



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
SECURITIES MARKET DIVISION

Before the Executive Director (Securities Market Division)
In the matter of Show Cause Notices issued to

Aqeel Karim Dhedhi Securities (Private) Limited

Under Section 22 of the Securities & Exchange Ordinance, 1969 and Rule 8 of the Brokers & Agents Registration Rules, 2001 for Violation of Regulation 3(b) of the Regulations Governing Futures Contracts of the Karachi Stock Exchange (Guarantee) Limited

Number and date of Notices	SMD-SOUTH/SCN/01/07 dated January 26, 2007 SMD-SOUTH/SCN/06/07 dated March 15, 2007
Date of hearings	February 27, 2007 March 29, 2007
Present	Ms. Rahat Kaunain Hassan - Legal Counsel Mr. Aadil Naeem Khan - Head of Group Compliance
Date of Order	April 3, 2007

ORDER

1. I have before me 56 cases involving broadly the same issues in relation to the 56 Show Cause Notices, issued by the Commission to 56 Brokerage Houses, for which I conducted hearings on various dates in relation to same. Since there is a commonality of issues involved, I have addressed the core issues raised by or on behalf of the 56 Brokerage Houses together, given the need to expedite the disposal of these matters. Accordingly, I have decided to issue a common order, which addresses all the core issues raised in the submissions made at these hearings and in the written responses filed by or on behalf of the 56 Brokerage House, even though, in certain instances, some of these core issues may not have been raised by each and every Brokerage House.

2. Accordingly, this order shall dispose of the proceedings initiated through Show Cause Notice No. SMD-SOUTH/SCN/01/07 dated January 26, 2007 and Supplementary Show Cause Notice No. SMD-SOUTH/SCN/6/07 dated March 15, 2007 issued to Aqeel Karim Dhedhi Securities (Private) Limited (the "Respondent") for violation of Regulation 3(b) of the Regulations Governing Futures Contracts (the "Regulations") of The Karachi Stock Exchange (Guarantee) Limited (the "Exchange") by the Securities and Exchange Commission of Pakistan (the "Commission").
3. Basic facts of the case are that the Respondent is a member of the Exchange and is registered with the Commission under the Brokers and Agents Registration Rules, 2001 (the "Brokers Rules"). Consequent to the submission of the Forensic Report regarding the Exchange events of March 2005 by Diligence USA, LLC, the Commission sought information from the Respondent to determine whether or not in February and March 2005, the Respondent had complied with Regulation 3(b) of the Regulations which requires that no member shall have a sale position in a particular scrip of more than Rs. 50 million, unless the actual shares sold over and above the aforesaid limit, are deposited with the Exchange or the broker gives documentary evidence that the shares are lying in Central Depository Company of Pakistan Limited ("CDC") or with some bank or Development Finance Institution ("DFI"), to the satisfaction of the Exchange management. For the purpose of establishing such sale position, net buy position in T+3, shall be net off from net sale position in Futures Counter.
4. An examination of the information provided by the Respondent revealed that 56 times, during the period from February 21, 2005 to March 24, 2005 the Respondent, had net sale positions in Futures Contracts, which were in excess of the prescribed limit of Rs. 50 million. In contravention of the requirement of Regulation 3(b) of the Regulations, the Respondent failed to either deposit with the Exchange the actual shares sold over the prescribed limit or submit to the Exchange the documentary evidence that such shares were lying in the CDC or a bank or DFI on the given dates.

