

Appellate Bench Orders

Before Appellate Bench No.1

October 23, 2002

Before Appellate Bench No. 1

In the Matter of

Appeal No. 52 of 2002

Mr. Samir Ahmed, Managing
Director,
Lahore Stock Exchange
(Guarantee) Limited

.....

Appellant

Versus

Mr. Shahid Ghaffar,
Commissioner (SM), SEC

.....

Respondent

Date of Impugned Order

July 24, 2002

Date of Hearing of appeal

September 19, 2002

Present:

For Appellant – Lahore Stock Exchange (Guarantee)Limited, Lahore.(LSE):

1. Mr. Rehmat Ali Hasnie, Chief Operating Officer
2. Mr. Ahmad Hasan Khan, Law Officer, LSE

For Respondent Commissioner Securities Market Division of the Commission

1. Syed Aamir Masood, Director S-III
2. Imtiaz Haider, Joint Director
3. Ikram ul Haq, Joint Director (Law)
4. Mahreen Rasheed, Assistant Director

Order

This is an appeal filed by the Lahore Stock Exchange (Guarantee) Limited through its Managing Director, Mr. Samir Ahmed under Section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the Order dated July 24, 2002 (impugned order) passed by the learned Commissioner (Securities Market).

2. The facts of the case are as follows: -

- i) The Securities and Exchange Commission of Pakistan notified the Brokers and Agents Registration Rules, 2001 (the Rules) vide S.R.O. 299(1)/2001 dated May 10, 2001 and laid down the Rules for the registration of the brokers. These Rules were to come in force within 90 days of these Rules coming into force.
- ii) The Securities and Exchange Commission of Pakistan wrote letter No. 2(33)SE/2001 dated December 12, 2001 to the Lahore Stock Exchange advising that w.e.f. January 1, 2002, only those members would be advised to deal in securities who are registered with the Commission under the Rules. The letter specifically demanded that this may be notified to all the members of the exchange.
- iii) On receipt of the application of the registration of the member by the Commission on June 10, 2002 from the Appellant the member was registered as a broker under the Rule on June 14, 2002. However, it came to the knowledge of the Commission that the member was dealing in securities from January 1, 2002 to June 13, 2002 without being registered as a broker with the Commission under the Rules.
- iv) A show cause notice dated June 22, 2002 was served under Section 7 and 22 for violation of the Rules and Section 5-A of the Securities and Exchange Ordinance, 1969 (the Ordinance).
- v) The hearing was fixed for July 5, 2002 and the impugned order July 24, 2002 (Impugned Order) was passed by the Commissioner, Securities Market Division whereby a penalty in the sum of Rs 1,00,000/- each was imposed on both the Appellant and the concerned member.
- vi) The Appellant filed its Appeal against the Impugned Order on August 23, 2002. The Appellant has termed the said order as illegal, void and without any justification or lawful authority.
- vii) The matter has come for hearing today.

3. It has been argued by the Appellant that the show cause notice was issued under Section 7 and 22 of the Securities and Exchange Ordinance, 1969 (the Ordinance) and where no violation has been committed by LSE under the said provisions the same cannot be invoked. It has been submitted that no duty is imposed by the Ordinance or Rules upon LSE if one of its members trades in securities without being registered with the Commission. It was further contended that under Section 5-A of the Ordinance a person who wants to deal in securities must be registered with the Commission and under the rules the only role of LSE is to forward application for registration as a broker to the Commission. In the Appellant's view all obligations pertaining to registering a member and the violations committed in respect thereof is the sole responsibility of the Commission. The Appellant argued that the mere fact that it suspended the trading rights of the

member and itself informed the Commission about the status of the member clearly establishes that the Appellant had more than fulfilled its moral and ethical duties and exhibited its bona fide. Hence issuance of show cause notice is unjustified.

