

Before Tahir Mehmood, Executive Director (Enforcement)

In the matter of

Dewan Sugar Mills Limited

Number & Date of the Show Cause Notice: EMD/233/339/2002-2899 dated April 24, 2009

Date of Hearing: May 25, 2009

Present: Syed Riazuddin, Advocate

ORDER

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

This order shall dispose of the proceedings initiated against the directors including the Chief Executive (the “respondents”) of Dewan Sugar Mills Limited (the “Company”) through show cause notice dated April 24, 2009 issued under the provisions of Section 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 listed on Karachi and Lahore Stock Exchanges. The authorized share capital of the Company is Rs.500,000,000/- divided into 50,000,000 ordinary shares of Rs.10/- each and paid up capital of the Company is Rs.365,119,920/- divided into 36,511,992 ordinary shares of Rs.10/- each, as per latest available annual audited accounts of the Company for the year ended on September 30, 2009.

3. Brief facts of the case are that examination of annual accounts of the Company for the year ended on September 30, 2008 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 maintained at the Securities and Exchange Commission of Pakistan (the “Commission”) reflected that the said advances were extended without obtaining the authority of a special resolution in terms of Section 208 of the Ordinance and no interest mark up was being charged on the amounts. Consequently, the Company vide Commission’s letter dated March 6, 2009 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 October 1, 2006 till February 28, 2009; and
- e) Certified copies of toll manufacturing agreements and detail of any subsequent changes/amendments.



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4. In response to observation of the Commission, the Company vide letter dated April 15, 2009 submitted the following information and documents:

- a) The advances have been extended to associated companies namely Bawany Sugar Mills Limited (“BSML”) Rs.284.700 millions and Al-Asif Sugar Mills Limited (“ASML”) Rs.25.004 million;
- b) The companies became associated of the Company on November 15, 2006 upon acquisition of majority of share holdings of BSML and ASML by Dewan Mushtaq Group/ Directors;
- c) Provisions of Section 208 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 provided;
- e) Copies of toll manufacturing agreements provided.

5. Analysis of the documents and reply submitted by the Company reflected that the Company had violated the provisions of Section 208 of the Ordinance. Consequently, a show cause notice dated April 24, 2009 under Section 208 of the Ordinance was served on the following respondents calling upon them to explain as to why penalties in terms of Sub-section (3) of Section 208 of the Ordinance may not be imposed on them:

- (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
- (vii) Mr. Anis Wahab Zuberi, Director (N.I.T. Nominee)

6. In response to the show cause notice, Mr. Haroon Iqbal, the director and Mr. Abdul Basit, the Company Secretary, submitted reply vide letter dated May 5, 2009, whereby they reiterated the earlier stance that the Company had toll manufacturing agreements with BSML and ASML and the advances extended to these companies were being adjusted against the toll manufacturing charges. They requested to close the show cause proceedings against the Company on the grounds that the afore-referred advances extended to the associated companies were normal trade transactions which did not fall under the ambit of Section 208 of the Ordinance.

7. In order to provide an opportunity of personal hearing, the case was fixed on May 14, 2009, however, based on subsequent request by the respondents, the hearing was adjourned and case was subsequently fixed for hearing in Karachi on May 25, 2009. On the date of hearing, Syed Riazuddin, Advocate, the Counsel, appeared before the undersigned on behalf of all the respondents with exception of Mr. Anis Wahab Zuberi, the nominee director of National Investment Trust (N.I.T.). The counsel maintained the same stance, as per submissions already made by the Company in writing. The Counsel made additional detailed statements in writing, which are given below in summarized form:

- The Company entered into toll manufacturing agreements dated September 1, 2004 (the agreements) with BSML and ASML. The term of agreements envisaged that BSML and



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ASML will provide their manufacturing services to the Company at the rates specified in the agreements.

