



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN  
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*Before Tahir Mahmood,  
Executive Director (Enforcement)*

*In the matter of*

*Searle Pakistan Limited*

Number and date of show cause notice      EMD/233/596/2002/7456-7463 dated June 15, 2007

Date of hearing      September 7, 2007

Present:      Mr. S.M. Nasir Raza (Director, Mehmood Idrees  
Qamar & Co; Chartered Accountants)

**ORDER**

**Under Sub-section (3) of Section 208 read with Section 476 of the Companies Ordinance, 1984**

This order will dispose of the proceedings pertaining to contravention of the provisions of Sub-section (1) of Section 208 of the Companies Ordinance, 1984 (hereinafter referred to as “the Ordinance”), which has arisen out of the show cause notice No.EMD/233/596/2002 dated June 15, 2007 served on all the directors including the Chief Executive of Searle Pakistan Limited (hereinafter referred to as “Searle”).

2. **Searle** was incorporated in Pakistan as a private limited company in October 1965. In November 1993, it was converted in to a public limited company having authorized capital of Rs.500 million divided into 50 million ordinary shares of Rs.10 each and paid up capital of Rs.220.099 million divided into 22.009 million ordinary shares of Rs.10 each as per its audited financial statements for the year ended June 30, 2006. **Searle** is listed on the Karachi and Islamabad Stock Exchanges in Pakistan since 1993 and is engaged in the business of manufacture of pharmaceutical products and low calorie sweetener, sale of food and consumer items and manufacture of pharmaceutical items for other companies.

3. The brief facts of the case are that while examining the annual audited accounts for the year ended June 30, 2006 (hereinafter referred to as “the Accounts”) of the **Searle**, it was observed from the Note 21 and 23 to the Accounts, that **Searle** has receivable balances of Rs.705.367 million and Rs.33.753 million disclosed as “Trade Debts” and “Other Receivables” respectively from its associated concern, namely International Brands (Private) Limited (“**IBL**”) and its subsidiary, namely IBL HealthCare (Private) Limited (“**IBLHC**”).



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**Quote**

		<b>2006</b>	<b>2005</b>
		<b>Rupees (000)</b>	<b>Rupees (000)</b>
<b>“Note 21</b>			
<b>TRADE DEBTS</b>			
<i>Unsecured - considered good</i>			
<i>Associated company</i>	<i>21.1</i>	<i>705,367</i>	<i>542,687</i>

**21.1** The receivable from International Brands (Private) Limited (**IBL**) (the associated undertaking) is stated net of amounts payable aggregating Rs 71.141 million (2005: Rs 67.929 million). This includes Rs 4.117 million (2005: Rs 3.773 million), receivable from institutions against sales made to them through **IBL** on behalf of the company.

The maximum aggregate amount due from **IBL** (net of amounts payable) at the end of any month during the year was Rs. 705 million (2003: Rs.810 million).

		<b>2006</b>	<b>2005</b>
		<b>Rupees (000)</b>	<b>Rupees (000)</b>
<b>Note 23</b>			
<b>OTHER RECEIVABLES</b>			
<i>Due from subsidiary company</i>	<i>23.1</i>	<i>33,753</i>	<i>30,728</i>

**23.1** The company had imported goods on behalf of IBL HealthCare (Private) Limited (the subsidiary) amounting to Rs 33.906 million in the year 2003 which were subsequently transferred inclusive of income earned on handling of such imports. Markup is being charged on the outstanding balances at the rate of 10.5% (2005:7.5%) per annum

The maximum aggregate amount due from IBL HealthCare (Private) Limited (the subsidiary) at the end of any month during the year was Rs. 33.753 million (2003: Rs.30.397 million).

		<b>2006</b>	<b>2005</b>
		<b>Rupees (000)</b>	<b>Rupees (000)</b>
<b>Note 38</b>			
<b>Expenses claimed by International Brands (Pvt) Limited</b>			
<i>Carriage and duties</i>		<i>12,942</i>	<i>13,521</i>
<i>Discounts</i>		<i>33,178</i>	<i>62,350</i>
<i>Warehouse rent</i>		<i>2,533</i>	<i>1,832</i>
<i>Mark-up expenses</i>		<i>277</i>	<i>391</i>
<i>Communication expenses</i>		<i>689</i>	<i>261</i>
<i>Corporate services charged</i>		<i>3,600</i>	<i>3,600</i>



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Vehicle hiring charges	3,687	4,323
Sales promotion expenses	4,300	-

**38.1** Sales to International Brands (Private) Limited (associated company) were made during the year at trade price less discounts of 10% and 12% as applicable (2005: 10% and 12%). In addition, the amounts of carriage and duties are also being reimbursed.

