Before Mr. Tahir Mahmood, Executive Director (Enforcement)

In the matter of

M/S JDW Sugar Mills Limted

(Under Section 208 Read with Section 476 and 492 of the Companies Ordinance, 1984)

No. and date of show cause notice	No. EMD / 233 / 34812002-3394-3401 Dated March 3,2008
Date of hearing	March 17, 2008
Present:	Mr. Shehzad A. Ellahi, Legal Counsel Mr. Muhammad Rafique, CFO, JDW Sugar Mills Limited
Date of Order	May 6, 2008

ORDER

This order shall dispose of show cause proceedings in the matter of Show cause No.EMD / 233 / 348 / 2002-3394-3401 dated March 3, 2008, under Section 208 and 492 read with 476 of the Companies Ordinance, 1984 (the "Ordinance") issued to M/S JDW Sugar Mills Limited, (the "JDWSML") and its Directors.

2. Show cause notices were issued to the directors of the JDWSML that required each of them to explain their position in writing on or before January 17, 2008 in respect of an amount of Rs. 484.857 million advanced to its subsidiary company namely M/s United Sugar Mills Limited (USML) without obtaining the shareholder approval, and omitting / misrepresenting material facts in the relevant financial statements on the aforesaid loans.

3. The financial statements of the JDWSML for the year ended on June 30, 2006 disclosed an amount of Rs. 484.857 million advanced to USML to meet working capital requirements and Note 19.1 of the aforesaid financial statements stated that;

> *"This represents advance given to the United Sugar Mills Limited, a subsidiary Company, to meet the working capital requirements at the rate of 12.5% per annum, which approximates the average cost of borrowed funds of the Company."*

4. The month-wise abstract of movement in the loan account of USML, having outstanding balance of Rs.484.857 million as at September 30, 2006 is as follows:

Monthly summarized movement of Loans					
Month	**Long Term Loan**		**Current A / c**		
	Debit	**Credit**	**Debit**	**Credit**	**Balance**
Oct-05	*620,000,000		7,392,660		7,392,660
Nov-05			17,872,199	816,144	24,448,715
Dec-05			146,401,563	54,140,292	116,709,986
Jan-06			229,223,611	22,307,200	323,626,397
Feb-06			353,342,994	42,170,643	634,798,748
Mar-06			166,947,497	107,896,411	693,849,834
Apr-06			16,190,284	133,586,614	576,453,504
May-06			46,901,807	32,664,200	590,691,111
Jun-06			64,275,167	327,145,301	327,820,977
Jul-06		620,000,000	649,509,250	585,330,105	392,000,122
Aug-06			136,158,089	105,876,540	422,281,671
Sep-06			120,353,943	57,777,945	484,857,669
Total	**620,000,000**	**620,000,000**	**1,954,569,064**	**1,469,711,395**	**484,857,669**

*Break up of Long Term Loans of Rs. 620 million advanced by JDWSML to USML		
Purpose / Nature	**Amount**	**Details**
Long term Loan	**450,000,000**	• Board of Directors (BOD) of the JDWSML approved long term loans of Rs. 450 million on October 6, 2005, entered into loan agreements with USML on October 8, 2005 and the loans were disbursed on October 10, 2005. • JDWSML also entered into a lease agreement with USML to take factory of USML on lease for the period of 10 years at the annual rate of Rs. 45 million payable in advance. USML acknowledges in the lease agreement that JDWSML advanced to USML a loan in the sum of Rs. 450 million and that the annual rental payable shall be adjusted against the said loan each year. The JDWSML represented that the lease transaction was never implemented or consummated, however the funds advanced were not

		recovered to JDWSML later on.
Long Term Loan	**170,000,000**	• BOD of the JDWSML approved long term loans of Rs. 170 million on October 13, 2005 to USML, entered into loan agreements with USML on October 13, 2005 and the loans were disbursed on October 15, 2005. • Loan advanced to USML to pay off obligation of all the financial institutions and certain other liabilities.
Total	**620,000,000**	

5. JDWSML acquired 96.63 % share capital of USML at the purchase price of Rs.333.33 / share by entering into Shares Purchase Agreement dated October 21, 2005 with the sponsors of USML for 75 % shares (constituting 2,250,000 shares) and acquisition of another 21.639 % shares (constituting 649,183 shares through public offer conducted between October 27, 2005 and November 17, 2005. As a result of this acquisition, USML become the subsidiary of the JDWSML.

