II

COMMENTARY ON SECURITIES LAW

LAWS RELATING TO SECURITIES

Introduction

27.1 The Laws and Regulations relating to securities and share markets in Bangladesh are new in practice and have come to be noticed only after the great turmoil in the share market in 1996 and the action taken by the Securities and Exchange Commission against some persons alleging that they contravened the laws relating to the conduct of the share markets.

The basic laws that cover the field are the Securities and Exchange Ordinance 1969 and the Securities and Exchange Commission Act of 1993. Rules and regulations have been framed under these laws. There has been only one major judicial decision on the working of these laws and this relates to the preliminary procedure to be followed by the Securities and Exchange Commission before filing a criminal action for violation of the provisions of the Securities and Exchange Ordinance. For the most part therefore the discussion on this will refer to the laws and regulations and the comparable provisions in other countries.

Historical Background

27.2 For a historical background of the laws relating to securities one must look into their origin in the United States of America in the New Deal Legislations of the Nineteen Thirtees when President Roosevelt's Democrats promised to give the nation a new deal in the form of labour laws and the investor protection laws after the great depression of the early thirtees following the great Wall Street Crash of 1929 when people literally jumped out of high rise buildings being ruined by a volatile fall of share prices in the New York Stock Exchange.

In the United States of America the Securities Laws are contained in the Securities Act of 1933 (and Rules and Regulations under that Act), the Securities Exchange Act of 1934 (and Rules and Regulations under that Act), Investment Company Act of 1940 , Investment Advisers Act of 1940 and SEC Procedural Rules and Rules of Practice. There are other related laws, e.g., Mail and Wire Fraud Statutes, the Foreign Corrupt Practices Act of 1977, Racketeer Influenced and Corrupt Organizations Act, the Commodity Exchange Act (selected provisions) etc. Of relevance to the Bangladesh Law are the basic laws of the American Securities Industry namely the Securities Act of 1933 and the Securities Exchange Act of 1934.

The Securities and Exchange Commission in the U.S.A. created by the 1934 Act is a highly prestigious body and controls and influences a significant portion of the American economy. The American Securities Act of 1933 regulates public offerings of securities. It prohibits offers and sales of securities which are not registered with the Securities and Exchange Commission (SEC) subject to exemptions for enumerated kinds of securities and transactions . It also prohibits fraudulent or deceptive practices in any offer or sale of securities.

The U.S. Securities Exchange Act of 1934 contains a number of distinct groups of provisions, aimed at different participants in the securities trading process. The Act established the Securities and Exchange Commission and transferred to it the responsibility for administration of the 1933 Act which had originally been assigned to the Federal Trade Commission. Other provisions of the Act impose disclosure and other requirements on publicly held corporations ; prohibit various "manipulative or deceptive devices or contrivances" in connection with the purchase and sale of securities; restrict the amount of credit that may be extended for the purchase of securities; require brokers and dealers to register with the SEC and regulate their activities; and provide for SEC registration and supervision of national securities exchanges and associations, clearing agencies, transfer agents and securities information processors. There is a popular misconception that the American SEC is a criminal enforcement agency. This is not so , for it has no criminal enforcement powers, but wide regulatory and civil enforcement powers. Criminal prosecution of those who willfully violate the Securities Acts, including the insider trading provisions, is handled by the Department of Justice.

In contrast to many other jurisdictions, the United States of America has put considerable resources into the enforcement of the laws and regulations governing the securities markets. The SEC, a self-standing commission responsible for the operation of the federal securities laws and for promulgating secondary legislation in that area had as its first chairman Mr. Joseph P Kennedy, who reputedly made a fortune in the turmoil of the 1929 Wall Street Crash and later achieved a greater fame as the father of late president John F. Kennedy. As a great manipulator of the share market the first Chairman sure knew where and how to plug the gaps in the laws and regulations of the securities industry. The SEC worked admirably and the warnings about 'placing the fox in the chicken coop' proved to be unwarranted.

The American SEC has been noteworthy for the high level of intelligence and integrity of its staff, and the flexibility and informality of many of its procedures. Its disclosure and enforcement policies have also been credited with making an important contribution to the generally favourable reputation which American corporate securities and American securities markets enjoy. It has always acted as a loyal watchdog for the investors inspite of the economic costs of the rules and requirements. In the U.S.A. the different stock exchanges had always been regulating its own activities even before the passage of the Securities Exchange Act of 1934 and that Act incorporated the exchanges into the regulatory structure, subject to certain oversight powers in the SEC. Also different state laws had always supplemented the regulatory features of the American securities laws. These state laws, known as 'blue sky laws' are of long standing and are designed to regulate transactions in securities and in that regard contain anti-fraud provisions. The attractive description 'blue sky' was applied to these laws by the U.S. Supreme Court in 1917[1] which described their purpose as the prevention of "speculative schemes which have no more basis than so many feet of blue sky".

The international impact of the regulation of the United States securities markets in the post-war period cannot be underestimated. Given the dominant position of the U.S. stock markets in share trading together with the rapid development of communications it was inevitable that as international markets grew the regulatory approach of the US would exert influence on other countries.

27.3 In *Australia* the Poseidon share scandal in the early 1970s in which scarcely any Australian family escaped unscathed caused an outcry and the Australian Labour Party headed by Gough Whitlam made an election promise to introduce reforms in the share market laws which until then were governed more by self regulations of the respective stock exchanges based on the English style rather than the statutory control that the Americans had introduced before the Second World War. The Corporations and Securities Industries Bill 1975 crossed the House of Representatives but was blocked in the Senate where the then opposition coalition of the Liberal and Country Parties were dominant. With the dissolution of the Australian parliament in 1975 and fresh elections which the Liberals won, the process of legal reforms was delayed. At present the Australian companies and securities legislation are based on the Corporations Act 1989 and the Australian Securities Commission Act 1989 and the regulations framed under these two laws.

The object of the Australian Securities Commission Act is to establish an Australian Securities Commission which must strive to maintain , facilitate and improve the

[1] Hall vs Geiger-Jones Co 242 US 539

performance of companies and of the securities markets and futures markets in the interests of commercial certainty and to maintain the confidence of investors in the securities markets and futures markets by ensuring adequate protection for such investors. This federal Act will apply to States which provide for that law to apply as law of that jurisdiction. The Commission will have at least three full time members including the Chairperson and the Deputy Chairperson and other full time or part time members.[1]

Where the Commission has reason to suspect unacceptable circumstances the Commission may make such investigation as it thinks expedient. The Commission may in this regard give notice to persons to appear before it and give all reasonable assistance in connection with the investigation.[2]

The Commission may require informations to be disclosed about securities or futures contracts.[3]

The Commission may by writing under its common seal , delegate to a person all or any of its functions and powers.[4]

It is interesting to note that the Bangladesh and the Australian laws speak of delegation of powers by the Commission which comprises the Chairman and other members of the Commission but there never arose any argument in Australia that the delegation must be by all members of the Commission acting as a Commission. In Bangladesh this question arose-see Shinepukur Holding Ltd and ors. vs SEC.[5]

The Australian Securities Commission (ASC) Act also establishes an Australian Accounting Standards Board to develop a conceptual framework, not having the force of an accounting standard, to review proposed accounting standards and interalia to make such changes to the form and conduct of a proposed accounting standard as it considers necessary.[6]

The ASC Act applies to the States. The States have passed uniform legislations giving ASC this jurisdiction.[7]

The Corporations Law 1989 deals not only with the company law of that country but also Securities, Exchanges and Stock Markets and makes extensive provisions relating to the Securities Clearing House and participants in the securities industry. The law provides for conduct of securities business, dealers' accounts and audit etc.

The Australians borrowed heavily from the U.S. Securities laws and regulations to frame their own law and the detailed provisions are aimed at countering possible share market manipulations. In any future remodelling of our laws the legislators should do well to look at the detailed Australian legislations.

27.4 *In India,* the Securities and Exchange Board of India Act 1992 (SEBIA) authorises the Central Government to establish a Board by the name of the Securities and Exchange Board of India. The Board consists of the Chairman and several members and the general superintendence, direction and management of the Board shall vest in a Board of members. The Chairman shall also have the powers of general superintendence and direction of the affairs of the Board.[8]

It is the duty of the Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market including regulating the business in stock exchanges, registering and regulating the working of stock brokers, sub brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries

[1] Sections 9 and 10 of the Australian Securities Commission Act

[2] Section 13 and 19 ibid

[3] Part 3, Division 4 of the Act

[4] Section 102

[5] (1998) 18 BLD (HC) 61

[6] Section 224 and 226

[7] Section 58 and 66 of the Corporations (name of State) Act.

[8] Section 4

who may be associated with the securities market in any manner. It shall also prohibit fraudulent and unfair trade practices relating to securities markets, and insider trading, regulating substantial acquisition of shares and take over of companies and conducting audit of the stock exchanges etc.[1]

It may conduct research and levy fees or other charges for carrying out its purposes.[2]

It has the power to issue directions after an enquiry to any person or class of persons in the interest of investors, or orderly development of securities market or to prevent the affairs of any intermediary being conducted in a manner detrimental to the interests of investors or securities market or to secure the proper management of such intermediary.[3]

The Indian Act provides for registration of stock brokers, sub-brokers, share transfer agents etc[4]

The Act contemplates the establishment of Securities Appellate Tribunal and a further appeal to the High Court from an order of the Securities Appellate Tribunal.

28.1 **The Securities and Exchange Ordinance 1969 (SEO)** was enacted on 28 June 1969 in Pakistan including the area now constituting Bangladesh to provide for the protection of investors, regulation of capital markets and issue and dealings in securities. The Act was amended consequent to the enactment of the Securities and Exchange Commission Act 1993. (SEC Act).The two laws must be read together along with the Regulations and Rules framed by the Securities and Exchange Commission.(SEC)

28.2 The SEO consists of 35 sections. Section 2 gives the definitions. The Commission has been defined as the Securities and Exchange Commission constituted under the SEC Act of 1993 (by amendment after the promulgation of the SEC Act).

The term **'equity security'** means any stock or transferable share or similar security representing ownership, any security convertible , with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security, and any warrant or right itself. It will include such other security as may be subscribed. The term 'equity security' has not been used extensively in the SEO and mostly the term 'securities' has been used. Section 2(l) as amended by the Securities and Exchange (Amendment) Act 1993 defines the term **'securities'** as including any government security, instruments creating a charge or lien on the assets of the company, and instruments acknowledging loan to or indebtedness of the company and guaranteed by a third party and entered into jointly with a third party, and includes any stock, transferable share, scrip, note, debenture, debenture stock, bond, investment contract and preorganisation certificate or subscription and in general any instrument or interest commonly known as a security. The term would also include any certificate of deposit for certificate of interest or participation in temporary or interim certificate for, receipt for, or any warrant or right to subscribe to or purchase any of the foregoing.

'Stock Exchange' has been defined as a person who maintains or provides a market place or facilities for bringing together buyers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood and includes such market place and facilities.

A **'broker'** means any person engaged in the business of effecting transactions in securities for the account of others.

A **'jobber'** means any person engaged in the business of effecting transactions in securities for his own account through a broker or otherwise but does not include any person who trades in securities .for his own account either individually or in some fiduciary capacity otherwise than as a part of a regular business.

[1] Section 11

[2] section 11 of the SEBIA

[3] section 11B ibid

[4] section 12 ibid

An **'investment adviser'** includes a person who is, for compensation, engaged in the business of advising others, either directly or through publications or writings as to the securities or as to the advisability of investing in , purchasing or selling securities but does not include a banker, lawyer, accountant, engineer or teacher or any broker, jobber, member or associate whose performance of such services is solely incidental to the conduct of his business as such.

The publisher of any newspaper, news magazine or other publication of general and regular circulation are also exempted.

An **'investment company'** is a company engaged principally or wholly in buying and selling securities of other companies and includes a company eighty percent of whose paid up capital is employed at any one time as investment in other companies.

An **'issuer'** means any person who has issued or proposes to issue any security.

'Person' includes a body of individuals whether incorporated or not, a company or other artificial juridical person.

28.3.1 Section 2A-2F have been inserted in the SEO by the Securities and Exchange (Amendment) Act 1993 . This was necessary because the office of the Controller of Capital Issues with its control over issue of capital was being abolished. Section 2A forbids any company incorporated in Bangladesh from investing anywhere other than Bangladesh except with the consent of the SEC. Also, any company whether incorporated in Bangladesh or not shall, except with the consent of the SEC make an issue of capital or any public offer of securities for sale or renew or postpone the date of maturity or repayment of any security maturing for payment in Bangladesh.

By a Notification dated 16 Sept. 1997 the SEC in exercise of the powers conferred on it by section 2D of the SEO granted exemption from the provision under clause (a) of subsection (2) of the SEO all private companies and any public company for an issue of capital upto Taka Ten Crores.

Section 2B gives SEC control over prospectus and other advertisements by forbidding any person from issuing any prospectus or other documents offering for subscription or publicly offering for sale any securities which does not have the consent of the SEC. No person shall without the consent of the SEC issue any document publicly offering for sale any security which does not contain a statement that the document was issued with the consent or recognition of the SEC.

Section 2C forbids a person to give any consideration for any securities in respect of an issue of capital unless the consent or recognition of the SEC has been obtained for the issue.