**Unquote**

4. The above statement raised doubt that the said receivable from **IBL** and **IBLHC** may not be in the nature of normal trade credit as provided in Section 208 of the Ordinance. The Enforcement Department (“the Department”) vide letter dated February 26, 2007 sought details of the aforesaid transactions from the **Searle**. **Searle**, in response, provided the following relevant information vide its letter dated March 9, 2007:

Transaction with **IBL**

√ Salient features of distribution agreement dated July 1, 2005 between **Searle** and **IBL** are as follows:

- **Searle** appointed **IBL** as its exclusive Distributor in the territory comprising of the geographical limits of Pakistan for the sale and distribution of pharmaceutical and non-pharmaceutical products;
- The cost of freight & octroi up to the delivery point will be borne by **Searle**;
- **Searle** will allow **IBL** a distributor’s commission of 10% on trade prices on all pharmaceutical products and between 3% to 12% on trade price on all non-pharmaceutical products;
- Credit period of sales 120 days for sales other than institution sales. Credit period of institutional sub-distributor sale will be decided in accordance with credit terms agreed by **Searle**;
- Markup @ 7.5% per annum on outstanding balance of more than 120 days.

√ Age Analysis of the receivable from **IBL** as on June 30, 2006 is as follows:

1-30 Days	Rs 192,375,152
31-60 Days	Rs 208,820,605
61-90 Days	Rs 199,389,352
91-120 Days	<u>Rs 104,781,761</u>
<b>Total</b>	<b><u>Rs 705,366,870</u></b>



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- √ It is normal/ standard practice that if any principal authorizes its distributors to pay for any expenses on the principal's behalf, the distributor is entitled to have the same reimbursed. Hence these expenses were not the part of distributor's cost.
- √ **Searle** is allowing commission to **IBL** at the rates prevailing in the pharmaceutical market. **IBL** has a country wide network and can only be compared for its quality of distribution with the likes of Muller & Phipps Pakistan (Pvt) Ltd;
- √ **Searle's** policy regarding the trade credit period to distributor is 120 days from the date of dispatch.
- √ **IBL's** policy for sale is cash for the market and credit to Government Institutions only, as per the terms of their contract.

Transaction with IBLHC

- √ Salient features of agreement dated July 1, 2000 between **Searle** and **IBLHC** are as follows:
  - **Searle** has agreed to continue import of goods on behalf of **IBLHC** till the banking facilities would be available to **IBLHC**;
  - **IBLHC** has agreed to settle all invoices within 90-days period; and
  - Markup @ 15% per annum on overdue balances.

- √ Age Analysis as on June 30, 2006:

Less than 1 Year	Rs 3,010,000
Between 1-2 Years	Rs 2,062,000
2-Years and above	<u>Rs 28,681,000</u>
<b>Total</b>	<b><u>Rs 33,753,000</u></b>

- √ During the initial period of **IBLHC** which is a wholly owned subsidiary of the **Searle**, did not have any credit lines with their banks. The Company made an agreement with **IBLHC** for import of their products on their behalf till the credit lines available with them.

5. Examination of afore-mentioned reply of **Searle** and scrutiny of the attached documents with the reply revealed the following facts:

- **Searle's** policy regarding the trade credit period to associated company **IBL**, which is also the exclusive distributor of the **Searle**, is 120 days without any charge, whereas **IBL** makes sales on cash basis. This credit policy is preferential and against the industry norms.
- **Searle** has been reimbursing the following expenditures to **IBL**, as disclosed in note 38 of the Accounts of the **Searle**. However as, per industrial practice of pharmaceutical companies no such charges are allowable for reimbursement as mentioned above except sales discounts.



