



SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
Securities Market Division

NIC Building Jinnah Avenue, Blue Area, Islamabad

Before The Executive Director (Securities Market Division)

In the matter of
Recovery of Tenderable Gain
Under Section 224(2) of the Companies Ordinance, 1984
From Mr. Najeeb-Ullah Ghauri, Director, NetSol Technologies Limited

Date of Hearing : 18/06/2009

Present at hearing :

Representing the Respondent:

- | | |
|--------------------------|--|
| (i) Mr. M. Javed Panni | Chief Executive, MJ Panni and Associates |
| (ii) Mr. M. Ayub Qureshi | Director, MJ Panni and Associates |

Assisting the Executive Director (SMD) :

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

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.222/13(365)2005 (the "**Notice**") dated 25/05/2009, against Mr. Najeeb-Ullah Ghauri, (the "**Respondent**") Director, NetSol Technologies Limited (the "**Issuer Company**").

NIC Building, Jinnah Avenue, Blue Area, Islamabad, Pakistan PABX: 0092-51-9207091-94,
FAX: 0092-051-9218595

Airphase I
Page 1 of 10

2. Brief facts of the case are that:-

- a) The Respondent made following purchase and sale transactions as a Director of the Issuer Company within the period of less than six months:-

Sr. No.	Date	Nature of transaction	No. of Shares	Rate per Share (Rs)
1	26.2.2007	Purchase	50,000	30.00
2	05.03.2007	Purchase	100,000	40.00
3	07.03.2007	Purchase	85,000	41.00
4	24.05.2007	Sale	100,000	66.00
5	25.05.2007	Sale	50,000	64.00
6	28.05.2007	Sale	50,000	67.00
7	06.06.2007	Sale	93,500	66.00
8	07.06.2007	Sale	89,500	65.00
9	01.10.2007	Purchase	100,000	120.00
10	05.10.2007	Purchase	50,000	123.00
11	08.10.2007	Purchase	39,925	125.00
12	17.10.2007	Purchase	24,200	119.00
13	19.10.2007	Purchase	65,000	125.00
14	22.10.2007	Purchase	66,200	135.00
15	25.10.2007	Purchase	35,300	133.70
16	26.10.2007	Purchase	50,000	140.00
17	29.10.2007	Purchase	37,500	147.00
18	01.11.2007	Sale	100,000	155.00
19	07.11.2007	Sale	136,800	148.00
20	12.11.2007	Sale	64,700	140.00
21	14.11.2007	Sale	200,000	145.00
22	05.02.2008	Purchase	200,000	141.00

- b) On account of the aforementioned transactions, the Respondent made gain of Rs. 15,584,690/- (Rupees Fifteen million five hundred eighty-four thousand six hundred and ninety 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 equity securities makes any gain by purchase and sale, or the sale and purchase, of any such security

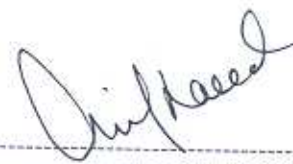
NIC Building, Jinnah Avenue, Blue Area, Islamabad, Pakistan PABX: 0092-51-9207091-94,
FAX: 0092-051-9218595

 Page 2 of 10

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 divulged to the Commission, as provided in Section 224(2) of the Ordinance, therefore, the Respondent was intimated vide this office letter dated 20/11/2008 that as provided in Section 224 of the Ordinance, the amount of the aforementioned gain has now vested in favour of the Commission. The respondent was advised to respond the matter, within 15 days of the said intimation. MJ Panni and Associates Corporate and Capital Market Consultants (the "Counsel"), subsequent to seeking extension in time twice, responded the matter on behalf of the Respondent vide its letter dated 09/01/2009. The Counsel *inter alia* stated that:-