- The Company entered into the agreements in the best interest of the Company which ultimately resulted in enhanced production and sales and benefited the Company.
- Initially the agreements provided that the manufacturing fee shall be due and payable to the ASML and BSML within twenty days of the invoices raised by them. However, the ASML and BSML later requested for advance payments against the toll manufacturing charges enabling them to meet the working capital requirements and provide the timely supply of sugar to the Company. The request was based on the general practice of sugar industry whereby the sugar companies receive payments in advance and delivery orders are issued to the customers, who lift sugar as per their convenience.
- The Company accepted the request for advance payments and supplementary agreements were executed with ASML and BSML accordingly (copies provided).
- The Company started making advances to ASML and BSML and the advanced amounts were adjusted against toll manufacturing charges. At the time of entering into agreements between the Company, ASML and BSML i.e. on September 1, 2004, these were not related to each other and these advances were normal trade transactions. The status continued till November 15, 2006 when these companies became associated companies and tolling arrangements between the Company, ASML and DSML continued in the same way as were carried on before the establishment of associated company relationship. The Company continued this arrangement in the best commercial interest as well as a contractual obligation.
- It is evident from plain reading of Section 208 and the "Explanation" annexed thereto that every advance made by a company can not be treated a loan or advance (covered by the expression "investment") that would bear a return within the meaning of proviso to Section 208 (1). There are certain exclusions and the normal trade credits between associated companies have been expressly kept out of the purview of expression "investment".

Based on above series of statements, the counsel contended that the show cause proceedings initiated against the respondents may be withdrawn. A brief of arguments given by the Counsel is produced below:

- The objective of agreements entered into between the Company, ASML and BSML was to conduct a normal trade between the companies as customer and suppliers through acquisition and provision of toll manufacturing services. ASML and BSML reflected the amounts of advances received against the agreements as their current liabilities while the Company booked those as current assets. The advances are neither loan / advance nor equity investment as envisaged in Section 208 of the Ordinance, therefore, question of charging any interest / mark up does not arise.
- There is no bar in law for extending advance in the nature of normal trade credit to an associated company, as the same have been excluded from the scope of Section 208 of the Ordinance. In this context, the pre or post-associated company relationship between the Company, ASML and BSML is of no material significance as the very nature of transaction is out of the scope of Section 208. Therefore, the advances extended by the



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Company to ASML and BSML, even after establishment of associate relationship with effect from November 15, 2006 would not make any difference.

- Based on the above, issues like obtaining authority of a special resolution or return on investment are not relevant and there is no question of contravention of the provisions of Sub-section (1) of Section 208 of the Ordinance.
- Purpose of Section 208 of the Ordinance is to secure the funds of the company and to curb the abuse of powers by the directors. In the case under consideration, the advances were made to against toll manufacturing services acquired by the Company from ASML and BSML since September 1, 2004 i.e. much before establishment of associate relationship. The benefits accrued to the company as a result of this transaction are evident from tremendous improvement in production and sales over the years, as reflected in the respective audited accounts of the Company with effect from 2004 onwards. It is not the case of siphoning of funds of the Company with malafide intentions. Since the transaction is out of the scope of Section 208 of the Ordinance, question of return, charging of mark-up/interest on advances, passing of a special resolution contravention of the provisions of Section 208(1), leading to imposition of penalty/fine on the directors of the company within the meaning of Section 208(3) of Section 208 of the Ordinance is misconceived.
- In view of the foregoing the proposed action in terms of Sub-section (3) of Section 208 of the Ordinance, may please be dropped.

8. As no response to the show cause notice was received from Mr. Anis Wahab Zuberi, nominee director of N.I.T., therefore, in order to provide him with another opportunity to clarify his position, a hearing in the matter was fixed on June 9, 2009. Subsequently, based on request from N.I.T. the hearing was adjourned till June 29, 2009. Mr. Zuberi submitted his written reply vide letter dated June 20, 2009. He apprised that he has been unable to effectively discharge his duties as a director of the Company owing to lack of cooperation including non providing of documents of Boards' meetings etc. on part of management of the Company. He further submitted that being a nominee director of N.I.T., he had taken up the matter with the Corporate Governance Department of N.I.T. to apprise them of the problems / complaints that he faced in discharging his duties as a director of the Company. However, N.I.T. did not resolve issues as relevant documents and information were not made available to him by the management of the Company. He further stated that he has retired from N.I.T. on January 31, 2009 after completion of his contract.

