Before the Director/HOD (MSRD)

In the matter of recovery of gain made in terms of Section 224(1) of the Companies Ordinance, 1984 by Mr. Nasim Beg, a Director of Arif Habib Securities Limited

Date of Hearing: November 28, 2014

Present at Hearing:

Representing Mr. Nasim Beg

(i) Mr. Emad ul Hassan
Advocate,
Abrar Hasan & Co.
Advocates and Legal Consultants

Assisting the Director/HOD (MSRD)

(i) Mr. Muhammad Farooq,
Joint Director, SECP

(ii) Mr. Muhammad Javaid,
Management Executive, SECP

Order

This Order will dispose of the proceedings initiated through Show Cause Notice No. S.M(B.O)222/1(114)06 **(Notice)** dated 06/01/2010. The said Notice was issued under Section 224 of the Companies Ordinance, 1984 (**Ordinance**) to Mr. Nasim Beg (**Respondent**) a Director of Arif Habib Securities Limited, subsequently renamed as Arif Habib Corporation Limited (**Issuer Company**). However, proceedings initiated under the said Notice were suspended in February 2010, because the Respondent challenged the said Notice before the Honorable Sindh High Court, Karachi.

2. The facts of the matter leading up to aforesaid Notice are that the Issuer Company is a public listed company and the Respondent is a Director of the Issuer Company. The Respondent

made the following sale and purchase transactions in ordinary shares of the Issuer Company within the period of less than six months:-

Sr. No.	Date	Nature of transaction	No. of Shares	Rate per Share (Rs)
1	18/04/2008	Sale	33,300	184.29
2	23/06/2008	Purchase	344,000	145.34
3	18/09/2008	Purchase	9,900	94.11
4	29/09/2008	Purchase	125,000	74.09

3. On account of the aforesaid transactions, the Respondent in terms of Section 224(1) of the Ordinance read with Rule 16 of the Companies (General Provisions and Forms) Rules, 1985 (**Rules**) apparently made gain of Rs 3,669,660/- (Rupees three million six hundred sixty-nine thousand and six hundred sixty only).

4. Section 224 of the Ordinance provides that where *inter alia* a director makes any gain by purchase and sale, or the sale and purchase of equity security within a period of less than six months, such director is required to make a report and tender the amount of such gain to the company and simultaneously send an intimation to that effect to the Registrar of Companies and the Commission. The said Section further provides that where such person fails or neglects to tender or the company fails to recover, any such gain within a period of six months after its accrual, or within sixty days of a demand thereof, whichever is later, such gain shall vest in the Commission and unless such gain is deposited in the prescribed account, the Commission may direct recovery of the same as an arrear of land revenue.

5. In the instant case, the Respondent did not show accrual of the aforesaid gain in Part-D of the prescribed returns of beneficial ownership filed with this Commission on Form 32 as at 26/06/2008. However, he sought clarification vide letter dated 25/07/2008 on the following issue:-

> *" the section 224 covers gains on purchase and sale or sale and purchase, within six months. The expression* ***"Sale and purchase"*** *refers to the entering in sale transaction by short selling and thereafter making purchase. In my case absolutely no short sale is involved, as the sale of existing shares was made to avail the tax exemption. I never had the intention to sell the shares, I therefore, request you kindly issue clarification that in such circumstances the provisions of section 224 are not attracted".*

6. In response, the Respondent was intimated vide letter dated 13/10/2008 that provisions of the Section 224 of the Ordinance are applicable in the instant matter as his arguments regarding non-accrual of tenderable gain have no merit in the light of Section 224 of Ordinance and Rule 16 of the Rules. The Respondent reiterated vide letter dated 20/12/2008 that no gain has been made on the relevant purchase, thus, the provisions of Section 224 are not applicable to the relevant purchase.

7. The Respondent was again informed vide letter dated 11/02/2009 that the issue has been reviewed thoroughly in the light of the prevailing Law and Rules on the subject matter and plea advanced by him for non-accrual of tenderable gain are not found satisfactory. It was further intimated that he is required to discharge his liability in the manner provided in Section 224 of the Ordinance. But, the Respondent neither tendered the gain to the Issuer Company nor the Issuer Company recovered it, within the period stipulated in sub-section (2) of Section 224 of the Ordinance. Therefore, the matter of accrual of the above mentioned gain and its recovery manner provided in Section 224(2) of the Ordinance was brought to Respondent's notice vide letter dated 09/07/2009. The Respondent vide letter 10/08/2009 reiterated his earlier view point "*that no gain has been made by him*". Since the said contention of the Respondent was not found plausible, therefore, the above mentioned Notice was issued wherein the Respondent was called upon to show cause and explain through written reply along with documentary proof, if any, within ten days from the date of the Notice, as to why action for recovery of aforementioned gain may not be taken against him as provided in Section 224 of the Ordinance.

