SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Department
Securities Market Division

NIC Building Jinnah Avenue, Blue Area, Islamabad

Before The Executive Director (Securities Department)

In the matter of
Recovery of Tenderable Gain
Under Section 224(2) of the Companies Ordinance, 1984
From Mr. Muhammad Haris, Director, Ahmad Hassan Textile Mills Limited

Date of Hearing : October 13, 2010

Present at hearing :

Representing the Respondent: The Respondent in Peron

Assisting the Executive Director (SD) :

(i)	Mr. Imran Inayat Butt	Director (SD)
(ii)	Mr. Muhammad Farooq	Joint Director (SD)
(iii)	Mr. Nazim Ali	Assistant Director (SD)

Order

This order will dispose of the proceedings initiated under Section 224(2) of the Companies Ordinance, 1984 (the "**Ordinance**") by the Securities and Exchange Commission of Pakistan (the "**Commission**") through Show Cause Notice No. S.M.(B.O)C.O.222/4(3947)95 (the "**Notice**") dated 03/09/2010, against Mr. Muhammad Haris (the "**Respondent**"), Director Ahmad Hassan Textile Mills Limited (the "**Issuer Company**").

2. Brief facts of the case are that:-

a) It was observed from the returns of beneficial ownership furnished by the Respondent under Section 222 of the Ordinance that he has made the following purchase and sale transactions, within a period of less than six months:-

Sr. No.	Date	Nature of Transaction	No. of Shares	Rate per Share (Rs)
1	26/06/2009	Purchase	200,000	28.00
2	27/06/2009	Purchase	4	28.00
3	27/06/2009	Sale	95,000	28.00

4	29/06/2009	Purchase	500	28.00
5	30/09/2009	Sale	240,000	21.00
6	19/10/2009	Purchase	110,000	18.00

b) On account of the aforementioned transactions, the Respondent made gain of Rs. 995,000/- (Rupees nine hundred ninety five thousand only), computed in the manner prescribed in Rule 16 of the Companies (General Provisions and Forms) Rules, 1985 (the "**Rules**").

3. Section 224 of the Ordinance provides that where *inter alia* a Director of listed company who is or has been the beneficial owner of any of its equity securities makes any gain by purchase and sale, or the sale and purchase, of any such security within a period of less than six months, such person 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.

4. Since neither the matter of accrual of the aforesaid gain was reported by the Respondent in Part-D of the prescribed returns of beneficial ownership filed by him with this Commission for the aforementioned transactions, nor its tendering or recovery was reported to the Commission, as provided in Section 224 of the Ordinance. The Respondent was, therefore, intimated vide letter dated 14/07/2010 that the aforementioned liability accrued under Section 224(2) of the Ordinance is apparently still outstanding as neither he has tendered the aforementioned gain to the Issuer nor the Issuer Company has recovered it within the stipulated period. The Respondent was further intimated that he may now discharge the said liability by tendering the aforementioned amount of gain in favour of the Commission or furnish reply within 15 days of the said letter, if his view-point is different from that of the Commission. In response the Respondent, vide letter dated 12/08/2010 stated that he has:-

> *"made no gain as shares were sold out of previous shareholding and not out of those purchased in June, 2009 and October, 2009.*

5. The plea of the Respondent was examined in the light of provisions of Section 224 of the Ordinance and Rule 16 of the Rules and was considered to be unsatisfactory. Thus, Notice under Section 224(2) of the Ordinance was served upon the Respondent on 03/09/2010 and personal hearing in the matter was fixed for 23/09/2010. On the request of the Respondent the said hearing was adjourned and re-fixed for 30/09/2010. However, the hearing was again adjourned to 13/10/2010.

6. On the given date, the Respondent appeared before me in person and requested to withdraw the Notice on the plea that the purchase and sale transactions made by him do not fall

in the ambit of Section 224(2) of the Ordinance. The arguments advanced by the Respondent in support of his foregoing contention in writing as well as verbally are summarized hereunder:-

a. **Purchased and Sold Shares were not same**: The Respondent stated that "*provisions of Section 224 of the Ordinance are not attracted in the instant matter, as purchased and sold shares were not same*. He added to support his statement that "*In fact purchase of shares was made on 26/06/2009, 27/06/2009, 29/09/2009 and 19/10/2009, whereas the shares sold on 27/06/2009 (95,000) and on 30/09/2009 (240,000) were out of the shares already held (transferred in dematerialized format) and not out of those purchased in June, 2009 and October, 2009*".

b. **No gain has been made:** The Respondent stated that "*no gain has been made by the purchase and sale, or sale and purchase of any security within a period of six months as envisaged in Section 224 of the Ordinance*".

c. **Payment of debt**: The Respondent asserted that "*Shares in question were sold to pay off debts; consequently the case does not attract provisions of Section 224 of the Ordinance*".