9. I have analyzed the facts of the case, provisions of Sections 208 of the Ordinance, arguments put forth by the respondents and their counsel in writing and during the hearing and observed as under:

- (i) The Company has been extending advances to ASML and BSML since 2005 and continued the practice after these companies became associated companies with effect from November 15, 2006, without obtaining the authority of a special resolution of shareholders and without charging any mark up/interest thereon. Annual audited accounts of the Company reflect that since the year 2006 onwards the Company started extending huge amounts of advances which even surpassed the total amount of charges paid by the Company during the respective years against toll manufacturing facility availed from the



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associated companies. On September 30, 2005 advances were Rs.160.562 million against Rs.248.847 million cost of toll manufacturing incurred during the next year ended on September 30, 2006. Whereas, on September 30, 2006, advances of Rs.440.980 million were outstanding against toll manufacturing cost of only Rs.284.733 million incurred during the next year ended on September 30, 2007 and the same trend is witnessed for the year ended on September 30, 2008. Besides that average number of days of repayment / adjustment against these advances started surging abnormally since the year 2006. This fact can be substantiated from the following trend analysis:

Year ended Sep 30	2004 (Million Rs.)	2005 (Million Rs.)	2006 (Million Rs.)	2007 (Million Rs.)	2008 (Million Rs.)
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

- (ii) It transpires that the advances extended by the Company to ASML and BSML, the associated companies, are by no means in the nature of normal trade credit. Mere fact that 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 specific repayment period and sporadic adjustments of the outstanding amounts against toll manufacturing charges. 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. This can be substantiated from the following pattern of outstanding amounts against these advances with clear reflection that these advances have never been cleaned out and huge amounts have always been outstanding:

Month End	BSML (Rs.)	ASML (Rs.)	Total (Rs.)
30-Sep-06	245,167,932	195,819,333	440,987,265
31-Oct-06	273,458,391	220,736,333	494,194,724
30-Nov-06	288,460,769	226,197,195	514,657,964
31-Dec-06	304,856,872	202,563,574	507,420,446
31-Jan-07	326,539,135	198,345,224	524,884,359
28-Feb-07	298,327,286	194,385,682	492,712,968
31-Mar-07	255,124,236	192,752,594	447,876,830
30-Apr-07	235,414,851	204,896,462	440,311,313
31-May-07	237,566,586	206,486,300	444,052,886
30-Jun-07	238,761,133	214,887,479	453,648,612
31-Jul-07	240,520,086	217,151,250	457,671,336
31-Aug-07	253,541,577	221,856,623	475,398,200
30-Sep-07	263,641,016	229,807,016	493,448,032

Month End	BSML (Rs.)	ASML (Rs.)	Total (Rs.)
30-Sep-07	263,641,016	229,807,016	493,448,032
31-Oct-07	264,210,347	229,993,708	494,204,055
30-Nov-07	253,236,954	224,248,147	477,485,101
31-Dec-07	248,989,548	194,471,299	443,460,847
31-Jan-08	227,619,069	146,637,427	374,256,496
29-Feb-08	178,730,486	100,472,574	279,203,060
31-Mar-08	121,210,548	66,972,180	188,182,728
30-Apr-08	126,297,253	93,381,199	219,678,452
31-May-08	152,057,580	96,492,158	248,549,738
30-Jun-08	154,277,694	98,689,595	252,967,289
31-Jul-08	174,985,587	48,332,127	223,317,714
31-Aug-08	192,013,587	39,634,586	231,648,173
30-Sep-08	284,699,890	25,004,236	309,704,126
31-Oct-08	294,415,994		294,415,994
30-Nov-08	303,974,265		303,974,265
31-Dec-08	304,749,085		304,749,085
31-Jan-09	295,651,714		295,651,714
28-Feb-09	268,434,716		268,434,716



