



**BEFORE THE
MONOPOLY CONTROL AUTHORITY
IN THE MATTER OF
M/s. Searle Pakistan Ltd
&
International Brands (Pvt.) Limited
(File No. 8(588)/INV/DD-R&I/MCA/94)**

Present

Mr. Khalid A. Mirza
Chairman

Raja Raza Arshad
Member

Mr. Abdul Ghaffar
Member

Dates of hearing: 05-03-2007, 19-03-2007 & 20-04-2007

Present for Respondents: Mr. Abdul Rehman Memon &
Mr. S. M. Nasir Raza Directors,
Mahmood Idrees Qamar & Company,
Chartered Accountants.

ORDER

1. The undertaking, M/s. Searle Pakistan Ltd, engaged in the manufacture of pharmaceutical products and low calorie sweeteners, sale of food and consumer items and manufacture of pharmaceutical items for other companies in Pakistan, (hereinafter referred to as “SEARLE”) is an undertaking, as defined under Section 2(1)(m) of the Monopolies and Restrictive Trade Practices (Control & Prevention) Ordinance, 1970

(hereinafter referred to as the “Ordinance”). SEARLE is among the leading pharmaceutical companies in Pakistan.

2. M/s International Brands (Pvt) Limited (hereinafter referred to as “IBL”) is an associated undertaking of SEARLE in terms of section 2(1)(b) of the Ordinance. It is also the sole distributor of SEARLE. IBL is a leading distribution company in Pakistan.

3. SEARLE provided its annual audited accounts for the year ended June 30, 2005 and the information required under the Monopoly Control Authority (Supply of Information) Rules, 1995 (hereinafter referred to as the “Rules”). The information supplied by SEARLE was examined and it was found that during the year ended June 30, 2005 its total sales to IBL, made at trade price less discounts of 10% to 12%, amounted to Rs 1,757.396 million. The commission/discount allowed amounted to rupees 63.650 million (Note 13-other receivables, to the accounts refers). The rates of commission/discount allowed by SEARLE to its associated undertaking, IBL, were observed to be higher as compared with the rates of commission/discount allowed by other companies of SEARLE’s size and standing in the pharmaceutical industry. During the year ending June 30, 2005, IBL also claimed Rs 23.928 million from SEARLE on account of miscellaneous expenses, (carriage and duties, warehouse rent, mark-up expenses, communication expenses, corporate service and vehicle hiring charges), which was a deviation from usual business norms/practice.

4. Section 4(b) of the Ordinance prohibits any dealings between associated undertakings, which have or likely to have the effect of *“unfairly benefiting the owners or shareholders of one such undertaking to the prejudice of the owners or share-holders of any other of its associated undertakings.”* The dealings of SEARLE with IBL were,

therefore, found to be, prima facie, in violation of Section 4(b) of the Ordinance.

5. Show Cause Notices No 30 & 31 of 2006-07 dated 07-02-2007 were, therefore, served, on SEARLE and IBL respectively under section 11 read with section 12(1)(a)(iii) of the Ordinance. Both undertakings were required to respond to these Show Cause Notices by February 22, 2007. They were also given an opportunity of being heard on March 05, 2007, at Karachi, in the same Notices.

6. In response to the Show Cause Notice, IBL, vide its letter dated February 21, 2007 submitted that the Show Cause Notice was received by it on February 20, 2007 and requested that they be allowed further time until April 15, 2007 to give their reply and represent before the Authority.

7. IBL was advised vide letter dated February 21, 2007 to appear before the Authority on March 05, 2007 at Karachi and make its submissions to the Authority for disposal of the Show Cause Notice as the matter had already been fixed for hearing on that date.

8. SEARLE, in response to the Show Cause Notice, vide its reply dated February 20, 2007, submitted as under:

“1. In our humble view the Show Cause Notice issued to us under Section 11 of the Monopolies and Restrictive Trade Practices (Control & Prevention) Ordinance, 1970 (“the Ordinance”) is not warranted or legally justified, as no violation, as alleged, of Section 3 of the Ordinance has occurred and the Show Cause Notice is liable to be withdrawn or treated as satisfied.

2. *That the present Show Cause Notice is apparently on the allegation of breach of Section 3 of the Ordinance on the following alleged basis:*

- a). *That Searle Pakistan Limited ("SPL") is allowing discount/Commission to the associated undertaking being M/s. International Brands (Pvt) Limited ("the Associated Undertaking") in its capacity as a distributor at a rate higher than the rate of discount/commission allowed to their distributors by other undertakings of the similar stature in the pharmaceutical market (as appears in paragraph 4 of the Show Cause Notice); and*
- b). *That SPL used to pay and has paid its Associated Undertaking in its capacity as a distributor a sum of Rs 23.928 million in re-imbursement of miscellaneous expenses during the year ended in 2005 as per SPL's annual audited accounts for the year ended on June 30, 2005, which is against business norms/practice of other undertakings of the similar stature in the pharmaceutical market (as appears in paragraph 5 of the Show Cause Notice).*

3. *With regard to the allegation made at paragraph 4 of the Show Cause Notice, we wish to explicate that SPL is allowing discount/commission to the Associated Undertaking at the rates prevailing in the pharmaceutical market. The Associated Undertaking has country wide network and can only be compared for its quality of distribution with the likes of Muller & Phipps Pakistan (Pvt) Limited. The prevailing discounting/commission rates in the pharmaceutical market may be judged by reference to the following undertakings' practice, which are of similar stature:*

- a). *Muller & Phipps Pakistan Ltd - 10% to 12%*
- b). *UDL Distribution - 10 %*
- c). *Pharma Link Distribution - 10% to 12%*

4. *That with regard to the rates mentioned in paragraph 3 above, we respectfully submit that such dealing or arrangement being in accord with that prevailing in the current pharmaceutical market cannot be said to be*

prejudicial to the shareholders of any undertaking and constitutes commercial arrangements on market terms. As such, we respectfully submit, that the same does not give rise to undue concentration of economic power under Section 4 of the Ordinance.