8. The Respondent vide letter 11/01/2010 sought extension of two weeks for filing of reply to the Notice, which was accepted. Besides, the matter was scheduled for hearing on 04/02/2010, before then Executive Director (SMD) at the Commission's Head Office, Islamabad. The Respondent vide letter dated 21/01/2010 filed written response to the Notice. Later on, the Respondent intimated vide letter 03/02/2010 that "*he has filed Civil Suit No. 139/2010 before the High Court of Sindh, Karachi challenging the Show Cause Notice issued by the Commission and the Court in its order dated 03/02/2010, has directed the Commission to maintain status quo in the matter*". The Commission followed the directive of the Court.

9. The Honorable Court vide Order dated 28/04/2014 dismissed the said Suit on the point of maintainability, inter alia with the following observation:-

The declaration sought by the plaintiff is not in respect of any legal character of the

plaintiff. In fact the defendants have not denied / disputed status of the plaintiff which he has narrated in paragraph 1 of the plaint. In prayer clauses A, B and C, plaintiff had sought a negative declaration to the effect that "the plaintiff has not realized any tenderable and / or other gain" and "the plaintiff is not liable to tender any amount / alleged gain to the Commission". The prayer clause D' is a consequential relief to the three, prayer clauses wherein he has sought a negative declaration. The very fact that the plaintiff has submitted a detailed reply to the show cause notice given to him under Section 224(2) of the Companies Ordinance, 1984, is contrary to his claim in the plaint. I have examined the contents of the reply to the notice, The plaintiff has not claimed in the reply to the defendants that the defendants have acted illegally, mala fidely or that the defendants otherwise are not competent to issue a notice under Section 224(2) of the Companies Ordinance, 1984. The very fact that he has submitted to the jurisdiction of the authority unconditionally amounts to accepting the jurisdiction of Securities and Exchange Commission of Pakistan to issue notice under Section 224(2) of the Companies Ordinance, 1984. The prayer clause D' is merely an afterthought. In paragraph 11 of the plaint, plaintiff has almost repeated the reply of show cause notice and the pleas, which he could have raised even at the time of personal hearing before the competent authority on 04.2,2010 at 11:30 a.m. Even otherwise. in the plaint., he has nowhere mentioned that the defendants have no right to issue a notice of this nature to the plaintiff or anybody else, who is guilty of selling shares within a period of less than six months to obtain illegal gain. The defendants cannot be permanently restrained from exercising the authority under the Companies Ordinance, 1984 unless it is shown that the authority is not vested in them. The cause of action claimed to have been accrued on issuance of show cause notice dated 06.1.2010 seized to exist once the show cause notice has been replied by the plaintiff without any reservation against the authority and having submitted his explanation for withdrawing the notice. If the plaintiff is not guilty of an offence as stated in reply to the show cause notice, after the reply, the plaintiff should have appeared for personal hearing to satisfy the authority about his claim. The plaintiff was only required to appear before the competent authority for personal hearing, which he had avoided and obtained injunction orders and seeking negative declaration, The plaintiff has never appeared before the competent authority for personal hearing though through the same show cause notice he was directed to appear for personal hearing followed by his written reply. He has not sought any declaration to his own rights and status. The declaration to the 'effect that the plaintiff has not realized any gain in breach of Section 224(2) of the Companies Ordinance, 1984 is a declaration neither

with regard to any legal character nor any right to or in any property, thus the relief sought by the plaintiff is outside the purview of Section 42 of the Specific Relief Act, 1877. ----------

In view of above discussion the plaintiff is neither entitle to the declaration nor permanent injunction. The suit is dismissed as incompetent and not maintainable, with no order as to cost".

10. Subsequent to the dismissal of the Civil Suit/aforesaid Court's Order, Mr. Emad-ul-Hassan, Advocate, Abrar Hassan and Company, Advocates and Legal Consultants, **(Legal Counsel)**, intimated vide letter dated 07/05/2014 that the Respondent did not prefer to file appeal against the Order of the Single Bench of the Honorable High Court, because, meanwhile, the Honorable Supreme Court of Pakistan while discussing the objective of Section 224 of the Ordinance in Civil Appeal No. 946/2005, (decided in May 2011) has held that:

"-------- in no case SECP is entitled to the gains. ------ It should be clarified that since the penal provision is stringent in nature it should be applied in an appropriate manner. In applying such a provision SECP should always bear in mind the importance of determining not merely a technical contravention but a substantial finding of guilt in relation to the person on whom the fine or penalty is being levied.

The Legal Counsel requested to drop proceedings with the plea that the Notice issued by the Commission has become redundant as the said Notice was issued upon a technical contravention of Section 224 of the Ordinance.