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Particulars	June 30, 2006 (Rs in million)	June 30, 2005 (Rs in million)
Carriage and duties	12.942	13.521
Discounts	33.178	62.350
Warehouse rent	2.533	1.832
M-up expenses	0.277	0.391
Commercial expenses	0.689	0.261
Corporate Services	3.600	3.600
Vehicle hiring charges	3.687	4.323
Sales Promotion	4.300	-
Total	<b>61.206</b>	<b>86.278</b>

- An amount of Rs. 28.681 million is due from its associated company namely **IBLHC** for more than 2 years. Credit facilities were granted to **IBLHC**, through an Agreement between **Searle** and the **IBLHC** dated July 01, 2000 according to which all the invoices were required to be settled within 90 days period. However, an amount of Rs.28.681 million, which comes to 85% of the total amount i.e. Rs.33.753 million advanced to **IBLHC**, is outstanding for more than two years. On the other hand bank liabilities of **IBLHC** were paid off by the **Searle** with regards to import of goods on behalf of **IBLHC**;
- An analysis of annual accounts of **IBLHC** for the year ending June 30, 2006 revealed that the **Searle** has been providing credit facility to **IBLHC** and **IBLHC** has been providing credit to **IBL**, another associated company, leading to an impression that as a result of this cycle **IBLHC** has not been able to pay its liabilities due to the **Searle** which were outstanding since the year 2000. Details obtained from the accounts of **IBLHC** are as follows:

Particulars	June 30, 2006 (Rs in million)	June 30, 2005 (Rs in million)
Due to Holding Company ( <b>Searle</b> Pakistan Ltd.)	33.754	30.067
Due from <b>IBL</b> (Pvt) Ltd.	54.292	50.102
Markup up earned by <b>IBLHC</b>	4.957	3.338
Mark up charged by <b>Searle</b> Pakistan Ltd., from <b>IBLHC</b>	3.010	2.062

- As per para 14 of the **Searle**'s 'Distribution Agreement' (the "Agreement") dated July 01, 2005, with **IBL** that the rights, interest or obligations assigned to **IBL** as a distributor shall not be assigned or assignable by **IBL** to any other party without the prior written consent of the Company. Whereas note 10 of the **IBLHC** accounts for the year ended June 30, 2006 reflects that intangible fixed assets amounting to Rs.95.749 million representing marketing and distribution rights of multinational companies acquired under an agreement from the **IBL**.

6. In view of the above findings, Show Cause Notice reference No.EMD/233/596/2002/746-7463 dated June 15, 2007 under the provisions Sub-Section (3) of Section 208 read with Section 476 of the Companies Ordinance, 1984 was issued to all the directors including Chief Executive of **Searle** namely, Mr. Rashid Abdulla, Mr. Tariq Ismail, Mr. Khalid Malik, Mr. Mushtaq Abdulla, Mr. Shahid Abdulla,



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Mrs. Maneezeh Malik, Mr. Azad Alladin and Mr. Muhammad Ali advising them to explain within 14 days of the date of the notice as to why penal action may not be taken against you under Sub-Section (3) of Section 208 of the Ordinance read with Section 476 of the Ordinance for contravention of the provisions of Section 208(1) of the Ordinance.

7. The aforesaid notice was responded by the Mehmood Idrees Qamar & Company on behalf of all directors of **Searle** vide letter dated June 29, 2007 seeking extension up till July 15, 2007 for reply. The extension was granted with the advised to submit reply by July 15, 2007. Thereafter, Mohsin Tayebaly & Company sought further extension of seven days for reply and the same was granted. The reply of the show cause notice was finally submitted by Mohsin Tayebaly & Company on behalf of all directors of the **Searle**, vide letter dated July 23, 2007, and following submissions were made:

- i) **Searle** entered into a Distribution Agreement dated July 01, 2000 with **IBLHC** pursuant to which **Searle** extended trade credit to **IBLHC** for 90 days period. It is denied that an amount of Rs 28,681,000 or any amount for that matter has been outstanding toward the **Searle** by **IBLHC** since year 2000. This amount relates to current year 2005-06. The same is confirmed as the Auditor of **Searle** has also not identified the amount outstanding since year 2000. Credit allowed to **IBLHC** by the **Searle** pursuant to the said agreement is simply a trade credit and is neither a loan nor an advance or equity and is in fact simply a normal trade credit which is specifically excluded from the ambit of Section 208 of the Ordinance. Therefore, the **Searle** was not required to pass a special resolution prior to entering into the said agreement and neither the **Searle** nor its directors have violated any provision of Ordinance.
- ii) This is submitted that the distribution rights conferred upon **IBL** by way of Distribution Agreement dated 01/07/2005 have certainly not been assigned to **IBLHC** or any other entity for that matter by **IBL**. **IBL** and **Searle** entered into Agreement dated May 27, 1997 and July 2, 1997 (Principal Agreement), whereby the Company agreed to purchase and acquire from **IBL** all its rights, title and interest for exclusive and sole distribution of pharmaceutical/healthcare product for itself or for the benefit of any company nominated by the Company. As such, the company entered into agreement dated November 3, 1997 with the **IBL** and **IBLHC** whereby the Company nominated **IBLHC** as the company to act as operating company in relation to Principal Agreements. The amount of Rs 95,749,000 indicated in note 10 of the said accounts, therefore, relates to distribution rights acquired by **IBLHC** under Agreement dated November 3, 1997.
- iii) Expenses incurred by **IBL** specifically on behalf of **Searle** on account of the following:
  - Carriage and duties: stock transfers from one branch/network to another branch/network towns.
  - Warehouse rent: utilizing portion of distributors warehouse for **Searle**'s stock storages.



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- Markup expenses: on outstanding with Govt. Institutions for supply of stocks on **Searle**'s instructions.
  - Communication: utilizing distributor's telephone, fax machine etc.
  - Corporate service charges: services provided to **Searle** on account of common's staff salaries and expenses.
  - Vehicle hiring charges: utilizing distributor's vehicles for **Searle**'s work.
  - Corporate Expense: comprise of proportionate rent of corporate floor, proportionate share of utilities of corporate floor, salaries and expenses of corporate office staff.
- iv) Reimbursement of expenses incurred by distributor on behalf of its principal has not caused any loss or disadvantage to Company or its shareholders.
- v) However, no reply from **Searle** was received in respect of preferable trade credit period of 120 days allowed to **IBL**.

8. A hearing in the matter was initially fixed for August 28, 2007 which was adjourned on the request of the **Searle**. Finally hearing was held on September 07, 2007 and was attended by the authorized representatives, on behalf of all the director of the **Searle**, namely Mr. S.M. Nasir Raza, Director, Mehmood Idrees Qamar & Co; Chartered Accountants ("the Counsel"). During the course of hearing, the Counsel admitted the default and reiterated the same arguments as were given through written submission in response to this Commission's letter and show cause notice. He further added as follows:

- a) **Searle** entered into an Agreement dated 01/07/2000 with **IBLHC** pursuant to which **Searle** extended trade credit to **IBLHC** for 90 days period in respect of import of goods on behalf of **IBLHC**. An amount of Rs 28,681,000 is outstanding for more than 2 years. However, no prior approval from shareholders was obtained in this respect.
- b) It is a normal business practice that due to presence of **IBL** having at 80 different cities and towns throughout Pakistan, the Field Force Staff of **Searle** draw cash from **IBL** and used facilities of **IBL** for the expenses and the same are reimbursed by the **Searle** to **IBL**. This practice is also being made by **IBL** for other principals. Hence it is normal trade practice; therefore no approval was obtained from shareholders in advance.
- c) **Searle** appoints the **IBL** as its sole distributor for sale of its pharmaceutical and non-pharmaceutical products. The reason of allowing trade credit period of 120 days without mark-up to **IBL** is due to premium category services provided by **IBL** that can also evident from the remarkable increase in Sale of **Searle**. This growth has enabled the management of **Searle** to maintain a constant dividend payout ratio to its shareholders. No specific shareholders' approval for allowing 120 days trade credit period was obtained in advance. Further, that the trade credit period of 120 days allowed to **IBL** is dis-advantageous to **Searle** and the management of **Searle** needs one year time to arrive at normal trade credit period as per the practices adopted by the



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Pharmaceutical Companies in Pakistan and following deadlines initially decided by the management of **Searle**:

- 90 days credit period                      December, 2007
- 60 days credit period                      June, 2008

d) **Searle** is allowing commission to **IBL** at the rates prevailing in the pharmaceutical market. **IBL** has a country wide network and can only be compared for its quality of distribution with companies likes Muller & Phipps Pakistan (Pvt) Ltd. The prevailing commission rates in the pharmaceutical market may be judged by reference to the following undertaking's practice, which are of similar stature:

- Muller & Phipps Pakistan (Pvt.) Ltd.      10% to 12%
- UDL Distribution                              10%
- Pharma Link Distribution                      10% to 12%

9. I have gone through the facts of the case, record of the **Searle**, relevant provisions of the Ordinance, arguments by the Counsel of the directors during the hearing and written submissions given in response to the show cause notice. I feel it appropriate to quote here the relevant provisions of the Ordinance. Sub-section (1) of Section 208 of the Ordinance provides that:

*(1) A company shall not make any investment in any of its associated companies or associated undertakings except under the authority of a 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 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.*

10. In the context of arguments put forth, following issues required determination:

- i) Whether transactions with **IBL** and **IBLHC** were in the nature of 'normal trade credits';
- ii) Whether **Searle** has suffered any loss due to violation of Section 208?
- iii) Whether such transactions have been prejudicial to the interest of its shareholders?
- iv) Whether directors have breached fiduciary duties towards **Searle** and its shareholders?

(i) **Whether transactions with IBL and IBLHC are in the nature of 'normal trade credit'**

It has been contended by the **Searle**, in its letter and during the course of hearing that transactions and credit arrangement with the **IBL** and **IBLHC** were in the nature of 'normal trade credit.' In order to determine the nature of these transactions, it would be useful to refer to the expression "investment"



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which has been defined in “Explanation” to Sub-section (1) of Section 208 of the Ordinance, referred above. It is clearly stated in this explanation that the term ‘investment’ includes all kinds of loans, advances, equity or any other amount excluding normal trade credit. Since the main issue in this matter is to determine whether the transaction with **IBL** and **IBLHC** is normal trade credit or not, it is necessary to analyze all the facts available in this regard.

**Transaction with IBL**

a) ***Credit period allowed to IBL was not normal:*** I am of the view that the words ‘normal trade credit’ have been used in the Section 208 of the Ordinance to refer to the ‘credit’ allowed by a company to its customers in the ordinary course of business and according to industry norms. The average trade debt collection period based on annual audited accounts for the years 2004-2005 and 2005-2006 of **Searle** and the listed pharmaceutical companies are found to be as under:

	Year 2005- 2006	Year 2004-2005
<b>Searle</b>	<b>136 days</b>	<b>119 days</b>
<b>Sector Average (exclusive of Searle)</b>	<b>10 days</b>	<b>8 days</b>

The trade collection period for the year 2004-2005 of the **Searle** is 119 days and for the year 2005-2006 is 136 days both of which are far greater than the sector averages. Preferential treatment was given to **IBL**, which is also a sole distributor of **Searle**, when it was allowed a trade credit period of 120 days without mark-up as per the distribution agreement dated July 1, 2005 between **Searle** and **IBL**. Whereas, per the analysis made in respect of listed pharmaceutical companies and independent confirmation from some of listed pharmaceutical companies, it is revealed that the pharmaceutical companies made sales to distributor on cash basis and sales to institution on credit basis.

The aforesaid analysis and independent confirmations also revealed that Commission to distributor is normally ranged between 6% to 10%. Whereas per the agreement dated July 1, 2005 between **IBL** and **Searle** states that **Searle** will allow **IBL** a distributor’s commission of 10% prices on all pharmaceutical products and between 3% to 12% on trade price on all non-pharmaceutical products. **Searle** allows the flat rate of Commission to **IBL** @ 10% on pharmaceutical products which is much above the industry practice of 6% to 10%. These rates of commission/discount are principally objectionable when considered alongside the prolonged trade credit period of 120 days allowed to



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**IBL** by **Searle**. It is pertinent to mention here that the **IBL**'s policy for sale is cash for the market and credit to Government Institutions only, which is similar to the pharmaceutical industry practice.

The contention of **Searle** that raise of sale of **Searle** is mainly due to **IBL**'s distributorship and that the **IBL** has a country wide network, also could not be treated as correct due to the reason that as per the following analysis, Gross Profit Margin of **Searle** is almost equivalent to sector average, whereas other ratios i.e. Net profit Margin, EPS and financial charges to Sales of **Searle** appears to be abnormal in comparison with the sector averages.

