



# Securities and Exchange Commission of Pakistan

## **BEFORE APPELLATE BENCH I**

In the matter of

**Appeal Nos. 31 & 32 of 2013**

- (i) Cyan Limited  
(ii) Mr. Abdul Samad Dawood, Director Hercules Corporation Ltd  
& Chief Executive of Cyan Ltd ... Appellants

Versus

Director/ HOD (MSRD)  
Securities and Exchange Commission of Pakistan ... Respondent

Date of Hearing 24/08/15

### **Present:**

#### **For the Appellants:**

- (i) Mr. Naveed-ul-Haq Chaudhry, Senior Advocate Supreme Court (Mandviwalla & Zafar)  
(ii) Mr. Hasan Mandviwala, Senior Associate (Mandviwalla & Zafar)  
(iii) Barrister Raja Adnan Khan, Associate (Mandviwalla & Zafar)

#### **For the Respondent:**

- (i) Mr. Abid Hussain, Executive Director (SMD)  
(ii) Mr. Amir Saleem, Joint Director (SMD)

## **ORDER**

1. This order is in appeal Nos. 31 and 32 of 2013 filed under section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated 19/04/13 (Impugned Order) passed by the Respondent.



## Securities and Exchange Commission of Pakistan

**SECP 2.** Brief facts of the case are that the Dawood Hercules Corporation Limited (DHCL) vide notice dated 23/07/12, addressed to the three stock exchanges, informed that the meeting of the Board of Directors (BOD) of DHCL will be held on 31/07/12 to consider the Annual Accounts of the Company for 2<sup>nd</sup> quarter ended 30/06/12. DHCL vide notice dated 01/08/12 announced its financial results for 2<sup>nd</sup> quarter ended 30/06/12 wherein loss of Rs.214.363 million and Earnings Per Share (EPS) of Rs.(0.45) was declared as compared to financial results of 1<sup>st</sup> quarter ended 31/03/12 wherein DHCL posted profit of Rs.871.147 million and EPS of Rs.1.81. During the month of May to July 2012, a major decline in the share price of DHCL was witnessed wherein its price decreased from Rs.44.38 to Rs.29.21 (from 10/05/12 to 23/07/12). Perusal of Ready Market trading data of the Karachi Stock Exchange Limited (KSE) from 08/05/12 to 26/07/12 (Period) revealed that Cyan Limited (Cyan), a company of Hussain Dawood Group, sold 5,391,872 shares of DHCL at average price of Rs.33.78 through Fortune Securities Limited (FSL), Trading Right Entitlement Certificate Holder/Broker of KSE. During the Period the Appellant's trading volume constituted 28% of the total trading volume in the scrip of DHCL. It is important to note that during the last four and half years, i.e. from 01/01/08 to 30/04/12 the Appellant sold only 4,618,515 shares of DHCL at average price of Rs.83.33 whereas during the Period, Appellant sold substantial quantity of shares. Due to the heavy selling by Appellant prior to announcement of financial results, the share price of DHCL decreased rapidly.

3. The review of list of BOD of DHCL and Cyan exhibited that Mr. Abdul Samad Dawood (ASD) was the Chief Executive Officer of Cyan and also a member of BOD of DHCL. Moreover, there were two more common Directors in DHCL and Cyan and their detail is as follows:



## Securities and Exchange Commission of Pakistan

Sr. No.	Name	Position held in DHCL	Position held in CYAN
1	Mr. A. Samad Dawood	Director	CEO / Director
2	Mr. Shahid Hamid Pracha	Director	Director
3	Mr. Isar Ahmad	Director	Director

4. The account opening form of the trading account of Cyan was obtained from FSL which revealed that ASD and Mr. Sulaiman S. Mehdi, Chief Operating Officer (COO) were the authorized persons to operate the trading account on behalf of the Appellant. Keeping in view the abovementioned facts, the Respondent vide letter dated 13/09/12 sought the rational from Cyan for selling substantial number of shares of DHCL prior to the announcement of financial results of DHCL. However, no reply was received by the Respondent. A reminder letter dated 26/09/12 was issued to Cyan wherein it was again requested to provide the requisite information failing which appropriate action will be taken against Cyan under the relevant provisions of law. The Appellants, however, again failed to respond to the Respondent to clarify their position in the matter.
5. Show Cause Notice, dated 06/11/12 (SCN) was issued to the Appellants under Section 15E of the Securities and Exchange Ordinance, 1969 (Ordinance) for insider trading in the scrip of DHCL. The Appellants were asked to explain their position through written reply and were also given a hearing opportunity. CEO and Mr. Faisal Nadeem, Chief Financial Officer (CFO) appeared on behalf of the Respondent. The Respondent, dissatisfied with the response of the Appellants, found the Appellants guilty for contravention of section 15A(1) of the Ordinance and in exercise of the powers under section 15E of the Ordinance, imposed a fine of Rs.2,000,000 on Cyan and a fine of Rs.1,000,000 on ASD.