- a) *It has been observed that bonus distribution announced by the company and bonus shares duly received by the director twice on 05-06-2007 and 15-11-2007 to the extent of 93,500 and 118,690 shares have not been reckoned and taken into account while calculating the impugned gain. In case the said bonus shares would have been accounted for the resulting gain would have been quite different".*
- b) *"The company has timely raised the demand, however, the matter has remained under correspondence with regards to difference of opinion with respect to quantum of gain, as there were divergent views regarding computation of gain, after taking into account the sale of bonus shares twice received by the director..... actual amount which Mr. Ghauri is ready to offer to the company in response to their demand.*



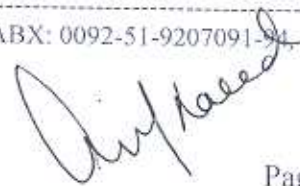
5. The plea of the Counsel was examined in the light of provisions of Section 224 of the Ordinance and Rule 16 of the Rules and was considered to be untenable. Thus, the Counsel was intimated accordingly on 11/02/2009. In response, the Counsel reiterated its earlier stance vide its letter dated 20/03/2009 and also provided copy of correspondence exchanged between the Issuer and the Respondent. The Counsel also requested for an opportunity of personal hearing. Thus, Notice under Section 224(2) of the Ordinance was served upon the Respondent on 25/05/2009 for providing him an opportunity of personal hearing on 09/06/2009, which on the request of the Counsel of the Respondent was adjourned and re-fixed for 18/06/2009. On the given date Counsel of the Respondent namely Mr. M. Javed Panni, Chief Executive, MJ Panni and Associates and Mr. M. Ayub Qureshi, Director, MJ Panni and Associates appeared before me and presented their written submissions and stated that: -

- 1) *The Respondent is entitled to retain the sale proceeds of bonus shares and the same should be excluded from his other purchase and sale or sale and purchase transactions which purportedly come within the ambit of Section 224. The impact of exclusion comes to Rs. 3,046,968/-.*
- 2) *The Respondent be allowed to tender the tenderable gain of Rs. 12,537,730/- to the Issuer Company.*

6. At the outset of verbal submissions, the Counsel stated that arguments in favour of the aforesaid disputations have been given in detail in its letters dated 09/01/2009 and 20/03/2009. Thus, the arguments advanced by the Counsel in support of its foregoing contentions in writing as well verbally are as under:-

- a. *The Respondent received 96,075 and 118,690 bonus shares on 05/06/2007 and 17/11/2007 and sold them on 06/06/2007, 07/06/2007 and 14/11/2007. There is no requirement in the law to specifically report which shares have been sold. Both sales were made on the close proximity to the receipt of bonus shares. First six day after receipt and second two days before receipt of bonus shares, as the director has been duly informed on both occasions about issue of the bonus shares by the Board of Directors of the Company.*

The Counsel further contended that the receipt of bonus shares (not constituting a purchase under sub-rule (2) of the Rule 16 ibid), therefore, their subsequent sale stands excluded from the ambit of Section 224 and the Rule or else it would have been



explicitly provided as such. The very basis for the applicability of provisions of Section 224 and Rule 16 is accrual of gain through purchase and sale or sale and purchase, which in the present scenario does not exist, as there is no purchase (in legal sense) to complete the transaction as enunciated in the said provisions.

The Counsel also cited, the Case of Mr. Mushtaq Ahmed vs. Commissioner Securities Market Division's Order dated 01/04/2002 and stated that the appeal filed under Section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the said Order of the Commissioner (SM) was accepted by the Appellate Bench (vide its Order dated 23/07/2002) of the Commission on the same grounds.