11. Since the above mentioned Civil Suit was dismissed by the Honorable Court on the point of maintainability, therefore, in order to resume proceedings, hearing in the matter was scheduled on 18/11/2014 at Commission's Head Office, Islamabad, which on the request of the Legal Counsel of the Respondent was rescheduled for 25/11/2014. On the said date, the Legal Counsel appeared before me and *inter alia* submitted submissions in writing. At the outset of the proceedings, the Legal Counsel was intimated that the Commission is resuming proceedings in the matter, under the same Notice, which was challenged by the Respondent, before the High Court. The Legal Counsel did not raise any objection.

12. The Legal Counsel advanced arguments in favour of his plea that the provisions of Section 224 of the Ordinance are not applicable in the instant case. It is pertinent to mention that in the instant case, submissions in writing, in support of the plea *"that provisions of Section 224*

of the Ordinance are not applicable" have been filed at two occasions, i.e. before filing the abovementioned Civil Suit and then after the dismissal of the Civil Suit High Court of Sind. The submissions made in writing as well verbally during the course of hearing be summarized as under:-

1. **Submissions submitted in response to Notice before filing of the Civil Suit:-**

   a) **Shares matched by the Commission for calculation of tenderable gain were not same**:- The Respondent stated that *"I was holding 33,333 shares of the said company at a cost of Rs.1,148,850 (average of Rs. 36.46 per share) as on 30th June 2007. I did not conduct any purchase or sale during the period of July 2007 till 18th April 2008, when I sold the said 33,300 shares for Rs. 6,136,801 (average of Rs. 184.29 per share). I realized a gain of Rs. 4,996,801 on this transaction (sale value of Rs. 6,136,801, minus cost of Rs. 1,140,000 of the 33,300 shares). It is clear that the gain realized by me on this sale of 33,300 shares does not attract the applicability of Section 224 of the Ordinance as I had held the shares for more than six months. I was left with only an odd lot of 33 shares at that stage. I would also emphasize that the SECP accepts this contention and is not claiming this gain as tenderable. At a subsequent date, i.e., 23rd June 2008, I purchased a much larger quantity of 344,000 shares with a much larger amount of approximately Rs. 50,000,000. This purchase was at an average rate of Rs. 145.34 per share. My position is that the previous transaction of 33,300 shares has been set off against the old holding (of more than six months) and the same shares cannot be double counted to treat it as a sale against a subsequent purchase".*

   b) **Did not indulge in short selling**:- The Respondent stated that *"sale and purchase as stated in Section 224 (1) does not apply to a transaction such as made by him. A person can only realize a gain by first selling and then buying if the person first conducts a short sale and then closes off the short position by a subsequent purchase. As against my earlier submission in this respect, the Commission disagreed with my contention and have stated that short-selling by directors is prohibited under Section 223, thus implying that my contention cannot apply. In my view, the wording in Section 224(1) has been included precisely to deal with a situation where a director realizes a gain through short selling, as the penalty prescribed in the law for contravention of Section 223 is a relatively small fine. The intention in 224(1) is to claw-back gains realized through short-selling,*

which can be substantial. With the application of this wording "sale and purchase", an insider should not be able to get away by making substantial gains through short selling and then simply paying a relatively smaller fine, which is not my case".

c) **Bonus impact has not been adjusted:** The Respondent stated that *"a further error in calculation of gain is that it ignores the fact that the purchase of 125,000 shares at Rs. 74.09 share on 29th September 2008 is for a different category of shares (diluted share). The company declared bonus shares at the rate of 25% and the share became ex-bonus on 20th September 2008. The worth of each share became 25% less due to the dilution effect. Thus, to compare like with like, the share price of 74.09 per share would be the equivalent of Rs. 92.61 for pre-bonus shares. Although an attempt has been made in clause 2 of Rule 16 to exclude the bonus shares, it is not worded appropriately to exclude the dilution impact as is in the case of the 125,000 shares purchased by me. Please consider the fact that the 33,300 shares I sold represented 0.0111% of the issued shares, whereas, 33,300 shares on 29th September 2008 represent 0.00888% of the issued shares, i.e., the purchase subsequent to 20th September 2008 (the cut-off book closure date for bonus entitlement) are of a lesser entitlement to the equity of the company and therefore not comparable in value terms to the shares acquired prior to that date, thus setting these off on a price to price basis would be inequitable".*

2. **Submissions submitted by the Legal Counsel after dismissal of Civil Suit:**

d) **SECP has not the powers to demand payment of the alleged Tenderable Gain' in lieu of 2011 CLD 907:** The Legal Counsel of the Respondent stated that *"as per the ruling held by the Hon'ble Supreme Court of Pakistan reported case as 2011 CLD 907, the Commission does not have the powers to demand payment of alleged 'Tenderable Gain' to the Commission. Our contention is based upon the following rulings in the said judgment.*