Section 2CC inserted in the Ordinance by Act 6 of 1997 provides that notwithstanding anything contained in the Companies Act or any other law or in any contract or any memorandum or articles of association of any company any consent or recognition accorded under section 2A, 2B or 2C, shall be subject to such conditions as the Commission may from time to time, think fit to impose.

28.3.2 **Lock in and Minimum Lot of Shares** – The SEC by a Notification No SEC/Section-7/Lock-in/97-128 -1 dated 16 Sept 1997 in order to promote fair dealing in securities and to further strengthen protection of investors and in exercise of powers conferred under section 2CC of the SEO restricted the transferability of securities by stipulating that the securities which are subscribed by the sponsors/promoters/directors as described in the prospectus shall be subject to a lock-in period of three years in case of companies intending to go for initial public offering (IPO) from the date of its approval thereof by the SEC or from the date of start of its commercial production whichever is later. This lock in provision is not applicable in case of foreign investors.

By another Notification being Notification NO SEC/Section-7/DPI/97-130 dated 28 Sept. 1997 in exercise of powers conferred by section 2CC , the SEC directed that while distributing securities in the IPO minimum market lot shall be securities worth Tk 5000

(Taka Five Thousand). This notification fixed a quota of ten percent for non resident Bangladeshis out of the total amount of the IPO. In case of over subscription the allotment will be made by the company on a pro rata basis subject to the nearest multiple of the minimum market lot. Of the ninety percent left seventy percent is to be allotted to those who applied for minimum market lot and thirty percent for those other than applicants for minimum market lot. The SEC regulators have obviously made a mistake in their arithmetics! Oversubscription in the category of minimum market lots will be decided through public lottery and that in the case of applicants other than minimum market lots, on a pro rata basis. In the case of under subscriptions the undersubscribed amount may be given to any other category preference being to applicants for the minimum market lot. That notification also lays down the procedure for return of oversubscribed money.

Section 2D gives the SEC power to exempt the application of sections 2A-C by a notification in the official gazette. It may also condone a contravention of any of the provisions of the above sections as if an exemption had been granted.

Section 2E gives power to an officer of the SEC to call for information or accounts, books or other documents if so authorised on this behalf by the SEC for the purpose of inquiring into the correctness of any statement made in an application for consent.

Section 2F forbids a person from making any false statement or give any information which he knows or has reasonably cause to believe to be false or not true in any material particular.

Section 2G inserted in the SEO in 1997 preserves the continuity of orders by providing that all orders made or deemed to have been made under the Capital Issues (Continuance of Control) Act 1947 shall continue to be in force and shall be deemed to be orders under the SEO.

The sections do not prescribe for any specific penalty for contravention of these sections and the only sanction that the SEC seems to have for any false statement that may have been made is to deny permission to issue shares etc.

Chapter IA containing the above sections had to be inserted when the office of the Controller of Capital Issues was abolished by the Securities and Exchange Commission Ordinance which again was replaced by the Securities and Exchange Commission Act. The SEC was given control over any issue of shares but in practice the SEC does not interfere if private companies are formed. Hence the advisability of forming a private company at first for any project, except as otherwise required by law or by the lender agencies, to start business and then convert to a public company after permission of the SEC has been obtained for issue of shares. The SEC will invariably require a public company above a certain subscribed capital to go for public issue. The policy changes from time to time.

28.4 Chapter II of the SEO provides for registration and regulation of the Stock Exchanges.

Stock Exchange must register – Section 3 requires a stock exchange to register with the SEC before operating or carrying on its functions. Dhaka Stock Exchange is amenable to the jurisdiction of the High Court Division under Article 102 of the Constitution.[1]

Eligibility for registration – Any stock exchange which fulfils such conditions or complies with such requirements as may be prescribed to ensure fair dealings and to protect investors shall be eligible for registration.[2]

Section 4(2) lays down the conditions which may be prescribed for the purpose of according registration of a stock exchange with the SEC. These relate to qualifications for membership and admission, exclusion, suspension, expulsion and readmission of members thereinto and therefrom, constitution and powers of the governing body and the powers and duties of the office bearers, representation of the SEC on the governing body of a stock exchange or any of the committees, the manner in which the business should be transacted including restriction on the business of the members, the memorandum and articles of

[1] Farzana Moazzem vs Securities and Exchange Commission and others 54 DLR 66; also see Sejal Rikeen Dalal vs Stock Exchange Bombay AIR 1991 Bom 30 and Shri Anadi Mukta vs Rudani AIR 1989 SC 1607.

[2] Section 4(1)

association, rules, regulations and bye-laws of a stock exchange and the maintenance of accounts including those of their members and audit.

Registration of a stock exchange – Under section 5 a stock exchange may apply for registration and if it fulfills the test of eligibility and the SEC is satisfied that it would be in the interest of the trade and also in the public interest to register the stock exchange the SEC may grant a certificate of registration to the stock exchange. Before refusing an application the applicant must be given a chançe to be heard.[1] .

Accounts, annual reports, returns etc - Section 6 requires every stock exchange to maintain such books of accounts and other documents in such manner as may be prescribed and every books of accounts shall be open to inspection by any person authorised by the SEC in this behalf. The Stock Exchange shall give annual report and periodical returns and such other informations as may be required by the SEC any time in writing.[2]

Cancellation of registration – Section 7 enables the SEC to cancel the registration of a stock exchange etc. If the SEC is of opinion that a stock exchange or a member, director, officer of a stock exchange has çontravened any provision or has otherwise neglected or failed to comply with any requirement of the SEO or of any rule , regulation or direction made or given under the SEO the SEC may, if it considers necessary for the protection of investors or to ensure fair dealings or fair administration of the stock exchange so to do, by order in writing suspend for a specified period the transaction of any business in the stock exchange or cancel the registration of the stock exchange or supersede the governing body or other authority of the stock exchange or remove the director , officer or member from office or membership after giving the person or governing body or authority concerned an opportunity of being heard.[3]

The SEC may while passing such order may direct that the functions of the governing body or other body which has been suspended or of the director or officer who has been removed shall be performed by such authority ŏr person as may be specified therein.[4]

Such an order will have effect notwithstanding any thing contained in any other law or any memorandum or articles of association but shall not affect the validity of any contract lawfully entered into before the date of such order.[5]

Restriction on dealings in securities – Section 8 is the all important section forbidding a person from transacting any business in securities on any stock exchange unless he is a member thereof. It further provides that no business shall be transacted on a non government security unless it is listed on the stock exchange. No person is to act as a dealer in a security listed on a stock exchange outside such stock exchange. Also no person other than a member shall act as a broker or a jobber for any security not listed on a stock exchange. A discounting of any security evidencing a loan shall not come within the ambit of restrictions in the section. This is the section which prohibits the curb marketing which has become now more famous for breach of the law than for its obeying. Outsiders have been active in dealing in securities outside the Dhaka Stock Exchange and this unlisted marketing of securities contributed a big way in fuelling rumours and shooting the market up abnormally until it came down with a bang in 1996. The introduction of the Central Depository Scheme (CDS) will go a long way to stop kerb marketing.

[1] Section 5(3)

[2] Section 6(2)(3)

[3] section 7(1)

[4] subsection (2)

[5] subsection (3)

Listing of securities – An issuer who intends to get any of his securities listed on a stock exchange shall submit an application in the prescribed form to the stock exchange and submit a copy to the SEC.[1]

After enquiry the stock exchange may list the security and if it refuses to list the security then the issuer may apply to the SEC or the SEC may acting on its own motion direct the stock exchange to list the security.[2]

Where after listing of the security the SEC or the stock exchange finds that the application had been deficient in any material respect or the issuer has failed to comply with any prescribed condition or a requirement and that the continued listing would not be in public interest, the stock exchange or the SEC may require the issuer to correct the deficiency within a specified period or revoke the listing.[3]

An issuer of a listed security may apply for delisting a security and the stock exchange may delist the security or may deny the application or grant it on such conditions as appear necessary for the protection of investors.[4] In case of a refusal to delist the SEC may on petition by the applicant within the prescribed time direct the stock exchange to delist the security.

The SEC or the stock exchange may if it considers to be in the interest of the trade or in the public interest so to do, suspend by order recording the reasons, trading in any listed security.[5] Such an order shall remain in force for a period of fourteen days which the SEC, or as the case may be, the stock exchange, extend for further periods not exceeding fourteen days at any time.[6]

Subsection (9) of section 9 provides that no application submitted for listing shall be refused or a listing revoked unless the issuer has been given an opportunity of being heard.

Compulsory Listing – The SEC may compulsorily require a particular security to be listed in the public interest after consultations with the stock exchange and after giving the issuer of the security an opportunity of being heard.[7]

28.5 **Regulation of Issuers** – Chapter III (sections 11-15 of the SEO) deal with regulation of issuers. An issuer of a listed security is to furnish to the stock exchange, its security holders and to the SEC an annual report of its affairs and such statements and other reports as may be prescribed.[8]

Beneficial ownership of shares of a director or issuer of shares as well as ownership of more than ten per cent of any class of securities has to be declared in returns to the SEC in such forms and at such times or at such intervals as may be prescribed.[9]

A director or officer of a listed equity security and any person who is the beneficial owner of not less than ten percent securities shall not engage in short selling such securities.[10]

In the case of the listed securities of a big issuer even less than ten percent of shares constitute a big chunk of shares. In any event short selling of securities is a dangerous precedence as it means persons not holding any share may contract to sell shares and may default in their commitments thus leading to malpractice. In the U.S.A. section 16(c) of Act of 1934 prohibits an insider to sell security if he does not own it.

[1] section 9(1)

[2] section 9(2)(3)

[3] section 9(4)

[4] ibid subsection (5)

[5] ibid subsection (7).

[6] ibid subsection (8)

[7] Section 10

[8] Section 11

[9] section 12

[10] section 13

At the time of writing this manuscript it is understood that the SEC has drafted a law which prohibits short selling. No Stock dealer or stock broker shall sell a security which he does not own either for his own account or his client except as prescribed by the regulations. A stock dealer or stock broker would not be allowed to short sell for his own account or for the account of his clients unless he has a valid contract to borrow the security to ensure delivery within the time stipulated by the clearing house of the stock exchange. The relevant contract to borrow the security would have to be countersigned by the stock dealer or broker dealing on behalf of the selling client to stand as guarantor for his client and ensure timely delivery of the security sold short. A person would not be allowed to make a short sale of a security below the last selling price of the same security in the stock exchange. The Chief executive Officer or any authorised Officers of the bourses will have the power to prohibit a stock dealer or stock broker from short selling any security. The broker or dealer will have to know whether the client has in his possession the securities he is selling and will keep proper records.

Section 14 provides that where any director or officer of an issuer of a listed security or any person who is directly or indirectly the beneficial owner of not less than ten percent of such securities makes any gain by the purchase and sale, or the sale and purchase of any such security within a period of less than six months, such person shall tender the amount of such gain to the issuer. A security acquired in good faith in satisfaction of a debt previously contracted is excepted. If the gain is not surrendered to the issuer or if the issuer fails to recover any such gain within a period of six months after its accrual or within sixty days of a demand therefor, such gain shall vest in the SEC and can be recovered as an arrear of land revenue. (Section 14). If a security is sold and then purchased then the gain even if any, remains with the purchaser and unless and until he sells the security again he does not realise the gain and there can be no question of his tendering the gain to the issuer. This section corresponds to section 16(b) of the Securities and Exchange Act, 1934 in the U.S.A. However, the gain in Bangladesh if not tendered vests in the SEC. In the U.S.A., the issuer or any shareholder may sue to recover the gain on behalf of the Issuer. A director who had connections with negotiations for a merger was held liable to disgorge profits while others who were not so connected escaped liability.[1]

The SEC may regulate the solicitation of proxies, consent or authorisation pertaining to a listed security.[2]

28.6 **Prohibitions and Restrictions** – Chapter IV (sections 16-20) relate to prohibitions and restrictions. Section 16 prohibits a member of a stock exchange or his associate from extending or maintaining credit or arrange for the extension of credit to or for any person for the purpose of carrying or purchasing any security, or borrow on any security or lend or arrange for the lending of any security carried for the account of a customer or pledge or arrange for the pledging of any security carried for the account of a customer. This section is clearly intended to protect the interest of a customer so that the member or the customer may not pledge the security and there is no obstruction in the transfer of securities in the market . This section borrows the idea of restricting credit, pledging and lending of customers' securities from section 8 of the U.S. Securities Exchange Act 1934 and Rule 8C-1 framed under the 1934 Act. However the American law does not speak of the restriction contained in sub-section (1) of section 16 of the SEO and this sub-section so far as it prohibits arranging or maintaining credit for the purchase of securities is meaningless; what is to be prohibited is pledging or hypothecation of the security and/or borrowing on the security. Rule 8C-1 forbids commingling of securities carried for the account of any customer with securities carried for the account of any other customer. Both the language of the section and the Rule in the American law is exhaustive and our lawmakers will do well to look into these to cover the loopholes in the law.