5. *That with regard to the allegation made at paragraph 5 of the Show Cause Notice, we would like to respectfully point out that it is normal/standard practice that if any principal authorizes its distributor to pay for any expenses on the principal's behalf, the distributor is entitled to have the same reimbursed. In this regard, we respectfully submit that this does not amount to undue concentration of economic power under Section 4 of the Ordinance, as no unfair benefit to the share holders of the Associated Undertaking or prejudice to the shareholders of any undertaking can take place by reimbursement of expenses of a distributor which have been carried out on behalf of the principal.*
6. *That in this regard, we wish to further inform that SPL has reimbursed expenses to its distributors paid on its behalf as under:*
 - a). *Carriage and duties for stock transfers from one branch/network towns to another branch/network towns.*
 - b). *Warehouse rent for utilizing portion of distributors warehouse for SPL's stock storages.*
 - c). *Mark-up expenses on outstanding with Government Institutions for supply of stocks on SPL's instructions.*
 - d). *Communication expenses for utilizing distributor's telephone, fax machine, etc.*
 - e). *Corporate services charges for services provided to SPL on account of common staff's salaries and expenses.*
 - f). *Vehicle hiring charges for utilizing distributors vehicles for SPL's work.*
7. *That in conclusion, it is respectfully submitted that the SPL has not violated any provision of the Ordinance and it is humbly requested that the Show Cause Notice be withdrawn or treated as satisfied.*

8. *That in the event that the above explanations and reply to the Show Cause Notice have not satisfied the Monopoly Control Authority, Government of Pakistan, we would request to avail the opportunity of hearing as provided.”*

9. Both the undertakings failed to appear before the Authority on March 05, 2007, fixed for hearing at Karachi.

10. IBL’s reply to the Show Cause Notice, vide its letter dated March 02, 2007 was mutatis mutandis the same as the reply submitted by SEARLE, referred under para 8 above, and it is reproduced below:

“1. *In our humble view the Show Cause Notice issued to us under Section 11 of the Monopolies And Restrictive Trade Practices (Control & Prevention) Ordinance, 1970 (“the Ordinance”) is not warranted or legally justified, as no violation, as alleged, of Section 3 of the Ordinance has occurred and the Show Cause Notice is liable to be withdrawn or treated as satisfied.*

2. *That the present Show Cause Notice is apparently on the allegation of breach of Section 3 of the Ordinance on the following alleged basis:*

a). *That M/s. International Brands (Pvt.) Limited (“IBL”) is receiving discount/Commission from the associated undertaking being M/s. Searle Pakistan Limited (the “Associated Undertaking”) in its capacity as a distributor of the Associated Undertaking at a rate higher than the rate of discount/commission allowed to their distributors by other undertakings of the similar stature in the pharmaceutical market (as*

*appears in paragraph 4 of the Show Cause Notice);
and*

b). That IBL used to receive and has received from its Associated Undertaking in its capacity as a distributor a sum of Rs 23.928 million on account of reimbursement of miscellaneous expenses as per the annual audited accounts of the Associated Undertaking for the year ended on June 30, 2005, which is against business norms/ practice of other undertakings of the similar stature in the pharmaceutical market (as appears in paragraph 5 of the Show Cause Notice).

3. With regard to the allegation made at paragraph 4 of the Show Cause Notice, we wish to explicate that IBL is receiving discount/Commission from the Associated Undertaking at the rates prevailing in the pharmaceutical market. IBL has country wide network and can only be compared for its quality of distribution with the likes of Muller & Phipps Pakistan (Pvt.) Limited. The prevailing discounting/commission rates in the pharmaceutical market may be judged by reference to the following undertakings' practice, which are of similar stature:

- a). Muller & Phipps Pakistan Ltd - 10% to 12%*
- b). UDL Distribution - 10 %*
- c). Pharma Link Distribution - 10% to 12%*

4. That with regard to the rates mentioned in paragraph 3 above, we respectfully submit that that such dealing or arrangement, being in accord with that prevailing in the current pharmaceutical market can not be said to be prejudicial to the shareholders of any undertaking and constitutes commercial arrangements on market terms. As such, we respectfully submit, that the same does not give rise to undue concentration of economic power under Section 4 of the Ordinance.

5. That with regard to the allegation made at paragraph 5 of the Show Cause Notice, we would like to respectfully point out that it is normal/standard practice that if any principal authorizes its distributor to pay for any expenses on the

principal's behalf, the distributor is entitled to have the same reimbursed. In this regard, we respectfully submit that this does not amount to undue concentration of economic power under Section 4 of the Ordinance, as no unfair benefit to the share holders of the Associated Undertaking or prejudice to the shareholders of any undertaking can take place by reimbursement of expenses of a distributor which have been carried out on behalf of the principal.

6. *That in this regard, we wish to further inform that the Associated Undertaking has reimbursed expenses to IBL paid on its behalf, inter alia, as under:*

- a). *[Carriage and duties for stock transfers from one branch/network towns to another branch/network towns.*
- b). *Warehouse rent for utilizing distributor's portion warehouse for the Associated Undertaking's stock storages.*
- c). *Mark-up expenses outstanding with Government Institutions for supply of stocks on the Associated Undertaking's instructions.*
- d). *Communication expenses for utilizing distributor's telephones, fax machine, etc.*
- e). *Corporate services charges for services provided to the Associated Undertaking on account of common staff's salaries and expenses.*
- f). *Vehicle hiring charges for utilizing IBL's vehicles for the Associated Undertaking's work.]*

7. *That in conclusion, it is respectfully submitted that IBL has not violated any provision of the Ordinance and it is humbly requested that the Show Cause Notice be withdrawn or treated as satisfied.*

8. *That in the event that the above explanations and reply to the Show Cause Notice have not satisfied the Monopoly Control Authority, Government of Pakistan, we would request to avail the opportunity of the hearing at some later date, other than March 05, 2007.*

11. The matter was fixed for hearing on March 19, 2007 at Islamabad. Mr. Abdul Rehman Memon, Director, Mahmood Idrees Qamar & Company, Chartered Accountants, appeared before the Authority, as authorized representative for both undertakings, and further amplified upon the written replies already submitted and provided necessary clarifications in response to queries put to him. He was directed to provide documents and information in respect of both undertakings, by March 26, 2007 as noted below:

- i). Memorandum and Articles of Association;
- ii). Annual audited accounts for the years ended in 2005 and 2006;
- iii). Copy of Sole Distributorship Agreement, executed between SEARLE and IBL;
- iv). Copies of Sole Distributorship or Distributorship Agreements, executed by IBL with other manufacturers; and
- v). Reply to the queries, in respect of certain entries in audited accounts and notes to the accounts, for the year ended in 2005.