1. *While discussing the meaning of the word 'vest' the Hon'ble Supreme Court held that ...SECP 's contention that the use of the word vest per se conferred an absolute title on it is erroneous'. (para 11, line 3 of 2011 CLD 907).*

2. *The Hon'ble Supreme Court also held that 'The gains will remain under all*

circumstances the property of the company and SECP has no right or entitlement thereto.' (para 19, line 27 of 2011 CLD 907)".

e) **There is no `Tenderable Gain as shares were sold in good faith to avoid capital gain:** The Legal Counsel stated that *"no gain of Rs. 3,669,660/- has been earned or realized by the Respondent on sale of 33,333, because the Respondent held 33,333 shares for more than six months and sold on 18.04.2008 in good faith to avoid imposition of capital gain tax on sale of shares, which was expected to be imposed for the tax year 2009. Subsequently, it was announced by the Federal Government that imposition of such tax was being exempted for another two years. Thereafter the Respondent purchased a total of 478,900 shares between 23.06.2008 to 29.09.2008. First lot of 344,000 shares purchased on 23.06.2008. These shares were held by the Respondent for a long time.*

The Legal Counsel further stated that *"Section 224 does not apply to the Respondent as per the proviso to subsection (1) of section 224, which provides exemption for security acquired in good faith. Furthermore, there is no tenderable gain rather all shares were subsequently sold at losses".*

f) **There is no Insider Trading, as Sale and Purchase Transactions were carried out in Good Faith:** The Legal Counsel stated that *"in lieu of the judgment of the Hon'ble Supreme Court of Pakistan reported as 2011 CLD 907, we understand that the objective is to curb insider trading i.e. by virtue of some inside information a person knows that prices will fall hence sold his shares and later on repurchased when the prices fell. While, in the instant case, the prices were generally falling. Thus, neither the transaction were made on the basis of inside information nor with malafide intention, but were made in good faith, as explained hereunder:*

1. *The Respondent filed the returns of beneficial ownership with SECP under sections 222 of the Companies Ordinance, 1984.*

2. *While discussing the objective of section 224 of the Companies Ordinance, the Hon'ble Supreme Court held that 'Although no direct answer is contained in this section, an answer can reasonable be inferred. It is clear that this section proceeds on the tacit assumption that the person in question was privy to*

inside information and, taking advantage of the same, obtained a gain to which accordingly he was morally not entitled and this was required to be surrendered it to the company. In other words, there is a presumption, which is tacit, to the effect that the person has done something which is unjust or inequitable, or in violation of his duties and obligations to the company as a person falling within any one of the prohibited categories, and thus should be compelled to surrender his gains to the company. para 15 of 2011 CLD 907).

3. *The Hon'ble Supreme Court further held that `... the section has been made on the tacit assumption that the person who has carried out the transaction has acted in an inequitable or illegal manner by relying on inside information.' [para 17(i) of 2011 CLD 907]*

4. *In para 16 of the Judgment reported as 2011 CLD 907, the Hon'ble Supreme Court is of the view that knowledge of some privileged/inside information is important, which knowledge might not be with the many other persons like Auditors or persons holding more than 10% shares and acted in 'good faith'. From the deliberations made by the Hon'ble Supreme Court we interpret that, having knowledge of some inside information and malafidely using the same to receive gain from trading is vital, for invoking provisions of section 224 of the Companies Ordinance, 1984.*

5. *While discussing powers of SECP to demand the alleged Tenderable Gain, the Hon'ble Supreme Court held that 'The question, therefore, arises as to what justification there is, if a person with inside information has carried out a transaction on the basis of inside information, to deprive the innocent shareholders of their equitable entitlement by penalizing the company as a whole. On a conceivable view of the matter the only two persons or entities entitled to retain the profits are either the person in question, assuming he has acted in good faith, or the company whose shares he has bought or sold within 6 months'. From this it is clear that if a person has acted in good faith, he is entitled to retain the gain. (para 17(ii) & (iii), page 923, line 2 of 2011 CLD 907).*

6. *The purpose of section 224 is to discourage Insider Trading however there is no Insider Trading as no such decision resulting in decrease of prices as prices*

were generally decreasing.