d. **Dates of some transactions were different from that mentioned by the Commission**: The Respondent stated that "*the transactions shown at serial number 1 to 4 of the table given in the Notice were actually made on 13/10/2008, 17/03/2009, 02/06/2009 and 09/06/2009 instead of 26/06/2009. 27/06/2009, 27/06/2009 and 29/06/2010 respectively, therefore, the said transaction specifically purchase of 200,000 shares do not fall in the ambit of provisions of Section 224 of the Ordinance, as it was made beyond the limitation of six moths of the sales*".

e. **Ignorance of the law**: The Respondent stated that he was "*unaware of the provisions of the law*" and requested to:-
   i. *waive of the entire amount of gain or*
   ii *Reduce the amount of gain to its minimum level by using any other formula*",

7. I have considered the facts of the case, written and verbal submissions made by the Respondent during the course of hearing and relevant provisions of law. My observations in this regard are as under;-

a) **Purchased and Sold Shares were not same**: The assertion of the Respondent has been considered and observed that the Respondent has divided his shareholding of same class of shares into two groups (i.e. previously held and newly purchased shares) and he is of the view that Section 224(1) of the Ordinance would only be attracted as and when particulars shares of the same class are purchased and sold or sold and purchased. To ascertain the legitimacy of the contention, 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 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 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."*

In order to check international practice in the matter, I have also consulted the relevant law in United States of America **(the "USA"**) wherein 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 Circuit Court of Appeals of USA clearly states that shares are identical and substitutable. Thus, the Respondent has misconstrued and misinterpreted the words "purchase and sale or sale and purchase" appear in Section 224 of the Ordinance, by arguing that purchased and sold shares were not same.

Now a question arises why shares of the same class of the same listed company are considered "fungible" in nature? Its answer 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.

b) **No gain has been made**: After determining the issue that "the shares of same class of the same listed company are fungible in nature", now the issue whether or not there was any gain on the transactions made by the Respondent is addressed. For this purpose, we again go through the contents of Section 224(1) of the Ordinance. It is pertinent to mention here that the said Section of the Ordinance requires tendering of "any gain" made by the purchase and sale, or the sale and purchase, of securities. So, the word "any" before the word "gain" has significance, which clearly stands for any type of gain.

For the accrual of tenderable gain, the Section 224 postulates the prerequisites that the transactions must be made in same class of equity security of same listed company by

a beneficial owner, within the period of less than six months. When these conditions are met, then the matter requires analysis whether "any gain", has accrued or not, which means it necessitates a formula for computation of "any gain". Plain reading of Section 224(1) of the Ordinance, suggests that the Section itself presupposes a way of matching of purchase(s) against sale(s), or sale(s) against purchase(s), and therefore there must be a principle upon which the difference of sale price and purchase price is to be determined and its answer is given in Rule 16 of the Rules. The said Rule provides that the amount of tenderable gain will be calculated by matching the purchases at lowest rates against the sales at highest rates prevailing within the six months. The rational of this methodology will be discussed later on in para 7(e) of the Order.

It is worth mentioning that the under reference transactions have admittedly been made by the Respondent in same class of shares i.e. ordinary shares of the Issuer as well as were made within the period of less than six months. Thus, the case meets all the prerequisites, laid down in Section 224(1) of the Ordinance. Now the next step is to check whether or not any gain was accrued on the said transactions. Under the prevailing Law and Rules, its answer may only be obtained by applying the manner given in Rule 16 of the Rules. By applying the said manner of calculation, the aforementioned transactions have been resulted in tenderable gain of Rs. 995,000/- to the Respondent. Thus, the contention of the Respondent that he has made no gain has no substance.

c) **Payment of debt:** The contention of the Respondent that "*the transactions made by him do not attract provisions of Section 224(2) of the Ordinance, as shares were sold for payment off debt*" has been considered in the light of provisions of Section 224(1) and specifically proviso given under said Section of the Ordinance. For ease of reference the said proviso is reproduced hereunder:-

> *Provided that nothing in this sub-section shall apply to a security acquired in good faith in satisfaction of debt previously contracted.*

The contents of the proviso clearly indicate that the only exception mentioned in the law relates to securities acquired in good faith in satisfaction of debt previously contracted. While sale of shares for payment for debt is not covered under this proviso, resultantly, the plea of the Respondent does not have any merit.