[1] Gold vs Sloan 486 F. 2d 340 (4th Cir. 1973)

[2] Section 15

Prohibition of fraudulent acts – Section 17 is the most important section in the SEO. The statute attempts to codify the fraudulent acts in the securities markets in this section with a language which is sometimes overlapping. This section inserted in 1969 contained a summary of the offences that were recognised in other countries especially in the U.S.A. The opening of the section is couched in a broad language. No person shall, for the purpose of inducing , dissuading, effecting, preventing or in any manner influencing or turning to his advantage, the sale or purchase of any security directly or indirectly do certain things which are given in clauses (a)-(e). Thus, nobody for the above purpose shall employ any device or scheme or artifice or engage in any act, practice or course of business which operates or is intended or calculated to operate as a fraud or deceit upon any person,[1] or make any suggestion or statement as a fact of that which he does not believe to be true,[2] or omit to state or actively conceal a fact having knowledge or belief of such fact[3] or induce any person by deceiving him to do or omit to do anything which he would not do or omit if he were not so deceived.[4]

Clause (e) of section 17 specifies the types of frauds and deceits that may be practised in the trading. Such acts are making any fictitious quotation or creating a false and misleading appearance of active trading in any security or effecting any transaction in such security which involves no change in its beneficial ownership or entering into any order for the purchase and sale of security which will ultimately cancel out each other and will not result in any change in the beneficial ownership of such security; or directly or indirectly effect a series of transactions in any security creating the appearance of active trading or of raising of price for the purpose of inducing the purchase by others or depressing its price for the purpose of inducing its sale by others or being a director or officer or holder of not less than ten percent security and in possession of material facts omitting to disclose them while buying or selling such securities.

28.7 Section 9 of the U.S. Securities Exchange Act of 1934 prohibits manipulation of security prices. Thus a person cannot create a false or misleading appearance of active trading in any security registered on a national securities exchange or a false or misleading appearance with respect to the market for any such security or to effect any transaction in such security which involves no change in the beneficial ownership thereof or to enter an order or orders for the purchase /sale of such security with the knowledge that an order or orders of substantially the same size, at substantially the same time, and at substantially the same price for the sale/purchase of any such security has been or will be entered by or for the same or different parties. Also a person is forbidden to effect alone or with one or more other persons a series of transactions in any security registered on a securities exchange creating actual or apparent active trading in such security for the purpose of inducing the purchase or sale of such security by others.[5] Section 17 (e) of our SEO corresponds to the American law. In the United States one of the most serious abuses in the securities markets on which Senate investigators focussed, in the hearings which led to the enactment of the 1934 Act , was the operation of "pools" which ran up the prices of securities on an exchange by series of well timed transactions effected solely for the purpose of "manipulating" the market price of the security, then unloaded their holdings on the public just before the price dropped. A familiar echo of happenings in our stock market in 1996. By and large the American provisions have been effective in the United States in preventing a recurrence of the widespread manipulation on exchanges which flourished in the 1920's. The present focus of concern in the States is the extent to which large transactions by 'institutional investors' such as pension funds, mutual funds and insurance companies produce undesirable fluctuations in the market price of

[1] clause (a)

[2] clause (b)

[3] clause(c)

[4] clause (d)

[5] Section 9

particular securities. However, the world wide fall in the stock markets in 1987 and 1989 were more a result of a change in investment patterns and other economic factors rather than a deliberate fraud with which the draftsmen of the American laws were concerned in the 1930s. The American law however permits a 'stabilizing operation' by underwriters so that markets are not depressed with the introduction of a new security. [1]

Section 17 (a) -(d) of the SEO is based on section 10 of the American Act of 1934 read with Rule 10b-5 of the U.S. law . These prohibit use of manipulative and deceptive devices to defraud or to make any untrue statement of a material fact or to omit to state a material fact or to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person. Section 10(b) of the U.S. Act is a catch-all provision designed to deal with abuses that escaped the specific prohibitions of section 9 and 10(a) of the Act. It prohibits the use or employment in connection with the purchase or sale of any security registered on a national stock exchange or not , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe. Rule 10b-5 in the 50 years since its adoption has been invoked in countless SEC and private proceedings in the States as this law is primarily designed to stop manipulations of share prices. In our country the SEC in the wake of the share scandal of 1996 has, after recommendations of an enquiry committee, sued a number of companies for violation of section 17 of the SEO and the same are pending disposal now. The SEC also frequently refers to this section while trying to bring to book alleged market manipulators. Sooner or later our prosecutors and courts will be forced to look to cases in other parallel jurisdictions especially the United States of America which is the pioneering nation in this law and leads the world for the financial discipline that it is revered for.

In the 1960's and the early 1970's many federal appellate courts the U.S.A. developed expansive interpretations of Rule 10b-5 and other anti-fraud provisions of the securities laws. They applied it to impose liability for negligent as well as deliberate misrepresentations, for breaches of fiduciary duty by corporate management and for failure by directors, underwriters, accountants and even lawyers to prevent wrongdoings by others. In private actions for damages, the courts were willing to imply a private right of action in anyone whose losses were remotely connected with the alleged wrongdoing. The Supreme Court played a compliant role until 1975 when a new conservative majority on the U.S. Supreme Court sharply reversed the trend giving a narrow reading to the anti-fraud provisions and limiting the situations in which a private right of action will be implied.

The U.S. Supreme Court has held that no person can be found to have violated Rule 10b-5 equivalent to our section 17 of the SEO in either an SEC or private action unless he is shown to have acted with "scienter".[2] The scienter requirement does not require that the person acted wilfully but may be met by showing that he acted recklessly. The recklessness standard has been articulated in terms of whether the defendants 'had reasonable grounds to believe material facts existed that were misstated or omitted, but nonetheless failed to obtain and disclose such facts although they could have done so without extraordinary effort."[3] A principle similar to that in *Derry vs Peek*[4] that the defendants made the statements in question with no belief in the truth or the falsity of the assertion or with reckless disregard to the truth or falsity. The implication of this line of thinking on any interpretation of our section 17 of the SEO is obvious. Rule 10b-5 can be used by purchasers or sellers of securities to show how they have been injured in connection with that purchase or sale due to deceptive conduct by a defendant acting with scienter.[5]

The words "upon any person" in section 17(a) of the SEO have their parallels in the American law. Rule 10b-5 of the U.S. Act of 1934 forbids a person to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit "upon

[1] Rules 10-b (6)(7) of the U.S. Act of 1934.

[2] Aaron vs SEC 446 U.S. 680 (1980); Ernst and Ernst vs Hochfelder 425 U.S. 185 (1976).

[3] Keirman vs Homeland Inc 611 F. 2d 785, 788 (9th Cir 1980).

[4] (1889) 14 App. Cas 337.

[5] Herman & MacLean vs Huddleston 459 U.S. 375 and on remand 705 F. 2d 775 (5th Cir 1983).

any person". In a suit by a corporation which had been defrauded into issuing shares for an inadequate consideration, the defendant argued that the issuance of stock was not a sale of a security and that the corporation was not an investor. The Court rejected both arguments, holding that the issuance was a sale and that the corporation having parted with the shares which had economic value was in the same position as an investor.[1] This decision is important as the basis for a large number of derivative actions in which shareholders have alleged that management or controlling shareholders defrauded the corporation by causing it to issue shares to them or their affiliates for an inadequate consideration. The U.S. Supreme Court has repeatedly stated that manipulation is 'a term of art' limited to certain types of transactions specifically designed to artificially affect the price of a security.[2]

While the fraud must be in connection with the purchase or sale of the securities it need not relate to the terms of the transaction . A group which obtained control of an insurance company caused it to sell certain securities which it owned, then misappropriated the proceeds for their own benefit. The Supreme Court of the United States reversing the Court of Appeals held unanimously that since there was a sale of a security and since fraud was used in connection with it so there is redress under Rule 10b-5 (equivalent to our section 17a of the SEO).[3]

Subsequent lower court decisions in America have read this decision narrowly-holding that the fraud must have infected the securities transaction itself rather than merely involving a misappropriation of the proceeds and there is no liability when there is a substantial time gap or no direct casual link between the sale and the alleged fraud.[4]

In the Hooper's case the court held that the issuance by a corporation of its own shares was a 'sale' under Rule 10b-5.(section 17 of the SEO). A merger involved a 'sale' of the stock of the disappearing company and a 'purchase' of the stock of the surviving company for the purpose of that law.[5] Other types of reorganisations may or may not be considered a 'sale'. An exchange of shares of an operating company for those of a newly-formed company may not be a 'sale' within the meaning of this Rule.[6]

Section 17 prohibits fraudulent acts in connection with any purchase or sale by any person of any security. Similar language is used in Rule 10b-5 of the American law. There is no exemption. It applies to securities which are registered or unregistered under the SEO. It applies to publicly held companies, to closely held companies , to any kind of entity which issues something that can be called a 'security'. It may even apply to 'exempted securities' within the meaning of section 2D of the SEO.

28.8. **Civil Liability** – Section 23 of the SEO is an attempt at the summary of the case law in the United States of America and other countries on the liability incurred by a wrong doer in tort. Sub-section (1) makes a contract which was made in contravention of the SEO or any rule made thereunder voidable at the option of a person who was not party to the contravention against the wrongdoer or any person with knowledge of the wrongdoing. The section does not say whether a seller of a security who was not a party or privy to the wrongdoing may be sued by a subsequent innocent purchaser. Obviously if the security has changed hands several times in the meantime the protection given by this section is meaningless for in order to benefit the innocent sufferer must sue his immediate vendor and if that person is also an innocent person then there is no question of avoiding the contract.

Sub-section (2) of section 23 makes liable a person who has made a false or misleading statement in any application, report or document filed with the SEC or the Stock Exchange with respect to any material fact for damages caused by the statement to a person who has

[1] Hooper vs Mountain States 282 F.2d 195 (5th Cir.1960)

[2] Santa Fe Industries, Inc vs Green 430 U.S. 462(1977); Ernst & Ernst vs Hochfelder 425 U.S. 185, 199(1976).

[3] Superintendent vs Bankers Life 404 U.S. 6(1971).

[4] In re Investors Funding 523 F.Supp.563 (S.D.N.Y. 1980); Ketchum vs Green 557 F.2d 1022 (3d Cir.1977); Rochelle vs Marine Midland 535 F.2d 523 (9th Cir.1976).

[5] SEC vs National Securities 393 U.S. 453(1969)

[6] In re Penn Central 494 F.2d 528 (3d Cir.1974)

relied on such statement and purchased or sold a security unless the maker of the statement can prove that he had made the statement acting in good faith and had no knowledge or reasonable ground to believe that the statement was false or misleading. The liability imposed on the maker of the statement is similar to the one imposed on the maker of a false statement in the prospectus and is irrespective of the fact that there was no contractual relationship between the maker of the statement and the sufferer of the wrongdoing.

Sub-section (3) of the section makes liable a person who participates in any act or transaction in contravention of section 17 of the SEO which prohibits fraudulent trading to a person who has purchased or sold security in reliance on such acts or transactions for damages caused by such reliance unless the person so contravening proves that he acted in good faith and had no knowledge or reasonable ground to believe that there was any fraud, untruth or omission. This provision of law has been taken from the American law.[1] The test of materiality is whether a reasonable investor would have considered the matter significant and it is not necessary to show that the investor would have acted differently.[2]

The civil liability shall also extend to any person who exercises control over the affairs of any person who is liable under this section.[3] This will include the persons controlling a defaulter company through a parent-subsidiary or group relationship.

Liability under section 23 of the SEO is joint and several and any person who becomes liable to a person may recover contribution from a person who if joined in the original suit, would have been liable to make the same payment.[4]

Any suit for enforcement of any right or remedy under this section must be brought within three years from the date of the accrual of the cause of the action but the rights and remedies provided by the Ordinance are in addition to any other right or remedy provided by any other law.[5]

28.9 Rule 10b-5 framed under the U.S. Securities Exchange Act of 1934 is worded as a prohibition – "It shall be unlawful for any person...". Although there is no civil liability prescribed for violation of the law, starting in 1946 the American courts have been applying to it the common law tort rule that a person who violates a legislative enactment is liable in damages if he invades an interest of another person that the legislation was intended to protect.[6]

The possibility that a person can be sued for damages if he has acted in contravention of the law and caused damages to another person where such an action may be brought under any other law (e.g. under the prospectus laws) was considered by the U.S. Supreme Court which held that Rule 10b-5 could be applied to misstatements in proxy statements even though proxy solicitation was governed by specific SEC rules.[7] One of the essential elements of a fraud claim is demonstrating that the defendant acted with scienter. In its strictest sense, scienter means an intent to deceive but there is substantial authority under common law that making statements in reckless disregard of the truth will suffice to establish scienter.[8] The scienter standard applies regardless of whether the action is one for damages or an enforcement action brought by the SEC.[9]

The American court has held that suit can be brought under Rule 10b-5 to recover damages resulting from misstatements in a case of registration under the Securities Act of 1933 even though such misstatements give rise to a specific right of action under that law.[10]

[1] Rule 10b-5 under the U.S. Securities Exch. Act 1934.

[2] Floger Adam Co. vs PMI Industries Inc. 938 F. 2d 1529.

[3] subsection (4)ibid

[4] sub-section (5) ibid

[5] subsections (6)(7) of section 23 ibid

[6] Kardon vs National Gypsum 69 F.Supp.512 (E.D.Pa.1946)

[7] SEC vs National Securities 393 U.S. 453(1969)

[8] Ernst & Ernst vs Hochfelder 425 U.S. 185(1976).