12. In compliance with the Authority's directives, SEARLE supplied the following documents and information vide its letter dated March 20, 2007 as quoted below from this letter:

- “i). Copy of Memorandum and Articles of Association of Searle Pakistan Ltd.*
- ii). Annual Audited Accounts for the years ended June 30, 2006.*
- iii). Copy of Distribution agreement between Searle Pakistan Ltd (Searle) and IBL (Pvt.) Limited (IBL).*
- iv). Statement showing the shareholding of IBL Directors into Searle with number of shares and percentage and*

details of Associated Concerns showing common directors, common controls, holding subsidiaries etc.

- v). *Normal credit period allowed to IBL is 120 days and Searle may charge mark-up of outstanding amounts remains for more than 120 days, at more than its average borrowing rate which varies year to year.*
- vi). *Average amount of Rs 684.825 M that remained payable by IBL to Searle which was within the agreed credit period hence no markup recovered thereon during the fiscal year 2005-06.*
- vii). *A statement of account of IBL in the books of Searle.”*

13. IBL also supplied the following documents and information, vide its letter dated March 27, 2007 as quoted below from this letter:

- “1). *Copy of Memorandum and Article of Association.*
- 2). *Audited Accounts for the year ended on June 2005 & 2006.*
- 3). *Copies of Distributorship Agreement between IBL and Searle Pakistan Ltd.*
- 4). *Distributorship Agreements between IBL and other companies (Procter & Gamble, Gillette Pakistan Ltd, PTCL, Mobilink, Sheezan International and Dupont Pakistan). IBL is not handling pharmaceutical business of any other manufacturer. Distribution of Beecham Pakistan has been discontinued. IBL was handling Beecham OTC Products only.*
- 5) *It is a normal business practices that all the principals of IBL having presence at 80 different cities and towns throughout Pakistan for the expenses of their local*

representatives draw cash from IBL and the same are reimbursed by the principals to IBL.

This practice is just to facilitate our principal's field, staff working at our branches in different cities and towns throughout Pakistan. A brief detail of expenses incurred by Searle field force at different location and subsequently reimbursed by Searle to IBL are as under:

- i). Stocks are transferred between the IBL branches from one city to another on the instructions of Searle Pakistan. Freight charges etc., are paid by IBL on behalf of Searle, which are reimbursed subsequently to IBL.*
- ii). Searle Pakistan is storing their stocks, which is not sold to IBL for distribution, at our National Warehouse, Karachi and other regional warehouses in Lahore, Islamabad and Peshawar. For the space, utilization for stocks owned by Searle Pakistan and stored at our warehouses IBL charged to Searle Pakistan.*
- iii). IBL supply stocks to various Government institution (health department, Government Hospitals and Military Hospitals). These stocks sold to Government Institution on longer credit terms, which is excess number of days of credit to government institutions compare to the retail market. Therefore, markup @ 11% is charged on credit sales to government institutions as per instructions of Searle Pakistan.*

- iv). *Telephone and Fax at IBL branches throughout Pakistan used by field force of Searle Pakistan is claimed from Searle Pakistan.*
- v). *Searle Pakistan is a group company of IBL Group. The expenses of Corporate Office comprising of Senior Management includes Chairman, Group Managing Director, Group Finance Head etc., are shared between the group companies and reimbursed to IBL by all the group companies.*
- vi). *Searle field force working in 80 different cities and towns throughout Pakistan utilizes IBL vehicles for their field work. Expenses incurred on vehicle running for SPL field force are claimed from Searle Pakistan.*
- 6). *As per Agreement between IBL and Searle under clause 6.2 has a credit facility of 120 days from Searle Pakistan Ltd. In case of any late payment by IBL to Searle on account of sales under clause 6.3 of the Distribution Agreement IBL is liable to pay markup to Searle Pakistan @ 7.5% per annum on all outstanding sales.*
- 7). *Average amount of payable by IBL to Searle remains between Rs 650 to Rs 700 million. The payable amount remains within the agreed credit period hence there is no markup paid by IBL to Searle during the year ended 2005 and 2006.*
- 8). *Copy of ledger of Searle Pakistan maintained by IBL in their books.*

We hope that the above explanations, clarifications and information attached would meet your requirements.”

14. The various distributionship agreements, received with IBL's letter of March 27 (see Para 13 above) show rates of commission allowed to IBL as follows:

- PTCL - 7.72% of face value of PTCL Calling Cards – 6% passed on to sub distributors and 5% to retailers.
- 3% for Telephone Bills Payment Cards – 2.25% passed on to sub-distributors and 2% to retailers.
- Gillette - 12% (2% commission is passed on to passive whole sellers).
- SEARLE- 10% on trade price on all pharmaceutical products.
- 12% on trade price on all non pharmaceutical products.
- Procter & - Shampoos and toilet soaps 7%
- Gamble - Detergents 6%
- Dupont 5-10%
- Sheezan 2-4%

15. At the next hearing which was held on April 20, 2007 at Karachi, Mr. S. M. Nasir Raza, Director, Mahmood Idrees Qamar & Company, Chartered Accountants, appeared as authorized representative for both the undertakings, and responded to the Authority's queries. He was also directed to supply further information with respect to both undertakings by May 5, 2007.