7. *The transaction of the alleged shares has been done in good faith, to avoid proposed tax on Capital Gain, a public knowledge.*

(h) **Demand of 'Tenderable Gain' not realized is a penal action:** The Legal Counsel stated that *"the demand of the alleged gain, which has not been realized by the Respondent is tantamount to penalty, which cannot be levied upon the Respondent as explained above and under:*

1. *The Hon'ble Supreme Court held that 'It should also be clarified that since the penal provision is stringent in nature it should be applied in an appropriate manner. In applying such a provision SECP should always bear in mind the importance of determining not merely a technical contravention but a substantial finding of guilt in relation to the person on whom the fine or penalty is being levied'. (para 20 of 2011 CLD 907).*

2. *It is clear that there was no 'inside information', and the proposed levy of tax on 'Capital Gain' was in the news as well as the market was generally having a declining trend, hence there is no malafide on part of the Respondent".*

13. I have considered and examined the aforementioned arguments and contentions of the Respondent in the light of prevailing Laws and Rules on the subject matter and my findings in this regards are as under;-

a) **The issue of matching of shares for calculation of tenderable gain:** The Respondent pleaded that the sold and purchased shares were not same, as delivery of sold shares was made out of previous holding and the newly purchased shares were sold later on. Thus, the said sale and purchased may not be matched for calculation of tenderable gain. The said viewpoint of the Respondent has been examined and observed that he is of the view that for the applicability of Section 224 of the Ordinance, the security purchased and sold or sold and purchased must be same.

To ascertain the legitimacy of the contention of the Legal Counsel, the issue "**whether or not the shares of the same class are substitutable and fungible"** is needed to be addressed first.

For this purpose, I have consulted the prevailing law and rules on the subject matter. In my opinion this aspect of the issue has visibly been narrated in Section 224(1) of the Ordinance and Rule 16 of the Rules. In order to elucidate the position, it is useful to reproduce Section 224(1) of the Ordinance here:

> *"Where any director, chief executive, managing agent, chief accountant, secretary or auditor of a listed company or any person who is directly or indirectly the beneficial owner of more than ten per cent of its listed* ***equity securities*** *makes any gain by the purchase and sale, or the sale and purchase, of* ***any such security*** *within a period of less than six months, such director, chief executive, managing agent, chief accountant, secretary or auditor or person who is beneficial owner shall make a report and tender the amount of such gain to the company and simultaneously send an intimation to this effect to the registrar and the Commission"*

I am of the view that the phrases "equity securities" and "any such security" appear in the Section 224(1) have very much significance here. The words "equity securities" signifies that a beneficial owner may own simultaneously more than one class of shares, while the word "such security" symbolizes here security of same class. Furthermore, noticeably the word "any" appears before the words "such security". Thus, it is emphasized here that the law uses word "any" instead of the word "particular". Hence, the tenderable gain will arise through purchase and sale or sale and purchase of "any security of same class" instead of "particular security of same class, by a beneficial owner of a listed company. This suggests that securities of same class of a same listed company are interchangeable/ fungible. And this concept has explicitly been expressed in Rule 16(1)(b) of the Rules, which states that;-

> *"-------the purchases and sales shall be matched as aforesaid so long as the securities involved in the purchase and sale are of the same class and of the same listed company and for this purpose the shares shall be deemed as fungibles.*

It is further pointed out that the concept "shares of same class are fungible in nature" is not a new concept, as it is prevailing since the promulgation of Securities and Exchange

Ordinance, 1969 ("**SE Ordinance**"), when the subject matter of trading by officers and principal shareholders of listed companies was monitored under the SE Ordinance. The issue was elaborated in Circular No. 2 of 1971 dated 26/06/1971 of the then Securities and Exchange Authority of Pakistan. The said Circular inter alia states:-

"A view has been expressed that for the purpose of matching sales and purchases, the securities sold should be same as were purchased during the period. This view is not correct. Securities are fungible and it would, therefore, not be necessary ever to show that the particular security which is sold is the one which was purchased. Purchases and sales would be match-able so long as the securities involved in the purchase and sale are of the same class."

Besides, in the abovementioned judgment of the Hon'ble Supreme Court of Pakistan reported as 2011 CLD 907, the order of transactions is same as in the instant case i.e. the said beneficial owner first made sale transaction on 15/06/2001 and thereafter made three purchase transactions, within six months of the said sale. The Honorable Supreme Court in para 3 of the said judgment held that "it is an undisputed fact that the respondent on account of above mentioned sale/purchase transactions had made again……."

In order to know the international practice on the subject matter, the prevailing legal frame-work in United States of America (the "**USA**") has been consulted, where, legal provisions on the subject matter are almost same as in Pakistan. In USA, the matter of trading by directors, officer and principal shareholders is dealt under Section 16 of the Securities and Exchange Act, 1934 (the "SEC Act, 1934"). It is worth mentioning that *Smolowe v. Delendo Corp. (1943, Circuit Court of Appeals, Second Circuit)* is the leading case regarding the construction of liability under Section 16(b) in the USA, wherein after detailed discussion, the court held that:-

"----where an insider purchases one certificate and sells another, the purchase and sale may be connected, even though the insider contends that he is holding the purchased security for sale after six months".

The aforementioned discussion as well as judgment of Supreme Court of Pakistan and the Circuit Court of Appeals of USA clearly states that shares of same class are identical and substitutable.