5. Based on the findings, a Show Cause Notice No.SMD-SOUTH/SCN/1/07 dated January 26, 2007 was issued to the Respondent under Section 22(1) of the Securities & Exchange Ordinance, 1969 (Ordinance) for violation of Regulation 3(b) of the Regulations, to explain in writing or in person before the Executive Director that why a penalty should not be imposed by the Commission in the subject matter. In order to provide an opportunity of being heard, a hearing was fixed on Tuesday, February 27, 2007 at 3:00 p.m.
6. The hearing was held on Tuesday, February 27, 2007 at 3:00 p.m. which was attended by Ms. Rahat Kaunain Hassan - Legal Counsel and Mr. Aadil Naeem Khan - Head of Group Compliance (the "Representative") who submitted a written reply and argued the case.
7. A summary of the contentions raised by the Respondent in the written submissions in response to the Commission's Show Cause Notice No.SMD-SOUTH/SCN/1/07 dated January 26, 2007 are given hereunder:
 - It was argued that the Show Cause Notice has been issued under Section 22(1)(c) which was amended by Finance Act 2006 bringing violations under the Futures Regulations within its scope and ambit. Whereas the violations pertain to the period between February 21, 2005 to March 25, 2005. The amended provision cannot be applied retrospectively to the alleged violations.
 - It was stated that the imposition of penalty under Section 22(1)(c) would be in violation of Article 12 of the Constitution of Pakistan.
 - It was further asserted that the requirement to deposit the shares with the Exchange or give documentary evidence to the satisfaction of KSE was only a procedural requirement without entailing penal consequence. Hence, such a requirement, for the purpose of alleged violations, can at best be termed directory and not mandatory.
 - It was argued that Section 22(1) entails penalty, provided the contravention or failure under the said provision had been "willful". The Respondent being a company cannot be termed to have acted "willfully". Moreover there is nothing on record which shows that the violations have been committed purposely, deliberately and intentionally.
 - It was asserted that, as per consistent practice of the Exchange, the documentary evidence under Regulation 3(b) is to be submitted to the satisfaction of the Exchange

upon receipt of a notice from the Exchange. The absence of such a notice, in effect, indicates the satisfaction of the Exchange. Moreover, under the circumstances, non-submission of such evidence cannot not be termed "willful" on part of the Respondent.

- It was argued that the term "wilfully" envisages and restricts application of the provision to natural person alone. The entire scheme used in the Companies Ordinance 1984 is such that, wherever the company itself has been made liable, the word "default" is used, whereas, the term "knowingly and wilfully" has been used in the Companies Ordinance 1984 with reference to the obligations of officers of the company (natural persons), for example Sections 172 (4) & (5), 197(2), 205(5), 261(4), etc.
- It was argued that the Respondent is of the view that it discharged its duty in satisfying the Exchange by the possession of the requisite shares at the time of subject sale.

8. Following submissions were made during the course of hearing:

- The legal counsel stated that there was no need to issue Show Cause Notice as the Respondent did not commit any violation. She also pointed out that irregularity and illegality are two different things.
- The legal counsel argued that the objective of Regulation 3(b) of the Regulations is to avoid short selling in Futures Market beyond the prescribed limit and in case of breach of such limit, the Respondent is required to furnish shares or documentary evidence to the Exchange.
- The legal counsel asserted that the Exchange followed a customary practice whereby notices were issued to brokers requiring documentary evidence that sufficient number of shares were in possession of broker or his client at the time of actual sale. During the period, the Respondent did not receive a single notice which reveals the satisfaction of the Exchange. Subsequently, the Commission has been satisfied and required documentary evidences were provided from time to time during the detailed investigation. She argued that the Show Cause Notice is factually not tenable, once the Commission has been satisfied that there was no short selling on the part of the Respondent.
- The legal counsel contended that Clause (a) and (b) of Section 22 cannot be applied on the Respondent. Clause (a) is only applicable to a natural person and clause (b) is

not relevant. Clause (c) can only be applied for violations of Regulation 3(b) pertaining to the period of February and March 2005. Whereas the amendment through which the Regulations have been brought under the ambit of this section, was made in the Finance Bill 2006. Therefore, the Commission cannot impose any penalty on the Respondent with retrospective effect.

- The legal counsel further added that Section 22 is only applicable to a natural person and cannot be applied on the Respondent as the Respondent is a private limited company. She mentioned that whenever any restriction is imposed on a company, it is clearly mentioned therein and quoted some section of Companies Ordinance 1984 i.e. section 90(1), 95(1), 205(5) etc wherein the word "default" has been used instead of "willful".
- In case of a company, willful does not apply and it is clearly stated that the company will be liable for any act or omission. She pointed out that Section 22(1) of the Ordinance entails penalty for the contravention or failure under the said provision had it been willful. The wording willful is applicable to any person only and a company cannot do any act or omission willfully. While discussing the word "willful", she emphasized that there are three essential elements of willful act or omission namely motive, purpose and deliberate.
- The legal counsel reiterated that there is nothing on record which reveals that the non-submission of documentary evidence was occurred purposely, deliberately and intentionally on the part of the Respondent.

