

**Before Mr. Tahir Mahmood, Executive Director (Enforcement)**

**In the matter of**

**M/S Haseeb Waqas Sugar Mills Limited**

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

No. and date of show cause notice	No. EMD/233/638/2002-2342-2349 dated December 12, 2007
Date of hearing	April 10, 2008
Present:	Mr. Mansoor Ali Shah, Advocate
Date of Order	May 5, 2008

**ORDER**

This order shall dispose of show cause proceedings in the matter of Show cause No. EMD/233/345/2002-3482-88 dated March 10, 2008 under Section 208 of the Companies Ordinance, 1984 (“Ordinance”) issued to the M/S Haseeb Waqas Sugar Mills Limited (the ‘Company’) and its Directors: Mian Muhammad Ilyas Mehraj, Mr. Saddique Akber Butt, Hafiz Muhammad Irfan Hussain Butt, Mian Waqas Riaz, Mr. Sohail Ahmed Butt and Mr. Raza Mustafa

2. Show cause notices were issued to the Company and Directors required each of them to explain their position in writing on or before March 25, 2008 in respect of the contravention with Section 208 of the Ordinance and continuing default from 2004 to 2007 in respect of the investments made in the associated concerns.

3. Brief facts leading to this case are that Rahman Sarfraz Rahim Iqbal Rafiq, Chartered Accountants (“Auditors”) of the Company has emphasized on the matter relating to related parties transaction by drawing attention of the members to Note 35.1 of the financial statements for the year ended on September 30, 2007 (the “financial statements”) regarding transactions with the related parties. Note 35.1 reflects following transactions with related parties, other than key management personnel



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Nature of Transactions	Amount in Pak Rupees	
	2007	2006
Purchase of molasses	-	16,800,000
Sale of molasses	50,937,867	132,300,879
Purchase of machinery and components	73,863,178	13,987,417
Purchase of chemicals	-	839,644
Markup Charged to related parties	1,383,843	
Markup Charged by related parties	1,760,435	
Other Transaction	81,566,238	127,938,193

4. The Company has stated in the note 35 of the financial statements for the year ended on September 30, 2007 that;

*'Other transactions include payments on behalf of related parties and vice versa including shared expenses. The Company charged/incurred markup at rates ranging from 14 % to 15% per annum, during the current year, on balances with the related parties resulting from such transactions. **These transactions are subject to ratification by the shareholders.***

5. Show Cause Notice dated March 10, 2008 was, therefore, issued to the Company and its Directors highlighting the prima facie violations of Section 208 of the Ordinance. The Company was also provided with an opportunity of personnel hearing on April 10, 2008.

6. In reply to the aforesaid show cause notice, the legal counsel of the Company submitted as under;

- i) That the SCN is based on note 35.1 of the Notes to the Financial Statements for the year ending 30<sup>th</sup> September, 2007. Therefore, the SCN is restricted to the year 2007 and cannot travel beyond the said year. The SCN inadvertently refers to years 2004 to 2006 which is not sustainable in law.
- ii) In Note 35.1 of Notes to the Financial Statements for the year ending 30<sup>th</sup> September 2007 the auditors of the company namely; Rehman Sarfraz Rahim Iqbal and Rafiq Chartered Accountants clearly explain that the other transaction include i.e. payments on behalf of related parties ii. Vice versa (payments from related parties) iii. Shared expenses. Therefore the amount of Rs 81,566,238 encapsulates all the above.
- iii) That the Auditors have confirmed in the said Note (accepted and relied upon by the commission) that the company charged mark up rates ranging from 14% to 15% per annum, therefore, the mischief of the proviso to section 208 (1) of the ordinance is not attracted and no violation of the same has been committed.