[9] Aaron vs SEC 446 U.S. 680 (1980)

[10] Herman & Maclean vs Huddleston 459 U.S. 375 (1983); Superintendent of Insurance vs Bankers Life and Casualty Co. 404 U.S. 6 (1971)

The Purchaser-Seller Requirement – The most important provision that has to be looked into in any action for civil damages is the "Purchaser-Seller" requirement. In American law as well as in our section 23 of the SEO the plaintiff must have purchased or sold a security in reliance on an illegal act. What happens when a minority shareholder attacks the sale of a controlling block of stock at a premium over the current market price as a 'fraud' on the minority shareholders ? In 1952 the court held that the purpose of the rule was to protect purchasers and sellers of securities from being defrauded and that since neither the minority shareholders nor the corporation had purchased or sold any securities, they had no cause of action.[1] This although the transaction complained of may be in breach of the controlling shareholders duties and faced consequences under state laws.[2]

The "purchaser-seller" requirement was reconfirmed by the U.S. Supreme Court in 1975.[3] A shareholder who is fraudulently induced to deliver his shares for collateral in a pledge may maintain a Rule 10b-5 action as defrauded seller.[4] Equitable owner of a share can maintain a claim.[5] (agreement to transfer shares to voting trust in consideration for future payment could support 10b-5 standing).

In the Blue Chip case defendants were obliged under an antitrust decree to offer plaintiffs certain shares in a new company . Plaintiffs alleged that defendants had violated Rule 10b-5 by giving a deceptively pessimistic portrayal of the new company in the prospectus for the purpose of inducing the plaintiff not to buy the shares. The court rested its decision denying standing to any person other than a purchaser or seller on the broad policy ground that it would deter "vexatious litigation" which "may have a settlement value out of any proportion to its prospect of success at trial" and which may raise "many rather hazy issues of historical fact the proof of which depends almost entirely on oral testimony". Justice Rehnquist's majority opinion was full of expressions of hostility to private actions against corporate management, leading Justice Blackmun a dissenting judge to remark that "the Court exhibits a preternatural solicitousness for corporate well-being and a seemingly callousness toward the investing public quite out of keeping ...with our own tradition and the intent of the securities laws".

The American courts have however made an exception to the purchaser-seller requirement in the case of a person whose shares are automatically converted into shares of another company in a merger(forced sale) put through by means of misleading statements as entitled to sue for damages.[6]

28.10 **Causation** – In an action for civil liability under section 23 of the SEO one pertinent question that may arise is whether the plaintiff has "transaction-causation" i.e., the illegal act caused the plaintiff to enter into the transaction and the "loss-causation" i.e., that the transaction caused the loss to the plaintiff. In civil actions claiming damages for violation of Rule 10b-5 the court insisted on this rule;[7] and that the plaintiff demonstrate that the loss was a result of the facts which were misrepresented by the defendant.[8] The U.S. Sixth Circuit has held that a tippee trading on information obtained from his father, a corporate insider, is not liable to purchasers in a faceless market because of the plaintiff's inability to prove the causation requirement necessary to recover damages under a fraud theory.[9] See also the discussion on who can sue for misuse of non public information in insider trading cases Para 30.3 below.

[1] Birnbaum v Newport, 193 F.2d 461 (2d Cir.1952)

[2] Perlman vs Feldmann 219 F.2d 173 (2d Cir.1955)

[3] Blue Chip vs Manor, 421 U.S. 723(1975); Chanoff vs U.S. surgical corp. 857 F. Supp 1011 (1994).

[4] Alley vs. Miramon 614 F.2d 1372 (5th Cir 1980).

[5] Bowers vs Allied Capital Corpn. Fed. Sec. L. Rep (CCH) 96,544 (D. Me 1991).

[6] Vine vs Beneficial Finance 374 F.2d 627(2d Cir.1967); Alley vs Miramon 614 F.2d 1372,1387 (5th Cir.1980)

[7] Schlick vs Penn-Dixie, 507 F.2d 374 (2d Cir.1974)

[8] Bastian vs Petren ,892 F.2d 680 (7th Cir.1990) ;"causal nexus" to suffice. Abbey vs Control Data 933F.2d 616 (8th Cir.1991)

[9] Friedrich vs Bradford 542 F. 2d 307 (6th Circuit 1976) cert. denied 429 U.S. 1053 S.ct. 767 (1977).

28.11 **Prohibition of False Statements** – Section 18 of the SEO prohibits making or giving of any false statements in a material particular in any document, paper, accounts, information or explanation which he is required by the SEO to file with the SEC.

This section is a followup of section 17 in that documents filed with the SEC may mislead the SEC. In view of section 19 of the SEO which requires a person who has access to any information in the course of performing his duties to maintain secrecy and not to divulge such information without the permission of the SEC any statement filed with the SEC would be essentially confidential but the SEC may divulge this in the interests of the investors.

Prohibitory Orders – Section 20 provides that where the SEC is of opinion that any person is engaged or is about to be engaged in any act or practice or any omission which constitutes or is calculated to constitute a contravention of the provisions of the Ordinance etc., the Commission may , in writing, direct him from abstaining from such act or omission and a person to whom the direction is given shall comply with the same.

Power of the Commission to issue direction in certain cases - Section 20A provides that where the Commission is satisfied that in the interest of investors or securities market or for the development of securities market it is necessary so to do, it may, by order in writing, issue such directions as it deems fit to any Stock Exchange, stock broker, stock dealer, issuer or investor or any other person associated with the capital market. *(Section 20A added by the Securities and Exchange (Amendment) Act, 2000 dated 27.11.2000)*

28.12 **Enquiry** – Section 21 of the SEO is an important milestone in the annals of security laws. It provides for enquiry by the SEC either at its own motion or on representation of at least five per cent of the holders of equity shareholders by an order in writing into the affairs of any stock exchange or of any issuer of a listed security or into the business of any transaction in securities by any member, director or officer of a stock exchange or of an issuer or of a director or officer thereof or by any person who is the beneficial owner of not less than five percent of a listed security. Every person who has had any dealing in the course of business with such stock exchange or issuer or with the officer concerned shall furnish such information in his custody as may be required by the enquiry committee. The enquiry committee may enter any premise and seize any books of accounts and documents and have the same powers as given to a judge to enforce the attendance of any person in the Code of Civil Procedure.

Section 22 of the SEO provides for penalties for refusal or failure to provide document or information etc or to comply with any order or direction of the SEC or if one contravenes or otherwise fails to comply with the provisions of the SEO. The SEC will have to give the alleged offender an opportunity of being heard and may order the offender to pay the SEC by way of a penalty a sum "Not less than one lac taka."[1] If not paid the sum may be realised in the same manner as arrear of land revenue.

The SEC has invoked this section for quite a few actions recently after the sharescam of 1996 and this weapon is a potent armour to enforce discipline in the market. However, the prosecutor is the judge here and this goes against the principle of fairness. In the U.S.A. section 21 of the Securities Exchange Act of 1934 provides for investigations by the SEC to determine whether any person is violating or has violated or is about to violate any provision of that Act , the rules or regulations thereunder. It has similar powers as given in our SEO but if it appears to the U.S. Commission that any person is engaged or is about to engage in acts or practices constituting a violation of the provisions of the Act, rules or regulations then the Commission may bring an action in the proper District Court of the United States. Similar if it appears to the Commission that a person has violated any provision of the Act, rules or regulations then it may bring an action in the proper District Court. The American law has thus not bypassed the judicial system in holding a person guilty. The Bangladesh law empowers the SEC to impose the fine and considering the futility of filing cases for penalty in the Court of the Magistrate perhaps this works better although it is a dangerous precedence to avoid the judicial process. Perhaps the law needs to be changed and the jurisdiction for adjudication whether a person has broken the laws be given to a higher court.

[1] Amended by the Securities and Exchange (Amendment) Act, 2000 dated 27.11.2000.

28.13 **Penalty for Fraudulent Acts etc** – Section 24 specially provides for penalty for contravening the provisions of section 17 of the SEO which prohibits fraudulent trading etc. The penalty may be an imprisonment for a term which may extend to five years or with fine which "shall not be less than five lakh taka"[1] or with both. The section further provides that where the person guilty of the offence is a company or other body corporate every director, manager, or other officer responsible for the conduct of its affairs shall, unless he proves that the offence was committed without his knowledge or that he exercised all diligence to prevent its happening, be deemed to be guilty of the offence.

In the fifteen sharescam cases filed by the SEC in 1997 many alleged offenders were companies and the SEC brought action also against its directors (though not all directors in all cases). An argument was raised in the revision cases filed by some of the accused that the fact that the offence attracted a penalty of imprisonment for a term which may extend to five years meant that this would be treated as an offence with a penalty for less than five years and therefore cannot be a case for warrant. This argument was rejected in all the courts including the Sessions Judge.

Section 25 of the SEO provides that no court shall take cognizance of any offence punishable under the SEO except on a report in writing of the facts constituting the offense by an officer authorised in this behalf by the Commission and no court inferior to that of a court of session shall try any such offence.

After the great sharescam of 1996 when share price index of the Dhaka Stock Exchange jumped from around 600 mark to the mid-three thousand within a span of three to four months and then slumped, the SEC constituted an enquiry committee by a gazette notification which gave a lengthy report identifying certain companies and firms being in breach of the provisions of section 17 of the SEO and commented that these were guilty of fraudulent acts in relation to share trading. The SEC then acted on the basis of the Report and filed fifteen sharescam cases for violation of section 17 of the SEO against companies and their directors etc in 1997. Three of the accuseds filed revision cases in the court of the Sessions Judge for a quashment. Among other grounds taken in the criminal revision cases was that the officer filing the complaints was not authorised by the SEC as required by section 25 of the SEO but by the Chairman. It was argued that the Commission consists of the Chairman and other members but the officer was authorised only by the Chairman. At the time of hearing of the revision cases before the Sessions Judge the SEC lawyers produced minutes of a meeting of the Commission held on the day the complaints were filed which showed that the Commission considered the report of the enquiry committee into the sharescam and authorised the Chairman to take all legal steps in that regard. The authorisation by the Chairman to the filing officer was however dated one day before the holding of that meeting and the accuseds strongly argued that the meeting did not cure the defect of the earlier authority. The Sessions Judge while rejecting other arguments of the accuseds accepted the objection that the complaints were not filed by an officer properly authorised by the SEC and sent the cases by way of reference to the High Court Division for quashment. The High Court Division rejected the reference for quashment on the ground that the cases being filed on the basis of the enquiry committee report and the enquiry committee being constituted under section 21 of the SEO a formal authorisation by the SEC was not needed. The High Court Division however held also that in their view the "Chairman as the Chief Executive of the S.E.C. is quite competent to do so for the purpose of initiating legal proceedings on behalf of the S.E.C. on the basis of the said report and there was no necessity of authorising the said officer by the Commission or for specifically confirming the authority given to him by the Chairman. Even if it is assumed that without being authorised by the S.E.C. the Chairman could not do so then there was implied ratification of such authority by the said resolution authorizing the Chairman to take all legal steps.

> Now the next question arises as to whether Chairman as delegatee could further delegate the said authority to the said officer. Authority given to the said officer was only to present the

[1] Amended by the Securities and Exchange (Amendment) Act, 2000 dated 27.11.2000.

extracts of the said report, to depose and produce documents before the Court. Such acts are of ministerial nature and require no personal skill.[1]

The further argument that such delegation of power should be done by a gazette notification under section 28 of the SEO was rejected by all the courts including the Sessions Judge. Section 17 of the Securities and Exchange Commission Act 1993 provides that the Commission may delegate under some specific term any power, except the power to frame regulations, to the Chairman, member or any officer of the Commission and this provision being directly related to the SEC and being in the later Act which created the SEC would prevail over any previous provision of law like the SEO.

The accused went on appeal to the Appellate Division which refused to grant leave to appeal broadly accepting the argument of the SEC lawyers that the Chairman would have implied authority to represent the SEC and the Magistrate before whom the complaints were filed was competent to assume that the complaints were filed on the authority of the SEC. It was argued by the SEC lawyers that under the doctrine of the "Turquand Rule " an outsider like the Magistrate would be entitled to assume that the Chairman had the mandate to authorise the officer but this argument did not find any mention in the judgment of the Appellate Division. The Appellate Division however set aside the reasoning given by the High Court Division that since the cases were filed on the basis of the enquiry report after an enquiry committee was formed under section 21 of the SEO so no formal authority was needed and proceeded to hold that the Chairman was competent to authorise the officer to file the complaint cases . The Chairman was the chief executive of the Commission (sub-section 5 of section 5 of the SEC Act of 1993) and was therefore authorised by law to undertake the functions of the SEC which included prohibiting fraudulent and unfair trade practices (subsection 2e of section 8 of the SEC Act of 1993).[2]

The Shinepukur cases held therefore that the Chairman was competent to authorise an officer of the SEC to initiate proceeding against a defaulter of the SEO, its rules and regulations and a formal meeting is not needed everytime to authorise such a filing of the criminal complaints.

This decision also held that the complaint cases filed by the SEC were warrant cases. Column 4 of Schedule II of the Code of Criminal Procedure relating to the offences against 'other laws' provides that warrant of arrest shall be issued against the accused persons if the offence is punishable with imprisonment for not less than two years and not more than five years. Since the offence in question is punishable with imprisonment upto five years so the High Court Division held that there was no illegality in passing an order of issuance of warrant of arrest against the accused persons.

Burden of Proof – Section 25A of the SEO introduces an exception to the established principle of the common law, namely that a person is not guilty unless so proved. This section provides that where any person is prosecuted for contravention of any provisions of the SEO or any order made thereunder which prohibits from doing any act without the consent or permission of the authority (the SEC) the burden of proving that he had not contravened the law will be on the accused.