6. The above table disclosed that immediately after extending the long term loan of Rs. 620 million, the JDWSML started advancing funds to USML for meeting its working capital requirements and the amount so invested in the form of advance as at March 31, 2006 and June 30, 2006 were as high as Rs. 693,849,834 and Rs. 327,820,977 respectively. On July 01, 2006, the JDWSML transferred the principal amount outstanding against long term loan to USML into the running account of USML in its books, through a book entry.

7. It has been observed that the JDWSML has been acting as a financier of USML and the shareholders approval under Section 208 of the Ordinance was not obtained while advancing / diverting the funds to USML.

8. Moreover, the disclosures of the aforesaid amounts were in conflict with the approvals extended by the BOD of JDWSML and agreements entered into with USML. This resulted in the financial statements presented before the shareholders giving wrong disclosures / classifications on the aforesaid loans / advances.

9. Since the funds of the public listed company were advanced to the subsidiary without the authority of the shareholders and the respective disclosures made by the JDWSML were not appropriate, it was therefore considered necessary to ascertain the extent of violations committed by the JDWSML for which necessary proceeding were initiated under section 208 and 492 of the Ordinance. Show Cause Notice dated December 12, 2007 was, therefore, issued to the JDWSML and its Directors highlighting the prima facie

violations of Section 208 and 492 of the Ordinance. M/s Cornelius, Lane & Mufti, Advocates and Solicitors (the "Counsel") have been appointed as Counsel by the directors of the JDWSML to present their case before the Executive Director of the Commission.

10. In reply to the aforesaid show cause notice the Counsel stated that;

a. The directors of the JDWSML, to the best of their knowledge (a) complied with all applicable requirements in relation to the loans / advances to USML, and (b) have not made any statement which is false or incorrect or omitted any fact knowing it to be material. Any purported violation or contravention of any provision of law on the part of the directors is wholly without knowledge or intent and is not willful. Since, as a principle of law generally, and under sub-section (3) of section 208 of the Ordinance specifically, a person can only be held responsible and liable for a violation or contravention of law if the violation or contravention has been done willfully i.e. a deliberate or intentional violation or contravention, but not one that is inadvertent or accidental. Further, under sub-section (3) of section 208 of the Ordinance additionally require that the violation or contravention should have occurred knowingly. Therefore, the provisions of sub-section (3) of section 208 of the Ordinance are not applicable to any of the directors, as none of them has knowingly and willfully defaulted in complying with the provisions of section 208 of the Ordinance. Accordingly the provisions of section 492 of the Ordinance are also not applicable to any of the directors as all information relating to the loan / advances, that the directors knew and considered to be material, was at all time duly disclosed in the quarterly, half yearly and annual accounts of the JDWSML for the financial year 2005-06.

b. The dates of execution of loan agreements and disbursement of the Long Term Loan of Rs. 450 million and Rs. 170 million provided by the JDWSML to USML were prior to the date of acquisition of majority shareholding and control of USML by the JDWSML i.e. prior to USML becoming a subsidiary and associated company of the JDWSML. Therefore on the respective dates of execution and disbursements of these loans to USML, there was no requirement under 208 of the Ordinance or any other provision thereof, except of a resolution passed at a meeting of Board of Directors (BOD), that was duly complied with.