## Securities and Exchange Commission of Pakistan

SECP6. The Appellants have preferred the instant appeal against the Impugned Order on the following grounds:

- a) The matters discussed in the BOD's meetings held in April and June pertained to the "deteriorating financial and operating position of DHCL". However, this information was available with the public. The Respondent has thereby erred in classifying the same as inside information for the purposes of section 15B (1)(a) of the Ordinance for the following reasons:
- (i) On a number of instances prior to and during the Period, the media had reported that fertilizer plants on the SNGPL Network, including DHFL, faced "permanent closure" as a result of severe curtailments in the supply of gas. It is submitted that such information was already well within the public domain and extracts of which are reproduced hereunder:

Newspaper	Date	Description
Dawn	16 December 2011	Dawood Hercules Fertiliser Limited and Engro even are currently completely shut down due to gas supply being denied, whilst remaining two plants with less production capacity are currently running. Dawood Hercules has suffered more than other units on the network, claimed its CEO, Rashid Lone. To date, it has been without gas for 180 days since January and



## Securities and Exchange Commission of Pakistan

		fears that it will not get gas for the remainder of December
E Paper Pakistan Today	3 January 2012	Thousands of furious people protesting against the unavailability of gas
Business Recorder	28 February 2012	Currently, all four fertilizer plants on SNGPL network are facing a complete shutdown, which has resulted in a huge production and financial loss to these Fertilizer plants. Dawood Hercules Plant only produced 39 percent of urea which stood at 199,000 tons against a production capacity of 513,000 tons
Daily Times	6 March 2012	After several months of forced closure due to gas curtailment in 2011 and first two months of 2012, gas supply to fertilizer plants on SNGPL network was restored on Saturday March 3, however, Dawood



## Securities and Exchange Commission of Pakistan

		Hercules Fertilizers Limited, Sheikhpura gas supply is suspended.
Business recorder	09 June 2012	Gas supply to Engro Fertilizers, Dawood Hercules to begin from June 10, 2012
Express Tribune	19 and 20 June 2012	Forced closure: Dawood and Engro plants shut down. Two fertilizer plants on SNGPL network has reportedly been shut down after SNGPL suspended their gas supply till further instructions
Business Recorder	19 and 20 June 2012	Gas supply to the four fertilizer plants on SNGPL system has been curtailed for an indefinite period, a Petroleum Ministry official told. These four includes Engro, Pak-Arab, Agritech and Dawood Hercules
Business Recorder	19 July 2012	Difficult times faced by Engro Corp due to acute gas shortages
Express Tribune	27 July 2012	Engro shifting its \$1 billion



## Securities and Exchange Commission of Pakistan

		from SNGPL network to non-network gas fields and requested banks to re-profile its debt repayment
Dawn	31 July 2012	Fertilizer Industry in throes of crisis is suffering a drop in production, sales and profits

- (ii) The Directors Report in DHCL's financial results for the first financial quarter ended 31/03/12 had already anticipated further gas shortages "in the peak summer months with its resultant adverse impact on domestic urea production" and predicted that declining production and sales in the first financial quarter ending 31/03/12 would "have a spillover effect in Q2 & Q3 2012". Moreover, it was expressly stated "oil & gas were major drags...gains were eroded by year-end with fertilizer companies facing severe gas curtailment" and that "fertilizers may disappoint". In addition to the abovementioned, DHCL filed the following public announcements with the Commission and the Lahore, Karachi and Islamabad Stock Exchanges, pursuant to the applicable listing regulations:

8<sup>th</sup> March, 2012: Announcement that the gas supply to DHCL had been "partially restored" on 06/03/12 and that "Startup activities were initiated";

2<sup>nd</sup> April 2012: Announcement that the gas supply had as of that date been suspended to DHCL, and that a subsequent announcement would be made and when the gas supply is restored;

9<sup>th</sup> April 2012: Announcement that the gas supply to DHCL was being discontinued "in accordance with the Prime Ministers directives during the 2<sup>nd</sup> National Energy Conference for the purposes of diverting the gas to the power sector" and that DHCL would make a subsequent announcement as and when the gas supply was restored.