A corresponding provision in the Australian law is found in section 765 of the Australian Corporations and Securities Legislation which provides that in the case of a prosecution for a misleading representation (a person not having reasonable grounds for making the representation) the person shall, unless the person adduces evidence to the contrary, be deemed not to have had reasonable grounds for making the representation.

In the U.S.A., with regard to criminal prosecutions, it has been held that generally, the "wilfulness" requirement means only that the defendant must have intended the act which he did, and does not require a showing that he knew he was violating the securities laws.[3]

[1] Shinepukur Holding Limited and others vs Securities Exchange Commission 18 BLD(1998) (HC) 61 at page 71.

[2] Shinepukur Holding Ltd. vs. Securities and Exchange Commission 18 BLD (AD) 189, 50 DLR (AD) 189.

[3] United States vs Schwartz CCH 93023 (E.D.N.Y. 1971).

The American courts have consistently rejected arguments by defendants that various provisions of securities laws are constitutionally vague when made the basis for criminal prosecutions.[1]

Our law seems to go further than the Australian or the American law in helping the prosecution cases in that the defence will have to show that the accused did not contravene the provisions of the law or the rules.

28.14 Chapter VI of the SEO provides for miscellaneous matters like the power of the SEC to constitute an advisory committee (section 27) or to delegate its power by notification in the official gazette (section 28) This provision of law may have been made nugatory by insertion of section 17 of the Securities and Exchange Commission Act 1993 which provides for delegation of powers, except the Rule making power, on certain conditions by the Commission to the Chairman, any member or any of its officers . In fact it was argued in the Shinepukur cases, referred to above, that the officer concerned who filed the cases was not authorised by the SEC by a gazette notification and therefore he was not authorised legally to file the cases but this argument did not find favour with any of the courts including the trial court .

Section 29 empowers the SEC to exempt any person or class of persons by gazette notification from the operation of all or any of the provisions of the SEO. No suit, prosecution or other legal proceedings shall lie against the SEC or an officer or authority subordinate to it or specially appointed for the purpose of the SEO for anything which is in good faith done or intended to be done under the SEO or any rules or orders made thereunder.

Section 31 of the SEO protects the rights of the possessor of an equity security, scrip, debenture, debenture stock or bond if he has acquired it without fraud and for a lawful consideration if it is noticed subsequently that the transferor of his security had a defective title himself. This provision is especially relevant in the wake of a large number of complaints made to the large listed companies that a particular security was stolen along with transfer forms against the claim of person who has obtained the security from a stock broker. The Dhaka Stock Exchange has issued some instructions which are inconclusive and there is no proper regulation approved by the SEC on the rights and liabilities of parties on this subject.

Sections 33 and 34 of the SEO provide for making rules and regulations by the SEC and the stock exchanges. Under section 33 the Commission may, by notification in the official Gazette, make rules for carrying out the purposes of the Ordinance after publishing in widely circulated daily newspapers of the country inviting opinion, advice or objection on the subject allowing two weeks time for submission of such opinion, advice or objection. Under section 34 a stock exchange may , subject to previous approval of the SEC make regulations not inconsistent with the rules to carry out the purpose of the SEO. Such regulations would cover, among other things, the constitution, powers and functions of the governing body of the stock exchange, the admission, suspension and expulsion of members, a member's financial responsibility, how dealing by members should be done if for their own account, methods of selection of officers and committees to ensure a fair representation of the membership, qualifications and functions of directors and officers of the stock exchange, listing and delisting of securities, the procedure and requirement of registration of issuers and regulation of the timing of trading and the types of contracts and settlements, forward trading, clearing house and so forth.

29.1 **Securities and Exchange Commission Act 1993** – By Act No 15 of 1993 a statutory body corporate was created for the purpose of "protection of investors in securities, for the development of securities markets and for matters connected therewith or incidental thereto".

Section 2 deals with definitions and refers to the various sections of the Act for definition of the "Commission","Chairman", "Fund", "Rules" and "Member" under that Act. A "person" would include an organisation. (Act 7 of 1997).

[1] United States vs Wolfson 405 F.2d 779 (2d Cir.1968)

The Commission (SEC) shall be a body corporate , having perpetual succession, and a common seal with power to acquire, hold and dispose of properties, both movable and immovable, and shall by the said name sue and be sued.[1]

The head office of the SEC shall be at Dhaka but the SEC may, with the previous approval of the Government, establish offices at any other place in Bangladesh.[2]

The SEC shall constitute of the Chairman and four members appointed by the Government including one from private sector who will be an expertise in the relevant topic.[3]

The Chairman and the members shall be the full time Chairman and members of the SEC.[4]

The qualification for being appointed as the Chairman and a member of the SEC will be expertise in company and securities markets, law, finance, accounting or any other topic that the Government may consider necessary.[5]

The Chairman shall be the chief executive of the SEC.[6]

Delegation of Power – Section 17 of the Act of 1993 provides that the SEC may delegate under some specific term any power, except the power to frame rules, to the Chairman, member or any officer of the Commission.

Section 17 Ka inserted by Act VII of 1997 provides that the SEC may constitute a committee of any person or persons to conduct any enquiry with regard to any person mentioned in clause 10(1) of the Act (i.e. those who apply for registration certificates with the SEC) and after the enquiry may submit their enquiry report to the SEC. The fact that the Chairman is the chief executive of the SEC was argued by the SEC lawyers in the Shinepukur case[7] to argue that the authorisation to the executive director of the SEC to file the sharescam cases would be an act of the SEC and that the Chairman being the chief executive would represent and have all the ordinary powers of the SEC to fulfil its purpose including suing for prosecution for violation of the SEC laws.

The Australian Securities Commission Act provides that the Commission may by writing under its common seal , delegate to a person all or any of its functions and powers.[8] No known case however arose in that jurisdiction that the authorisation by the Chairman to an officer of the Commission would have to be sanctioned in a board meeting of the Commission.

The Indian law makes it clear and provides that the Chairman shall also have powers of general superintendence and direction of the affairs of the Board and may also exercise all powers and do all acts and things which may be exercised or done by that Board.[9]

Section 4A of the U.S. Securities Exchange Act of 1934 provides that in addition to its existing authority, the Securities and Exchange Commission shall have the authority to delegate by published order or rule any of its functions to ...an individual. Section 4B further provides that 'there are hereby transferred from the Commission to the Chairman of the Commission the functions of the Commission with respect to the assignment of Commission personnel, including Commissioners , to perform such functions as may have been delegated by the Commission to the Commission personnel, including Commissioners, pursuant to section 4A of this Act'.

The Australian law seems to be the closest to our law in regard to the delegation of powers by the SEC.

[1] Section 3

[2] Section 4(2)

[3] Section 5(1)(2)

[4] ibid subsection (3)

[5] ibid subsection (4)

[6] ibid subsection (5).

[7] 18 BLD (1998) 61

[8] Section 102(1)

[9] Section 4(3) of the Securities and Exchange Board of India Act 1992.

29.2 **Meetings of the Commission** – The meetings of the SEC will be held at the prescribed place and time and until the notification is made at the place and time selected by the Chairman.[1]

The quorum of any such meeting shall be three members;[2] the Chairman and, in his absence, any member elected by the members present in the meeting shall preside over the meetings and, shall have a casting vote in case of a tie;[3] however, no meeting or its proceedings shall be invalid because of any vacancy or defect in the constitution of the Commission.[4] During the sharescam cases one of the points raised unsuccessfully by the accused - objectors was that at the relevant time two of the members of the Commission were ordered by the High Court Division to resume their duties as members of the SEC but they were not allowed to do so and any meeting authorising the Chairman to file the cases was invalid .

29.3 **Functions of the Commission** – Section 8 describes the functions of the SEC. Broadly speaking, the responsibility and duty of the Commission is to ensure the proper issuance of securities, to protect the interest of the investors in securities and to promote the development of and to regulate the capital and securities market.

This section is an identical copy of section 11 of the Securities and Exchange Board of India Act 1992. In sub-section (2) the duties of the SEC are mentioned particularly. These are regulating the business of the stock exchanges or any other securities market; registering and regulating the working of stock brokers, sub-brokers, share transfer agents, bankers and managers to an issue, trustee of trust deeds, registrars to an issue, underwriters, portfolio managers, investment advisers, merchant bankers, property management companies, credit rating companies and such other intermediaries who may be associated with securities market in any manner whatsoever; registering, regulating and monitoring the working of any form of collective investment scheme including all forms of mutual funds; prohibiting fraudulent and unfair trade practices relating to securities or in any securities market; promoting investors education and training of all intermediaries of securities market; prohibiting insider trading in securities; regulating substantial acquisition of shares or stock and take-over of companies; calling for information from, undertaking investigation and inspection, conducting inquiries and audit of any issuer or dealer of securities, the stock exchanges etc; compiling, analyzing and publishing indices on the financial performance of any issuer of securities; levying fees or other charges for carrying out the purpose of section 8 and conducting research and publishing information for the above purposes. It is submitted that this section unnecessarily lengthens the list of functions as most of the functions are mentioned elsewhere or are covered by the broad objective of protecting the interest of the investors in securities. Many of the terms used have not been defined and will no doubt be identified in the Rules, Regulations or directives leaving a question of the competence of the SEC to include in the definitions persons or activities which may not fall directly within the competence of a subordinate legislation.

The U.S. Securities Exchange Act of 1934 does not attempt to lay down the functions of the Commission in one section but gives a detailed description why it was necessary to set up the Commission.[5]

This is understandable because of the timing of the legislation. It came to remedy the situation obtaining during the Wall Street disaster of 1929. The American Act however lays down by law the restrictions on the players in the securities markets[6] and provides for liabilities in certain cases.[7] The U.S. Act of 1934 specifically mentions civil penalties for

[1] section 7(1)

[2] ibid sub-section (2)

[3] ibid sub-section (3)(4);

[4] ibid sub-section (5).

[5] section 2

[6] sections 7-17

[7] sections 18-20A

insider trading[1] and authorises the Commission to institute action in an United States district court having the relevant jurisdiction to impose civil penalties enumerated in the section itself. As we shall notice our law leaves it to the Rules framed by the SEC to determine the consequences of insider trading. Section 1002 of the Australian Corporations Law defines an insider and prohibits trading by insiders. By leaving it to the discretion of the SEC while framing rules the legislature has given a very wide power to the SEC to regulate insider trading.

29.4 **Registration Certificate** – Section 10 of our Securities and Exchange Commission Act provides for registration with the SEC for certain class of persons and prohibits any sale or dealing in securities by them otherwise. The category of persons would include stock brokers, sub-brokers, share transfer agent, bankers to an issue, trustee of trust deed, registrar to an issue, underwriter, portfolio manager, investment adviser, merchant banker, property management company, credit rating company and such other intermediaries who may be associated with securities market in any manner.[2]

The Commission may by order, suspend or cancel a certificate of registration in such manner as may be provided by regulations; provided that no such order shall be made unless the person or organisation concerned has been given a reasonable opportunity of being heard.[3]

The SEC has published the Securities and Exchange Commission (Stock Dealer, Stock Broker and Authorised Representative) Rules, 2000 which provide for the procedure to be followed by a stock dealer, stock broker or authorised representative for registration and lay down the qualifications and disqualifications for such registration. An applicant for registration certificate to act as a stock dealer or stock broker must be a member of a stock exchange; must not be a merchant banker, portfolio manager, trustee to a mutual fund, ...or property management company; must be a company or statutory organization and its capital must be not less than twenty five lakh; the applicant or any member of its Board of Directors must not have been convicted of any criminal offence related to forgery, fraud or dishonesty.[4]

The SEC may cancel or suspend the registration certificate of a dealer, broker or sub-broker for contravention of any law, or the Rule or any condition of registration. The person concerned must be given at least seven days notice to give his reply in writing to the charges against him. However, the Commission may immediately issue a suspension order if satisfied that suspension of the registration certificate is necessary before deciding on the cancellation of the same.

The stock broker, dealer and the authorised representative will have to maintain books of accounts and records of clients etc and the SEC may inspect these.[5]

Rule 16 provides for an appeal from any order of the SEC.

Section 16 of the Act of 1993 gives power to the Government to give directions to the SEC to fulfill any of its objects provided that the Government shall, before giving any such direction, invite opinion thereon from the Commission.

Section 17Ka inserted in the Act in 1997 authorises the SEC to institute an enquiry into the affairs of any person mentioned in section 10(1) of the Act, namely, a stock broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, underwriter, portfolio manager, investment adviser, merchant banker, property management company, credit rating company and such other intermediaries who may be associated with securities market in any manner. Strangely enough a dealer is not mentioned in this category of persons. Section 10 requires these persons to take out a registration with the SEC before acting as such. The Stock Broker Rules however provide for the registration of a stock dealer and defines them as persons who trade in securities on their own account and for others as a stock broker. Since a stock dealer is not mentioned in section 10 can the SEC enquire about them ? The Rules seem to indicate so but the Act is silent.

[1] section 21A

[2] sub-section (1)

[3] sub-section (3)

[4] Rule 4

[5] Rules 13-16

29.5 Penalty for Contravention etc.– Section 18 of the SEC Act of 1993 provides a penalty for contravention of any of the provisions of the Act – rigorous imprisonment for a term not exceeding five years or a fine which shall not be less than five lakh taka ; also if directions given under the provisions of the Act are not complied with or for failure to supply necessary information or to afford proper co operation to any person involved in any enquiry- then after giving the offender a chance of hearing – a fine which shall not be less than one lakh taka and for every day that the default continues a fine not exceeding ten thousand taka per day.[1]

It is not clear whether the penalty under sub-section (2) can be awarded by the SEC alone without going to the court and if that is so as it seems to be the practice then the SEC is exercising a substantial judicial power which under our constitution must be exercised by judicial bodies. This point has not yet been tested in the courts and it is too early to say whether the courts will strike off this power given to the SEC. In the United States of America the SEC prosecutes in the court if such a default occurs.