c. The JDWSML provided short term advances to USML to meet working capital requirements due to the importance of USML business operations for the JDWSML where USML could not obtain them from financial institutions due to negative equity and distorted current ratio. These advances were accordingly approved by the JDWSML's BOD in their meeting dated December 9, 2005 and subsequently the shareholder's approval was also taken in Annual General Meeting (AGM) of the JDWSML dated December 31, 2005, for these advances along with the transfer / conversion of pre-acquisition long term loans / advances into short term advances. Due to commercial exigencies faced by USML and to avoid losses to USML that became the "more than 96 % owned subsidiary" of the JDWSML, the directors had to act quickly, without the opportunity to seek comprehensive professional advice and guidance. To the best of their knowledge, the directors in good faith complied with the law and passed the aforesaid resolution in the BOD meeting as well as approval obtained from shareholders of the JDWSML in general meeting. If any default or contravention of the requirements of section 208 of the Ordinance has taken place, it is wholly without intention or knowledge and is not willful. Further, the transfer / conversion of pre-acquisition long term loan into a short advance on July 1,2006 was not a fresh disbursement; i.e. it merely changed the nature of a loan / advance made by the JDWSML prior to section 208 of the Ordinance becoming applicable. Therefore, such conversion / transfer of the long term loan into a short term advance, and the continuation thereof, does not come within the purview of section 208 of the Ordinance.

d. Full disclosure of the pre-acquisition long term loan of Rs. 620 million by the JDWSML was made in its quarterly accounts for the period ending December 31, 2005, March 31,2006 and June 30,2006. Pursuant to the abovementioned resolution of the shareholders of the JDWSML, the pre-acquisition long term loan was converted / transferred into short term advances on July 1, 2006. Full disclosure of the post-acquisition short term advances was made in its quarterly accounts for the period ending March 31, 2006 and June 30, 2006. In the annual accounts of the JDWSML for the financial year ending September 30, 2006, the aggregate of the short term advances (including the above mentioned converted long term loans *of Rs. 620 million*) in the preceding year and the amount outstanding as of September 30, 2006 were duly disclosed. Furthermore, the long term loan had already been converted into short term advances prior to September 30, 2006. For the aforesaid reasons, the respective terms of the long term loans were no longer material or relevant and accordingly no detailed disclosure in respect of such long term loans was separately required in the said annual accounts.

e. Mark-up amounting to Rs. 102,815,204 was duly charged by the JDWSML on the aforementioned loans @ 12.5 % per anum, having suffered no loss as a result.

f. The directors of the JDWSML did not have interest in USML at the time of disbursement of short term working capital advances nor did they benefit from such advances, except for the qualification shares held by some of the directors in USML. USML is an almost wholly owned subsidiary of the JDWSML and any benefit accruing to USML directly benefits the JDWSML as shareholder and indirectly benefits the shareholders of the JDWSML as such. USML required working capital for its continued operations that it could not borrow due to negative equity and distorted current ratio. In providing the working capital advances to USML, the JDWSML did not suffer any loss and infact the JDWSML improved its value of shareholding in USML.

11. In addition to above submissions, the Counsel also submitted that;

a. The short term working capital advances provided by the JDWSML to USML were also made in compliance with the substantive purpose, spirit and intention behind Section 208 of the Ordinance that is interpreted by the superior courts of Pakistan to be to secure the funds of the company, to curb abuse of powers by the directors who hold interest in more then one company and to make the matter as regards investments by a company in its associated company to be transparent.

b. On becoming aware at the end of Financial Year 2006-2007 of the possibility of certain of the above transactions being construed as contravening the said Section 208, the directors of the JDWSML took immediate steps to remedy the situation and special resolutions fully complying with the requirements of Section 208 were duly passed in the Extra-Ordinary General Meeting held on November 24,2007 and the AGM held on December 31,2007 in respect of renewal / sanction of short term working capital advances to USML which is further evidence of their good faith and intention.

c. The directors of the JDWSML have, to the best of their knowledge, not made any statement which is false or incorrect in any material particular, or omitted any material fact knowing it to be material; if any violation or contravention of law took place, it was inadvertent, not intentional or willful and not within the knowledge of the directors.

d. In light of the above, it is therefore requested that the Notice be forthwith withdrawn as being without cause or justification and that no further action be taken against the Directors in this regard.