## Securities and Exchange Commission of Pakistan

8<sup>th</sup> June 2012: Announcement that SNGPL had notified DHCL that the latter's gas supply would resume on 10/06/12;

18<sup>th</sup> June 2012: Announcement that as of 17/06/12, SNGPL had confirmed that it would not be in a position to continue gas to DHCL till further instructions. Further, it was confirmed that the plant had been forced to shut down. The abovementioned public announcements detailing the suspension of gas supply, discontinuation of gas supply to DHCL, confirmation that SNGPL would not be in a position to continue gas to DHCL, the forced closure of the plant as of 17/06/12 and 1<sup>st</sup> QTR Results all constituted public information available well before the commencement of the Period during which shares of DHCL were offloaded. Appellant No. 2's attendance or deemed attendance by virtue of obtaining the April Minutes, did not grant him access to insider information that was not available in the public domain, which he may have allegedly used to offload DHCL shares held by Cyan to influence the share price of DHCL. The allegation of insider trading, therefore, cannot be sustained as the Respondent's finding is related specifically to information available in the public domain.

- b) Section 15(B)(1)(a) of the Ordinance classify inside information, as that information which if disclosed to the public would have an effect on the price of shares or listed securities. The scenarios pertaining to no gas supply to DHCL were hypothetical and that such information of a wholly speculative nature cannot be deemed likely to have an effect on DHCL's share price if made public. The Respondent has erred in focusing solely on 'Scenario 4' given in the scenarios set out in the April Minutes which provided for a range of possible outcomes, both positive and negative. Even if the hypothetical scenarios discussed were to be disclosed to the public, it is unlikely that this would have an effect on the share price as there were buyers who had purchased the shares of DHCL during the Period willingly while knowing the severe gas curtailment and impending closure that the DHCL plant was facing. The





## Securities and Exchange Commission of Pakistan

Appellants have, therefore, not contravened the provisions of section 15(B) of the Ordinance and any conviction on the basis of the said section is liable to be dismissed on this ground alone.

- c) The Respondent has erred in concluding that DHCL's Earning Per Share (EPS) fell due to the aggressive offloading of shares by ASD during the Period. The EPS of a company is calculated by dividing the net income after subtracting taxes and preference dividends, by the number of outstanding equity shares of the company. DHCL's EPS value declined owing to the suspension of gas supply in the market which effected production and as a result the net income. Neither Cyan nor ASD could exercise control or influence over the declining EPS of DHCL as restricted gas supply had a direct effect on net income which accounted for the fall in the EPS of DHCL. The decline in EPS can also be attributed to the issuance of bonus shares by DHCL. The issuance of bonus shares, which are issued at zero value, effect the computation of EPS in the following manner:

- (i) EPS is equivalent to Net Income/Loss divided by number of outstanding shares; and
- (ii) While there is no value added to the Net Income/Loss figure by the issuance of zero value bonus shares, the value of number of outstanding shares increase by virtue of the issuance resulting in a lower EPS value.

- d) The Appellant's decision to sell DHCL's shares during the Period was primarily driven by the parameters of the Business Restructuring Program (BRP) approved in the Board of Directors meeting dated 19/01/11 and by the shareholders in the Extraordinary General Meeting (EOGM) dated 10/03/11 in terms of which Cyan was inter alia required to: (i) reduce its exposure in low yielding fertilizer companies such as Engro and DHCL; and (ii) to establish a high yielding liquid portfolio business. In accordance with the BRP's objective of establishing a high yielding liquid portfolio and owing to the fact that Hub Power Company, Pakistan



## Securities and Exchange Commission of Pakistan

Petroleum and Pakistan Oilfields are all defensive, high yielding stocks, Cyan acquired 32,260,000 ordinary shares of Hub Power Company Limited (HUBCO) on 13/06/12 at a price of Rs.31 per share, pursuant to the Share Purchase Agreement dated 22/03/12 with National Power International Holdings (HUBCO Acquisition). It should be noted that this deal was signed prior to the April and June BoD's meeting that discussed the deteriorating financial aspects of DHCL. The sale consideration for the HUBCO Acquisition of approximately Rs.1,000,000,000 was paid by Cyan on 13/06/12. Owing to the need to finance the said acquisition at the time, it was necessary to divest a sizeable part of Cyan's share portfolio, namely the shares of DHCL as had been previously contemplated pursuant to the BRP. In view of this, there was no fixed timeline during which the BRP was to be implemented. The alleged inside information contained in the April minutes was only made available to ASD in May 2012 through the board of director minute packs. It is pertinent to mention that Share Purchase Agreement for the HUBCO Acquisition was signed on 23/03/12, pursuant to which Cyan reduced its exposure and divested the shares of DHCL in order to partly finance the HUBCO Acquisition. The BRP was an investment strategy for three to five years and was approved by the shareholders in the EOGM, which proved that trades could be validly executed within the Period as it fell within both three and five years of the approval of the BRP in the EOGM. The decision to realign Cyan's portfolio was contemplated in 2010, the Directors' Report announced with 1<sup>st</sup> Quarter Results in April 2012 states the need for "mitigating the concentration risk towards the fertilizer sector" by substituting sizable investment in group companies such as Engro and DHCL with energy, oil and gas companies. This decision was also prior to the Period, which proves that the Respondent's allegation that the offloading DHCL shares was based on inside information was unfounded given that there were a combination of indicative and deciding factors leading to the sale of DHCL shares. ASD became