It is admitted fact that in the instant case, the Respondent has made sale and purchase transactions in the shares of same class i.e. ordinary shares, which are ranked pari paasu in all respect. Thus, difference between previous holding and newly purchased shares may not be made for purpose of matching of shares for calculation of tenderable gain. Hence, the Respondent has misconstrued and misinterpreted the provisions of Section 222 of the Ordinance.

Now a question arises why shares of the same class of the same listed company are considered "fungible" in nature? Answer of this question may be derived from the characteristic and rights attached with a security/share of a same class. It is worth mentioning that each share of same class carries same denomination/par value, fetches same market price, same payout and same voting rights. Even delivery of any share of same class may be received and made at the time of purchase and sale respectively. Hence no distinction can be made among the shares of the same class on the basis of rights attached thereto.

Furthermore, in my opinion, the whole mechanism envisaged in Section 224 of the Ordinance revolves around the concept that the "securities of same class are fungible". For instance, if we assume that the shares of the same class are not fungible in nature and tenderable gain would accrue on purchase and sale or sale and purchase of "only particular" securities, then it would definitely lend the redundancy to whole scheme build up in Section 224 of the Ordinance. For example, a beneficial owner makes handsome gain on purchase and sale transactions within the period of six months. He will be able to escape easily from the mischief of Section 224 of the Ordinance on the plea that the purchased and sold securities were not same, which is not intention of the law.

b) **The issue of short selling:-** The issue of short selling has already been clarified to the Respondent during the correspondence exchanged with him before the issuance of Notice. The Respondent was intimated that the contention "*the expression sale and purchase transaction refers to the entering in sale transaction by short selling and thereafter making purchase*" is contrary to the scheme envisaged in Section 224 of the Ordinance. It is pointed out that Section 223 of the Ordinance specifically prohibits the persons mentioned in Section 222 of the Ordinance from practicing directly or indirectly short selling. Thus, the Respondent has misconceived the text of Section 224(1) of the Ordinance, because, the shares of same class are fungible, therefore, the order of

transactions i.e. purchase and sale or sale and purchase does not make any difference with respect to applicability of the provisions of Section 224, if others conditions are met.

c) **The issue of adjustment of bonus impact**: The issue of matching of cum-bonus shares sold after the announcement of approved payout with ex-bonus shares has been considered by the Commission and with the approval of Federal Government, the following insertion in Rule 16(3) of the Rules has been notified to seek public comments.

> *Provided that in case of matching of cub-bonus/cum-right shares sold after announcement of said pay-out, duly approved by Board of Directors, with purchase of ex-bonus/ex-right shares, sale price may be adjusted to the extent of pay out, subject to production of such documentary evidences*

The issue has been discussed in detail in para 16 of this Order.

d) **The issue of recovery of gain by the Commission in lieu of 2011 CLD 907:** The Commission has already considered the issue, in detail, in the light of aforesaid judgment, wherein, the honorable Supreme Court of Pakistan held "*the gain under all circumstances will remain property of the company. ---------- the gain shall vest to the Commission as an enforcement action*" and the Commission has resolved to follow the judgment in this regard. Thus, the amount of gain shall vest to the Commission as an enforcement mechanism and the recovered amount will be later on passed on to the company.

e) **The issue of making sale in good faith to avoid Capital Tax:** The contention of the Respondent that *33,333 shares were sold in good faith after holding more than six months to avoid imposition of capital gain tax on sale of shares* of has been examined in the light of proviso to Section 224(1) of the Ordinance and observed that the only exception mentioned in the law relates to securities acquired in good faith in satisfaction of debt previously contracted. The transactions made for tax purpose or any other purpose cannot therefore be exempted from the purview of Section 224 of the Ordinance. Since the transactions made by the Respondent do not be categorized as given in the proviso, therefore, claimed exemption may not be granted.

f) **The issue of making Sale and Purchase Transactions in good faith rather than misusing of inside information/indulging insider trading:** The Plea of the Legal

Counsel that *"in lieu of the judgment of the Hon'ble Supreme Court of Pakistan reported as 2011 CLD 907, we understand that the objective is to curb insider trading. While, In the instant case prices were generally falling. So, there is no malafide or illegal action by the Respondent"* has been considered in the context of the term "insider trading appears in the aforesaid judgment as well as the connotations of "insider trading".