16. As a consequence, on behalf of SEARLE, M/s. Mahmood Idrees Qamar & Company, Chartered Accountants, vide their letter dated May 04, 2007, submitted as under:

“In continuation of our client’s earlier letter dated March 20, 2007 and with reference to the hearing proceedings we attended on April 20, 2007, wherein you gave us further opportunity to provide further details and explanations in support of our contention, we are pleased to provide the following:

- 1. Searle Pakistan was a private limited company in 1993 when it was taken over by the IBL group. Therefore, no specific approvals from the shareholder were either obtained nor required.*
- 2. No specific shareholders’ approval for enhancement in credit period from 40 days to 120 days was obtained in the year 2005. The reason being it was not considered as in agenda item for general body. The original agreement, as required, is enclosed for your perusal. The industry trend is generally 45 days credit which again is linked with the number of days inventory is required to be held by the distributor.*
- 3. There is no written agreement for the re-imburement of expenses. No specific shaeholders’ approval for the reimbursement of expenses was obtained as it was not considered as an agenda item for general body by the management. Being associated companies, these facilities were solicited from, and accordingly offered by, the distributor. However, if considered appropriate and insisted*

by the Authority, our client is willing to abandon this practice in a month's time and is ready to implement its own system of maintaining regional bank accounts and accounting infrastructure to handle re-imbursement of field and other related expenses.

4. *A copy of amendment No. 1 dated April 01, 2006, which is an amendment to the main distribution agreement dated July 01, 2005 is enclosed by virtue of which the mark up to be charged by our client was revised and made floating at the rate of Kibor 6-months plus 2.5%.*
5. *Corporate expenses comprise of proportionate rent of corporate floor, proportionate share of utilities of corporate floor, salaries and expenses of corporate office staff, etc. Total expenses amount to Rs 1.6 on an average basis which is being shared by the group companies in the following fashion:*

	<i>Rs.</i>
• <i>Searle Pakistan</i>	<i>300,000</i>
• <i>UDL Modaraba</i>	<i>400,000</i>
• <i>IBL Modaraba</i>	<i>100,000</i>
• <i>International Brands (Pvt.) Limited</i>	<i>800,000</i>

It may kindly be noted that all the group companies have separate independent office premises run by teams of professionals. Only the expenses of corporate office are shared among these group companies. Corporate floor is occupied and used by the chairman and his secretariat only.

6. *Copy of form 29 confirming the appointment of Mr. Mohammad Ali as the company secretary is also enclosed.*

We hope the above will suffice and look forward to your favorable consideration. Needless to say, we shall be pleased to provide any further explanation or detail, if you so desire.”

17. Further, on behalf of the associated undertaking IBL, M/s. Mehmood Idrees Qamar & Co, Chartered Accountants, vide their letter dated May 04, 2007, submitted as under:

“In continuation of our client’s earlier letter dated March 27, 2007 and with reference to the hearing proceedings we attended on April 20, 2007, wherein you gave us further opportunity to provide further detail and explanation in support of our contention, we are pleased to provide the following:

1. *Schedule of distribution commission/margin received by our client from various principals ranging from 1.5% to 25% is enclosed for perusal.*
2. *Corporate expenses comprise of proportionate rent of corporate floor, proportionate share of utilities of corporate floor, salaries and expenses of corporate office staff, etc. Total expenses amount to Rs 1.6 on an average basis which is being shared by the group companies in the following fashion*

	<i>Rs.</i>
• <i>Searle Pakistan</i>	<i>300,000</i>
• <i>UDL Modaraba</i>	<i>400,000</i>
• <i>IBL Modaraba</i>	<i>100,000</i>
• <i>International Brands (Pvt.) Limited</i>	<i>800,000</i>

It may kindly be noted that all the group companies have separate independent office premises run by teams of professionals. Only the expenses of corporate office are shared among these group companies. Corporate floor is occupied and used by the chairman and his secretariat only.

3. *There is no written agreement for the re-imbursement of expenses. Being associated companies, these facilities were solicited from, and accordingly offered by, our client. However, if considered appropriate and insisted by the Authority, our client is willing to abandon this practice in a month's time if Searle Pakistan is ready to implement its own system of maintaining regional bank accounts and accounting infrastructure to handle re-imbursement of field and other related expenses.*

Sir, it is pertinent to mention that IBL is one of the largest and most modernized distribution house in Pakistan with presence in 93 cities covering approximately 450 towns on a daily basis. A sophisticated online system programmed in oracle is installed at the head office to monitor and report daily activities carried out in all those branches for more than a dozen principal suppliers. This size is, as claimed by our client, is unparalleled. Therefore, they pride themselves as the sole distributor of a giant like Procter & Gamble who is happy to give away 9.1% commission since more than a decade against this nationwide coverage of their range of products. Swift and timely reporting of their daily sales through the online system is rightly considered as a value added service.

In fact, this nationwide presence and over a century's distribution experience was a driving factor for the owners of IBL group to acquire the then Searle Pakistan - a private limited pharmaceutical company striving to survive in this market. The management and the owners of IBL group were confident on their abilities to swing the fortunes of this company as is also evident from a mere view on the past performance of Searle Pakistan - statistics enclosed for your perusal. With no introduction of new significant products, the figures of Searle's turnover starting from Rs 373.40 million in 1993 and ending up in Rs 2.422 billion are self speaking. This growth has enabled the management of Searle to maintain a constant dividend payout ratio to its shareholders.

It may seem unusual on the part of Searle which has appointed IBL as a sole distributor. At the same time, it should also be considered that IBL has committed itself to the distribution of Searle only when it comes to pharmaceutical business. It may kindly be noted here that Searle's business constitutes not more than 11% of IBL's total business. Legally, nothing stops IBL from acquiring more business from other giant pharmaceutical companies operating in Pakistan. Any multinational pharmaceutical would be more than willing to avail the economies of scale offered by IBL which is currently being enjoyed solely by Searle.

Searle is fully independent to appoint any other distributor large enough to handle its nationwide sale with swift online reporting of its daily activities. The management of IBL believes that the terms of distribution agreement with Searle, under which it is operating, are reasonably fair and is charging rightful price for the magnitude of the services offered by it. Loosing Searle's business will not matter much to IBL as it does not constitute more than 11% of its total business. On the other hand, it will open doors for IBL to expand its pharmaceutical business by way of attracting other giants in the pharmaceutical sector.

We hope the above will suffice and shall be glad to provide any further explanation of details, if you so desire."