## Securities and Exchange Commission of Pakistan

aware of the 2<sup>nd</sup> Quarter Results on 24/07/12 following the circulation of the board of director minutes packs to the directors of DHCL. By the time ASD became aware of such information, the Appellants had already sold 5,122,372 out of the 5,392,372 DHCL shares. It is abundantly clear that the aggressive offloading of DHCL shares was not prompted by ASD's knowledge of the 2<sup>nd</sup> Quarter Results. The Impugned order also fails to identify any unfair advantage achieved as a result of selling DHCL shares within the Period. The Respondent has moreover ignored the fact that the share price of DHCL rose from Rs.29.87 at the date of the last sale by Cyan on 26/07/12 to Rs.40.04 on 19/09/12. The counterparties to the trades in question benefitted from the rise in the value of the shares acquired from Cyan.

The Respondent's conclusion that ASD has passed on inside information to the Appellants runs contrary to the fact that neither ASD/members of the Dawood family nor any associated concerns thereof (Sponsors) sold any of their shareholding i.e. 145,684,486 shares in DHCL during the Period and consequently lost Rs.2.2 billion as a result of not selling these shares. The sale by Cyan of investment in shares of DHCL and the resulting drop in DHCL's share price caused a huge loss of value to the Sponsors on a mark to market basis, which is evidence of the fact that the decision to dispose of DHCL shares was taken independently by the Board of Directors of Cyan, and not by inside information that ASD may have been privy to by virtue of his position as non-executive director of DHCL. Furthermore, ASD was also Director of Dawood Lawrencepur Limited which held 77,931,896 shares of DHCL (16.19%) as per Annual Report of DHCL for the year ended 2012. The shareholding of Dawood Lawrencepur in DHCL of which ASD was also a director, was significantly larger than Cyan's shareholding in DHCL. The Respondent has failed to take notice of the fact that passing of insider information did not occur in any of ASD's associated concerns even though there were many



## Securities and Exchange Commission of Pakistan

options and higher stakes involved to engage in insider trading activities by virtue of ASD's directorships.

- e) The Respondent has determined that "mens rea is not essential" to make out an offence under section 15A of the Ordinance, therefore, insider trading is an offence of strict liability. Section 15A of the Ordinance requires "using inside information" as an essential element of the offence, the Respondent is clearly required to establish the mens rea of ASD and it is submitted that the Respondent has failed to meet the requirement for the reasons set forth above. Reliance is placed on the judgment of the Sindh High Court judgment of Gammon (Hong Kong) Ltd & Others versus Attorney General of Hong Kong [1984] 2 All E.R. 503 which stated that, "there is a presumption of law that mens rea is required before a person can be held guilty of criminal offence...". The Respondent has failed to meet the requirement and the Impugned Order is set aside without the imposition of any fine or penalty.

### 7. The Respondent rebutted the grounds of appeal as follows:

- (a) The Appellant has relied upon newspaper articles to establish that the information of fertilizer plants potentially closing due to gas supplies was already public. In this regard, it may be noted that it is not possible that the actual financial impact of non-availability of gas to the DHCL was known to public as asserted by the Appellant. This was material price sensitive information and financial impact of non-availability of gas was discussed at length in the BoD meeting of DHCL. Further, most of the articles quoted are having dates of December 2011 while one article was published in October 2012, whereas, the offence was made during the period of May to July 2012. Furthermore, the board meetings wherein the financial prospect of the Company about the deteriorating financial position was discussed



## Securities and Exchange Commission of Pakistan

were held in April 2012 and June 2012. The articles, therefore, do not provide accurate projections about the period under review. Public information is general in nature regarding fertilizer industry and cannot be construed to provide fair assessment about performance of DHCL in particular. ASD, being director of board for DHCL, was privy to fairly accurate and privileged information regarding operating performance discussed in board meetings and, therefore, this information was inside information. A reference in director's report regarding uncertain gas supply does not mean disclosing broader financial picture of the company which was bound to unfold with time. Moreover, the gravity of financial impact with regard to non-availability of gas to DHCL was first discussed in BoD meeting held in April 2012 and later on in June 2012. The impact was not discussed earlier and disclosed in the Directors' Report for 1<sup>st</sup> Quarter ended 31/03/12.