Also, it is not clear what enquiry sub-section (2) of section 18 refers to. Any enquiry is done under the SEO and not under the SEC Act of 1993.

Sections 19 and 20 of the SEC Act provide for cognisance of offences under the Act (by the Sessions Judge and on a complaint filed by the SEC or by an officer authorised by the SEC) and who shall be responsible if the offence is committed by a company (the owner, director, manager, secretary, or any other officer or agent of the company responsible for the contravention unless he can prove otherwise). It is to be noted that while under an offence under the SEO the complaint must be filed at the court of the relevant magistrate who after taking cognisance sends the files to the Sessions Judge in an offence under the SEC Act of 1993 the cognisance must be taken by the Sessions Judge.

Section 21 provides for an appeal to the SEC by a person aggrieved by an officer or member of the SEC within the prescribed time. This gives a chance to make amends by the company concerned with the SEC.

Section 24 gives power to the Government to make Rules for carrying out the purposes of the Act by notification in the official gazette after publishing in widely circulated daily newspapers of the country inviting opinion, advice or objection on the subject allowing two weeks time for submission of such opinion, advice or objection.

30.1.1 **Insider Trading** – Until recently if a person traded in shares on the basis of privileged information, he was generally regarded as not having done anything which merited punishment. Thus, a company director who had inside information about something which would, when publicly known, cause the price of the company's shares to rise might himself take advantage of that information and buy the shares cheap. Similarly a person who had a professional relationship with that company, and shared the confidence, might do the same. Similarly, tips about future price movement in the stock market were always available. "The crime of being-something in the City" was the rather graphic description given to insider trading by the Financial Editor of The Sunday Times on 4 February 1973. By then the tide had turned. Although no insider trading law was enacted in the United Kingdom until the 1980s, during the early 1970s the subject began to catch the attention of the press. The courts in the United States of America had by then roundly condemned the profit taking from insider knowledge and in Australia pursuant to the Poseidon crisis the Labour Party then in power was considering reforms in the working of the stock exchange which until then had been guided mainly by the gentlemanly and old boy spirit of the Eton-Harrow league. The British press was closely following the Poseidon scandal during which time (and probably the only time) the turn over of the Sydney Stock Exchange exceeded even that of the New York Stock Exchange. When the market collapsed in Sydney in the early Seventies scarcely a family in Australia remained untouched.

In England the early decision of *Percival vs Wright*[2] did much to discourage the notion of profit taking on an insider trading as wrong. Directors of a private company were approached by shareholders who wanted to sell their shares in the company. The directors

[1] sub-section (2) of section 18.

[2] (1902) 2 Ch 421

agreed to buy them but did not inform the shareholders that there was an imminent take-over bid for the company which would greatly increase the value of the shares. The take-over bid did not in fact occur but the shareholders found out about it and sought to have the sale of the shares set aside. In his judgment Swinfen Eady J made the following statement which has become the classic statement of the English law which protects from being liable to the company's shareholders for insider trading :

> ... I am therefore of the opinion that the purchasing directors were under no obligation to disclose to their vendor shareholders the negotiations which ultimately proved abortive. The contrary view could place directors in a most invidious position as they could not buy or sell shares without disclosing negotiations, a premature disclosure of which might well be against the best interests of the company. I am of the opinion that directors are not in that position.[1]

The court thus held that directors of companies do not owe a fiduciary duty to the shareholders but to the company alone and thus consequently they do not, in general, owe a duty of good faith to disclose information to individual shareholders of the company. In England Percival vs Wright has not been critically examined by any appeal court. The Court of Appeal in New South Wales in Glandon Pty Ltd vs Strata Consolidated Pty Ltd (unreported 15 September 1993) did not take the opportunity to disapprove of the Percival case though Mahoney JA considered that changed attitudes to insider trading may require it to be considered in an appropriate case. In New Zealand at first instance in Coleman vs Myers Mahon J. said thus[2] :

> " I reach the unhesitating conclusion that the decision in Percival vs Wright directly opposed as it is to prevailing notions of correct commercial practice, and being in my view, wrongly decided , ought no longer to be followed in an important transaction where a director dealt with identified shareholders".

In this case the plaintiffs were minority shareholders who sold out to the managing director who had mounted a take-over bid for the whole company. The bid price had been agreed upon by a number of substantial shareholders acting on professional advice. Once the managing director had acquired the whole of the share capital he sold certain company assets and declared a capital dividend which more than covered the cost of the acquisition. The Court of Appeal in New Zealand side stepped the issue of insider trading but was of the view that the managing director had deliberately misrepresented his intentions and the value of certain properties in the hope that the plaintiffs would agree to a prompt sale of their shares without further enquiry. He was held to be in breach of fiduciary duty and the court awarded damages to the plaintiffs.

In the United States a court in Georgia seemed to have rejected the type of approach in Percival vs Wright and held that directors were under a fiduciary obligation when dealing with shareholders to disclose all material facts relevant to a transaction in the company's shares.[3]

In an appeal from the Supreme Court of the Philippine Islands, the United States Supreme Court held that a controlling shareholder and general manager of a company was guilty of fraud in purchasing the shares of a minority shareholder without disclosing the then current negotiations for the sale of the company's property. The special circumstances were that the defendants had been entrusted with the negotiations to sell the corporate assets. Basically the court held that the combination of facts raised a duty to speak.[4]

In *Regal (Hastings) vs Gulliver*[5] the directors of the company (Regal) were anxious either for the sale of the company to take place or for Regal to extend the sphere of its business operations by acquiring two cinemas in addition to those it alraedy owned. For these purposes a subsidiary company was established; the subsidiary had the same directors as

[1] ibid at page 426

[2] [1977] 2 NZLR 225, 298

[3] Oliver vs Oliver 45 SE 232(SC Georgia 1903)

[4] Strong vs Repide 213 US 419 (1909).

[5] [1967] 2 AC 134; [1942] 1 All E.R.378

Regal with the addition of Regal's solicitor. Regal could subscribe for only 2000 of the 5000 shares in the subsidiary. It was agreed that the directors, the solicitor and certain other persons should subscribe for the remaining 3000 shares. The shares were duly paid for and allotted. When the business of Regal was transferred to new owners, the directors made a substantial profit from their shares in the subsidiary company. Regal, under the control of the new owners, then successfully brought an action against the directors to account for the profits they made. The House of Lords unanimously held that the respondents, as directors of Regal, stood in a fiduciary relationship to it. If in the course of their management they entered into a transaction in which they utilised the position and knowledge possessed by them by virtue of their office as directors they were liable to account for any profits they acquired from that transaction. The liability of a fiduciary to account for such profits in no way depends on fraud, corruption or absence of bona fides and does not depend on proof of loss or damage to the company.

Similarly in Industrial Development Consultants vs Cooley[1] Roskill J. stated thus:

> ...Information which came to him while he was managing director and which was of concern to the plaintiffs and was relevant for the plaintiffs to know was information which it was his duty to pass on to the plaintiff because between himself and the plaintiffs a fiduciary relationship existed.

The defendant in this case got in touch with the Eastern Gas Board for a contract and then resigned to take the contract for himself.

A New York court held similarly :

> A corporate fiduciary who is entrusted with potentially valuable information may not appropriate that asset for his own use even though in so doing he causes no injury to the corporation.[2]

These cases were however more on fiduciary duties of directors. The decision of the House of Lords in Boardman vs Phipps[3] pushes fiduciary liability further. Knowledge gained while dealing with a company for a trust was not shared with others and the House of Lords by a majority of three to two held that the beneficiary would have to account for the profit. The lawlords differed whether the knowledge gained was a trust or not.

The traditional corporate insiders, both directors and senior employees, will often be in a position, while acting for a company, whereby they come into possession of inside information: They must not let their duty to the company and their self-interest conflict. Laskin J. in a Canadian case observed thus;

> The general standards of loyalty, good faith and avoidance of conflict of duty and self-interest, to which the conduct of a director or senior officer must conform, must be tested in each case by many factors which it would be reckless to attempt to enumerate exhaustively. Among them are the factor of position or office held, the nature of the corporate opportunity, its ripeness, its specificness and the director's or the managerial officer's relation to it, the amount of knowledge possessed, the circumstances in which it was obtained and whether it was special or, indeed, even private...[4]

These cases held that the conflict of interest rule gives rise to a liability to account for profits arising out of insider trading. If, however, as two of the Lawlords considered in *Broadman vs Phipps*,[5] information is property, it is then capable of being held in trust and accordingly an insider might attract liability as a constructive trustee, as might a tippee of knowing or in receipt of sensitive information or as someone who knowingly assisted in the dishonest design. English cases worth to be seen in this regard are *Selangor United Rubber Estates Ltd vs Cradock (No 3)*,[6] *Belmont Finance Corporation Ltd vs Williams Furniture*

[1] [1972] 1 WLR 443

[2] Chief Judge Fudd in Diamond vs Oreamuno 24 NY 2d 494(1969) at page 496

[3] [1967] 2 AC 46

[4] Canadian Aero Services Ltd vs O'Malley (1973) 40 Dominion Law Reports (3d) 371,388.

[5] Supra

[6] [1968] 1 WLR 1555

Ltd,[1] *Baden vs Societe General du Commerce SA,*[2] *Agip (Africa) Ltd vs Jackson,*[3] and *Eagle Trust plc vs SBC Securities Ltd.*[4]

In the Hongkong case of Nanus Asia Co Inc vs Standard Chartered Bank[5] a tippee of inside information was regarded as a constructive trustee.

In making an insider account for the profit he has made Lord Blanesburgh said in 1932 that 'the company has no concern in his profit and cannot make him accountable for it unless it appears -this is the essential qualification-that in earning that profit he has made use either of the property of the company or of some confidential information which has come to him as a director of the company.'[6]

In order to have confidentiality, the information must not be something which is or may be known to all, i,e., the public. In Thomas Marshall Ltd vs Guinle[7] Sir Robert Megarry VC suggested four elements which may be of assistance in identifying such confidential information. First, the information must be information the release of which the owner believes would be injurious to him or advantageous to his rivals or others. Secondly, the owner must believe that the information is confidential and not in the public domain. Thirdly the owner's belief must be reasonable and fourthly the information must be judged in the light of the usages and practices of that particular industry.

The insider should not get a start over others by using the information which he received in confidence.[8]

In England it is difficult to imagine the English courts giving a civil remedy for insider trading on the basis of breach of statutory duty. In such an action the plaintiff must establish a breach of statutory obligation which, on the proper construction of the statute, was intended to be a ground of civil liability to a class of persons of whom he is one.[9] In the United States there may be a right of private action against someone who has violated section 10(b) Securities Act 1934 or Rule 10-b.[10]

A listed company shall inform the Securities and Exchange Commission and the relevant Stock Exchange of any price sensitive information within thirty minutes of a decision relating to the information by fax, special messenger or courier by a message in writing signed by the Chairman, Chief Executive Officer or Secretary of the Company.[11]

30.1.2 **Chinese Walls** – The conflict of interest rule sometimes puts a multiservice securities house in problem which combines corporate finance, mergers and acquisitions, retail booking and market making. Thus if a bank through its mergers and acquisitions department is in possession of inside information about X Ltd, will it be in breach of duty in not using that information in managing the discretionary portfolios of its investment clients ? On the basis of the decision in Harrods Ltd vs Lemon,[12] if the bank acted contrary to the interests of its discretionary investment client it risks being held in breach of fiduciary duty. The bank was the agent of those investment clients ; by not disclosing or using the information , it placed its duty to those clients in conflict with its other interests. This case is the authority for the proposition that information known by part of a company is known by every other part of the company. A concept adopted to overcome the problems of conflict of interest and misuse of confidential information has been that of creating a 'Chinese Wall'. This means that

[1] [1979] Ch. 250

[2] [1983] BCLC 325

[3] [1991] Ch. 547

[4] [1993] 1 WLR 484

[5] [1990] 1 HKLR 296

[6] Bell vs Lever Brothers Ltd [1932] AC 161,194

[7] [1979] Ch 227

[8] Lord Denning MR in Seager vs Copydex Ltd [1967] 1 WLR 923 at page 931.

[9] Halsbury's Laws of England Vol 45 para 1279; Lonrho Ltd vs Shell Petroleum Co. Ltd [1982] AC 173 .

[10] Basic Inc vs Levinson 485 US 224.

[11] SEC Order No.SEC/SRMID/2000-985/2248/Pro-02/1 dated 19.12.2000.

[12] [1931] 2 KB 157

information known to persons involved in one part of a business is not available directly or indirectly to those involved in another part of the business and it is accepted that in each of the parts of the business so divided decisions will be taken without reference to any interest which any other such part or any person in any other such part of the business may have in the matter. The object is to segregate information by the segregation of functions. A typical example would be the separation in a merchant bank of the investment division from the corporate finance division.