9. Subsequently, a Supplementary Show Cause Notice No.SMD-SOUTH/SCN/6/07 dated March 15, 2007 was issued under Rule 8 of the Brokers Rules to the Respondent stating that the Respondent has prima facie contravened Rule 12 of the Brokers Rules read with Clause A5 of the code of conduct contained in the Third Schedule to the Brokers Rules. The Respondent was called upon to show cause in writing within seven days and appear before the Executive Director on March 22, 2007 at 11:00 a.m. for a hearing to be attended, either in person and/or through an authorized representative. Subsequently, on the request of the Respondent the date of the hearing was extended and rescheduled on March 29, 2007 at 4:00 p.m.

10. In this regard, hearing was held on Thursday, March 29, 2007 at 4:00 p.m. which was attended by Ms. Rahat Kaunain Hassan - Legal Counsel and Mr. Aadil Naeem Khan - Head of Group Compliance (the "Representative") who submitted a written reply and argued the case.
11. Submissions made by the Respondent in its written reply to the Commission's supplementary show cause notice No.SMD-SOUTH/SCN/6/07 dated March 15, 2007 are given hereunder:
 - It is axiomatic that what cannot be done directly, cannot be done indirectly. Issuance of the Supplementary Show Cause Notice by the Commission is an attempt to circumvent law to achieve its purpose through indirect means by invoking provisions of Brokers Rules where the Commission has admittedly failed to charge the Respondent directly under Section 22 of the Ordinance. The same is therefore not tenable in law.
 - Once the Commission has decided to adopt one procedure, it could not adopt any other procedure; as such switch over of procedures during the course of proceedings is not permissible under law and renders the impugned action without lawful authority and of no legal effect.
 - The issuance of Supplementary Show Cause Notice dated 15 March 2007 is, in effect, an admission on part of the Commission of the deficiency and non-maintainability in law of the first Show Cause Notice dated 26 January 2007. The illegality of Supplementary Show Cause Notice is manifest from the fact that the same is premised on the first Show Cause Notice, which itself being void in nature, cannot be used as a foundation.
 - The issuance of the first Show Cause Notice under Section 22 of the Ordinance and the subsequent issuance of Supplementary Show Cause Notice under Rule 8 of the Brokers Rules, suffer from malice in law as much as both relate to the alleged violations of Regulation 3 (b) of the Regulations.
 - The Commission has failed to meet the pre-conditions, required for invoking the provisions of Brokers Rules by not discharging the onus on proving as to how action against the Respondent would be in the 'public interest'.

- The Commission first mentioned Section 22 of the Ordinance, and thereafter Rule 8 of the Brokers Rules which indicates ambiguity in the mind of the adjudicating authority in the application of law. Such infirmity is to be interpreted in favor of the person who is to be adjudicated on.
- Owing to the ambiguity in the Supplementary Show Cause Notice, the Respondent cannot duly exercise the "appropriate opportunity of being heard", as guaranteed under Rule 8 of the Brokers Rules. Even otherwise, any proceedings in pursuance thereof would be in breach of the well settled principle of audi altrem partem.
- The Commission has to exercise its discretion in a fair, reasonable and non-discriminatory manner. Application of law in relation to subjects, falling within the same class in different modes and varying in severity, is violative of Article 25 of the Constitution of Pakistan, 1973 and inconsistent with the fundamental right of equal protection of law.
- Giving effect to the intent of the Commission in application of Rule 8 would be inconsistent to the provisions of Section 22 of the Ordinance, which again would be in blatant disregard of the well settled principle that any anomaly between the subordinate and principal legislation has to be resolved in favor of the parent law.

12. Following verbal submissions were made during the course of hearing:

- The arguments were initiated by stating that the initial Show Cause Notice has been issued under Section 22 of the Ordinance while the Supplementary Show Cause Notice has been issued under the Brokers Rules. She contended that as per the law, the Supplementary Show Cause Notice should be in continuation of the initial Show Cause Notice while in this case the Subsequent Show Cause Notice was issued on totally different grounds.
- It was further contended that the Judgment stated that if something is inherently defective then the structure cannot be based on the defective base. Same is the case with the Supplementary Show Cause Notice which has no connection with the contents of the initial Show Cause Notice as Section 22 of the Ordinance which has been quoted in the initial Show Cause Notice cannot be retrospectively applied to the

brokers, thus making the FSCN null and void and subsequently rendering the Supplementary Show Cause Notice void.