- (b) No documentary evidence is provided which exhibits that ASD had authorized the COO to take investment decisions independently. The contention that the COO was managing the Appellant's portfolio and was making independent trading decisions to fulfill the requirements of the Appellant's investment policy and BRP does not hold merit. Further, the Share Purchase Agreement, as stated by the Appellant, was made on 22/03/12, therefore, selling shares of DHCL during the Period under review, with the sole objective of payment for HUBCO acquisition does not hold any merit.
- (c) Sponsor's shareholding in DHCL is a separate matter and has no connection with the appeal under consideration. ASD is CEO of Cyan and is insider by definition as defined in section 15C of the Ordinance. ASD being director on board of DHCL was privy to proceedings in April (through minutes of meeting) and June 2012 meetings and thus had privileged access to proceedings of the board and discussions made thereon.



## Securities and Exchange Commission of Pakistan

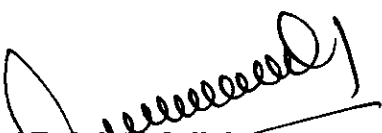
- (d) It is established in the instant case that the three components of section 15 of the SEO 1969 i.e. insider, inside information and insider trading are present and established. The Appellant was the insider as he possessed the inside information regarding the deteriorating financial system of DHCL. The financial result was the inside information and selling of shares by Cyan on the basis of inside information just days before the announcement of financial result of the DHCL constituted insider trading.
- (e) The assertion of the Appellant that a penalty or punishment cannot be in the form of any absolute or no fault liability and must be preceded by mens rea must be rejected. For breaches of provisions of the Ordinance and secondary legislation made thereunder, which are civil in nature, mens rea is not essential.
8. We have heard the arguments and perused the record provided to us by the parties i.e. the Appellant and the Respondent.
9. We have examined the evidence provided to us and seen the trading pattern in the scrip's of DHCL during the period between 08/05/12 and 26/07/12. The newspaper articles ranging from December 2011 to July 2012 had provided some insight into the gas shortage and the media had reported that fertilizer plants on the SNGPL Network, including DHCL, faced "permanent closure" as a result of severe curtailments in the supply of gas. The gas supply crisis had been ongoing for some time and DHCL had been informing members and making disclosures from time to time. Therefore, we concur with the Appellant that the information regarding gas curtailment resulting in losses for DHCL was in the public domain for some time at the time of selling off of DHCL shares. It is also important to note that the Appellants had sold 4,618,515 shares from 14/3/11 until 30/12/11. This implies that Cyan was already in the process of selling shares of DHCL since 2011. Further, we have noted that Cyan had sold 5,122,772 shares out of a total of



## Securities and Exchange Commission of Pakistan

SECP 5,392,772 shares before ASD became aware of the 2<sup>nd</sup> Quarter Financial results on 24/07/12. The share prices of DHCL also bounced back only after a few months from Rs.29.87 on 29/07/12 to Rs.40.08 on 19/09/12 which suggests no gain was made by the Appellants and counterparties to the Appellants benefitted from the increase in share price.

10. The Appellants had decided on 28/01/11 to reduce its exposure in its associated companies including DHCL and to establish a high yield liquid portfolio business. In accordance with this policy, Cyan acquired 3,22,60,000 shares of HUBCO on 13/06/12 at a price of Rs.30 pursuant to a Share Purchase Agreement with National Power International Holdings BV. This seems to be the result of a well-considered approved investment policy and not the result of insider information or trading. Further, the shareholding of ASD and the sponsors in DHCL is around 14,56,84,476 shares. Neither ASD nor the Sponsors sold off their shares during the Period and instead made a loss of Rs.2.2 billion as a result of not intervening which exhibits that they were not involved in insider trading.
11. In view of the foregoing, we are of the view that the Respondent has not been able to establish that the Appellants had acted on inside information in contravention of section 15A(1) of the Ordinance and avoided a loss by selling shares of DHCL. The Impugned Order, therefore, is set aside with no order as to costs.

  
(Zafar Abdullah)  
Commissioner (SCD)

  
(Tahir Mahmood)  
Commissioner (CLD)

Announced on: 10 SEP 2015