12. Moreover, in order to provide an opportunity of personal hearing, the case was fixed for March 17, 2008. Mr. Muhammad Rafique, Company Secretary, JDWSML and Mr. Shehzad A. Ellahi, Legal Counsel representing the JDWSML and the directors of the JDWSML, appeared before me, they reiterated the submissions made in the written reply to the show cause notice.

13. I have gone through the facts of the case, record of the JDWSML, relevant provisions of the Ordinance, written submissions and representations made by the JDWSML and the Counsel of the directors of JDWSML during the hearing. My observations on the issue are as follows;

a. With the objective to look after the public interest in the listed companies, Code of corporate governance (Code) was made applicable to the listed companies. The Code provides that the directors of listed companies shall, at the time of filing their consent to act as such, give a declaration in such consent that they are aware of their duties and powers under the Ordinance and Memorandum and Articles of Association and the listing regulations of stock exchanges in Pakistan.

b. The statement of compliance annexed with the annual accounts of the JDWSML for the period ended September 30, 2005 stated that the powers of the Board have been duly exercised and decisions on material transactions have been taken by the Board. This further stated that the Board has developed significant policies, includes policies pertaining to;

- transactions or contracts with associated companies and related parties;
- determination and delegation of financial powers; and
- investments

c. The directors of the JDWSML, who are being conferred / mandated with the development and implementation of significant policies listed above, would be fully aware of their duties and responsibilities and that has been affirmed from the consent filed with the Commission u/s 184 of the Ordinance. Moreover, statement of compliance with the Code re-affirms, that the directors of the JDWSML have the necessary knowledge of regulatory compliance. They cannot be assumed to be committing deviation from these policies which are developed in line with the legal and regulatory requirements, otherwise then willfully and knowingly acting in such a manner.

d. As far as the question of Knowledge is concerned it is further evident from the minutes of the meeting of BOD of the JDWSML held on December 9, 2005 that;

Quote

> *"It was informed to the Board of directors that prior to acquisition of USML an amount of Rs. 620 million was advanced as long term loan at mark up rate of 14.50 p.a. in order to enable USML to pay off obligation of all the financial institutions and certain other liabilities. Chairmen instruct the Company Secretary to get the approval from shareholders in the forthcoming AGM and following resolution was passed.*
>
> *"Unanimously Resolved that short term working requirement of United Sugar Mills Limited be met by JDW Sugar Mills Limited as and when required by USML at mark up rate higher than charged to JDWSML by the bank."*
>
> ***Unquote***

The BOD of JDWSML was fully aware of the requirements regarding approval of the shareholders for making investment in USML in respect of renewal / sanction of short-term working capital advances to USML, however this was not complied with in the forthcoming AGM of December 31, 2005. As per JDWSML representation, special resolutions fully complying with the requirements of Section 208 were passed in the extra-ordinary general meeting held on November 24, 2007 and the AGM held on December 31, 2007.

The argument that the default has been made due to lack of knowledge and is not willful or intentional has also been analyzed. In Burton v. Bevan (1908) 2 Ch 240, it was held that the term 'knowingly' signifies knowledge of the facts on which the contravention depends. As a Director of the Company, there was a fiduciary duty cast upon them. Characteristically, the fiduciary is required to have greater knowledge and expertise about the matters being handled and is held to a standard of conduct and trust above that of a stranger or of a casual business person. If the requirements of law on a particular matter are clear, it is totally wrong for the fiduciary to claim that he has no knowledge of the matter. The duties and responsibilities of a director require that the powers are properly exercised. Any such non-compliances points to the fact that the Director was fully conscious of his duty to follow the laws, and his realization of the apparent default can thus be justifiably inferred from his knowledge and expertise. In the case of City Equitable Fire Insurance Co. Ltd. Re, 1925 Ch 407, it was held that a default, in case of breach of duty, will be considered 'willful' even if it arises out of being recklessly careless, even though there may not be knowledge or intent. Simply put, if the Director admits to know the duties and responsibilities and claims to have followed them when in reality, as proven above he has not, then keeping in view his status as a professional businessman and his duty as a fiduciary he should be held to be willfully committing the default.