4. The Appellant also argued that the letter dated December 12, 2001 was not a directive. In support of his arguments, it was stated that the directive should have been sealed with the seal of the Commission and should have been published in the official gazette under Section 22 of the Securities and Exchange Commission Act, 1997 (the Act). Furthermore, it was submitted that the kinds of directive that could be issued under the Ordinance are restrictive namely under Section 9(3), 9(6), 10, 15-B(3), 21, 22(1) and 34(4), therefore, the letter does not fall within the purview of the directives that can be issued under the Ordinance. Regarding Section 20(6)(g) of the Act it was stated that the power conferred on the Commission is a general power and the Commission can issue a directive in furtherance of its functions under the Act, however, it was emphasized by the Appellant that no directive can be deemed good under the law if it is against the Act or the Ordinance. Notwithstanding the above it was admitted by the Appellant that the intention of the person signing the letter was clearly to inform LSE as to its contents. Additionally, it was argued that if at all there has been a violation since the same was not willful on part of LSE provision of Section 22 cannot be invoked for imposing the penalty stipulated therein. The definition of the term 'willful' was cited from the 6th Edition of the Black's Law Dictionary, which reads as follows:

"An act or omission is 'willfully' done, if done voluntarily and intentionally and with the specific intent to do something the law forbids, or with the specific intent to fail to do something the law requires to be done; that is to say, with bad purpose either to disobey or to disregard the law"

Further it was argued that the Respondent in his Impugned Order has failed to determine whether the contravention of LSE was willful or not, despite the fact that the Appellant had vehemently argued that the contravention (if any) was unwillful/inadvertent mistake. Appellant also made a request before this Bench that if at all any violation is construed on part of the Appellant the Bench may kindly condone the same, as the same was neither willful nor voluntary.

5. The Appellant argued that the Respondent while relying on the telephone conversation between the Managing Director of LSE and himself has omitted to state the fact that in the said conversation he had allowed the restoration of the trading rights of the members after the Appellant suspended the same. According to the Appellant in para 21 of the Impugned Order the Respondent mis-stated the facts that the LSE restored the member's trading right before registration was granted to him which is denied as such restoration was only done with the permission of the Respondent.

6. Lastly, it was submitted that as per Rule 4 of the Rules a person is only eligible for registration if he has not defaulted. A question was posed by the Appellant that when the Commission had full knowledge that the member had acted in violation of the rule why did the Commission provide the registration certificate. This very act, according to the Appellant, reflects that the Commission had condoned any such violations.

7. In rebuttal of the above arguments the Respondents contended that it is incorrect to argue that no duty is imposed on the Appellant under the Ordinance and the Rule *viz a viz* registration of broker. It was argued that the Appellant being a frontline regulator was negligent in performing its functions *inter alia* to regulate the conduct of its members. It was also argued that the Appellant has to be aware of the provisions of the Ordinance or any other relevant law and in this regard it also has the responsibility to ensure compliance by its members of the relevant laws and directive of the Commission. Further, it was contended that the Appellant had knowledge regarding promulgation of the Rule, which also specify the requirement for registration of broker and agent. From the plain reading of the Section 5-A of the Ordinance it is apparent that the registration of a member with the Commission is mandatory. It was further submitted that under Rule 3(1) read with Rule 3(4) of the Rules, application for the registration with the Commission is forwarded through the relevant stock exchange. The Appellant has failed to diligently monitor and perform its responsibility and hence has rightly been penalized. It was also submitted that under the Rules, forwarding of applications implicitly also provides discretion to LSE in so far as analyzing the application is concerned. It was argued that this view is strengthened by the practice carried out with respect to applications already received by the Commission.

8. With respect to the objections that the letter was not a directive it has been firmly asserted that the said letter was a directive because it imposed an obligation on LSE and the objections with respect to the same being sealed and not notified in the official gazette are not relevant in view of the plain and ordinary reading of Section 22 of the Act. It was also argued that the letter dated June 8, 2002 of the Appellant clearly acknowledges violation of the Rules and further it also accepts and recognizes its obligation that the trading rights of such member who is acting in violation of the Rules are to be suspended with immediate effect.