- The legal counsel of the Respondent quoted the law which states that “what cannot be done directly, cannot be achieved through circumvention of law by indirect means”. So if the Commission was unable to penalize the Respondent under Section 22 of the Ordinance then it cannot penalize them under Rule 8 of the Brokers Rules.
- She further argued that while invoking Rule 8 of the Rules in the Supplementary Show Cause Notice the Commission has failed to define “public interest” and since “public interest” is not defined in the Supplementary Show Cause Notice, therefore, the Commission cannot ask the Respondent to defend itself on this ground.
- The Law of Proportionality was quoted with reference to the Ordinance wherein progression of the Ordinance was cited as protection of investor interest, securities market interest and lastly the protection of public interest. It was stated that the Commission was adopting a course which ignored the stated Law of Proportionality.
- It was also contended that as per precedents of the Supreme Court cited during the course of the hearing the changed/ alternate procedure adopted by the Commission in relation to the Supplementary Show Cause Notice as opposed to the initial Show Cause Notice is not permissible under law.
- It was further contended that since the Commission has failed to establish the grounds for any violation under the Parent Law i.e. the Ordinance (which sets the mandate for all other Legislations) attempts of making them liable under the Sub-ordinate Legislation i.e. the Brokers Rules, which shows inconsistency and the malicious intentions of the Commission.
- The Representative while referring to Article 25 of the Constitution of Pakistan, 1973 alleged that Supplementary Show Cause Notice issued by the Commission is in contradiction of the said Article.

13. I have considered the contentions of the Respondent and the core issues raised therein and the same are addressed by me below:

- In relation to the Respondents' contention that there has not been a violation of Regulation 3(b) of the Regulations, it may be noted that Regulation 3(b) has two limbs. The first pertains to regulating the underlying mischief, i.e. to ensure that no member indulges in 'short selling' over and above the Rs. 50 million threshold by providing that no member shall have a sale position in a particular scrip of more than Rs. 50 million, unless (a) the actual shares sold over and above the aforesaid limit are deposited with the Exchange or (b) the broker gives documentary evidence that the shares are lying in CDC or with some bank or DFI to the satisfaction of the Exchange. The second pertains to complying with the reporting requirement / action to be taken by each broker, every time that a broker exceeds the Rs. 50 million threshold, i.e. by either depositing the shares or providing documentary evidence for same. Therefore, it will follow that the reporting requirement / action is an independent obligation under Regulation 3(b) and is meant to ensure that there is no 'short selling' by placing on the broker an obligation to deposit shares or provide documentary evidence for same. Failure by a broker to comply with the above would infer that the Broker has indulged in 'short selling'. Therefore, the fact that at the material time (i.e. when a member had taken a sale position in a particular scrip of more than Rs. 50 million), the Respondent did not deposit shares or provide documentary evidence, and only did so subsequently at the request of the Commission, resulted in non-fulfilment of Regulation 3(b).
- As to the Respondent's next contention that only the Exchange is empowered to take action under the Regulations, I do not find substance in same, more so since the Regulations have been notified by the Exchange under Section 34 of the Ordinance. Under the Ordinance and indeed under the Securities and Exchange Commission of Pakistan Act, 1997, the Commission, inter alia, has wide powers to regulate all matters relating to capital markets, securities and ancillary issues. In any event, more specifically, under Rule 8(iii) of the Brokers Rules, the Commission can take action under Rule 8(a) or (b) of the Brokers rules if "...the Commission is of the opinion that a broker... has contravened the rules and regulations of the stock exchange". The Commission as the apex regulator of all corporate activities is not precluded from taking appropriate action where there is any violation or non-compliance of the laws,

rules or regulations. Hence, even if the Exchange may not have acted against any non-compliance of Regulation 3(b) in letter and spirit or may have allowed a certain practice to develop in this context, would not absolve the Respondent from the consequences of any non-compliance of the said Regulation, or indeed preclude the Commission from taking remedial action. The Respondent has an independent obligation to comply with the legal requirement as it is settled law that there cannot be an estoppel against the law.

