A DESSERTATION
ON
INTERESTED DIRECTOR'S
TRANSACTION IN THE CORPORATE SECTOR
OF PAKISTAN

SUBMITTED BY ALAM ZEB KHAN

LLM (CORPORATE LAW)

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INTERESTED DIRECTOR'S TRANSACTION IN THE CORPORATE SECTOR OF PAKISTAN

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DECLARATION

I, Mr. Alam Zeb Khan, do hereby certify that all the material included in this dissertation, borrowed from other sources has been identified and any secondary information used in this thesis has been duly acknowledged.

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ABSTRACT

Ownership in a company is actually in the hands of shareholders. They are the real owners of the company shares and the assets concerned. Directors and other employees are trustees of the shareholders and investors. They have to run the business of the company in a smooth and fair way. Therefore, it is very crucial that the precious investment of the shareholders and investors be protected from any malpractices in the company in order to protect the shareholders from any loss on the one hand and the company from bankruptcy on the other hand. In order to protect the shareholders interest sections 233,234 and 245 of the Company Ordinance, 1984 require that timely, adequately, meaningful, true and fair information is transmitted to them in the form of annual and interim accounts. Board of directors is ultimately responsible for the smooth functioning of the company. To protect the shareholders' interest and the company to run its business smoothly, it is very important to have an effective law on the director's transaction as well as its implementation in the interests of investors and the shareholders on the one hand and the company on the other hand.

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ABBREVIATIONS

AIR	ALL INDIA REPORTER
ABIL	ASSOCIATED BISCUITS INTERNATIONAL LIMITED
AGM	ANNUAL GENERAL MEETING
BCL	BUSINESS CORPORATION LAW
B0D	BOARD OF DIRECTORS
CLRC	CORPORATE LAWS REVIEW COMMISSION
CEO	CHIEF EXECUTIVE OFFICER
CFO	CHIEF FINANCIAL OFFICER

EU	EUROPEAN UNION
EUD	EUROPEAN UNION DIRECTIVES
EBM	ENGLISH BISCUITS MANUFACTURER (PVT) LTD.
FSA	FINANCIAL SERVICE AUTHORITY
FSA	FEDERAL SECURITY ACT, 1933
FSEA	FEDERAL SECURITY EXCHANGE ACT, 1934
FSMA	FINANCIAL SERVICES AND MARKET ACT 2000
IDD	INSIDER DEALING DIRECTIVES
ISE	ISLAMABAD STOCK EXCHANGE
ISS	INSTITUTIONAL SHAREHOLDER SERVICES
IT	INSIDER TRADING

KSE	KARACHI STOCK EXCHANGE
LSE	LAHORE STOCK EXCHANGE
MAD	MARKET ABUSE DIRECTIVES
MLD	MONTHLY LAW DIGEST
NYSE	NEW YORK STOCK EXCHANGE
NASDAQ	NATIONAL ASSOCIATION OF SECURITIES DEALERS AUTOMATED QUOTATIONS
PLD	ALL PAKISTAN LEGAL DECISIONS
SECP	SECURITY AND EXCHANGE COMMISSION OF PAKISTAN
SECP ACT 1997	SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN ACT,
SHC	SINDH HIGH COURT

SBP	STATE BANK OF PAKISTAN
SOX	SARBANES OXLEY ACT, 2002
US SEC	UNITED STATES SECURITIES AND EXCHANGE COMMISSION
UK	UNITED KINGDOM
USA	UNITED STATES OF AMERICA

INTERESTED DIRECTOR TRANSACTION IN THE CORPORATE SECTOR OF PAKISTAN

CHAPTER 1

1.1 INTRODUCTION

Interested director's transaction is one where the director has his self interest in the underlying transaction, contract, sale and purchase either with a person, group of persons or other company, corporation or entity. Interested director's transaction is prohibited by the law of every jurisdiction in the world. A director stands in a fiduciary relation with a company. He is trusty as well as an agent of the company. He has to perform his duties for the benefit of the company and the owners of the company (shareholders).And where a director feels that his interest conflicts with the interests of the company/shareholders; he has to prefer the interest and benefit of the company/shareholders over his own interests.