18. There are several inaccuracies and inconsistencies in the submissions received from SEARLE and IBL. We feel that little purpose will be served by dwelling on these matters since the analysis in the following paras necessarily brings out the essential facts for consideration. We may begin by reiterating that the Show Cause Notices to SEARLE and IBL were issued on the following grounds:

- (i). SEARLE had been allowing 10%-12% commission/discount to its associated undertaking as a distributor, which was comparatively higher than the rate of commission/discount allowed to distributors by pharmaceutical companies of comparable size and standing in the market; and

- (ii). SEARLE was ostensibly reimbursing IBL on account of expenses, like carriage, duties, warehouse rent, mark-up expenses, communication expenses, corporate service charges and vehicle hiring charges to IBL, which was at variance with the norm for such business situations and which clearly represented an undue favor to the associated undertaking.

19. During the course of the proceedings, it was noted that since July 2003 SEARLE had been allowing 120 days interest-free credit to IBL and was charging IBL 7.5% mark up per annum (revised in April, 2006 to KIBOR + 2 ½ %) on payments received after 120 days.

20. It may also be mentioned that the IBL Group (i.e. IBL, Karachi Investment Company (Pvt.) Limited, First IBL Modarba, First UDL Modarba and the family of Mr. Rashid Abdullah) holds 52.79% shares in SEARLE, whereas 47.21% shares are held by the general public, including public sector corporations, companies, banks, development finance institutions, non-bank finance institutions, insurance companies, modarbas, mutual funds, foreign investors, and individuals.

21. The information provided shows that SEARLE signed a distribution agreement with IBL on July 01, 2000 for a period of 10 years renewable for a further 10 years on the following terms and conditions:

- i). Commission: 10% on pharmaceuticals
12% on items other than pharmaceuticals
- ii). Freight and Octroi: To be borne by SEARLE

- iii). Credit period: 75 days.
- iv). Mark up: 15% per annum on delayed payments.

22. Through an amendment, effective from July 01, 2003 the following changes were incorporated in the above agreement:

- i). Credit period 120 days
- ii). Mark up 7.5% per annum on delayed payments

A new distribution agreement executed on July 01, 2005 retained the commission of 10% for pharmaceutical products, the credit period of 120 days and the mark-up of 7.5% per annum on delayed payments. Through another amendment that took effect from April 01, 2006 the mark-up on delayed payments was revised to 6 months KIBOR plus 2.5%. It is noteworthy that the two distribution agreements did not say anything about re-imburement of expenses and also that the distribution agreement of July 01, 2000 did not mention payment of mark-up in respect of outstandings with institutional sub-distributors (primarily government institutions).

23. We have examined several distribution agreements involving various premium pharmaceutical companies like SEARLE in order to objectively determine industry practice with respect to the terms of distribution agreements. These distribution agreements reflect the following terms:

Name of the Company	Name of the distributor	Commission/Discount %	Credit Period	Reimbursement of Expenses.
Parke Davis & Company Limited	UDL Distribution (Pvt) Ltd.	7%	15 days advance payment	No
Pfizer Laboratories Ltd.	UDL Distribution (Pvt) Ltd.	7%	15 days advance payment.	No
Brookes Pharmaceutical Laboratories (Pakistan) Ltd.	Pharma Logistic (Pvt) Limited.	8.5%	Advance payment	No.
Cyanamid (Pakistan) Ltd.	Millat Agencies	7.5% - local 5.0 % -Imported	7 days credit. 2.5% penalty on monthly basis on delayed payment.	Transportation, insurance, octroi and inter-branch transfers.
Aventis Limited	S. Amin Trading Company.	4.5%	Advance payment plus interest free security of Rs. 100,000	Octroi charges.
Highnoon Laboratories Limited.	United Medical Hall.	9% - Local 5% - Imported	Advance payment.	Transportation expenses.
Merck Sharp & Dohme of Pakistan Ltd.	Muller & Phipps Pakistan (Pvt) Ltd.	5%	120 days	No
Roche Pakistan Limited	Muller & Phipps Pakistan (Pvt.) Ltd.	On purchases of: Less than Rs. 1 billion = 8.00% Exceeding Rs.1 billion = 7.50% Exceeding Rs.1.5 billion. = 7.00%	21 days	1.5% of the trade price as transportation.
Bristol Myers Squibb Pakistan (Pvt) Ltd.	Muller & Phipps Pakistan (Pvt) Ltd.	10%	40 days	2.5% of the trade price as freight charges.
Pharmatec Pakistan (Pvt) Ltd.	Muller & Phipps Pakistan (Pvt) Ltd.	9% - Local 7% - Imported.	40 days	2% freight and forwarding.
Getz Pharma Pakistan	Muller & Phipps Pakistan (Pvt) Ltd.	9%	30 days	1.5% as freight charges.
Becton Dickinson Pakistan (Pvt) Ltd.	Muller & Phipps Pakistan (Pvt) Ltd.	8 ¼ %	30 days	No

24. From the table above, it is difficult to discern any established or standard industry norm with regard to terms of distribution contracts. However, it is observed that commission/discount rates vary from 4 ½% to 9% with only one instance when the commission charged by the distributor is as high as 10%. Also, while there are several instances when

advance payment by the distributor has been stipulated, and credit periods, if allowed, have generally not exceeded 40 days, there is one example in the table above where the credit period allowed is as much as 120 days. It is noteworthy, however, that this extended 120 day credit period appears to have been balanced by a low 5% commission. On the other hand, the one instance in the above table where the commission charged is as high as 10%, the credit period allowed is only 40 days. While there must be other considerations that get factored in (e.g., the inventory turnover ratio, negotiating strength of the parties, their preferences etc), it is obvious that generally speaking there tends to be an inverse relationship between the commission paid and the credit period allowed to the distributor. Clearly distinguished from this is one instance where the commission paid is only 4 ½% but advance payment is stipulated instead of allowing credit period of suitable tenor as one would ordinarily expect in a case like this — it seems, prima facie, that the distributor has got a rough deal at both ends of the stick.