e. As for as the violation of section 208 is concerned for advancing short term working capital advances by JDWSML to USML, it is an admitted fact by the JDWSML that funds advanced, from the date of acquisition of USML to Nov 24, 2007 (i.e. date of shareholders approval extended in EOGM) were in violation of the section 208 of the Ordinance. However, the JDWSML represented that due to commercial exigencies faced by the USML the directors had to act quickly, without the opportunity to seek comprehensive professional advice and guidance. If any default or contravention of the requirements of section 208 of the Ordinance has taken place, it is wholly without intention or knowledge and is not willful. Moreover these advances were provided by the JDWSML to USML in compliance with the substantive purpose, spirit and intention behind Section 208 of the Ordinance.

f. Moreover, the directors of the JDWSML explicitly admitted that there was a need for complying with regulatory requirement of obtaining shareholder's authorization for extending short term working capital advances to its associated / subsidiary company as special resolutions fully complying with the requirements of Section 208 were passed in the extra-ordinary general meeting held on November 24, 2007 and the AGM held on December 31, 2007 in respect of renewal / sanction of short term working capital advances to USML, which further substantiate the violation of section 208 for the interim period where no special resolution was passed.

g. Considering the directors representation that they have, to the best of their knowledge, not made any statement which is false or incorrect in any material particular, or omitted any material fact knowing it to be material and that if any violation or contravention of law took place, it was inadvertent, the matter was not discussed exhaustively however the gist of the analysis of the arguments put forward by the directors of JDWSML are given in the following;

- JDWSML entered into a lease agreement with USML to take factory of USML on lease for the period of 10 years at the annual rate of Rs. 45 million payable in advance. USML acknowledges in the lease agreement that JDWSML advanced to USML a loan in the sum of Rs. 450 million and that the annual rental payable shall be adjusted against the said loan each. The said lease agreement was never executed while funds were advanced to USML. The terms and conditions of long tem loan advanced are not disclosed in the accounts of JDWSML for the year ended September 30, 2006.

- JDWSML advanced another Loan of Rs. 170 million to USML to pay off obligation of all the financial institutions and certain other liabilities. The terms and conditions of loan are not disclosed in the accounts of the JDWSML for the year ended September 30, 2006.

- The Counsel represented that pre-acquisition long term loans of Rs. 620 million were converted into short term loans on July 1, 2006 and were accordingly approved by the BOD of JDWSML in their meeting dated December 9, 2005 and subsequently the shareholder's approval was also taken in AGM of the JDWSML dated December 31, 2005, for the transfer / conversion of pre-acquisition long term loans / advances into short term advances. The notice of meeting dated December 9, 2005 attached with Financial Statements for the year ended Sept 30, 2005 does not contain this item in the agenda for the business to be transacted in the AGM and provision of section 208 (2) states that "No change in the nature of an investment or the terms and conditions attached thereto shell be made except under the authority of a special resolution". The argument of JDWSML if considered in view of the above discussion, indicate the non compliance of the section 208 (2) of the Ordinance which states that " No change in the nature of an investment or the terms and conditions attached thereto shell be made except under the authority of a special resolution"