- iv) That the note clearly states that these transactions are subject to rectification by the shareholders". This has been done as the accounts were put up before the AGM in the year 2008 and unanimously approved by the shareholders. Shareholders have not objected to the said accounts in the context of other transactions. The purpose and spirit behind section 208 of the ordinance is to protect the investment of the share holders and if the shareholders approve of any such investment in the AGM (it does not matter if it is before or after the transaction) the question of violation of the said does not arise. The Commission can only watch the interest of the shareholders and once the shareholders have no objection, the Commission has no gainsay or jurisdiction to investigate into the matter any further.
- v) That presently no amount is outstanding and the entire investment has been repaid along with markup. No loss what so ever has been incurred by the company and this has been certified by the auditors.
- vi) That the directors had no knowledge of the investment to the related parties and the matter first came up when the accounts were audited and placed before the Directors in January 2008. The same were duly ratified by the shareholders. The alleged payments (investments) were made by one Hafiz Irfan Butt, Director and also cane and procurement In charge and the director have no knowledge of the same. Infact there is no resolution of the directors on the record that can establish that the directors willingly and knowingly violated section 208 of the Ordinance. Upon probe by the directors it was discovered that Mr Hafiz Irfan Butt extended the payment to related parties under the false understanding that he had the authority to do so. In any case the payments (investment) have been incurred besides the share holders approved the account in the AGM held on 31<sup>st</sup> January, 2008.
- vii) There is no finding in Annual report or as per clause 35.1 that our clients were knowingly and willfully involved in any unlawful act or made a statement in any report statement or return, etc which was also false in any material particulars knowing it to be false or omitted to make a material statement, report etc. Therefore, issuance of notice to or Clients is unfounded, arbitrary and unsustainable.
- viii) That from the day our Clients joined the Board of Directors they have been discharging their duties vigilantly and in accordance with law. Wherever necessary they have been questioning and challenging and supervising the activities of management. The vigilance, professionalism and expertise of our clients with which they have been discharging their functions is manifest from the Board Meetings.



- ix) It is categorically submitted that the directors had no knowledge whatsoever regarding the allegation leveled in the SCN under reply. Therefore alleged violation of the law is not willful, deliberate or intentional.
- x) The directors as a precautionary measure also put up a special resolution under section 208 of the Ordinance before the AGM on 31-1-2008 so that the problem does not arise in the future. This also shows the *bona fide* conduct of the directors.
- xi) That major payments were prior to June 2007 and therefore the penalty under section 208 (3) prior to the amendment made in the year June 2007 will be applicable, if at all. No penalty has been envisaged for an officer of the company who is not a director.
- xii) That the efforts to illegally take over the company under Listed Companies (Substantial Acquisition of Voting Shares and Takeovers) Ordinance, 2002 by 30% of the illegal shareholders cannot be lost sight of. The company field complaints against the illegal shareholders before the Commission and could not hold AGM due to this reason. Recently, show cause notices have been issued by the appellate Bench of the Commission to the illegal shareholders and three directors who cannot work as directors under the order of Lahore High Court dated 19-1-2007. This illegal takeover also disrupted the working of the Company.
- xiii) That this is the first bona fide lapse committed by an officer / director of the Company without the knowledge of the other directors and may graciously be excused. A series of decisions of the Commission show that the Commission has shown leniency and grace in such matters of penalty.

7. Moreover, in order to provide an opportunity of personal hearing, the case was fixed for April 10, 2008. Mr. Mansoor Ali Shah, Legal Counsel representing the Company and its Directors appeared before me, they reiterated the submissions made in the written reply to the show cause notice while graciously admitting the default on part of the Company .

8. I feel it appropriate to quote here the relevant provisions of the Ordinance. 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 associates 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."*

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

- i) 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.
- ii) The statement of compliance annexed with the annual accounts of the Company for the period ended September 30, 2007 stated that the powers of the Board of Directors (BOD) have been duly exercised and decisions on material transactions have been taken by the BOD. This is further stated that the BOD has developed significant policies, includes policies pertaining to;
  - i. transactions or contracts with associated companies and related parties;
  - ii. determination and delegation of financial powers; and
  - iii. investments
- iii) The directors of the HWSM, 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 HWSM 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.
- iv) The Legal frame work through appropriate policies and procedures, ensures that transactions with associated undertakings are arm length transaction and to ensure that the power to approve the transactions is vested with the shareholders. In the current situation the fairness of the transaction is even not ensured as the transactions are executed by authorities who are interested in the said transactions and they are not delegated with the powers to transact with associated companies.



- v) The representation of the HWSM that the investment decision was made only by one Director, Mr. Hafiz Irfan Butt and other members of the Board of Directors were not aware if considered correct would mean that Mr. Hafiz Irfan Butt along with Chief Executive Officers and Chief Accountant have been acting in deviation of the policies and procedures. However, since the transaction with associated undertakings are material it is not possible that BOD is not in knowledge that the policies and procedures are circumvented and unauthorized transactions are carried out. The representation is in total contradiction with the statement of compliance with the Code of Corporate Governance annexed with the account and BOD of directors cannot absolve them of their responsibilities.
- vi) Moreover, it is also pertinent to mention here that the Board of Directors is approving the quarterly, half yearly and annual accounts of the Company from the year 2004 to 2007. The transactions with associated concerns are explicitly disclosed in these accounts. Hence it is not possible that the directors had no knowledge of the aforesaid transaction.
- vii) The argument of the legal counsel that the shareholders have ratified the transactions with the associated concerns in their Annual General Meeting (“AGM”) dated January 31, 2008 by approving the annual accounts of the Company cannot be acknowledged. In this regard, reference is made to Order passed by the Appellate Bench of the Securities and Exchange Commission of Pakistan in the case of Gharibwall Cement Vs. Executive Director (Enforcement) SECP, 2003 CLD 131, It has been decided in the aforementioned Order that prior permission of the shareholders is a mandatory requirement for investments in associated concerns, investment made in the associated concern cannot be validated by virtue of subsequent ratification by the shareholders and doctrines of the substantial compliance cannot be resorted to where there has been a clear violation of mandatory provisions.
- viii) Moreover, approval of the annual accounts does not mean that investment in the associated concerns is authorized. In fact, Section 208 requires a special resolution to be passed by the shareholders and a special resolution is passed with a majority of not less than three-fourths of such members entitled to vote as are present in person or by proxy at a general meeting of which not less than twenty one days notice specifying the intention to propose the resolution as a special resolution has been duly given, while approval of annual accounts does not require special resolution.
- ix) The shareholders mindset is reflected when the following resolution, presented by the management, in the AGM dated Jan 31, 2008 was disapproved.