With regard to the concept that the "Securities are fungible" the Counsel contended that the concept "shares are fungible" was more applicable, when the shares were in physical form and with the introduction of "dematerialization of the shares" the said concept in this regard has become almost redundant. The Counsel added that when two terms viz *pari passu* and *fungible* are applied in context with Section 224 it denotes that all securities, stocks, shares which are received by the shareholders of a listed securities are similar substitutable and have the same rights and privileges. These shares are identical and possess equal rights and entitlement, when dividend in cash or stock is distributed by the listed companies. The Counsel further stated that an important point to underscore and understood here is for the application of the law i.e. section 224 and Rule 16 in the relevant situations and case, some imperceptible distinction is required to be made to distinguish between shares held in the beneficial holding of a shareholder. Now a very pertinent point arises that in order to discern shares purchased and sold and vice versa during the six months period by such persons as provided in the law, certain subtle distinctions of shares added (through purchase) or subtracted (by way of sale) along with the dates of such transactions has to be made in order for law to take its course for determining gain accrued on the transactions, if it is made in violation of six months period. As a corollary to the same receipt of bonus shares by the Respondent, there being no specific restrictions on sale of such shares either in law or rule, the director or other persons referred in the law would be at liberty to sell such shares without attracting provisions of section 224 *ibid*. The Counsel stated that in the instant matter, the Respondent sold same number of shares which he received as bonus on both occasions and duly reported the same on the prescribed return to the Commission.

- b. Concerning its second point/submission (Respondent be allowed to tender the gain to the Issuer), the Counsel argued that the company raised the demand on November 20, 2007 for tender of gain which was well within the stipulated time after coming to know that the director has made certain transactions by asking him to furnish detail of such transactions and consequential gain, if any. The director in equal responsible and prompt showed his willingness without any if and but to tender the gain. The intervening delay has been caused due to receipt and subsequent sale of bonus shares and its overall impact over the eventual working out of amount of gain to be tendered.



The Counsel also stated that *it is right of the Company to receive the amount of the tenderable gain and the Commission has no legal ground for claiming the same under the law.*

7. Having considered and examined the arguments presented by the Counsel of the Respondent in writing as well as verbally during the course of hearing, my findings in the light of prevailing Laws and Rules on the subject matter are as under:-

a) Concerning the Counsel's plea that *sale of bonus shares is excluded from the ambit of Section 224 of the Ordinance*, it is pointed out that this matter has visibly been narrated in Rule 16 of the Rules. When we read text of the Rule 16 conjunctively, the matter stands clear. For convenience the said rule is reproduced hereunder:-

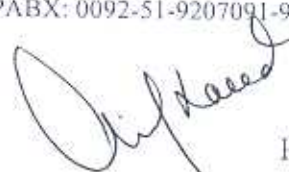
(1) Any gain made from the purchase and sale, or sale and purchase, of a listed security within a period of less than six months, which is required to be reported to the Commission and the registrar, and to be tendered to the company under section 224 shall be computed in the following manner, namely:-

a) *the purchase at lowest rates shall be matched against the sales at highest rates prevailing within the six months, and the recoverable amount calculated with respect to every individual transaction by reference to the difference between the purchase price and the sale price of a purchase and sale, or sale and purchase disregarding any other transactions, that is to say, the lowest in rate and highest out rate of the purchases and sales or the sales and purchases shall be matched; and*

b) *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.*

(2) *For the purpose of sub-rule(1), distribution of bonus shares and allotment of right shares by a listed company to an existing shareholder either on the basis of his entitlement or on account of purchase of right allotment letters from market shall not constitute a purchase .*

Thus, the Rule simultaneously provides that for the purpose of determination/calculation of tenderable gain the securities are fungible, but distribution of bonus shares shall not constitute a purchase. Thus, the Rule specifically exempts only receiving of bonus shares from the applicability of the



Section 224, while, it is silent about the sale of bonus shares, because as per the said Rule, the shares are fungible, hence after receiving, the bonus shares becomes part of entire holding of the beneficial owner, and such discrimination, specially in dematerialized form of shares becomes impossible.