A director acts like an agent. He is obliged to carry out the duties assigned to him by his principal in a fair and honest way. The director of a company is required to use utmost care and diligence while performing his duties. He has to perform his duties within the prescribed limits. Whenever he performs his duties which are ultravires the company; they can not be ratified by subsequent approval of the shareholders. However, if any act of the director is ultravires his power then in that situation, it can be ratified by the approval of the majority shareholders.
Moverover a director who has any self interest or concern in any contract or transaction he is required, under the company ordinance, 1984 to disclose that interest in the meeting of Board of

directors. Otherwise his transaction or contract would disclose him to criminal as well as civil liabilities which include heavy fine and disqualification from future appointment for directorship. In addition to disclosure of his interest to the directors in the meeting of Board of Directors, it is also mandatory under the company ordinance, 1984 that a register is maintained in every company/corporation wherein all the transactions and contracts will be entered into in which the directors are interested.

The job of a director is consolidated and performed by the board of directors who are mostly elected by the shareholders in almost every jurisdiction in the corporate world. Board of directors is the supervisory body of a company. They supervise the day to day affairs of the company and manage the affairs of the company through management i.e CEO, Company Secretary and CFO etc. In order to run the affairs of the company in a fair and honest way, it has been made mandatory for every board to have three kinds of directors (i) Executive director (ii) Independent director and (iii) non-executive director. Every board requires having at least one independent director who will represent minority shareholders. In most of the jurisdictions there is one tier system like America,Uk and other European countries whereas in Germany and in some other companies in France, there is two tier systems (i) The supervisory board, which supervises the affairs of the management, their appointment, remuneration and (ii) the management board, which manages the affairs of the company. In a nutshell, in order to combat interested director's transaction in a company, every modern corporate law has emphasized for the establishment of a board, containing disinterested directors who can perform and oversee the affairs of the company in a fair, smooth and honest way, which will resultantly be in the best interest of the company, its shareholders and the public at large.

1.2 DEFINITIONS

1.2.1 DEFINITION OF INTERESTED

"Having the attention engaged/diverted to other side; having emotion or passion excited; as, an interested listener. Having an interest have inclination; concerned in a cause or in consequences which leads to be liable/ affected or prejudiced; as, an interested one."[1]

1.2.2 DEFINITION OF INTERESTED DIRECTOR

As per Section.2 of the Companies' Ordinance, 1984 "director" stands for a person who occupies the position of a director in a company or corporation.

. It further means the interest of a person in a transaction wherefrom he or she, directly or indirectly, makes profit in a firm/company in which he or she is a director. Such interest must be disclosed to other directors of the firm as well as to all shareholders in a general meeting. However, an interest that does not create a conflict of interest is generally not required to be disclosed[2]

. The New York's Business Corporation Law (BCL), explains interested by saying that a company member is to be considered "interested" in a transaction when, either as an individual or a director of another company, the board member enters into a transaction with the company or otherwise has a substantial financial interest in the transaction.[3]

1 www. brainyquote.com.....last visited on 23/6/2009

2 http://www.businessdictionary.com/definition/interest-of-director.html last visited on 25.7.2009

3 N ew York Law Journal, Vol: 238-No 3, July 5, 2007by Richard Siegler and Eva Taiel

A director stands in a fiduciary relation with the company and it is universal principle that a person who has such duties to discharge is not allowed to enter into a transaction wherein he has his own interest conflicting with the interest of company's shareholders. Where a director enters into a contract and he has his own interest conflicting with the company's interest, he has to comply with the following requirements:-[4]

(1) The director is required to disclose his interest at the meeting of directors at which such contract is to be discussed and determined;
(2) Where a director acquiring an interest in any contract following the meeting of directors wherein such contract had been determined he must disclose the same at the first meeting of the directors after gaining his interest;
(3) It is also required that a register is to be maintained at the registered office wherein all contract or similar arrangements are to be entered in which directors are interested and that register will be open to the public for examination and inspection.
(4) It is also mandatory that an interested director shall not be counted for the purpose of forming a quorum at the time of meeting wherein such contract/transaction is to be determined;
(5) A director who has any interest either directly or indirectly in a contract/arrangement shall not vote for that contract/arrangement at a meeting wherein such contract/arrangement is to be determined and if he votes that will not be counted for the purpose;
(6) The company must disclose to the public through a general meeting that any director or directors has a personal interest in a contract/transaction with the company and that notice shall be considered to be a sufficient disclosure;
And where a director goes beyond the above mentioned requirements he or she will be punished with fine and face other consequences.