30.2 In England the laws relating to insider trading are to be found mainly in Part V of the Criminal Justices Act. This replaces the 1985 Act which created twelve offences. The Financial Services Act of 1986 provided for the first time a specific power of investigation into possible contravention of the 1985 Act. The Criminal Justice Act 1993 creates three insider dealing offences. These are;

a) insider trading in price affected securities;[1]

b) encouraging another to deal in price-affected securities;[2]

c) disclosure of inside information to another otherwise than in the proper performance of the functions of his employment, office or profession;[3]

In Australia pursuant to the report of the House of Representatives Standing Committee on Legal and Constitutional Affairs (Fair Shares for All) there were amendments in the Corporations Law in 1991 and Pt.7 .11 Div 2A was introduced. Under this law it would not matter whether the information was acquired through employment or some other connection with the company, or through overhearing a conversation in an elevator. The statute applies to securities as defined in section 1002A(1) of the Law which makes the legislation apply to put and call options. That same section defines 'information" to include matters of supposition and other matters that are insufficiently definite to warrant being made known to the public. Ss 1002E and 1002F relate to possession of information which have the effect that a body corporate is taken to possess information which an officer possesses as such, and partners are taken to possess information possessed by other partners or employees of the partnership where the information comes to them in that capacity.[4] An information is generally available if it consists of readily observable matter, or it has been disseminated in a manner likely to bring it to the attention of investors and a reasonable period has elapsed. It is necessary to show that if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of securities. Section 1002G (1) and section 1002(c) expands this notion by stating that a reasonable person would be taken to expect information to have a material effect on price or value if the information would be likely to influence persons who commonly invest in the securities in deciding whether or not to do so. Further, it must be proved that the defendant knows, or ought reasonably to know, that the information is not generally available and that if it were, it might have a material effect on the price or value of the securities. The Australian Law creates three offences- the trading offence; section 1002G(2)(a) the procuring offences. 1002G (2)(b) and the communicating offence. section 1002G(3)

30.3 **The American Law** – Section 10 of the Securities Act of 1934 prohibits use of manipulative and deceptive devices or contrivance or short sale in contravention of such rules and regulations as the Commission may prescribe. Section 20A provides that any person who violates any provision of the Act or the rules or regulations thereunder by purchasing or selling a security while in possession of material non public information shall be liable in an action to any person who contemporaneously with the purchase or sale of securities that is the subject of such violation , has purchased or sold securities of the same class. This means that any person who has suffered may sue the insider for the profit the insider has made. Rule

[1] section 52(1)

[2] section 52(2)(a).

[3] section 52 (2)(b)

[4] Section 1002 b (2)

10b-5 which is similar to our section 17 of the SEO of 1969 makes it unlawful for any person to employ any device, scheme or artifice to defraud or to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading or to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person in connection with the purchase or sale of any security. It is Rule 10b-5 which has been relied on by the American courts to prosecute insiders who make profit using their inside knowledge. This Rule has been utilised to craft a rule of law that subjects certain persons in possession of material nonpublic information to a 'disclose or abstain' rule.

In a series of administrative decisions and injunctive proceedings, commencing in 1961 the SEC widened the applicability of Rule 10b-5 as a general prohibition against any trading on "inside information" in anonymous stock exchange transactions as well as in face -to-face dealings. The rule was firmly established in *Cady Roberts,*[1] *SEC vs Texas Gulf Sulphur*[2] and *Investors Management.*[3] But the subsequent decisions of the U.S. Supreme Court in *Chiarella vs United States*[4] and *Dirks vs SEC*[5] have some what curbed the use of this doctrine.

In *Cady Roberts* a partner of a brokerage firm had sold shares in a company when he learnt that the board of directors had decided to cut the dividend. The sale was done before the news of the cut was disseminated. In *Texas Gulph Sulphur* officers and employees of the company had made substantial purchase of its shares after learning that the exploratory dealings of the company showed promising results. In *Investors Management* an aircraft manufacturer disclosed to a broker-dealer, which was acting as principal underwriter for a proposed debenture issue, that its earnings for the current year would be substantially less than it had previously forecast publicly. The broker-dealer's underwriting department passed the information to members of its sales department who in turn passed it to representatives of major institutional clients. The institutions sold large amounts of stock before the revised earnings estimate became public. In all these cases, the persons who effected the transactions or who passed the information to those persons were held to have violated Rule 10b-5.

In *Zweig vs Hearst Corp.*[6] a financial columnist was held liable to a forced purchaser pursuant to a merger and who did not rely on the column. The court reasoned that the defendant's failure to disclose his "scalping" activities defrauded the market by causing an artificially high price and that the plaintiff's injury arose from having to pay that price. The columnist had purchased stock prior to publishing his buy recommendations.

In *Chiarella* an employee of a financial printing firm, who was working on documents relating to tender offers, ascertained the identity of the companies which were the targets of these offers, purchased stock in those companies and sold the stock at a profit after the tender offers were announced. The Supreme Court reversed his conviction of a criminal violation of Rule 10b-5. The Court held that in a market transaction, at least when that information was market information 'rather than fundamental information related to the issuer's condition."

In *Dirks* a security analyst received confidential information from a former employee of Equity Funding Corporation (EFC) to the effect that a large percentage of EFC's policies were fake. The employee's motivation in giving Dirks the information was to obtain his aid in exposing the fraud. While attempting to ascertain the truth of these allegations, Dirks passed along the information to a number of his institutional clients, who sold large amounts of EFC stock. Subsequently the allegations were confirmed and EFC went into bankruptcy. The SEC brought a disciplinary proceeding against Dirks, alleging that he had violated Rule 10b-5 by giving the information to his clients. The Supreme Court held that Dirks had not acted illegally, since (a) he owed no duty to purchasers of EFC stock and (b) he could not be found to have aided and abetted a violation by the insider from whom he obtained the information, since the insider had not acted from an improper motive. However, one *post*

[1] 40 SEC 907 (1961)

[2] 401 F.2d 833 (2d Cir. 1968)

[3] 44 SEC 633 (1971)

[4] 445 U.S.222(1980)

[5] 463 U.S. 646 (1983)

[6] 594 F 2d 1261 (9th Circuit 1979)

Chiarella decision upheld an SEC complaint seeking injunctive relief and disgorgement of profits in an action against a proof reader who allegedly "misappropriated" tender offer information from a "financial printer"[1]. In *United States vs Newman*[2] the defendant was the head of a brokerage house's over— the – counter trading department. He received a tip concerning impending takeover attempts from two investment bankers whose clients were active prospective tender offerors. The Second Circuit Court held (certificate denied 464 U.S. 863) ruled that in tipping the information the investment bankers had breached a fiduciary duty of confidentiality to their clients – the impending tender offerors. "By sullying the reputations of (the investment bankers) as safe repositories of client confidences, appellee and his cohorts defrauded those as surely as if they took their money."

It is enough that a tipper knowingly breached fiduciary duty, and it is not necessary that he or she was aware of the traders intent to trade.[3] It is sufficient that the tippee knew the information has been improperly communicated, and it need not be shown that the tipee knew the precise source of the information.[4] Actual use of the information need not be shown; it is sufficient to show that the trader under a duty of confidentiality, entered into the transaction while knowingly possessing material nonpublic information.[5] The U. S. Second Circuit Court held in *Moss vs. Morgan Stanley Inc*[6] that the open market seller of a target company's prior stock prior to the tender offer's announcement does not have a 10b-5 claim against a non-insider tippee who purchased shares based on non-public material information obtained from the tender offeror's investment advisor. However the same Court recognised the fraud on the market theory of insider trading liability when the defendant is a corporate insider when it upheld a complaint by open market purchasers against a corporate insider who was selling securities while the corporation was issuing materially misleading optimistic information.[7]

The upshot of the laws in the U.K., Australia and the U.S.A. is that any person being possessed of an inside knowledge about some material particular of the company which if publicly known would affect the price of the shares of the company, cannot take advantage of the inside knowledge either directly or through others (tippees) to buy or sell shares of that company. Any person gaining such knowledge through him is under the same obligation. The American law is based on court interpretations of Rule 10b-5 which is not explicit but others especially the Australians have nicely spelt out the law relating to insider trading.

30.4.1 **The Bangladesh Position** – Section 17 of the SEO 1969 prohibits fraudulent acts and in doing so borrows the language of section 10 of the U.S. Securities Exchange Act of 1934 and Rule 10b-5 framed under the same American law. Thus it is unlawful for a person for turning to his advantage the sale or purchase of any security, directly or indirectly to omit to state or actively conceal a material fact having knowledge or belief of such fact. It is to be seen whether this language by itself will be enough to convict or hold a person liable for insider trading. Section 8 (2) of our Securities and Exchange Act 1993 specifically mentions that it is one of the specific functions of the SEC to prohibit insider trading. The SEC has framed under section 25 of the Act of 1993 Regulations to prohibit insider trading by a gazette notification on 24.8.95. In these Regulations a "Price Sensitive Information" is such information which if published may influence the market price of the concerned security and Regulation 2 (Gha) includes in the definition such information, news relating to the company's financial condition, dividend, any decision to give rights or bonus shares or to sell or purchase any immovable property of the company, or information relating to BMRI or to set up new units and any basic change in the activities of the company, e.g., finished products and planning and policies.

[1] SEC vs Materia 745 F.2d 197 (2d Circuit 1984) cert. denied 471 U.S. 1053

[2] 664 F. 2d 12(2d Cir 1981)

[3] United States vs. Libera 989 F. 2d. 596 (2d. Cir. 1993).

[4] United States vs. Chestman 947 F. 2d 551 (2d. Cir 1991) cert. denied 503 U.S. 1004.

[5] United States vs. Teicher 987 F. 2d. 112 (2d. Cir 1993).

[6] 719 F. 2d. 5 (2d. Cir. 1983)

[7] Goldman vs. Belden 754 F. 2d. 1059 (2d. Cir. 1985).

An insider has been defined as a company's director, 'main' shareholder, managing agent, banker, auditor, adviser, officer or employee. Also such a person who because of his connections with these persons or because of his connections with the company may be in a position to know any value related information.[1] In India in an appeal before the Appellate Authority under section 20 of the Securities and Exchange Board of India Act, it was held that the information about merger of two healthy companies would be a price sensitive information but not serious enough to warrant prosecution. Further SEB could not award compensation under general powers available under the Act for breach of insider trading regulations.[2]

Regulation 3 prohibits an insider to supply any price sensitive information to any other person. Regulation 4 prohibits insider trading as also any advise or assistance to that effect. Regulation 5 gives SEC the following authority in case of an insider trading :

a) if the insider is a stock broker, or stock dealer or his authorised representative then his licence may be suspended or cancelled under the Stock Dealer, Stock Broker and Authorised Representative Regulations 1994; (The Stock Dealer, Stock Broker and Authorised Representative Regulations, 1994 has been repealed by the new Stock Dealer, Stock Broker and Authorised Representative Rules, 2000)

b) to direct not to transfer the shares and pass incidental directions to the company.

Provided that no action shall be taken under Regulation 5 without giving the person concerned a chance to be heard. The SEC may also institute an enquiry to find if anyone has broken the provision of Regulation 4 and take any decision or give direction after receipt of the enquiry report for protection of the investors or for further enquiry.[3]

30.4.2 It is obvious that SEC relies mainly on the Regulations to prohibit and control insider trading. If so then what action it can take against a real insider, namely, director, officer or employee of a company who are in a position to gain inside knowledge and make profit or save loss out of improper use of the knowledge. If the person is not a broker, or dealer then there can be no question of his losing any licence. The efficacy of the SEC prohibiting transfer of shares is meaningless because the insider will have already transferred the shares as otherwise he would not have made any profit. What possible benefit there can be to prohibit an act done and closed? The innocent purchaser or seller will then have lost his money as well as the shares.

Further, the law and not the regulations or the rules should prohibit insider trading and define what is an insider trading. In the U.S.A. the courts have interpreted the language of Rule 10b-5 to hold an insider guilty of undue profit taking but here the language of section 17 alone may not be enough to convince our judges that an insider taking advantage of his special knowledge cannot be allowed to make any profit out of a share transaction. The law must be drafted so that the stock brokers, dealers, investors , and directors and officers know clearly what is insider trading and what would be the effect of it. Any prosecution under section 17 of the SEO will depend on the interpretation of the American law and its relevance in this country.

In India the Securities and Exchange Board of India Act 1992 does not define what is an insider trading and prescribes a fine of Tk five lacs only as penalty for insider trading – a small sum to pay if someone has made big money out of illegal use of inside information. Our Legislature must deal with it by enactment as the Rules framed by the SEC do not go far enough.

31.1 **Rules and Regulations** – The Government and the SEC have framed a number of Rules and Regulations . The relevant ones are;

a) Securities and Exchange Rules 1987.

b) Credit Rating Companies Rules 1996.

c) Securities and Exchange Commission (Merchant Banker and Portfolio Manager) Rules 1996.

[1] Regulation 2 Uma

[2] Hindustan Lever Limited and ors vs Securities and Exchange Board of India and Unit Trust of India vs SEB. (1998) 3 Company Law Journal 473.

[3] Regulation 6 and 7

d) Securities and Exchange Commission (Meetings) Rules 1994.

e) Securities and Exchange Commission (Prohibition of Insider Trading) Regulations 1995.

f) Securities and Exchange Commission (Appeal) Regulations 1995.

g) Public Issue Rules 1998.

h) Rights Issue Rules 1998.

i) Settlement of Stock Exchange Transaction Regulations 1998.

