



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN

[Islamabad]

Before Tahir Mahmood, Executive Director (Enforcement)

In the matter of

Dadabhoy Cement Industries Limited

Number and date of notice: No. EMD/233/371/2002-1054-60
December 29, 2009

Date of Hearing: March 08, 2010

Present: Syed Haroon Aziz
Authorized Representative

Order

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

This order shall dispose of the show cause proceedings initiated against directors of Dadabhoy Cement Industries Limited (DCIL) through show cause notice dated December 29, 2009 under Section 208 read with Section 476 of the Companies Ordinance, 1984 (the "Ordinance").

2. The facts leading to this case, briefly stated, are that examination of annual audited accounts of DCIL for the year ended June 30, 2009 (accounts) revealed following transactions with an associated company for which shareholder's approval in terms of Section 208 of the Ordinance was not found on record;

- a) Note 11.1 to the accounts disclosed an amount of Rs.62.077 million advanced to Dadabhoy Energy Supply Company Limited (DESCL), an unlisted public company, on account of purchase of electricity. No interest was being charged on the advance.
- b) Note 39 to the accounts disclosed investment of Rs.12 million as investment in share capital of a related party during 2008. The Company Secretary of DCIL confirmed vide letter dated December 12, 2009 that said investment was made in DESCL.

3. Further scrutiny of the DCIL's accounts for previous years revealed that advances against purchase of electricity were extended to DESCL in past too. Amounts outstanding from DESCL during last five years, on account of advances against purchase of electricity, were observed as follows;

	2009	2008	2007	2006	2005
	<i>Rs.000</i>				
Advances as on June 30	62,077	45,496	-	110,747	65,815

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

Continuation Sheet (1)

4. In view of the above a show cause notice dated December 29, 2009 was issued to the directors of DCIL highlighting the violations of Section 208 of the Ordinance calling upon them to explain as to why penal action may not be taken against them for contravention of said provisions of the Ordinance. Reply to the show cause notice submitted by the Company Secretary of DCIL, vide letter dated January 14, 2010, was not found satisfactory. Hearing in the matter was held on March 08, 2010. Syed Haroon Aziz of M/s. Aziz Associates, Income Tax & Company Law Consultants, appeared before me to represent the directors of DCIL. He also submitted written representation during the course of hearing.

5. Contentions raised by the directors and their Authorized Representative in their written representations and during the course of hearing have been summarized below:

Investment of Rs.12 million in share capital of DESCL: Initially, in response to the show cause notice, DCIL stated that it was erroneously stated in its letter dated December 12, 2009 that it has invested Rs.12 million in the share capital of DESCL. It was informed that amount of Rs.12 million disclosed in the accounts as "investment in share capital of a related party" was in fact investment made by the directors in the DCIL by subscribing its right shares. Subsequently, during the course of hearing, it was informed that the said amount was neither investment in DESCL nor right subscription by DCIL's directors but it was just a printing error.

Advances to DESL: Regarding advances to DESCL following arguments were presented:

- a) DESCL is a subsidiary company owned by the directors of DCIL and their associated group companies. DESCL supplies electricity to DCIL. The amounts outstanding from DESCL are against trade activity i.e. against supply of electricity; therefore, the same do not attract provisions of Section 208 of the Ordinance. Adequate disclosures regarding these amounts have been made under the head "transactions of associated companies".
- b) Electricity produced by DESCL is solely purchased by DCIL and DESCL has no survival without support of DCIL. DCIL made payments on behalf of DESCL for purchases of raw material and other expenses and these payments have been treated as advances against purchase of electricity.
- c) The terms of the advances extended to DESCL satisfy the normal terms and conditions of trade and ensures that the transactions are undertaken at arm's length price which is evident from the sale of electricity agreement between the parties which has already been provided to SECP. As per terms of the agreement, DCIL has to make

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

(Continuation Sheet - 2 -)

payment to DESCL in advance which will be adjustable against subsequent electricity bills. For these reasons accounts of DCIL shows advances in the name of DESCL. The following table shows the total amount of electricity consumed in each of the preceding five years together with amount of advance for electricity consumption:

Year	2009	2008	2007	2006	2005
	Rs. in million				
Advance as on June 30	62,077	45,496	-	110,747	65,815
Electricity Consumption	9,336	142,368	197,360	251,193	114,245

The above clearly depicts that the charges for consumption of electricity are significantly higher than the amount of advance. However, in 2009 DCIL could only operate for two months therefore the consumption is lower than the amount of advance balance.

- d) The operations of DCIL are closed since 2008 and it is suffering huge losses and drastic crunch of cash flows.

It was requested that on the basis of above submissions, looking at DCIL status and observing that no intentional default was committed minor omissions of disclosures may be ignored as DCIL is already suffering losses. It was also assured that management of DCIL will comply with the rules and regulations in proper manner in future.

6. I have duly considered written and verbal submissions of DCIL's directors and their Authorized Representative in the light of relevant provisions of the Ordinance and information/documents placed before me. It has been contended that advances provided by DCIL to DESCL were for the purpose of 'normal trade credit' and were legitimately made under the terms of the agreement between the two companies. In order to examine the aforesaid contention it would be pertinent to examine the terms of said agreement. Relevant terms of said agreement are reproduced below:

- 1) That the buyer *after* receiving bill of the electricity supplied by the seller shall pay the amount of electricity received during the month to seller. Provided that the adjustment of electricity bill shall be adjustable against the advances received from buyer.
- 2) That the seller shall issue monthly invoice of the amount of electricity to the buyer and the purchaser is liable to pay the said bill to the seller.