I also do not agree with the contention of the Counsel *that the shares are identical and possess equal rights and entitlement only when dividend in cash or stock is distributed by the listed companies.* In this regard, I am of the view that shares are identical and fungible for all practical purposes including sale, as each share of same class carries same denomination/par value and fetches same market price that is why the Rule 16 does not exempt the sale of claimed bonus shares from the applicability of Section 224 of the Ordinance.

During the course of hearing, the Counsel agreed that the securities of same class are fungible, identical, substitutable and have the same right and privileges, but simultaneously it was also stated that *for the applicability of the under reference law, some imperceptible distinction is required to be made to distinguish between shares held in the beneficial holding of a shareholder.* I do not intend to agree with this contention of the Counsel, as this view-point not only crushes the concept of "shares are fungible" but also assigning of such distinction in the present system of dematerialized shares is impossible.

I have also gone through the case cited by the Counsel. In the instant case, the transactions were made in 1993, when the shares were kept in physical form, while, the concept of "fungibility" was made part of the Rule 16 of the Rules on 21/08/2001, subsequent to introduction of Central Depository System. The under reference order was passed by the Commissioner (SM) on 01/04/2002; wherein appeal was accepted vide Appellate Bench Order dated 23/07/2002.

In addition to above above, in my views, if some how the proposed segregation between the bonus shares and other shares (held of the same class) is made and the plea of the Counsel that *"the director or other persons referred in the law would be at liberty to sell such shares without attracting provisions of section 224 ibid* is accepted, then it would not only lend the redundancy to whole scheme envisaged in Section 224 of the Ordinance and Rule 16 of the Rules, but, also cause several implications. For instance, if a beneficial owner of a listed company receives 100,000 bonus shares on a specific date. After receiving the bonus shares he/she may indulge in sale and purchase of shares on the plea that sale is being made out of bonus shares, resultantly, the beneficial owner would be able to defeat the purpose of the law.

Notwithstanding above, I have also looked into the plea of the Counsel that *sale executed on 06/06/2007, 07/06/2007 and 14/11/2007 was disposal of bonus shares, which was received by the Respondent on 05/06/2007 and 17/11/2007 respectively.* In

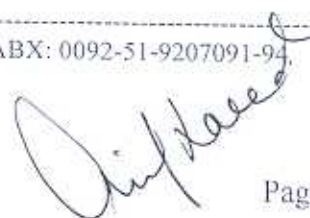


this concern I have consulted the returns of beneficial ownership, filed by the Respondent, CDC's letter dated 06/06/2007 provided by the Counsel and Activity Report of the CDC's account of the Respondent and observed as under:-

- I. The Form-32, filed by the Respondent for change in shareholding shows that 96,075 and 118,690 bonus shares were allotted to him as at 31/05/2007 and 15/11/2007 respectively.
- II. Manager Operations, Central Depository Company's letter dated 06/06/2007 (provided by the Counsel, as pledged in personal hearing) shows that the bonus shares were credited into respective accounts in the Central Depository System at the end of the day of 05/06/2007.
- III. Activity Report of Respondent's CDC Account No. 7293 shows that 96,000 bonus shares were credited to the account on 19/06/2007. While, 85,300 and 33,330 shares were credited to the account on 20/11/2007 and 22/02/2008 respectively.

Thus in my opinion effective dates of receipt of bonus shares by the Respondent are 19/06/2007 (for 96,000 shares), 20/11/2007 (for 85,300 shares) and 22/02/2008 (for 33,300 shares). The record suggests that the Respondent did not made any immediate sale transaction subsequent to receipt of 96,000 bonus shares (which were credited to his account on 19/06/2007), but he purchased 468,125 shares from 01/10/2007 to 29/10/2007 in nine transactions. Similarly, no sale transaction has also been reported by the Respondent after the receipt of second tranche of the bonus shares. Thus, the claim of the Counsel that sales made on 06/06/2007, 07/06/2007 and 14/11/2007 were out of 96,075 and 118,690 bonus shares does not have any force. The acceptance of the said plea of the Counsel would imply that the shares were sold before their actual receipt.