25. Conversely, in the matter under consideration, the distributor, i.e. IBL, has a cushy deal at both ends. Not only is the supplier, i.e. SEARLE, paying commission to IBL at the very high levels of 10-12% but also SEARLE is allowing the longest credit period of 120 days to IBL. This is quite untenable, particularly when one considers SEARLE's operational relationship with IBL until July 2005.

26. Despite having appointed IBL as the sole distributor of its products, the distribution agreement in vogue until July 2005 stipulated a somewhat unique arrangement, namely, that SEARLE's stock of finished goods were kept on consignment with IBL instead transferring this inventory by way of sale to IBL. The risk remained fully with SEARLE

and all costs related to the goods and their storage as well as movement from one place to another being borne by SEARLE. It is only when IBL actually effected a sale that the ownership of the goods sold got transferred from SEARLE to IBL and then immediately from IBL to the buyer with invoices being raised from SEARLE to IBL and from IBL to the buyer. Thereafter, while IBL had 75 days or 120 days to make the payment to SEARLE, the payment terms agreed between IBL and the buyer varied from immediate payment to a few days credit (not likely to have exceeded 40 days which is apparently the maximum prevalent in the trade).

27. Through this arrangement, IBL clearly benefited from the float arising as a consequence of the cash inflow from buyers who had bought on cash payment/shorter credit basis and the payments passed on to SEARLE for which IBL had the much longer credit period of 75 days or 120 days. If, on the odd occasion, this period was exceeded, IBL was expected to pay mark-up to SEARLE on the outstanding balance at the stipulated rate, which seldom, if ever, occurred. Interestingly, this arrangement also provided for the reverse i.e. for IBL to charge SEARLE mark-up at the same rate whenever IBL, purportedly on the instructions of SEARLE, was obliged to extend credit to an institutional buyer beyond whatever was the agreed credit period i.e. 75 days or 120 days. Thus, effectively, in such cases, the mark-up paid by SEARLE to IBL served to precisely compensate IBL for the markup paid by it to SEARLE. We are, therefore, surprised to note an anomaly in IBL's submission of March 27, 2007 to the effect that *"mark-up @ 11% is charged on credit sales to government institutions"* whereas *"IBL is liable to pay mark-up to Searle Pakistan @ 7.5% per annum"* — this not only compensates IBL but also earns for it a handsome financial spread!

28. We find that, in comparison with distribution agreements concluded by other premium pharmaceutical companies, the distribution arrangements of SEARLE with IBL that were extant until June, 2005, were actually quite extraordinary inasmuch as:

- As distinguished from the usual seller/buyer relationship pharmaceutical companies have with their distributors, IBL was, in the first instance, a consignee of SEARLE. However, the conclusion of a sale meant that title to the goods sold passed seamlessly from SEARLE to IBL to the ultimate buyer. Till the sale occurred, SEARLE effectively retained title, and as owner, all costs related to the goods sold were to SEARLE's account. IBL — unlike other distributors in the industry — took no risk as a buyer till the goods were actually sold at which point it intermediated, back-to-back, between SEARLE and the ultimate buyer.
- The credit period of 120 days allowed by SEARLE to IBL was in fact three times more than what is ordinarily the upper limit (i.e. 40 days). The fact that this takes effect not from the date of delivery to IBL but from the date of sale to the ultimate buyer further compounds the enormous financial benefit passed on to IBL at the cost of SEARLE.
- The 10% commission/discount allowed to IBL for pharmaceutical products is above the range of 4 ½ - 9% ordinarily seen in the trade. Rates of commission/discount exceeding this range accompanied by a credit period of 75

days or 120 days are inconceivable. Based on the observed practice in the trade, it is actually unconscionable that such a high level of commission/discount subsisted alongside the most generous credit terms.

- Despite the fact that the distribution agreement of July 01, 2000 does not make any provision for payment of mark-up by SEARLE to IBL on outstandings with institutional sub-distributors (primarily Government institutions) in respect of sales made on credit terms purportedly agreed by SEARLE, it has been averred (in the replies of SEARLE and IBL to the Authority's Show Cause Notice) that the expenses reimbursed by SEARLE to IBL include such mark-up costs. Since the agreement of July 01, 2000, envisages back-to-back sales from SEARLE to IBL and then from IBL to the buyer, and further stipulates that sales to institutional buyers would be on "*credit terms agreed by SEARLE*", there should not be any question of mark-up costs incurred by IBL to be reimbursed by SEARLE. The only exception would be default on payment by the buyer but this has not been indicated.
- The distribution agreement of July 01, 2000 uniquely provides that the "*cost of freight and Octroi up to the ultimate customer (i.e., customers of IBL) will be borne by SEARLE*". This type of blanket and sweeping transfer of liability on account of transportation of goods to the supplier is most unusual and rare. It is usual for distribution agreements to provide that the supplier bears the cost of

transportation of the goods up to the relevant significant location of the distributor. Beyond this, the cost of any further movement of the goods is borne by the distributor albeit there are instances where the supplier also, to some extent, bears this burden — however, any such arrangement rationally influences the rate of commission paid to the distributor.

- IBL has charged SEARLE warehouse rent for “*stock storages*”. There does not exist any provision for this in either the distribution agreement July 1, 2000 or in that of July 01, 2005. Nor have we come across any distribution agreement for pharmaceutical products (or for consumer products) that specifies that the distributor can charge the supplier for storage of the products being marketed since, barring rare exceptions, this is clearly an accepted and necessary part of the package of services that constitute the function of distribution. Both the distribution agreements executed between SEARLE and IBL appoint IBL the “*exclusive Distributor*” and use the same language to require “*IBL*” to distribute all products being “*marketed*” and to “*purchase all products exclusively direct from SEARLE*”. The distribution agreements fully bind both parties – SEARLE is obliged to sell all its products only through IBL, and IBL must sell all SEARLE’s products without exception. The question of any inventory of SEARLE being held by IBL merely for storage is inconceivable. The Authority has not been provided any reason as to why, as alleged by IBL in their letter of March 27, 2007, “*Searle Pakistan is storing*

their stocks, which is not sold to IBL for distribution at our National Warehouse Karachi and other regional warehouses ”. This simply does not make any sense. It is noteworthy that the thin veil of a consignor–consignee relationship stipulated in the agreement of July 01, 2000 does not provide any room for charging storage costs to the consignor (i.e. SEARLE) when the consignee (ie., IBL) has taken on the exclusive responsibility to distribute all the consignor’s products. A consignment arrangement – particularly one between non-armslength parties – must not serve to militate against normal business practice and common sense.