9. With regard to the submissions made by the Appellant in respect of telephone conversation the Respondents argued that the contention of the Appellant holds no weight in so far as what is stated by the Commissioner in para 21 of the Impugned Order as the same does not affect the contraventions committed by the Appellant in this regard.

10. With respect to the issue of willfulness, it was argued by the Respondent that this could only be answered by first ascertaining what was in the knowledge of LSE at the relevant point in time. In this regard, it was argued that LSE maintains and at all relevant times maintained *inter alia* the record with respect to its members and the information relating to their trading and details of registration with the SEC. Therefore, despite being in control and in possession of such record the Appellant failed to recognize and act upon matters within its actual knowledge, as such the Appellant willfully and voluntarily failed to discharge its positive duty as against the member and as a frontline regulator.

11. As for the last objection that granting of certificate of registration infact condoned the conduct of the member and the alleged violation. It was argued by the Respondent that this plea if at all tenable, could only be taken by the broker who has infact deposited the penalty and is not contesting the Impugned Order.

12. Having heard the parties at length, we are of the considered view that the basic issue that needs to be adjudicated upon is whether, in the light of all the facts

and circumstances the Appellant has committed any violation under Section 22 of the Ordinance. With respect to the argument that the show cause notice was served only under Section 7 and 22 we have reviewed the said show cause notice wherein, it has been clearly pointed out that the notice under Section 7 and 22 was served in view of the contravention and non compliance with the applicable provisions of the Ordinance as well as the Rules. Therefore, firstly it needs to be examined whether there is any contravention on part of the Appellant either under the Ordinance or the Rules. In this regard Section 5-A of the Ordinance is relevant which is reproduced as under:

[5A. Broker or agents not to engage in business without registration.--- No person shall act as broker or agent to deal in the business of effecting transactions in securities unless he is registered with the Commission in such manner, on payment of such fees and charges and on such conditions as may be prescribed]

From the plain and ordinary reading of the above provision it is clear that a restriction is imposed on trading by a person, i.e. to deal in the business of effecting transaction in securities in such manner and conditions as may be prescribed. Admittedly Rules have been prescribed in this regard, hence, all the conditions prescribed therein must be observed. The argument that no duty is imposed on LSE under the said section and that under this provision it is actually the person who wants to deal with the securities is required to be registered with the commission is unique. It does not appeal to common sense that where such a person is allowed to continue trading by the concerned stock exchange how can the said stock exchange absolve itself of the responsibility it has in monitoring and ensuring compliance with the law as a front line regulator. The appellant by allowing a person to trade who is not registered with the Commission has clearly in our view committed a violation of section 5A of the Ordinance .It is clear from the rules that not only the application is to be received through the stock exchange in fact the stock exchanges are required to certify the membership and recommend registration with the Commission .As under First Schedule Form A read with rule 3(1) of the Rules, it is for the stock exchanges to ensure that the conditions for registration has been satisfied. Hence we are of the view that liability of the appellant under section 22 of the Ordinance is independent of the contraventions committed by the broker and at least it can be said that even if the appellant has not contravened it has certainly otherwise failed to comply with the provision of this Ordinance because it is responsible for regulating the conduct of its members. It was in Appellant's knowledge that the member was trading, since the application of registration was never forwarded to the Commission, being the frontline regulator it is expected to have knowledge that the said person was not registered with the Commission. Further, the Appellant does not deny receiving letter dated December 12, 2001 which further warrants due diligence on part of the Appellant. In our view, as discussed the Appellant cannot wriggle itself out from this matter by merely stating that it has no role to play in matters of registration where the same is clearly spelt out.