In-fact, the Honorable Supreme Court, in abovementioned judgment has discussed the different aspects of the provisions of Section 224 of the Ordinance, including the meanings of expression "vest" appears in Section of the Ordinance, objective, weaknesses as well as requirements of the Section 224 of the ordinance. In para 13 of the judgment the court has stated that:-

'..... there is a more substantial question which arise in relation to the interpretation of section 224. What was the objective underlying this section? No direct answer to this is provided by the language used in it. It merely states that in the event of a person falling within any of the categories mentioned therein making a profit in relation to a sale and purchase within a period of less than six months failing to tender the said profit within the prescribed time limit to the said company, or the company failing to recover it from the said person, the quantum of the gain is to vest in the SECP. But why? What is the justification for such a provision? What objective, rooted or based in public policy, is sought to be achieved thereby? Although no direct answer is contained in this section, an answer can reasonably be inferred. It is clear that this section proceeds on the tacit assumption that the person in question was privy to inside information and, taking advantage of the same, obtained a gain to which accordingly he 'was morally not entitled and thus was required it to surrender it to the company. In other words; there is a presumption, which is tacit/to the effect that the person has done something which is unjust or inequitable, or in violation of his duties and obligations to the company as a person falling within any one of the prohibited categories, and thus should be compelled to surrender his gains to the company. Obviously, it would have been better if this presumption had been made explicit and not tacit but, accepting that the presumed legislative intent was the above, we can proceed further with our analysis....",

So, in the foregoing para of the judgment, the Supreme Court of Pakistan has structured the objective of the provisions of Section 224, which is based on tacit

assumption that the persons mentioned in Section 224(1) are privy to inside information, therefore, the gain accrued on purchase and sale or sale and purchase, within the period of six months is required to be tendered to the company and the Commission does not have entitlement thereto. I am of the view that this tacit assumption is not required to be proved that the person has acted on the basis inside information, but, this Section will mechanically apply, without regard to the purpose of the trades or actual use of material, non-public price sensitive information. If relevant purchase and sale or sale and purchase or purchase and sale occur within the period of six month and yield gain, the beneficial owner/insider must tender the gain to the company even in the absence of wrongdoing. Thus, the basic purpose of the Section 224 is protect the "outside/small shareholders" against at least short-swing speculation by the directors/beneficial owners/insider, who are likely to have advance information about the company.

The abovementioned objective of Section 224 of the Ordinance is duly supported by aforesaid judgment of the Supreme Court of Pakistan, wherein, the beneficial owner/respondent by virtue of mechanical application of provisions of Section 224 of the Ordinance has already tendered the gain to the issuer and Supreme Court has accepted it and did not order to revert/refund it.

Furthermore, the United States Court of Appeals for the Second Circuit, while describing the beneficial ownership has stated in Docket No. 02-7550 (decided on 08/08/2003) that "*Section 16(b) of the Securities Act, provides that various classes of corporate insiders, including beneficial owners of more than 10% of any class of a corporation's securities, must disgorge any profit made from short-swing transactions in that security to the issuer, irrespective of any intention on the part of such beneficial owner to engage in such transactions or to misuse inside information*".

In addition to above, the Appellate Bench of the Commission has recently held in Appeal No. 14 of 2010 that "*the question of whether the transactions are bona fide or not have to be decided on the threshold provided in the judgment. However, in the instant case it is difficult to establish whether the transactions were bona fide or not. The aforementioned para of the judgment mentioned in paragraph 6(a) above has spelled out the purpose of Section 224 of the Ordinance which states that the gain made shall at all-time remain the property of the Company and SECP has no entitlement thereto*".

For clarity of the subject matter, let us discus what is insider trading. Usually, this term is associated with illegal conduct. But the term actually includes both legal and illegal conduct. The legal version is when corporate insiders i.e. officers, directors, and beneficial owners buy and sell shares of their own companies. When corporate insiders trade in their own securities, they must report their trades to the Commission and in the event of making gain on purchase or sale or sale, with the period of six months, the gain is required to be surrendered tot eh company. Whereas, illegal insider trading refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, nonpublic information about the security. This subject matter is comprehensively dealt under Securities and Exchange Ordinance, 1969, wherein, the accused inter alia may be directed to surrender an amount equivalent to the gain made or loss avoided by him along with hefty amount of penalty for this offence.

g) **The issue of raising demand of 'Tenderable Gain' not realized is a penal action:** No doubt, in the instant case, the Respondent by virtue of aforesaid sale and purchase transactions has made tenderable gain in terms of the provisions of Section 224(1) read with Rule of the Rules, therefore, he is liable to discharge his liability accrued under Section 224 of the ordinance. Moreover, tendering or recovery of tenderable gain is not a penalty action.

14. From the foregoing, it may be inferred that the primary plea of the Authorized Representative is that the Respondent did not make any gain on account of under discussion transactions, as shares were sold out of previous holding, which were held for more than six months and the transactions were made in good faith rather than on the basis of any inside information. But, as discussed above in detail, that merits of the case do not support the contention submitted on behalf of the Respondent. Admittedly, the Respondent has made sale and purchase in same class of shares, within the period of less than six months. As explained earlier, by virtue of "*fungible*" shares of the same class may not be divided in two groups i.e. previously held shares and newly purchased shares. Moreover, the provisions of Section 224 of the Ordinance are very mechanical and will be automatically applicable in the event of yielding gain on purchase and sale or sale and purchase, made with in the period of six month, irrespective of any intention on the part of such person to engage in such transactions or to misuse inside information because said Section run on tacit assumption that the director/beneficial owner was privy to the inside information. Thus, the Section 224 of the

Ordinance aims to protect the minority/small shareholders of the company from short-swing speculation by the directors/officers/beneficial owners of the company. Hence, the arguments presented by the Respondent do not have any merit and substance.