- Despite the fact that there is nothing in either the agreement of July 01, 2000 or in the subsequent agreement executed after five years of experience on July 01, 2005, with regard to reimbursement of expenses (including vehicle hiring charges) incurred by IBL on account of SEARLE, yet such reimbursements appear endemic in this relationship. While one can readily appreciate that being two separate corporate entities, SEARLE must reimburse IBL for any expense incurred by IBL for SEARLE and vice versa, such reimbursements must be based on the application of strict criteria and tests to indisputably establish the veracity of the reimbursement claimed, particularly in view of the associated status of the two undertakings and the potential for abuse. It is clear that ordinary, “*in due course*” audit procedures applied by external auditors may not suffice. In fact, if the reimbursements are an on-going occurrence that

are a part of the business relationship (which appears to have been urged in this case) carefully devised procedures with in-built, independent checks are called for. We have been provided no evidence of this. We have been essentially advised that field staff of SEARLE working in 80 stations across the country often utilize IBL's telephone/fax facilities and vehicles — and SEARLE is then required to reimburse these expenses. This seems loose and open-ended. Neither SEARLE nor IBL have been able to provide information regarding any criteria or process put in place to verify or justify the reimbursability of the expenses in question. In a group situation, there could also be fundamental conceptual issues related to reimbursability e.g. if the work of SEARLE's field staff, for the most part, directly or indirectly, facilitates the sale and distribution of its products this would represent a service to IBL, and in view of this, IBL would not be entitled to claim re-imbursement. On the contrary, it may well be fit and proper for IBL to pay SEARLE for the time spent by SEARLE's staff in assisting or facilitating IBL discharge its contractual obligations to distribute SEARLE's products under the distribution agreements.

29. We find that the distribution agreement executed on July 01, 2005, made three material changes, as follows:

Firstly, the consignment basis has been replaced by the more usual seller/buyer relationship. SEARLE now bears the cost of

transportation up to “*the delivery point*” of IBL — at this stage the title and all risk of damage or loss pass on to IBL;

Secondly, the 120 day credit period starts from the date the goods are delivered and not from the date the goods are eventually sold to the ultimate customer. This is much more in line with normal business practice albeit the 120 day credit period together with the 10% commission/discount allowed on pharmaceutical products constitutes an exceedingly generous package for IBL. However, IBL is allowed to claim mark-up from SEARLE on outstandings with institutional sub-distributors (mainly Government institutions) that exceed the normal credit period of 120 days. This may have some merit if the sales to these institutions were indeed made on the instructions of SEARLE and in accordance with credit terms agreed by SEARLE as stipulated in the distribution agreement. As indicated earlier, there is really no justification for this on such sales under the previous agreement of July 01, 2000; and

Thirdly, the commission/discount allowed for non-pharmaceutical products will vary from 3% to 12%, as negotiated, and not a uniform 12% on all non-pharmaceutical products. This seems more reasonable. The commission/discount on pharmaceutical products was continued at 10%, which, as stated earlier, is perhaps the highest in the industry.

30. As indicated, the 2005 agreement is, in some ways, an improvement over the earlier agreement — in structural terms it can be regarded as somewhat closer to the distribution agreements generally executed by leading pharmaceutical undertakings in Pakistan. However,

despite this improvement, the specific terms of the 2005 agreement remain fairly onerous for SEARLE and exceptionally beneficial for IBL. We refer primarily to the 10% commission on pharmaceutical products and the extended 120 day credit period allowed to IBL. Also, as discussed in preceding paras, IBL makes recoveries from SEARLE with respect to a variety of cost items which, for the most part, are not in keeping with normal trade practice. The overall arrangements are skewed in favour of IBL to the detriment of SEARLE and it is impossible to conceive of these arrangements as occurring between two unconnected parties.

31. As it happens, SEARLE and IBL are associated undertakings, and the IBL Group (i.e. IBL, its shareholders, and entities fully controlled by IBL and its shareholders) has a controlling equity interest in SEARLE. In 2005, four out of eight directors of SEARLE were also on the board of IBL where they comprised 80% of the IBL board (i.e, four out of five directors). These directors along with Mr. Shahid Abdullah, a major, 11.54% shareholder of IBL, who is also on the board of SEARLE, effectively meant that, IBL controlled SEARLE in 2005. With some inconsequential variations, this situation, i.e. the substantial control of SEARLE by IBL, has prevailed both before and after 2005, possibly since IBL's acquisition of a major equity interest in SEARLE in 1993. The extension of 120 days payment credit by SEARLE to IBL is a significant deviation from the usual industry practice of securing advance payment from distributors or at most extending a few days credit which hardly ever exceeded 40 days. In its submission of May 04, 2007, SEARLE has admitted that the "*industry trend is generally 45 days credit which again is linked with the number of days inventory is required to be held by the distributor*". Despite being given every possible opportunity to do so, neither SEARLE nor IBL has provided any commercial

rationale for the 120 days credit or for that matter the 75 days credit previously allowed to IBL.

32. It is obvious that this excessive and concessionary credit to IBL with costly implications for SEARLE and its shareholders could only occur because of IBL's control over SEARLE. By no means can either the very high commission/discount of 10% allowed to IBL (essentially above the industry range) coupled with the 120 days concessionary credit can be deemed to be a normal commercial arrangement when considered in the light of industry practice as observed by us. It is clear that the 120 days credit without any justification or redeeming feature whatsoever cannot be regarded as normal trade credit. In fact, instead of provisions to ameliorate the extraordinary 120 days credit, the distribution arrangements contain unique aspects that allow IBL to reap additional benefits that are not in accord with usual industry practice like charging SEARLE for storage of stock, requiring SEARLE to reimburse certain expenses, passing on to SEARLE the costs of carriage and duties until delivery to the ultimate customer etc.