Particulars	Year ended June 30, 2006	Year ended June 30, 2005
<b><u>Gross Profit Margin</u></b>		
Searle	35	32
Sector Average (exclusive of Searle)	38	38
<b><u>Net Profit Margin</u></b>		
Searle	3	3
Sector Average (exclusive of Searle)	14	13
<b><u>EPS</u></b>		
Searle	3.53	3.19
Sector Average (exclusive of Searle)	17.18	15.95
<b><u>Financial charges to sales</u></b>		
Searle	3	3
Sector Average (exclusive of Searle)	0.48	0.29

In view of the above, sale of pharmaceutical and non-pharmaceutical product through the sole-distributor, **IBL**, an associated company, cannot be termed as normal trade credit and advantageous for **Searle**. Since the 120 days credit period along with the high rates of commission allowed to **IBL** cannot be regarded as normal trade credit, this would appear to fall within the purview of Section 208 of the Ordinance, requiring a special resolution of the shareholders which was not obtained.

b) **Reimbursement of expenditure to IBL by Searle:** It has been contended by the **Searle**, in its response to SCN and during the course of hearing that it is normal/ standard practice that if any principal authorizes its distributors to pay for any expenses on the principal's behalf, the distributor is entitled to have the same reimbursed. Hence these expenses were not the part of distributor's cost. Same have been tabulated as under:

Particulars	June 30, 2006 (Rs in million)	June 30, 2005 (Rs in million)	Nature (as provided by Searle)
Carriage and duties	12.942	13.521	stock transfers from one branch/network to another branch/network towns.



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Warehouse rent	2.533	1.832	utilizing portion of distributors warehouse for <b>Searle's</b> stock storages.
Mark up expenses	0.277	0.391	on outstanding with Govt. Institutions for supply of stocks on <b>Searle's</b> instructions.
Commercial expenses	0.689	0.261	utilizing distributor's telephone, fax machine etc.
Corporate Services	3.600	3.600	comprise of proportionate rent of corporate floor, proportionate share of utilities of corporate floor, salaries and expenses of corporate office staff.
Vehicle hiring charges	3.687	4.323	utilizing distributor's vehicles for <b>Searle's</b> work

However, as per independent confirmation from listed Pharmaceutical Companies, the freight is the only expenditure which was borne by the pharmaceutical company. Moreover, most importantly, **Searle's** Distribution Agreement dated July 1, 2005 with **IBL** does not support the re-imburement of any type of expenditure. Furthermore, expense on account of warehousing stock reimbursed by **Searle** to **IBL** is also not justified and not according to market practice prevailing in the pharmaceutical sector due to the reason that **IBL** is a sole-distributor of **Searle** and **Searle** is obliged to sell all its products only through **IBL** and storing of **Searle's** stock without sale is questionable. In addition, payment of mark-up to **IBL** on outstanding balance with regard to supply of stocks to Government Institutions on **Searle's** instructions is again against the market norm and the rate of mark-up allowed to **IBL** must not exceed the rate of markup payable by **IBL** to **Searle** on account of payments received after the credit period allowed to **IBL**. Hence the re-imburement of expenditures by **Searle** to **IBL** is also against the industry norms.

*c) Interest free credit and interest less than the borrowing cost:* It has also been observed that the **Searle** not only allowed **IBL** interest free credit of 120 days but also charged mark up @7.5% after expiry of credit period of 120 days, which is much lower than its own borrowing cost of 10 to 12% as disclosed in the annual accounts.



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Keeping in view the above facts I, therefore, hold that **Searle** has violated the provisions of Section 208 of the Ordinance over a long period of time while dealing with **IBL** by granting interest free credit period and also by charging interest less than the borrowing cost.

**Transaction with IBLHC**

Although the words 'trade credit' could be of widest scope in general legal usage, I am of the view that the context in which these words have been used in the aforesaid provisions of law has limited meaning. In my opinion, 'normal trade credit' has been used with reference to investing company and refers to the credit allowed by the investing company to its customers in the ordinary course of business.