- In this context, I now refer to the Respondent's related contention that documentary evidence to the satisfaction of the Exchange had been provided from time to time. However, the said information was provided before and after March 2005, but it is noteworthy that during March 2005, no information was provided by the Respondent in terms of Regulation 3(b). Lastly, on a related point, it has been argued that there was no specific procedure set out in Regulation 3(b) nor any timeframe was given within which the evidence was to be forwarded to the Exchange. In my view, there was no requirement for any specific procedure to be provided, as the language of Regulation 3(b) is clear, as stated above, inasmuch as it presupposes that no member shall have a sale position in a particular scrip of more than Rs. 50 million unless the actual shares sold over and above the aforesaid limit are deposited with the Exchange or documentary evidence relating to same are furnished.
- The Respondent has next contended that imposing any form of a penalty would not be in the "public interest". I have perused the case law cited by the Respondent and in my view, in fact it supports the position of the Commission. The entire purpose of this enquiry leading to issuance of Show Cause Notices, not only to the Respondent, but also to other Brokerage Houses was done, keeping the "public interest" in mind. Ensuring compliance of the Regulations and indeed compliance of all the corporate laws is the primary duty and function of the Commission, which is discharged in the public interest. The action in this instance is all the more necessary, particularly bearing in mind the recent history of the stock market crisis, which seriously compromised the interest of the public at large and particularly the small investors.

Hence, these proceedings were initiated to enquire as to whether there had been any violation of Regulation 3(b) in March 2005 and were conducted in public interest.

- As regards the Respondent's contention that Section 22 of the Ordinance is not attracted, as it was not applicable at the material time and cannot be applied retrospectively, there is no denying that if there was any non-compliance of Regulation 3(b) of the Regulations, the Commission also has the power under Rule 8 of the Brokers Rules to take punitive action. Accordingly, upon consideration of the Respondent's contentions, and to meet the ends of justice, the Commission issued a Supplementary Show Cause Notice under Rule 8 of the Brokers Rules to which the Respondent not only submitted its written response but also attended the hearing and made submissions thereon, which were duly considered by the Commission. In relation to same, it is pertinent to note that the Commission's power to independently proceed under Rule 8 of the Brokers Rules was not challenged by the Respondent. Moreover, due process was followed by the Commission with the 'rules of natural justice' being fully met. As such, the Respondent's contentions in this context are misconceived.
- As regards the contention that no loss has been caused, nor there was any short selling beyond the threshold of Rs. 50 million, I have already held above that there are two elements of Regulation 3(b), i.e. the first being to ensure that there is no 'short selling' and the second being a reporting requirement / action. Hence the fact that there has been no loss or 'short selling' would not absolve the Respondent from its obligation at the material time to comply with the reporting requirement, envisaged under Regulation 3(b) by either depositing the concerned shares or providing documentary evidence to that effect as prescribed in the said Regulation 3(b). In this instance, in relation to the issue of short selling, my perusal of the evidence provided by the Respondent substantiated the existence of the required shareholding in compliance of Regulation 3(b), in which context, I am satisfied to the extent that there was no short selling beyond the prescribed limit in Regulation 3(b) at the material time.

14. In view of what has been discussed above, and my considering the arguments presented before me in writing, as well as at the time of hearing and my having perused the documents and information placed on record, I am of the view that the Respondent has not fulfilled the requirement of reporting / taking action as envisaged under the said Regulation 3(b). However, certain extenuating circumstances have emerged from the Respondent's practice of supplying the requisite evidence under Regulation 3(b) only when required by the Exchange, which may have persuaded the Respondent to believe that it had discharged its obligation under Regulation 3(b), which clearly it did not for reasons stated above. I am also mindful of the fact that no evidence of 'short selling', has been revealed from the examination of the records provided by the Respondent.
15. In this background, I am inclined, on this occasion, to take a lenient view in the matter and will not take any punitive action under Rule 8 of the Brokers Rules. As such, I believe a 'caution' in this instance to the Respondent would suffice and I would further direct the Respondent to ensure that full compliance is made of all the Regulations in future for avoiding any punitive action under the law.

Zafar Abdullah
Executive Director