13. In view of the forgoing the issue whether the letter dated 12 December, 2001 falls within the purview of a directive or that the same could be issued under the Ordinance is no more relevant as under section 22 of the Ordinance the contravention of the provision of the Ordinance or any act which otherwise fails to comply with the provision of the Ordinance is sufficient for invoking the said

provision 22(1)(C). Regarding the issue of telephone conversation and placing reliance on the same and as to what extent it condones the alleged violations we are of the considered view that the same cannot be relied upon by either sides, as there is no proof on record. Despite the fact that the Respondents do not deny the fact of communication both the parties have conflicting statements to make as to the time for granting approval, therefore, in our view it would not be appropriate for the Bench to indulge in this matter and place any reliance on the same for the purposes of determining the issue at hand. In this regard, the objection of the Appellant that when the Commission had full knowledge that the member had acted in violation of the Rules then the providing of registration certificate by the Commission infact reflects that the Commission had condoned any such violation does not appear to be tenable. As this plea if at all valid could only be taken by the member himself who ironically has not contested the Impugned Order and infact has deposited the penalty.

14. Now coming to the issue of willfulness for imposition of penalty under Section 22, the Appellant has taken the stand that if at all there was any contravention on part of the Appellant since the same was not willful and was a result of inadvertent mistake the same may kindly be condoned. They have also quoted the definition of 'willfulness' as stated above from the Black's Law Dictionary, which precisely provides that a willful act or omission has to be intentional and must be done voluntarily. It has been argued that by virtue of suspending the trading rights of the member and the act of informing the Commission about the status of the member, the Appellant 'had more than fulfilled its moral and ethical duty'. In this regard the Respondent's have contested that the Appellant despite being in control and possession of all facts and relevant record has failed to recognize and act upon matters within its actual knowledge hence, the Appellant has willfully and voluntarily failed to discharge its positive duty as against the member and as a frontline regulator.

15. In this regard, we have taken note of fact that the Appellants admits that the intention of the person signing the letter of December 12, 2001 or as the Appellant terms it the alleged directive was merely to inform LSE as to its contents as well as to request LSE to circulate the same and the Appellant in its own letter dated June 8, 2002 to the member has made reference to this letter No. 2(33)/SE/2001 dated December 12, 2001 stating as follows:

"This has already been brought to your notice that as per the letter No.2(33)/SE/2001dated December 12, 2001 under the above said rules, "with effect from January 01, 2002, only those members would be allowed to deal in securities who are registered with the Commission".

In view of the above, it is clear that the Appellant had knowledge that only such members would be allowed to deal in securities who are registered with the Commission. Even otherwise the Appellant is expected to know all the relevant laws and regulations in field and to ensure its compliance. Where the application for such registration is to be forwarded through the Appellant (Rule 3(1)) and intimation of registration is required to be given by the Commission to Appellant (Rule 5(1)) and where neither an application has been made nor registration has been granted, if Appellant allows its member to deal in securities, it is not understandable why it should be exonerated absolutely. The primary responsibility is that of the Stock Exchange to ensure that settlements through the clearing house relate to the

authorised persons only. After the commencement of the Rules, the Lahore Stock Exchange was taking a risk of settlement of trades of an unregistered person. Furthermore, it has also not been explained as to why and how after six months suddenly the Appellant woke up to recognize its obligation. In our view the Appellants have not fully discharged the onus as to why and for what reasons the member was allowed to continue trading for several months despite the admitted fact that the requirement of registration of members was in their knowledge. However, in view of the Appellant's request for taking a lenient view on the plea that such violation was not intentional, we are inclined to concede to such request. The objective of penalizing LSE was primarily to make it realize that as a frontline regulator it cannot afford to overlook or become lax or passive in ensuring compliance with the regulatory framework *viz a viz* its member. Notwithstanding any direct nexus between the Commission and the brokers, the active intermediary role of the frontline regulator cannot be undermined. As stated above, we have also been informed that the concerned member has deposited the penalty we, therefore, consider it appropriate that the Appellant be given a warning to remain vigilant in performing its obligations under the Ordinance and the relevant Rules and Regulations. In view of what has been discussed above the penalty is hereby reduced to a sum of Rs. 25,000. Appeal is disposed of accordingly.

(Etrat H. Rizvi)

Commissioner

(Insurance & Information Technology)

(Abdul Rehman Qureshi)

Commissioner

(Enforcement & Monitoring)

Islamabad

Announced : October 23, 2002