



**BEFORE APPELLATE BENCH NO. I**

In the matter of

**Appeal No. 48 of 2005**

Sherman Securities (Pvt.) Limited ..... Appellant

Versus

Joint Director (SMD)  
Securities and Exchange Commission of Pakistan ..... Respondent

**ORDER**

Date of hearing 15-11-11

**Present:**

**For the Appellant:**

Mr. Muhammad Ali Lashari, Advocate

**For the Respondent Department:**

Mr. Atif Hameed, Deputy Director

Mr. Muhammad Ali, Deputy Director



## SECURITIES & EXCHANGE COMMISSION OF PAKISTAN

1. This order shall dispose of appeal No. 48 of 2005 filed under section 33 of the Securities and Exchange Commission of Pakistan (the "Commission") Act, 1997 (the "SECP Act") against the order dated 23-08-05 (the "Impugned Order") passed by the Respondent.
  
2. Facts leading to the case are that from 01-03-05 till 31-03-05, the Appellant carried out two hundred and thirty one (231) trades in the shares of Oil & Gas Development Company ("OGDC"), Pakistan Oilfields Limited ("POL"), Pakistan Petroleum Limited ("PPL"), Pakistan State Oil Limited ("PSO") and Pakistan Telecommunication Company Limited ("PTCL") through the Karachi Automated Trading System ("KATS") at Karachi Stock Exchange ("KSE") on behalf of its four (4) clients. In the course of these trades, the Appellant purchased and sold 210,700 shares of OGDC, 200 shares of POL, 260,800 shares of PPL, 11,300 shares of PSO and 3,500 shares of PTCL on behalf of the afore mentioned clients. Each of these trades cancelled each other out with the effect that there was no change in the beneficial ownership of the shares i.e. *wash trades*. The Commission obtained KATS data from KSE for the relevant period which showed that in March 2005, the Appellant had executed trades which cancelled out each other and did not result in a change in beneficial ownership.
  
3. Show cause notice dated 15-07-05 ("SCN") was issued to the Appellant calling upon it to show cause as to why action should not be initiated under section 17 of the Securities and Exchange Ordinance, 1969 (the "Ordinance") and the Brokers and Agents Registration Rules, 2001 (the "Rules"). The Appellant responded to the SCN and hearing in the matter was held. The Respondent, dissatisfied with the response of the Appellant, passed the Impugned Order and imposed a penalty of



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Rs.100,000 on the Appellant under rule 8(b) of the Rules for violation of rule 8(iv) read with rule 12 of the Rules.

4. The Appellant has preferred the instant appeal against the Impugned Order. The Appellant's counsel argued that:

- (a) it is apparent from the contents of the SCN and the Impugned Order that the Respondent has only picked up certain isolated transactions from the entire record of the Appellant's trading account. In the SCN, the Respondent has not stated any criteria on the basis of which the transactions in question were selected. The Respondent has exercised the power vested in him arbitrarily in issuing the SCN and passing the Impugned Order, therefore, they are liable to be set-aside;
- (b) the record of trading account shows that during the time in question, the Appellant was executing massive trading orders on behalf of its clients involving buying and selling of hundreds of thousands of shares. The transactions in question form less than even 0.5% of the daily trading account hence, it is highly improbable that the Appellant could adversely affect the market or gain huge advantage from such small and inconsequential transactions;
- (c) during the period in question hundreds of millions of shares of OGDCL, POL, PPL, PSO and PTCL were traded on the Stock Exchange. In such a scenario, it is highly improbable that the Appellant or any of its clients could gain an illegal or undue advantage from squaring the trade of a few thousand shares of any particular scrip which form less than even 1% of the actual volume of shares traded on that day. The alleged undue



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advantage obtained by the Appellant through buying and selling the same security on the same day did not result in any gain to the Appellant;

- (d) section 17 read with Section 22 of the Ordinance entails penal actions, therefore, under the general principal of the law, the two sections read together only come into play when the acts prohibited under section 17 are done by a person with a mala fide intention to commit fraud. The explanations given through written reply and during the hearing clearly shows that these transactions were not executed with mala fide intentions. The facts of the case do not establish existence of *mens rea* on the part of the Appellant or any of its clients or investors. The trades were not executed to mislead or manipulate the market price of the shares and in any event constituted a very small part of the total trades executed on those dates and therefore, were not capable of manipulating the market. Moreover, the acts of the Appellant were not willful, as such, the penalty is not attracted.