7. It may be noted that the agreement provides for payment of electricity bills in arrears i.e. after the receipt of monthly bill, and not in advance. In addition the proviso to clause (1)

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

Continuation Sheet - 3 -

provides that electricity bill shall be adjustable against the advances received from buyer. In my opinion, such adjustment shall only be applicable in case of such advances that are either made in the ordinary course of business or that are duly *authorized* by a company's shareholders. The advances extended by DCIL to DESCL against purchase of electricity are neither approved by its shareholders nor such advances are usually made in ordinary course of business with a power generation project. These advances were extended merely due to association between the companies. Such advances therefore, were subject to approval of shareholders and DESCL was required to pay interest on the outstanding balances.

8. As may be seen from following analysis, during the last 5 years, except in 2007, huge amounts were outstanding from DESCL which were many times greater than its average monthly consumption of electricity;

Year	2009	2008	2007	2006	2005
	<i>Rs. in million</i>				
Electricity Consumption for year	9.336	142.368	197.360	251.193	114.245
Average monthly bill (Electricity consumption for year/12)	0.78	11.86	16.45	20.93	9.52
Advance as on June 30	62.077	45.496	-	110.747	65.815

It may also be noted from the above table that as on June 30, 2008 an amount of Rs.45.496 million was receivable from DESCL. DCIL stopped operations in August 2008 due to unavailability of working capital. Despite this, DCIL provided additional funds to DESCL increasing receivable balance to Rs.62.077 million as on June 30, 2009.

9. DCIL extended advances to DESCL and did not charge any return thereon as required under mandatory provisions of the Ordinance and thus provided undue advantage to DESCL. For its own financial needs, however, DCIL had to resort to pricey borrowings.

10. The argument that DESCL is a subsidiary of DCIL is also not a valid argument because Section 208 of the Ordinance prescribes the code for "investments in associates" and a subsidiary is also included in the definition of associate. It is therefore, held that DCIL's 47.86% shareholding in DESCL does not in any way dilute the effect of non-compliance with the statute. I am also not convinced with the plea that the default was not intentional. The directors are supposed to be aware of the requirements of the statute therefore non-compliance with any mandatory provision of law cannot be termed as unintentional.

11. The aforesaid situation shows that DCIL is acting as a financier for DESCL at the cost of its shareholders and has deprived them of the return that could have been earned by investing these amounts in any other mode. The directors of the DCIL have therefore violated

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

(Continuation Sheet - 4 -)

the provisions of Section 208 of the Ordinance and are thus liable for penalties as provided there under.

12. Now I come to the issue of alleged equity investment of Rs. 12 million in DESCL. Though I am now convinced that DCIL has not made such investment in DESCL, however, I would like to point out that Commission's suspicions in this respect were primarily raised due to erroneous disclosure in DCIL's accounts and its management's careless approach towards the regulator's calls for information. Had the management responded to this office with due care and responsibility, precious time would have been preserved. I hereby strictly warn the management to ensure strict vigilance while preparing financial statements, the only source available to shareholders about a company's state of affairs, and also while communicating to the regulator.

13. Although the default under Section 208 of the Ordinance is established, however, considering the circumstances of DCIL and significance of DESCL for it I am inclined to take a lenient view and instead of imposing maximum penalty of Rs.10 million on each director as provided under Section 208 of the Ordinance impose a fine on the directors of DCIL in the following manner:

S.#	Name of Directors	Penalty (Rs.)
1	Mr. Muhammad Hussain Dadabhoy, Chairman	100,000
2	Mr. Muhammad Amin Dadabhoy, Chief Executive	100,000
3	Mr. Fazal Karim Dadabhoy, Director	100,000
4	Mrs. Yasmeen Dadabhoy, Director	100,000
5	Mrs. Noor Bakht Dadabhoy, Director	100,000
6	Mr. Naseemuddin, Director	100,000
7	Syed Nasim Ahmed, Director	100,000
	Total	700,000

14. Before parting with the order, I consider it necessary to give directions regarding recovery of said advances and interest thereon. I hereby invoke provisions of Section 473 of the Ordinance and advise the directors of DCIL to immediately provide in DCIL books the amount of interest accrued on receivables from DESCL since 2005 to till date at a rate not less than the weighted average borrowing cost of DCIL and submit working of the same, duly certified by statutory auditors, to the Commission within 30 days of the date of this order. Considering the fact that DESCL is a captive power project of DCIL and at present is operating at nominal capacity due to closure of DCIL's operations, instead of ordering for

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Enforcement Department

Continuation Sheet - 2

immediate recovery of advances and interest thereon; I advise the directors of DCIL to submit a plan for recovery duly approved by DCIL board within 30 days of this order:

15. Besides, I also hereby order, in terms of Section 208 of the Ordinance that in case the said advances and interest thereon could not be recovered the directors of DCIL will be personally liable for the loss caused to DCIL.

16. The Chief Executive and directors of DCIL are hereby directed to deposit the aforesaid fine in the designated bank account maintained in the name of the Securities and Exchange Commission of Pakistan with MCB Bank Limited or pay through a demand draft in the name of the Securities and Exchange Commission of Pakistan within thirty days from the receipt of this order and furnish receipted bank voucher to the Commission, failing which proceedings for recovery of fines as an arrear of land revenue will be initiated. It may also be noted that the said penalty is imposed on the Chief Executive and directors in their personal capacity; therefore, they are required to pay the said amount from their personal resources.



Tahir Mahmood
Executive Director (Enforcement)

Announced
March 26, 2010