It is evident that **Searle** has neither been a company having its major object to import goods nor has it supplied any goods manufactured by it during the normal course of its business, the outstanding payment of which could be termed as normal trade credit. Instead, Credit facilities were granted to **IBLHC**, through an Agreement between the **Searle** and the **IBLHC** dated July 01, 2000 according to which all the invoices were required to be settled within 90 days period. At this point, I also consider it necessary to look at the transactions of **Searle** with **IBLHC**. A perusal of the agreement between **Searle** and **IBLHC** revealed that **Searle** has agreed to continue import of goods on behalf of **IBLHC** till banking facilities would be available to **IBLHC** and **IBLHC** has agreed to settle all invoices within 90-days period. However, age analysis and summary of current account provided by the **Searle** with **IBLHC** shows that an amount of Rs.28.681 million, which comes to 85% of the total amount i.e. Rs.33.753 million receivable from **IBLHC** as on June 30, 2006, is outstanding for more than 2 years. On the other hand bank liabilities of **IBLHC** were paid off by the **Searle** with regards to import of goods on behalf of **IBLHC**. As such these advances could not be treated as 'normal trade credits.' I, therefore, hold that **Searle** has violated the requirements of Section 208 of the Ordinance by not taking shareholders approval in advance while giving credit facility to its associates, **IBLHC**.

(ii) ***Whether Searle has suffered any loss due to violation of Section 208?***

Having established the fact that sale of products through **IBL** and receivables from **IBLHC** are not in the nature of normal trade credit, and is a violation of Section 208 of the Ordinance; it is to be determined whether the **Searle** has suffered loss due to the action of directors. From the details given in the above para it can safely be concluded that **Searle**'s Net Profit Margin, EPS which are far below the sector averages and Financial charges on sales are higher than the sector average and all this



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mainly attributes to the preferential trade arrangement with **IBL**. On the other hand **IBL** utilizes the benefit of this arrangement and made sales to market on cash basis and to government institution on credit basis. Such types of arrangement by **Searle** for **IBL** have the effect of siphoning off of the gains of the shareholders accruable on the aforesaid arrangement to **IBL**. This is obviously unfair to the shareholders of investing company as benefit to the shareholders of the associated company was provided at the cost of the shareholders of the investing company. This undue advantage given to **IBL**, an associated undertaking resulted into loss to the **Searle** and its shareholders and is an unwarranted benefit to the shareholders of associated undertaking. As regards, transactions with **IBLHC**, it is evident that the **Searle** could have saved much of its financial cost by not spending on behalf of **IBLHC** and even if charged mark up equivalent to its borrowing cost. For the forgoing, I am left with no doubt in holding that **Searle** has suffered losses as a consequence of transaction with **IBL** and **IBLHC**.

*iii) Whether such transactions have been prejudicial to the interest of its shareholders?*

Having discussed that **Searle** has suffered loss on transaction with **IBL** and **IBLHC**, it would be easy to conclude as to whether these transactions have been prejudicial to the interest of its shareholders. The value of the shareholding of its members has diminished by conducting transaction on the terms and conditions other than industry practice with **IBL** and **IBLHC**. This, therefore, has seriously jeopardized the interest of its shareholders. Looking from the point of a reasonable bystander, the investments resulting into loss to **Searle** are unfairly prejudicial to the interest of its shareholders. Also the course of conduct of directors constitutes mismanagement of affairs, which again is prejudicial to the interest of the shareholders.

*iv) Whether directors have breached fiduciary duties towards Searle and its shareholders?*

The directors owe fiduciary duties to the company and its shareholders. The fiduciary must treat all the shareholders fairly, whether they are sponsors or the general public. Moreover, they must discharge their statutory obligations in good faith with conscientious, fairness, morality and honesty in purpose. In the present case, the directors of **Searle** are also the directors of its associated companies. As such they appeared on both side of the transactions. In such a situation, the directors, in my view, have not made a conscious decision. This conflict of interest has deprived the shareholders of **Searle** of substantial benefits. They have also failed to exercise reasonable care to see that mandatory provisions of law are complied with. In view of the above discussion, I hold that the directors have breached their fiduciary duties, which they owe to **Searle** and its shareholders.



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11. From the above discussion, facts of the case and arguments put forward by the Counsel, I am of a considered view that the provisions of Section 208 of the Ordinance have been violated and directors are liable for the penalties as defined in Sub-section (3) of the aforesaid provisions of the Ordinance. 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 the 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 it in this respect. This action becomes more important because of the responsibility put on the Commission under sub-section (6) of Section 20 of the Securities and Exchange Commission of Pakistan Ordinance, 1997 which requires that, in performing its functions and exercising its powers, the Commission, which is the Regulator, is to strive, among others, to maintain facilities and improve the performance of companies and securities markets, in the interest of commercial certainty, reducing business costs, and efficiency and development of the economy.