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- (iii) It is pertinent to mention that during the year 2008, toll manufacturing agreement with ASML was terminated due to sale of its controlling shares by the directors/sponsors of the Company. Consequently, the advances to ASML were adjusted /cleaned out and accordingly declining trend is observed in the total outstanding balance during the year. Whereas, in case of BSML which still remains an associated company, the huge amounts remain outstanding.
- (iv) In view of the above facts, the respondents' plea that the advances extended by the Company to its associated companies are normal trade credit and are excluded from the ambit of Section 208 of the Ordinance, is not tenable.
- (v) The respondents' plea that the benefits accrued to the company as a result of this transaction are evident from tremendous improvement in production and sales over the years, is also nullified by the fact that despite increased turnover, profitability, liquidity and overall financial position of the Company has deteriorated over the years subsequent to the dates of agreements, as is evident from the following trend:

Year ended Sep 30	2008	2007	2006	2005	2004
	(Rs. in Millions)				
Gross Turnover	6,200.501	4,854.496	7,262.919	3,307.344	1,274.133
Net Profit/(Loss) After Tax	(539.303)	(212.019)	38.150	10.724	150.017
Shareholders' Equity	(2.534)	572.339	746.031	698.308	388.478
L. Term Debt + Curr. Liab.	5,082.850	4,143.035	3,294.014	3,732.466	1,950.057
Current Ratio (CA/CL)	0.58	0.76	0.89	0.99	0.88

- (vi) Another reflection of the Company's worsening financial position is that the auditors of the Company have qualified their report on annual audited accounts of the Company for the year ended on September 30, 2008. The paragraph containing qualification is reproduced hereunder:

"The financials statements of the Company for the year ended on September 30, 2008 related loss after taxation of Rs.539.303 million and as of that date it has accumulated losses of Rs.486.349 million which have eroded its capital and its current liabilities exceeded its current assets by Rs.2124 billion. Further, short term borrowing facilities from the banks have not been renewed and the company has been unable to ensure the timely repayments for the installments of the long term borrowings. These conditions indicate the existence of the material uncertainty which may cast significant doubt on the company's ability to continue as a going concern."

- (vii) The above synopsis of the company's financial and liquidity position coupled with the points raised by the auditors in its report is a reflection of how the Company has gradually run into liquidity and financial crunch. It transpires that diversion of high cost funds, borrowed from various banks by the Company, to associated companies free of cost, has significantly contributed towards worsening of the situation.



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(viii) The respondents' stance that the Company has been extending the advances to ASML and BSML even before these companies became associated with the Company can not validate the Company's act to continue extending advances to these companies after establishment of associated companies relationship. I am of the view that provisions of Section 208 became applicable to the Company in chorus with establishment of associated companies relationship with effect from November 15, 2006 and any loan or advances made by the Company to ASML and BSML subsequent to that date without the authority of special resolution of shareholders of the Company, constitutes violation of these provisions.

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

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.

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 ten 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.

11. The aforesaid provisions of the law are clear and explicit. Considering the facts and circumstances of the case and analysis of relevant record, it is evident that directors have failed to comply with provisions of Section 208 of the Ordinance in respect of advances extended by the Company to its associated companies. The advances have been extended to ASML and BSML free of interest/mark up and without obtaining the authority of a special resolution by the shareholders of the Company. The said advances are not normal trade credit, as elaborated in the preceding paragraphs, and hence fall within the ambit of Section 208 of the Ordinance. Due to the interest/mark up free nature of these unauthorized advances, huge loss has been caused to the Company, which has obtained short term finance of Rs.2.754 billions from various banks at a price ranging up to three hundred basis points above the Karachi Inter Bank Offered Rate (KIBOR), as disclosed in annual audited accounts for the year ended on September 30, 2008. The intent and purpose of the Section 208 is to protect against diversion of a company's funds to pass on undue benefits to associated companies or undertakings of a company at the cost of the shareholders of such company. Due to this reason authority of special resolution of shareholders of a company is mandated by the law for making any investments, loans, advances etc. to associated companies or undertakings. Any leniency while deciding the cases involving such



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instances would defeat the whole purpose of the legislation. Circumstances of the case warrant no sympathy for the respondents who have ruthlessly allowed misuse of Company's funds for the benefit of the associated companies, causing huge loss to the Company and its shareholders.