*Quote*

*Resolved that consent and approval of the members of the Company be and is hereby accorded under Section 208 of the Companies Ordinance, 1984 for sanction of payment/receipt of amount aggregating to Rs. 25.00 million (Rupees Twenty Five Million Only) to all or any of the following related parties;*

- i. Abdullah Sugar Mills Limited*
- ii. Yousaf Sugar Mills Limited*
- iii. Haseeb Waqas Engineering Limited*

*Further Resolved that mark-up at a rate not less than the average borrowing cost of the Company shall be charged against outstanding on this account to the respective Company/Companies.*

*Further Resolved that common facilities which include utilities, weighbridges, sewerage etc. may be utilized by / for and on behalf of the above-related parties. Proper cost thereof shall be charged to the respective Company/Companies.*

*Further Resolved that the Chief Executive of the Company be and is hereby authorized to give effect to the above resolution, take all necessary steps as required under the law or otherwise and sign and to execute any document, application or agreement etc. for and on behalf of the Company in the relation to the above resolution.*

*Unquote*

- x) It has been wrongly inferred that the SCN is based on note 35.1 of the Financial Statements for the year ending 30<sup>th</sup> September, 2007 and is restricted to the year 2006-07. In fact, the SCN refers to accounts balance consequential out of events and transactions to which Auditor has drawn attention of the members. The events and transactions under considerations, are reason of default from 2004, 2005, 2006 and 2007, to which reference is made in the SCN.
- xi) The provisions of Section 208(1) are very clear that the investment in an associated company cannot be made without authorization of shareholders. The expression 'investment' has been explained in the aforesaid Section which shall include loans, advances, equity, by whatever name called, or any amount which is not in the nature of normal trade credit.". It is evident that the balances appearing in the financial statement are not in nature of normal trade credit. Hence, in absence of the shareholders authorization, charging of any interest rate on the investment in associated concerns does not constitute to be compliance of Section 208(1) of the Ordinance.



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10. 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 have breached their fiduciary duties, which they owed to the Company and its shareholders. In fact, the Company has been acting as a financier by providing funds to the associated concerns to fulfill their financial requirements at the cost of the Company.

11. For the foregoing reasons, it is established that the Directors have violated the provisions of Section 208 of the Ordinance and have invested funds without authorization of the shareholders. After analyzing the facts of the case and arguments put forward I am of a considered view that these do not carry rationalization and are not acceptable. Violation of section 208 of the Companies ordinance is established and all directors are responsible for the said violation. However, I, instead of imposing maximum penalty of Rs. 10,000,000 (Ten Million rupees) on each of the director as prescribed by Sub-section (3) of Section 208 of the Ordinance, impose a fine a fine of Rs. 500,000 (Rupees five lacs only) on Mr. Hafiz Irfan Butt . The representation of the Company that Mr. Hafiz Irfan Butt is only responsible for the violation is not cogent and the other directors are reprimands to remain careful in future.

12. The Company is also directed to get certification from the statutory auditors that all the transaction since 2004, attracting section 208 of the Ordinance, with the associated undertaking are at arm length and all outstanding balances arising out of these transactions have been duly received. Moreover, it should also be worked out that the Company has incurred no loss and markup has been appropriately charged. Further, extracts of all transactions with associated undertakings since 2004 should be brought in the notice of the shareholders.

13. Mr. Hafiz Irfan Butt is hereby directed to deposit the aforesaid fine totaling to Rs. 500,000 (Rupees five lacs 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 vouchers 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 penalties are imposed on the Chief Executive and other Directors in their personal capacity who are required to pay the said amount from their personal resources.

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**Tahir Mahmood**  
Executive Director (Enforcement)