12. The Chief Executive and directors have breached their fiduciary duty by providing unnecessary benefits to its associated undertakings where they are major shareholders and thereby acting against the interest of its shareholders. This also clearly manifests that they did not exercise due care while entering into transaction with **IBL** and **IBLHC**. This clearly establishes that the Chief Executive and all the Directors have purposefully and deliberately avoided complying with the mandatory provisions of the Ordinance knowing well that they were duty bound to do so. The default, therefore, is considered deliberate and willful. The Chief Executive and the Directors have, therefore, made themselves liable for fine as provided under Sub-section (3) of Section 208 of the Ordinance.

13. The directors of the Company therefore deserve no sympathy on this account however keeping in view the that default is admitted I instead of imposing maximum fine impose an aggregate penalty of Rs. 1,400,000 (One million and four hundred thousand rupees only) on all the directors in a manner that Rs. 300,000 (three hundred thousand rupees only) on the then Chief Executive, Rs. 200,000 (two hundred thousand rupees only) each on common directors between **Searle**, **IBL** and **IBLHC** and Rs. 100,000 (one hundred thousand rupees only) each on rest of the directors who failed to play their role being part of the Board and involved themselves in such illegitimate transactions. The directors of **Searle** are hereby directed to deposit the following amounts of fine 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 furnish receipted bank vouchers to the Commission:



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S. No.	Name of Director	Amount (Rs.)
1	Mr. Tariq Ismail, Chief Executive	300,000
2	Mr. Rashid Abdulla, Director	200,000
3	Mr. Khalid Malik, Director	200,000
4	Mr. Mushtaq Abdulla, Director	200,000
5	Mr. Azad Alladin, Director	200,000
6	Ms. Maneezah Malik, Director	100,000
7	Mr. Shahid Abdulla, Director	100,000
8	Mr. Muhammad Ali, Director	100,000
	<b>Total</b>	<b>1,400,000</b>

In case of non-deposit of the penalty, proceedings for recovery of the fines as an arrear of land revenue will be initiated. It may also be noted that the said penalties are imposed on the directors in their personal capacity; therefore, they are required to pay the said amount from their personal resources.

14. Further, in terms of the provisions of Section 473 of the Ordinance, I hereby direct the **Searle** to submit a report to the Commission covering the following aspects of the above case within thirty days of this order:

- (i) Recover the balances outstanding from **IBL** and **IBLHC** immediately;
- (ii) **Searle** shall reduce the credit period along with Commission allowed to **IBL** in order to bring it in close proximity to the sectoral normal trade credit collection period and Commission allowed to distributors;
- (iii) Policy for reimbursement of expenditure to **IBL** shall also be formulated by **Searle** according to the prevailing market practice adopted by pharmaceutical sector and same shall be incorporated in the Agreement with **IBL**; and
- (iv) Auditors' certificate on full compliance of the above directions shall be submitted by the **Searle** to the Commission.

15. In furtherance of the aforesaid direction, I hereby direct the **Searle** to immediately appoint the statutory auditor or a firm of Chartered Accountant meeting the criteria given in the provisions of Section 254 of the Ordinance which shall examine the transactions with **IBL** and **IBLHC** since inception of such transactions and prepare a report on losses suffered on accounts of such transactions keeping in view the scenario that if these would have been carried out according to the prevailing market terms and interest on the outstanding balances would have been charged equivalent to the borrowing cost of **Searle**. **Searle** shall inform the Commission immediately of such appointment of the auditor. The auditor so appointed



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shall coordinate with Mr. Abid Hussain, Director (Enforcement) for coordination and shall submit his report directly to the Commission within 30 days of such appointment.

16. I hereby further direct my office to file a reference with the concerned Registrar of Companies drawing his attention to the transactions between the **IBLHC** and **IBL** for possible violation of the provisions of Section 208 of the Ordinance as **IBLHC** is a private limited company and a subsidiary of **Searle** which is a listed company and therefore, provisions of Section 208 of the Ordinance are equally applicable on it.

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**Tahir Mahmood**  
Executive Director

**Announced**  
September 24, 2007  
Islamabad