- b) Concerning the second plea of the Counsel that *the Respondent now be allowed to tender the amount of gain to the Issuer Company*, I have consulted the provisions of Section 224(2) of the Ordinance, which inter alia determines the time limit for the purpose of recovery of amount of gain by the issuer as well as tendering of the gain by the beneficial owner to the issuer. It provides that where among others a Director 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. In the instant case, the prescribed time limit has already been elapsed, neither the Respondent tendered the gain to the Issuer nor the Issuer recovered it, therefore, the Respondent is now required to tender the gain in favour of the Commission. It is also pointed out that even the Commission does not have any power under the Ordinance to allow the



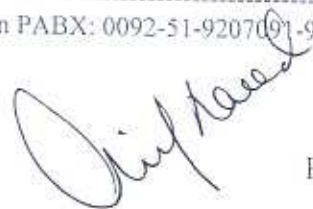
Director to tender the said amount of gain to the Issuer Company subsequent to the lapse of stipulated time limit.

I have also examined the correspondence exchanged between the Issuer Company and the Respondent (provided by the Counsel), which reflects that the Respondent intimated the Issuer on 20/11/2008 that the Commission has also initiated proceedings for recovery of the under reference amount of gain. After the said intimation, the Issuer Company has never approached to the Commission for becoming party of the said proceedings on the basis that it has already raised demand for this purpose. Even, in response to my query, the Counsel stated that it is representing only the Respondent. So, the circumstances suggest that the Issuer Company is not only aware of the legal position of the matter, but also stands agreed with the view-point of the Commission.

Perusal of the correspondence exchanged between the Respondent and the Issuer Company further reveals that the Issuer Company raised demand for recovery of the gain, on the basis of information received from the Central Depository Company of Pakistan, while, on the request of the Respondent; the Issuer Company provided him the details of computation of tenderable gain. The contents of the Computation Sheet (prepared by the Issuer Company) suggests that the Issuer Company has given him the benefit of disposal of the bonus shares with the remarks that "Delivery of 93,500 (vide Sr. No. 3 of the Computation Sheet) and 118,690 bonus shares (vide Sr. No. 13 of the Sheet) were received in CDC account on 05/06/2007 and 17/11/2007 respectively. While, in-fact the said bonus shares were received in the CDC account of the Respondent on 19/06/2007 and 20/11/2007. Thus, in my views, the said contents of the Computation Sheet indicate two issues as follow:-

- i) The Issuer Company has not properly examined the activity report of the CDC's account of the Respondent, on the basis of which the claimed demand was raised by it.
- ii) The Computation Sheet also negates the claim of the Respondent that the delay in tendering of the gain to the Issuer Company was due to difference of opinion with respect to quantum of gain, after taking into account the sale of bonus shares, but, the under reference correspondence does not give any such indication of difference of opinion.

I have also examined the view point of the Counsel that *it is right of the Issuer Company to receive the amount of the tenderable gain and the Commission has no legal ground for claiming the same under the law*. In this connection, I am of the view, that the amount of tenderable gain is not an outcome of any activity of the issuer company, but it generates from market-based activity of the beneficial owner,



therefore, the law provides an opportunity to the company to recover the gain within the stipulated time period and it does not become company's right.

8. In view of the foregoing, I am of the considered opinion that the arguments presented by the Counsel of the Respondent do not have any merit and substance. Hence, the request of the Counsel to exclude the sale transactions made on 06/06/2007, 07/06/2007 and 14/11/2007 from the ambit of the Section 224 of the Ordinance and to allow the Respondent to tender the gain to the Issuer Company at this stage is rejected and the Respondent is, hereby, directed to tender Rs. 15,584,690/- (Rupees Fifteen million five hundred eighty-four thousand six hundred and ninety 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 (SM)

Islamabad.
Announced on 08/07/09