- The JDWSML represented that pursuant to transfer / conversion of pre-acquisition long term loans / advance made into short term advances, the <u>aggregate of the short term advances (including the above mentioned converted long term loans) in the preceding year and the amount outstanding as of September 30,2006 were duly disclosed,</u> and that for the aforesaid reasons, the respective terms of the long term loans were no longer material or relevant and accordingly no detailed disclosure in respect of such long term loans was separately required in the said annual accounts. However both the pre-acquisition long term loan and post-acquisition short term loan were different in terms of nature, purpose, tenor and repayments terms, which is evident from the approvals and respective loan agreements. The minutes of JDWSML's BOD meeting held on December 9, 2005 and the financing agreements disclosed the purpose of long term loans to USML to enable USML to pay off obligation of all the financial institutions and certain other liabilities, whereas the short term loan was advanced to USML to meet its working capital requirements. As discussed above, the matter of transfer / conversion of the nature of long term loans did not appear in the Notice of AGM dated December 9, 2005 attached with Financial Statements for the year ended Sept 30, 2005. The resolution in the minutes of JDWSML's BOD meeting dated December 9, 2005 also doesn't solicit any change in nature, purpose and terms of long term loans. Hence in the absence of any approval for the transfer / conversion of long term loan into short term loan, the disclosure of the outstanding balance of long terms loans of Rs. 620 million as part of outstanding balance of Rs. 484.857 million appearing in the books as on September 30, 2006 as short term advance is in violation of section 492 of the Ordinance. The outstanding balance of long term loan being different in nature and substance and having different purpose and repayment terms was to be classified and disclosure separately to disseminate correct information to the shareholder.

Considering the fact that the directors of JDWSML has expressed regret on inadvertent error in its representation, I am inclined to take a lenient view of the default made u/s 492 of the Ordinance. The JDWSML and its Directors are hereby warned to be careful in future while complying with the requirements of law.

14. The JDWSML advanced amounts for meeting working capital requirements of USML after USML becoming subsidiary of JDWSML without authorization of the shareholders. It is a mandatory requirement of Section 208 of the Ordinance that the funds can only be invested in the associated / subsidiary company under the authorization of the shareholders. It has been established that the JDWSML has violated the mandatory requirements of Section 208 of the Ordinance. The management of the JDWSML has deprived the shareholders to exercise their legitimate right to make a decision to invest in its subsidiary. The shareholder of JDWSML have also not been given the specific disclosures in terms of SRO 865 / (I) / 2000 dated December 6, 2000 for investment in subsidiaries / associated concerns.

The directors owe fiduciary duties to the Company they serve and its shareholders. They must discharge their statutory obligations in good faith with fairness and honesty. The directors have failed to exercise reasonable care to see that mandatory provisions of law were being violated and have not respected the mandate of the shareholders. Therefore, the directors of JDWSML have breached their fiduciary duties, which they owed to the Company and its shareholders. The directors of JDWSML made unauthorized transactions out of the funds of the JDWSML. In fact the JDWSML has been acting as a financier by providing funds to the associated concerns to fulfill their financial requirements at the cost of the JDWSML.

For the foregoing reasons, it is established that the provisions of Section 208 of the Ordinance have been violated and funds have been advanced in total disregard to the shareholders approval. After analyzing the facts of the case and arguments put forward, I am of a considered view that these do not carry rationale and are not acceptable. However, considering the representations of the Counsel that sufficient markup was charged on the loan advanced by the JDWSML and subsequent transactions with the associated undertaking were made in compliance with section 208 of the Ordinance, I , instead of imposing maximum penalty of Rs. 1,000,000 (One million rupees) on each of the director as prescribed by Sub-section (3) of Section 208 of the Ordinance, impose a fine of Rs. 700,000 (Rupees seven hundred thousand only) on Ms. Meher Khan Tareen, the Chief Executive of the JDWSML who is mainly responsible for extending these advances and reprimand the other directors to remain careful in future.

15. The Chief Executive is hereby directed to deposit the aforesaid fine of Rs. 700,000 (Rupees seven hundred thousand only) in the designated bank account maintained in the name of Securities and Exchange Commission of Pakistan with Habib Bank Limited within thirty days from the receipt of this Order and furnish receipted voucher or pay by a DD / pay order issued in the name of Commission for information and record, failing which proceedings under the Land Revenue Act,1967 will be initiated which may result in the attachment and sale of movable and immovable property. It may also be noted that the said penalty is imposed on the Chief Executive in the personal capacity and she is required to pay the said amount from her personal resources.

Tahir Mahmood
Executive Director (Enforcement)