5. The Respondent argued that:

- (a) the plea of the Appellant that the transactions in question have been selected without any criteria is not correct. The data annexed to the SCN has been obtained and selected on the basis where the buyer and the seller remained the same through out transactions. Such transactions cancelled each other out at the end without any change in the beneficial ownership of the shares. The fact is that those trades did become part of over all trading volume at that particular day which gave false impression of active trading at the time of execution of such trades;



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- (b) & (c) in the course of its written as well as oral contentions, the Appellant has not denied the fact of carrying out 231 trades, no matter whether the said transactions formed less than 0.5% of the daily trading account of the Appellant or were less than 1% of the actual volume of shares traded at the stock exchange on that day. Further, it is also evident from the relevant KATS data obtained from KSE that such trades did not result in any change in the beneficial ownership of shares and gave false impression of shares being traded on that particular day.
- (d) the Appellant has failed to abide by the Code of Conduct prescribed by the Third Schedule of the Rules. In failing to ensure that a proper system was in place to avoid repeated occurrence of trades, the Appellant has failed to act with due skill, care and diligence in the conduct of its business. Consequently, the Appellant has failed in its duty to maintain high standards of integrity, promptitude and fairness in the conduct of its business and therefore acted in violation of Rule 8(iv) read with Rule 12 of the Rules.
6. We have heard the parties. Rule 8, 12 of the Rules and the extract of Code of Conduct from Third Schedule have been reproduced for ease of reference:

***Rule 8. Suspension of registration;***

*Where the Commission is of the opinion that a broker-*

*(iv) has failed to follow any requirement of the code of conduct laid down in the Third Schedule, the Commission may, if it considers necessary in the public interest so to do, by order in writing:-*



(a) *suspend the registration of a broker for such period as may be specified in the order; or*

(b) *impose on a broker a fine not exceeding one hundred thousand rupees.*

Emphasis added

**Rule 12. Brokers to abide by the Code of Conduct;**

*A broker holding a certificate of registration under these rules shall abide by the code of conduct specified in the Third schedule.*

Emphasis added

**THE THIRD SCHEDULE**  
**[See rules 8 (iv) and 12]**

**CODE OF CONDUCT**

**A. General**

1. *Integrity.- A broker shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.*
2. *Exercise of due skill and care.- A broker shall act with due skill, care and diligence in the conduct of all his business.*
3. *Manipulation.- .....*



4. *Malpractices. - A broker shall not create false market either singly or in concert with others or indulge in any act detrimental to the investors' interest or which leads to interference with the fair and smooth functioning of the market. A broker shall not involve himself in excessive speculative business in the market beyond reasonable levels not commensurate with his financial soundness.*
5. *Compliance with statutory requirements. - A broker shall abide by all the provisions of the Act and the rules, regulations issued by the Commission and the stock exchange from time to time as may be applicable to him.*

Emphasis added

(a), (b) & (c)

SCN was issued to the Appellant under section 17 and section 22 of the Ordinance read with the Rules. The 'Code of Conduct', prescribed in the Third Schedule of the Rules read with rule 12 of the Rules prohibit interference with the fair and smooth functioning of the market. The Appellant has not denied the transactions mentioned above. It is evident from the facts and evidence provided that the Appellant has failed to act with due skill, care and diligence in the conduct of its business and has therefore, acted in violation of Rule 8 (iv) read with Rule 12 of the Rules.

- (d) Section 17 of the Ordinance would only be applicable if the creation of false trading and misleading appearance of active trading in any security is meant to operate as a fraud, deceit or manipulation. In the instant case no such charge has been proved. On the issue of whether the act was willful, we place our reliance on the definition of 'willful' as reproduced in Black Law Dictionary




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as an act done with stubborn purpose, but not with malice, as done intentionally, knowingly and purposely as distinct from an act done carelessly, thoughtlessly, heedlessly or inadvertently. It is in fact the act, and the circumstances surrounding such act which point towards the intention of a person committing an offence. In the instant case, the transactions mentioned above had the effect of 'wash trades' and the act was deliberate and was done with stubborn purpose. The Appellant has not been alleged to have benefitted by indulging in the said transactions, however, the Appellant has certainly breached the Code of Conduct by indulging in practices which had the effect of interfering with fair and smooth functioning of the market. The unfair trade practices like 'wash trades' are harmful for the development of market. The Commission is bound to protect the interest of investors and in doing so it has been empowered to deal with elements which effect smooth and fair functioning of the stock exchanges. The Appellant, by creating false transactions induced other investors into buying the shares and have indirectly caused loss to many other investors. The Respondent could have suspended the license of the Appellant as a broker; however, the Respondent by taking a lenient view has rightly imposed a penalty of Rs. 100,000/- (Rupees One Hundred Thousand only) under rule 8(b) of the Rules.

In view of the above, we see no reason to interfere with the Impugned Order. The Appellant is directed to ensure compliance of all the rules, regulations and directives of the Commission in future for avoiding any serious punitive action under the law. The appeal is dismissed with no order as to cost.

  
(Tahir Mahmood)  
Commissioner (CLD)

  
(Mohammed Asif Arif)  
Commissioner (Insurance)

Announced on: 12-01-12