15. Prior to conclude the findings, it seems necessitated to mention the following:-

(a) During the pendency of the Civil Suit No. 139/2010 before the Sindh High Court, the Appellate Bench of the Commission decided Appeal No. 49/2011 filed by Mrs. Nasreen Humayun Shaikh, a beneficial owner of Azgard Nine Limited. The Appellate Bench vide Order dated 19/06/2013, stated that "*rule 16 of Rules has not been framed within the four corners of section 224 of the Ordinance. We are aided by the judgment in the matter of Messrs Honda Atlas Car (Pakistan), ltd., Lahore versus C.I.T, Legal Division, R. T. Lahore*". The Bench further held that "*the rule 16 of the Rules is inconsistent with the statute and contradicts the express provisions of the statue from which it derives authority. The Appellant cannot be burdened to submit a gain, which never accrued to her in first place*". Besides, the Appellant Bench in the said Appeal calculated the amount of gain by matching the purchase and sale transactions in sequential manner rather than by applying lowest in highest out manner prescribed in Rule 16 of the Rules.

(b) The amount of tenderable gain in the instant matter (at the time of issuance of Notice) was calculated pursuant to the manner provided in Rule 16(2) of the Rules, which has been declared "*inconsistent with the statute*" by Appellate Bench of the Commission. The issue of deviation of the manner of calculation of gain used by the Appellate Bench with the method of calculation prescribed in Rule 16 of the Rule was placed before Commission. The Commission considered and *inter alia* decided in its seventh meeting held on 25/05/2014 that the cases of recovery of gain be disposed of in the light of judgment made by the Appellate Bench of the Commission in the aforesaid appeal as well as the judgment made by Supreme Court of Pakistan in the matter of Appeal No. 946/2005.

16. Pursuant to the aforementioned decision of the Commission, the amount of tenderable gain in the instant matter has been recalculated as under, in the light of manner approved by the Commission:-

Buy Date	Buy Quantity	Sale Date	Sale Quantity	buy Quantity to be Matched	Sale Quantity to be Matched	Quantity Matched	Buy Rate (Rs.)	Sale Rate (Rs.)	Gain Per Share (Rs.)	Total Gai (Rs.)
23/6/08	344,000	18/4/08	33,300	344,000	33,300	33,300	145.34	184.29	38.95	1,297,035/
Total gain										1,297,035/

17. In pursuance of the decision of the Commission, the benefit of the manner approved by the Commission has been passed on in the instant matter, resultantly, the amount of tenderable has been reduced from Rs 3,669,660/- to Rs 1,297,035/-

18. It is evident from the foregoing discussion that the Respondent has made gain on account of the aforesaid sale and purchase transactions. Since the transactions have resulted in gain, therefore, the Respondent was required to discharge its certain obligations pursuant to Section 224(1) of the Ordinance. But, the Respondent has failed to discharge its said obligations, therefore, the request to withdraw the Notice is rejected. Since, the amount of gain is still with Respondent, therefore, as provided in Section 224(2) of the Ordinance the gain has vested to the Commission. Since Supreme Court of Pakistan in aforementioned judgment held that "the gain will remain under all circumstances property of the company". While, the entitlement of SECP to recover the amount in question from the director/beneficial owner would be treated as being in nature of an enforcement mechanism to ensure that the wrongful gains do not remain with person who has violated the section, but are transferred for the benefit of the company. Since ultimately, the amount of gain is required to be transferred to the Issuer Company, therefore, in order to make the process of recovery of gain simple, the Respondent is hereby directed to tender Rs 1,297,035/- to Issuer Company, within 30 days of the Issue of this Order and provide a copy of his bank account statement of the respective date highlighting therein debit entry of aforementioned amount, for the record of this office, within seven days of the tendering of the gain.

19. This order is issued without prejudice to any other action that the Commission/Registrar may initiate against the Respondent, in accordance with the law on matter subsequently investigated or brought to the Notice of the Commission.

20. A copy of this Order may also be provided to the Issuer Company, for information as well as with directive to provide a copy of its bank account statement of the respective date highlighting therein credit entry of aforementioned amount, for the record of this office, within seven days of the receipt of the gain.

(Imran Hayat Butt)
Director/HOD (MSRD)

Islamabad.
Announced on December 31, 2014