d) **Dates of some transactions were different from that mentioned by the Commission**: The contention of the Respondent that "*the transactions shown at serial number 1 to 4 of the table given in the Notice were actually made on 13/10/2008 17/03/2009, 02/06/2009 and 09/06/2009 instead of 26/06/2009. 27/06/2009, 27/06/2009 and 29/06/2010 respectively* has been considered. In this regard, the Respondent was intimated during the course of hearing that the dates of the under reference transactions were taken from the returns of beneficial ownership filed by him. He was further intimated that for the purpose of calculation of tenderable gain the transactions mentioned at Sr. No. 3, 5 and 6 of the table given in

the Notice were matched and despite revised date of transaction (given at Sr. No. 3) the amount of gain as well as matching of transactions would remain same. However, the Respondent was asked to file revised return of beneficial ownership showing therein exacts dates of the transactions. Nevertheless, it is once again clarified that filing of revised return of beneficial ownership in this regard would not compose any impact on the amount of tenderable gain.

e) **Ignorance of the law**: In my opinion this assertion of the Respondent has three different components. (1) ignorance of law (2) request to waive of the amount of gain and (3) reduction in the amount of gain and these are required to be discussed separately.

Concerning the contention that he was unaware of the provisions of Section 224 of the Ordinance, it is pointed out that the Respondent is on the Board of Director of the Issuer Company since 17/05/1994 and has been filing his returns of beneficial ownership under Section 222 of the Ordinance. So he is supposed to be acquainted with duties and liabilities of a director of a listed company including arisen out of the provisions of Section 224 of the Ordinance. Even if, presumably he was unaware of the provisions of the under reference law, it is an ancient legal doctrine that "ignorance of the law is no excuse". I am of the view that if a beneficial owner of listed company is allowed to escape from legal responsibility merely by saying "I didn't know there was tenderable gain", the mechanism provided in Section 224 of the Ordinance would become redundant.

Concerning the request of waiving of the amount of tenderable gain, it is pointed out that the Commission does not have any power under the Ordinance to waive off the amount of tenderable gain. It is required to be tendered as per the scheme provided in the law.

Concerning the request to reduce the amount of gain to its minimum level by applying any other manner of calculation, it is pointed out that the amount of gain has been calculated in the light of manner Lowest-in Highest-out prescribed in Rule 16 of the Rules. The Commission does not have power to reduce the amount of gain by applying any other method of calculation except the manner given in the Rule 16 of the Rule. In my opinion, the said manner of calculation has basis and rational. In order to gauge the said rational and reasons, we have to evaluate the spirit of the provisions of Section 224(1) of the Ordinance. In fact, the provisions of Section 222-224 of the Ordinance are applicable on only particular class of persons. The Section 224(1) *inter alia* intends to persuade the said particular class of persons to concentrate on their fiduciary and ethical duties rather than indulging in trading activities, which may lead to many market-evils. That is why the Section speaks about the recovery of "any gain" made by the said persons on purchase and sale or sale and purchase of shares within the period of less than six months. Thus the law proposes to recover all possible gain out of shares transactions and even it does not allow them to minimize their gain by virtue of setting off their losses. In brief Section 224 of the Ordinance is inclined to establish a standard so high to prevent any conflict between the selfish

interest of a fiduciary officer/beneficial owner and the faithful performance of his duty.

Hence keeping in view the spirit and objective of the provisions of Section 224 of the Ordinance i.e. squeezing of any gain, the Federal Government had no option other than the specifying the manner prescribed in Rule 16 of the Rules. All others alternate manners of calculation like Matching of Transaction to Transaction, Average Method, FIFO, LIFO etc. do not meet the criteria laid down in Section 224 of the Ordinance.

In this regard, I have also consulted the relevant law in USA i.e. Section 16 of the SEC, Act 1934 and noticed the said Section does not specify any method for computation of amount of profit (short swing profit). However, in USA the Court has determined, a methodology for calculation of short-swing profit, which is same as in Pakistan i.e. Lowest-in Highest-out rates are matched. In the case of *Smolowe v. Delendo Corp. (1943, Circuit Court of Appeals, Second Circuit)* the court held that:

> *"---The only rule whereby all possible profits can be surely recovered is that of lowest price in, highest price out-- within six months-- as applied by the district court. We affirm it here, defendants having failed to suggest another more reasonable rule....*

Hence it can safely be inferred form the aforesaid discussion that Rule 16 of the Rule is not only in conformity with the spirit of Section 224 of the Ordinance but also in accordance of practice set by court in USA. Thus, the request of the Respondent "to reduce the amount of gain " has no justification and basis.

8. In view of the foregoing, I am of the considered opinion that the arguments presented by the Respondent do not have any merit and substance. Hence, the request to withdraw the Notice is rejected and the Respondent is, hereby, directed to tender Rs. 995,000/- (Rupees nine hundred ninety five thousand only) to the Securities and Exchange Commission of Pakistan as provided in section 224(2) of the Companies Ordinance, 1984, through a demand draft in favour of the Commission, within thirty days of the issue of this order.

(Akif Saeed)
Executive Director (SD)

Islamabad.
Announced on March 18, 2011