J) Depository Act 1999.

k) Securities and Exchange Commission (Stock-dealer, Stock-broker and Authorised Representative) Rules 2000.

l) Depositories Regulations 2000.

m) Securities and Exchange Commission (Market Making) Rules 2000.

n) Securities and Exchange (Mutual Fund) Rules 2001.

o) Securities and Exchange Commission (Over-the-Counter) Rules 2001.

p) Securities and Exchange Commission (Capital Issue of Public Limited Company) Rules 2001.

q) Securities and Exchange Commission (Acquisition of Substantial Shares, Merger and Take-over) Rules 2002.

r) Depository (User) Regulations 2003.

32.1 **The Securities and Exchange Rules 1987** – deal with qualifications to be a member of the stock exchange, manner of transactions of a member's business , maintenance of accounts and audit by members, submissions of periodical returns by a stock exchange, listing of a security, submissions of annual report by issuers as also a half yearly account. These Rules describe what is to be contained in the balance sheets and profit and loss account of the issuers. These differ from and are in addition to the forms of balance sheets and the profit and loss account to be prepared under the Companies Act.

32.2 Securities and Exchange Commission (Merchant Banker and Portfolio Manager) Rules 1996 define a portfolio manager and a merchant banker as one who advises clients on purchase and sale of securities. A merchant banker may also advise on such purchase and issue managements. A merchant banker must have a registration certificate from the SEC and the SEC will consider an applicants' location of office and business etc., its manpower in working as a merchant banker, adequacy of capital, as also whether the applicant or any of its partners are involved in any loans or cases with the SEC [Rule 5(1)]. No stock dealer, stock broker, property management company to a mutual fund or trustee shall be eligible for registration certificate to act as a merchant banker or portfolio manager [Rule 5(2)]. An application may be refused on written grounds but SEC will give the applicant a hearing in the matter. An applicant will also have a right to ask for a reconsideration of the decision by an appeal within thirty days of the refusal.[1]

A merchant banker will have to keep books of account and records of profit and loss and must submit every three months an unaudited balance sheet to the SEC.[2]

A merchant banker must submit to the SEC all relevant materials relating to the Due Diligence Certificates. A merchant banker is prohibited from using any price sensitive information obtained from its clients in purchasing or dealing with securities either through itself or its associates or relatives. The definition of relatives is meaningless as a merchant bank cannot have any blood relative.

These Rules similarly prohibit working without obtaining a registration certificate for portfolio managers and prescribe similar procedures and qualifications for applying for such certificates.[3]

[1] Rules 8 and 9

[2] Rules 11 and 12

[3] Rules 16-22

A portfolio manager must submit every three months unaudited accounts to the SEC and must maintain books to show what expenses he has incurred for his clients. A portfolio manager must enter into an agreement with his clients which mention among others the objectives of the investment and the services to be provided, the capital to be invested and the field of investment, the fees to be paid, the keeping of the securities.[1]

A portfolio manager must not obtain money or securities from a client for a period of not less than three months (Rule 30) and must submit a statement to clients at least every six months regarding the constitution and value of his securities, dates of transactions, any interest, dividend or profit received, expenses for operating the portfolio and a description of the risks involved in investing in the securities. (Rule 31)

The SEC may inspect the books, records and documents of a merchant banker and portfolio managers through an appointed Inspector. The Inspector may investigate any complaint against such merchant banker or portfolio manager. (Rule 33)

These Rules also provide for a code of conduct for merchant bankers and portfolio managers.

32.3 *The Securities and Exchange Commission (Stock Dealer, Stock Broker and Authorised Representative) Rules 2000* gazetted on 30 October 2000 define a stock dealer, stock broker and authorised representative. A stock dealer is a person who buys and sells securities for himself. A stock broker is a person who buys and sells securities for others. An authorised representative is a person who buys sells and deals with securities as a representative of a stock dealer or a stock broker.

To qualify as a stock dealer or a stock broker a person must be a member of a stock exchange, must not be a merchant banker, portfolio manager, trustee to a mutual fund or property management company, must be a company or statutory organization having capital not less than twenty five lakh taka, must not be convicted of an offence for forgery, fraud or dishonest activities, must not be adjudged a bankrupt or of unsound mind, must not be a member of the board of directors of a stock dealer or stock broker of which registration certificate has been cancelled during the last three years, must appoint a compliance officer having qualifications prescribed by the Commission under the terms and conditions approved by the Commission.

A stock dealer, stock broker and authorised representative must apply for registration certificate to act as such and the period of such certificate will be of one year duration but may be renewed.[2]

The SEC may cancel or suspend such certificates (Rule 12) and the stock dealer, stock broker or authorised representative must keep books of account, records of contracts with clients etc. for at least seven years (Rules 13 and 14). The SEC may have the books of account inspected either to see whether the prescriptions of law are being obeyed or if there is any complaint against such stock dealers, stock brokers and authorised representatives (Rules 15 and 16). These Rules further lay down certain inherent conditions for such registration which require the person obtaining the certificate to obey the Rules and all conditions mentioned in the certificate. A Code of conduct has been laid down in these Rules for stock dealers, stock brokers and authorised representatives. Among these is not creating a false market.

32.4 **The Credit Rating Companies Rules** – were promulgated under section 32 of the SEC Ordinance. A Credit Rating Company means an investment adviser company which intends to engage in or is so engaged primarily in the business of evaluation of credit or investment risk through a recognised and formal process of assigning rating to present or proposed loan obligations or equity of any business enterprise. Rule 3 requires every issue of public debt or issue of shares at a premium or issue of rights shares made by a public company to be rated

[1] Rule 29

[2] Rules 7 and 8

by a credit rating company and declaration about such rating is given in the prospectus or right share offer document. Eligibility for registration requires such a company to be a public company and associated with an internationally recognised credit rating company. The promoters must be men of means and integrity and such company must have at least two professional staff having professional or postgraduate degree in finance, accountancy, business, economics and/or law and experience for at least two years in credit rating or investment advisory activities.[1]

The registration of a credit rating company may be suspended by the SEC for contravention of any of the provisions of the SEO or any Rule or any direction given or made thereunder. Directions may be given by the SEC in public interest or capital market to a credit rating company. (Rules 6 and 7)

A credit rating company is to submit report for a quarter of the year in such form as may be required by the SEC by order in writing within fifteen days of the close of the quarter. (Rule 8)

32.5 **Guidelines on Foreign Placement or Allotment of Securities** – [Superseded by Notification No. SEC/Section 7/DPI/97-130 dated 28.9.1997]"

32.6 **Guidelines for Raising of Capital by Greenfield Public Companies** – By Notification dated 13 June 1995 the SEC has issued guidelines for issue of shares by greenfield public companies. This envisages a Project Feasibility Report approved by the lenders in the case of loan based projects and prepared by recognised investment advisers in the case of 100% equity/public debt-based projects.

32.7 **The Public Issue Rules** – The Public Issue Rules 1998 will radically change the approach of the SEC while approving prospectus etc. There is a clear shift from the SEC's existing policy of merit examination to full and adequate disclosure.

32.8 **The Rights Issue Rules 1998** – framed under section 33 of the SEO relate to pricing and ratio of rights shares. There should be an Issue Manager licensed under the SEC (Merchant Banker and Portfolio Manager) Rules 1996 to ascertain feasibility of the rights issue. There should also be an underwriter under the same regulations to underwrite the rights issue on a firm commitment basis. The SEC will have to be informed about the rights issue fund. Contents of the rights issue offer documents must contain certain informations (Rule 9). There is a provision for lock in of directors rights shares for a period of three years from the date of closure of the rights share subscription.

32.9 The Depository Act, 1999 and the Depository Regulations, 2000 notified on 14 June 2003 provide for the establishment of a Depository and transfer of securities from one account to another. Pursuant to this Central Depository Bangladesh Ltd (CDBL) was incorporated as a Public Limited company.

Its objective is to operate and maintain the Central Depository System (CDS) of Electronic Book Entry. This would involve the recording and maintaining securities accounts and registering transfer of securities, changing the ownership without any physical movement or endorsement of certificates and execution of transfer instruments, as well as various other investor services including facilitation of the secondary market trading of Treasury Bills and Government Bonds issued by the Bangladesh Bank. The Act recognises electronic ownership and transfer of shares. It is obvious that the provisions of section 38 of the Companies Act relating to the transfer of shares as well as section 158 of the Companies Act relating to issue of certificates have been suspended by the CDS.

The CDBL system helps in reducing the infrastructure requirements required for vaults and physical verification of securities by providing various services like Bangladesh Owners'

[1] Rule 4

account opening, Dematerialization, Rematerialization, settlement of trades (on market and off market) and also advanced features like pledging, redeeming, confiscation of securities, calculation and distribution of cash and non cash benefits arising out of corporate announcements, distribution of securities to Beneficial Owners for new issues coming with Dematerialized environment, transfer and transmission of securities.

Depository Participants, Issuers, Banks, Exchanges (DSE, CSE), and Bangladesh .Bank are connected to CDBL through Front End interfaces with access by dial up telephone lines. The Depository Participants (DPs) of CDBL have to be licensed by the Securities & Exchange Commission. They fall into four categories:

(a) Trading Participant i.e. stockbrokers/dealers operating their own Accounts and Clearing Accounts only to settle Stock Exchange transactions;

(b) Full Service Participant i.e. stockbrokers/dealers operating their own Accounts, Clearing Accounts and the Accounts of the investors;

(c) Custody Participant i.e. Banks and financial institutions operating their own accounts, and Custody Accounts of their customers and Clearing Accounts of stockbrokers/dealers;

(d) Settlement Agent Participant operating Clearing Accounts for settlement of Stock Exchange transactions of stockbrokers/dealers.

Functions of the Participants – Participants access online to the CDBL system for the following:

(a) Account opening in the CDS for shareholder/Beneficial Owners (BOs).

(b) Dematerialization of the physical certificates.

(c) Settlement transfers (pay-in and pay-out transfers for the trades setup at Stock Exchanges).

(d) Off-market module used for trades between Beneficial Owners outside the Stock Exchanges.

(e) Inquiry facilities from the Master Files modules e.g. listed company/ISIN, holidays, error codes.

(f) Facility to update local database by using the Transfer Update module.

(g) The Opconsole Module used to download the reports generated by the system into the local workstation.

(h) Use of the Host Report Manager to view the reports downloaded.

(i) Use of the Request Report Module to set up request in the system for specific reports required e.g. BO Holding Report for ISIN (DP), BO Account Statement, etc.

(j) Use of the Master Reports Module to request for List of ISINs, Taxation Rate Details, Applications & Events Allowed, DBA Security Maintenance Log, etc.

(k) Database Administration module used to create users within the DP for internal control purposes.

(l) BO-ISIN inquiry module to inquire the BO holding details online.

(m) Facilities using Transfers and Transmission Module involving change of ownership arising from gifts, death of the account holder or transfers between different accounts of the same BO.

(n) Use of the Freeze and Suspension Module to freeze any BO-ISIN account or to suspend the BO from debit/credit or both.

(o) Use of Pledge Module to pledge securities.

(p) Rematerialization.

(q) Tariffs and Billing inquiries.

Functions of the Issuers - Issuers access online to the CDBL system for the following:

(1) Confirmation / Rejection of Dematerialization.

(2) Dematerialization of New Issues (IPO).

(3) Confirmation/Rejection of Dematerialization Requests.

(4) Corporate Events Announcements Enquiry e.g. Bonus, Rights Issue, etc. (Cash and Non-Cash).

(5) Statutory reporting and management information.

(6) Confirmation of Freeze.

(7) Security Elimination.

Functions of the Stock Exchanges - Stock Exchanges access online to the CDBL System to

(1) Transmit daily Trade files.

(2) Receive Shortage file (If any) on the pay-in day.

(3) Transmit Auction files (If any).

(4) Transmit pay-out file.

(5) Transmit daily closing prices of securities.

Bangladesh Bank

Bangladesh Bank as an Issuer of Treasury Bills and government bonds, access the CDBL system for:

(a) Transmitting the allotments of Treasury Bills and Bonds arising from weekly auctions.

(b) Repo and reverse repo.

(c) Receiving reports of Investor Holdings.

Types of Accounts

Account Structure of CDBL provides for the following:

(1) Principal Accounts for holding participants own securities;

(2) Customer Accounts for holding securities of investors/BO available to Full Service Participants as well as Custody Participants;

(3) Omnibus Accounts for holding co-mingled securities of investors who have agreed to this in writing available to Full Service Participants as well as Custody Participants;

(4) Clearing Account for settling market obligations of stock broker/dealers;

(5) Direct Accounts opened by investors with CDBL without going through a Participant.

The author expresses his gratitude to Mr. Imtiyaz Husain/Ahmed for the depository scheme.

32.10 **Administrative Rules** – The SEC has framed the Securities and Exchange Commission (Meetings) Regulations 1994 relating to holding of meetings of the Commission and has also framed the Securities and Exchange Commission Employees Regulations 1995 which deal with appointment, selection, salaries and allowances, leaves, code of conduct, discipline, retirement and termination of service of its employees.

32.11 **Settlement of Stock Exchange Transaction Regulations** – Dhaka Stock Exchange (DSE) has framed these regulations under section 34 (1) of the SEO with the prior approval of the SEC. These regulations provide for the method of settling transactions at the DSE. Regulations 7 and 8 which provide for the DSE settling the transaction if a member fails to pay his obligations was held to be binding on the DSE.[1]

[1] Farzana Moazzem vs Securities and Exchange Commission and others 54 DLR 66.