12. The directors owe fiduciary duties to the Company they serve and its shareholders. Moreover, the fiduciary must treat all the shareholders whether may be sponsors or the general public, fairly. They must discharge their statutory obligations in good faith with fairness and honesty. The concerned directors have failed to exercise reasonable care and to see that mandatory provisions of law were being violated and also have not respected the mandate of the shareholders. The concerned directors, therefore, have breached their fiduciary duties, which they owed to the Company and its shareholders.

13. For the foregoing reasons, I am of the firm opinion that the provisions of Section 208 of the Ordinance have been violated and the respondents are liable for the penalties as prescribed by Sub-section (3) of Section 208 of the Ordinance. Therefore, in exercise of the powers conferred by the aforesaid provisions of the Ordinance, I hereby impose a fine of Rs.3,500,000/- (Rupees three million five hundred thousand only) in aggregate on all the respondents excluding Mr. Anis Wahab Zuberi, the nominee director of N.I.T., for contravening the provisions of Sub-section (1) of Section 208 of the Ordinance. The respondents are directed to deposit the aggregate fine of Rs.3,500,000/- (Rupees three million five hundred thousand only) in the following manner:

Name of Respondents	Amount in Rupees
1. Dewan Muhammad Yousuf Farooqui, Chief Executive	Rs.1,000,000
2. Dewan Abdul Rehman Farooqui, Managing Director	Rs.500,000
3. Dewan Asim Mushfiq Farooqui, Director	Rs.500,000
4. Dewan Abdullah Ahmed Swaleh Farooqui, Director	Rs.500,000
5. Dewan Abdul Baqi Farooqui, Director	Rs.500,000
6. Mr. Harron Iqbal, Director	Rs.500,000
TOTAL	Rs.3,500,000
(Rupees three million five hundred thousand only)	

The aforesaid fines must be deposited in the designated bank account number **0183089871000097** maintained with MCB Bank Limited in the name of the "Securities and Exchange Commission of Pakistan" within thirty days from the receipt of this order and furnish receipted bank vouchers to the Commission. In case of non-deposit of the penalties, proceedings for recovery of the fines as arrears of land revenue will be initiated. It may also be noted that the said penalties are imposed on the respondents in their personal capacity; therefore, they are required to pay the said amount from personal resources.

Further I hereby, strictly warn the nominee director of N.I.T. namely Mr. Anis Wahab Zuberi to be vigilant in future with regard to compliance with various provisions of the law. Nominee directors being the main element of transparency in the decisions of the Board of Directors of a Company have the same duties and responsibilities as any other director of the Company. The law expects the nominee directors and non-executive directors to give full attention to the affairs



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of the companies and look after the interest of the Company as a whole and discharge the functions entrusted under the Ordinance with due care and prudence. The director should have brought to the notice of the Commission his observations regarding the non-providence of minutes of the Board of Director's meeting which is a violation of Section 173 of the Ordinance, so that necessary action could have been taken against the concerned at the relevant time.

14. Before departing with the order, I hereby invoke provisions of Section 473 of the Ordinance and direct the respondents, as under:

- To make good the default by recovering all the outstanding amounts extended by way of advances to the associated companies without complying with the provisions of Section 208 of the Ordinance;
- To make good the loss, sustained by the Company, by recovering the amount of interest / markup on the advances extended to the associated companies, as calculated by the statutory auditors based on weighted average cost of short term financing obtained by the Company from the banks; and
- To furnish with the Commission the auditors' certificate regarding final settlement of all the outstanding amounts against advances to associated companies and recovery of mark up/interest thereon, within thirty days of the date of this order.

Tahir Mehmood
Executive Director (Enforcement)

Announced:
June 30, 2009
Islamabad