25.004	284.700	309.704

(This figure is based on ledger accounts provide by the Company. The audited accounts show a figure of Rs.426.210 million as total toll manufacturing charges during the year ended on Sep. 30, 2008)

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During the period 1/10/07 to 30/09/08, the services worth Rs.490.142 million were obtained from the associated companies against the outstanding advances of Rs.493.448 million (ASML: 229,807 + BSML: 263,641) which were outstanding as on 30/09/07. The Company instead of adjusting the outstanding advances against the value of services obtained during the period so as to bring down the outstanding amounts, further extended Rs.386.263 million to associated companies during the year. Further, despite adjustment of almost entire balance from ASML with which the toll manufacturing agreement was terminated during the year (as stated in Directors' Report), a huge balance of Rs.309.704 million was outstanding at the year end. The average month end balance outstanding during the year 2007-08 was Rs.311.888 million. The above pattern clearly demonstrates that even during the relevant period i.e. from 15/11/06 until 30/09/08, the Company extended advances to the ASML and BSML and these advances were not normal trade credit. Further, the mere fact that the parties to the agreement have covered the amounts advanced by entering into toll manufacturing agreements and these have been classified as current assets and current liabilities in the respective balance sheets, do not make these advances fall within the ambit of normal trade credit. Examination of ledger accounts of ASML and BSML maintained in the books of the Company further reveals that the advances are open ended credit without a specific repayment period.

- c) The Appellant's objection that the Respondent has attempted to unnecessarily expand the scope of SCN by discussing issues and matters having no nexus, connection or relevance with the SCN is not tenable because as per normal procedures, the SCN was based on preliminary findings and the Appellants were provided ample opportunity to clarify their position in writing and during the course of personal hearing. The Appellants' plea that maxim audi alteram partem and principles of natural justice have been violated is not tenable. The detailed submission in writing was made by the representative of the Appellants to the SCN and those submissions have been included in detail at para 7 of the Impugned Order. All the figures quoted and analysis made in the Impugned order were entirely based on the information and documents



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submitted by the Company in connection with the issue which is the subject matter of the SCN and the Order. It has been stated in para 9(vii) of the Impugned Order that diversion of high cost funds of the borrowed from various banks by the Company, to the associated companies free of cost, has significantly contributed towards worsening of the situation. Para 11 of the Impugned Order states as provisions of section 208 of the Ordinance were contravened, the circumstances of the case warranted no sympathy for the Appellants who have allowed misuse of Company's funds for the benefit of the associated companies, causing huge loss to the Company and its shareholders.

- d) The Impugned Order was passed in accordance with the law and penalties have been imposed in line with the level of default and are not harsh by any means. As the nature of defaults with regard to violation of Section 208 by allowing unauthorized advances to ASML and BSML is similar and directors in default are also the same, therefore, it was not felt necessary to impose separate penalties. Para 13 of the Impugned Order reflects that penalties of Rs.3.5 million have been imposed in aggregate on six directors of the Company against maximum penalty of Rs.10 million on every director, as prescribed by section 208(3) of the Ordinance.
8. We have heard the arguments and perused record with the able assistance of parties i.e. the Appellant and the Respondent.
9. Section 208(1) of the Ordinance require companies to obtain a special resolution in case of investment in associated companies. The proviso to section 208(1) of the Ordinance states "return on investment in the form of loan given by a company to its associated concern shall not be less than the borrowing cost of the company". A company cannot under any circumstances make advances/loans to its associated companies without charging any interest or return on investment.



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10. We are of the view that in the instant case, ASML and BSML became associated with the Company from 15/11/06. The Appellant's argument that the Respondent had mentioned the period prior to 15/11/06 in the Impugned Order was to demonstrate the general trend for extending balances to ASML and BSML is not valid. The Company had started extending huge advances to ASML and BSML which had surpassed the total amount of charges paid by the Company against toll manufacturing facility availed from the associated companies. The advances were made without any specific repayment period, therefore, they cannot be advances in the nature of normal trade credit. Moreover, we concur with the Respondent that only a year to year comparison can reflect the true picture by comparing the value of services obtained during a year against the advances. Therefore, once the associated relationship with the Company had taken effect on 15/11/06, the Company was bound to comply fully with the requirements of section 208 of the Ordinance. In the instant case, no special resolution was passed nor was any interest or markup charged on the amounts. As such, the requirement of law is unequivocal and cannot be avoided.
11. The word "willful default" has been defined in Oxford Dictionary of Law Fifth Edition as "The failure of the person to do what he should do, either intentionally or through recklessness." The argument of the Appellants that there was no mens rea holds little merit as even there may not be knowledge or intent, the Appellants did not exercise the due skill and care required of them as directors of the Company. We are of the view that the penalties were rightly imposed on the Appellants.
12. In view of our observations in paragraphs 8 and 9 above, the Impugned Order is upheld to the extent of Appellants 1, 2 and 6 and appeal is dismissed with no order as to costs.
13. However, we have noted that no one appeared on behalf of Appellants 3, 4 and 5. This Bench is of the view that ample hearing opportunities have previously



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been provided to the Appellants 3, 4 and 5 on 07/11/12, 20/4/12, 18/09/12, 07/11/12, 20/02/14, 02/01/15 and 15/01/15. Further, no reason was provided for their absence from the hearing on 14/10/15. Therefore, to the extent of Appellants 3, 4 and 5 the appeal is dismissed for non-appearance and non-persuasion.

**(Fida Hussain Samoo)**  
Commissioner (Insurance)

**(Zafar Abdullah)**  
Commissioner (SCD)

Announced on: **17 NOV 2015**