33. It is somewhat amazing that SEARLE was not able to produce any documentation manifesting appropriate corporate approval of these extraordinary distribution terms, whether in the shape of clearance by the Board or a shareholders' resolution. Since the 120 days credit cannot be regarded as normal trade credit, this would appear to fall within the purview of Section 208 of the Companies Ordinance, 1984, requiring a special resolution of the shareholders which was not arranged. Prima facie, it also seems, in view of the common directorships held, that the loan accommodation provided by SEARLE to IBL comes within the mischief of Section 195 of the Companies Ordinance, 1984, which inter

alia prohibits loans to directors as well as entities in which they have a material interest as specified in this Section. A loan to a private company of which a member or director is also a director of the lending company is not permitted under Section 195. However, we feel, it is not for the Authority to delve into these matters but would prefer to leave it to the Securities & Exchange Commission of Pakistan being the corporate regulator to adopt a considered view in this connection.

34. We have very carefully considered this case in the light of the various submissions made by both the parties, the extensive deliberations at the hearings, and our own market inquiries. The business relationship between SEARLE & IBL is not the outcome of rational interaction between two economic agents on a level playing field. The content of both distribution agreements and, even more so, the actual dealings of the parties with each other reflect the marked tilt in favour of IBL as compared with most distribution arrangements put in place by major pharmaceutical undertakings in Pakistan. It is self-evident that IBL has been able to use its majority equity interest and control over SEARLE to extract a most favourable arrangement for itself which is way out of line from market practice, and which has greatly disadvantaged the other shareholders of SEARLE. It is difficult to imagine a more glaring manifestation of undue concentration of economic power at play and a more obvious situation to which Section 4(b) of the Ordinance applies. As already indicated in preceding paras, we find that the following aspects of the distribution arrangements have the effect of unfairly benefiting the shareholders of IBL to the prejudice of the shareholders of SEARLE and would have to be revised or eliminated as stated against each:

First, the commission of 10% for pharmaceutical products is above the range of 4½ - 9% for such products and the commission of 12% for non-pharmaceutical products (until July 01, 2005) is perhaps at the very high end for such products. These rates of commission/discount are particularly unacceptable when considered alongside the lengthy credit period of 75/120 days allowed to IBL. Considering the overall circumstances, while we may be willing to concede these rather high rates of commission/discount, in good conscience, we cannot accept or permit the rather excessive credit periods allowed to IBL which must be reduced to 40 days. Also, the credit period must commence from the date of delivery to IBL and not — as was the case until July 01, 2005 — from the date of sale to the ultimate buyer. This arises out of the consignment basis in vogue prior to July 01, 2005, which inter alia had the effect of starting the credit period from the date of sale. Consistent with normal market practice, the consignment basis will have to be deemed retrospectively as inoperative with the necessary consequences that follow from this — instead of placement with IBL on consignment, each delivery of the products to IBL will be deemed sold to IBL with a 40 day credit period. In this connection, we are of the view, considering the circumstances, that mark-up calculations may be made at the rates stipulated by the parties from time to time since the effect of any reasonable revision of these rates is likely to be marginal;

Second, all amounts charged to SEARLE on account of warehousing stock being not in accord with market practice will need to be reversed;

Third, instead of bearing the cost of transportation up to the ultimate customer which was the case until July 01, 2005 in terms of the Distribution Agreement of July 01, 2000, adjustments will have to be made to ensure that SEARLE does not, in any instance, bear the cost of transportation beyond IBL's location of sale i.e. the point from which the products are dispatched to the customer;

Fourth, payment of mark-up to IBL on account of credit availed by institutional sub-distributors (mainly Government institutions) beyond the credit period allowed to IBL is possible only if incontrovertible evidence exists on record to show that the transaction occurred "*on the discretion and approval of SEARLE*" as has been specified in both the distribution agreements. Also, the rate of mark-up allowed to IBL must not exceed the rate of mark-up payable by IBL to SEARLE on account of payments received after the credit period allowed to IBL; and

Fifth, being not in keeping with market practice, it is not possible to allow reimbursement of miscellaneous expenses (such as telephone/fax charges, vehicle hiring charges etc allegedly incurred by SEARLE field staff) unless (i) incontrovertible evidence is on record to unquestionably demonstrate pre-authorization by SEARLE in each case; and (ii) it can be irrefutably shown that the expense in question was not incurred to assist or facilitate IBL in fulfilling its contractual obligations to SEARLE, whether directly or indirectly. We are, however, prepared to allow payment of charges on account of group corporate services to the extent of approximately Rs.300,000 out of Rs.1,600,000 for the entire group

(i.e. about 18.75%) specified in the submissions of both SEARLE and IBL dated May 04, 2007, as this appears reasonable.

Order

35. In the light of the foregoing, we direct and order as follows:

- (i) the principles and specifications enshrined in para 34 will apply henceforth to all dealings between SEARLE and IBL and will supersede as well as take precedent over any distribution agreement or other understanding between these parties, whether written or verbal.
- (ii) SEARLE and IBL will procure that the statutory auditors of SEARLE (or alternatively, a firm of Chartered Accountants approved by the Authority) examine all transactions between these undertakings since July 01, 2000 to date in the light of our observations in para 34 above and determine the net amount due from IBL to SEARLE after adjusting for payments already made. Any clarification needed in this respect will be provided by the Chief (Investigation) of the Authority or such other person as may be designated by the Authority for this purpose. This task must be completed within 90 days of the date of this Order and settlement for the net amount determined as due and payable must be

effected to the satisfaction of the Authority within 120 days of the date of this Order; and

- (iii) the Registrar of the Authority will make a reference to the Securities & Exchange Commission of Pakistan (“the Commission”) drawing their attention to para 33 of this Order to enable the Commission to take cognizance of possible contravention of Sections 195 and 208 of the Companies Ordinance, 1984, and to take such measures as may be deemed appropriate by the Commission.

(Khalid A. Mirza)
Chairman

(Raja Raza Arshad)
Member

(Abdul Ghaffar)
Member

Islamabad the September _____, 2007