4 Ss.214, 216 and 219 of the Company Ordinance, 1984.

The following case law will further elaborate the interested director's transaction:-

Associated Biscuits International Limited (ABIL)

Vs.

English Biscuits Manufacturers (pvt) Ltd. (EBM) & others

Sindh High Court Affirmed the petition gave judgment against the Respondents and in favour of petitioners. It is the case of the Associated Biscuits Company Limited (in short ABL), the petitioner, that on 30-8-1999, a notice for 34th AGM of English Biscuits Manufacturers (Private ltd.) (Hereinafter EBM) was issued with Director's report ending 30-6-1999,inter alia, Agenda was in respect of the acquisition of 49% equity stake in Coronet Foods (pvt) (ltd) (CFL in short) by EBM to make it wholly owned subsidiary and to avoid conflict of interest. The entire BOD of EBM (who were family members except respondent No.7) on 1999 approved a resolution that the EBM will purchase the 49% share of CFL by financing, issuing further equity stake, 20 per share and a notice was issued to ABL (since 1993, the ABL has neither representation on the BOD of EBM ,nor any other managerial or any executive influence pertaining to its affairs except holds 40% share) either respond to the notice of the purchase of shares of the CFL(subsidiary of the EBM) and in case of no reply, it will be assumed that it has ignored the notice of purchase and the EBM will proceed accordingly. This total transaction was against ABL.

As a result, on 4-12-2001, CMA No. 3518 of 2001 was filed by ABL against the respondents 2 to 7, which was elaborated by the learned counsel of the petitioner that the respondents 2 to 7, Controller of the affairs of the EMB, have taken a decision in board meeting dated 22-12-1999 to purchase CFL share at 100% premium by issuing further shares smacks of undue personal enrichment and oppression of minority shareholders. The valuation of the CFL shares have been made to the undue personal advantage of the respondents 2 to 7, which have been artificially inflated to a ridiculous 100% premium value through a non-transparent process where the sellers have maneuvered the price at which ABL is being compelled to purchase CFL shares which has been done for no other than to personally benefit the respondents 2-7. He also pointed out that valuation report of Messrs Ferguson dated 6-12-1999 clearly based on forecast and has no

relation with reality. On the other hand, counsel of the respondents contended that from the facts of the case, there is no oppression insofar as respondents are concerned, all the decisions have been taken by the Board of EBM in the interest of the company .The decision to issue fresh shares was also known to the petitioners through the Director's report and provision of section 86 of the Companies Ordinance was fully complied with.

To analyze the above facts of the case, were the respondents interested in the sale and purchase of the shares for their own interests and they did not follow proper procedure while making contracts with the third parties?[5]

The Court has affirmed the petition that the respondents No. 2 to 7 were interested in the instant transaction with the CFL and were accordingly penalized. Court declared, in the instant case, that a transaction is null and void which is carried out by the directors in their own interest with clear disregard to the interests of the shareholders. The law relating to interested Director Transaction is provided in Ss.214 to 229 of the Companies Ordinance 1984.The duty of the Courts is to safeguard the interests of the shareholders who provide seeds for the formation of the companies. The directors, on the other hand, are trustees, ultimately responsible for the good management of the trust. In case of any violation, which is in their own interest and benefit, the courts are obliged to protect that mismanagement in the interests of shareholders as well as public at large.

However, it is difficult to exactly decide that what constitutes an interested director and the extent to which such a director can participate in board deliberations. However, the following points may be helpful to constitute a director to be interested one:-

1. It is to be ascerned whether a director has a substantial financial interest in a transaction concerned. However, the director's interest must be actual, not otherwise,

5 CLD, 2003, Sindh at 815.

2. And a director will not be interested where the financial benefit received by him is not different from that which benefit received by shareholders alike.
3. A director is said to be interested if he or she is constrained by a self-interested director. However, interested directors may be counted for quorum purposes at a board meeting, which approves an Interested Director Transaction.
4. A director shall also be deemed as interested one if any of his relative i.e. Spouse or a minor child is so interested or concerned in the said transaction.[6]

1.3 HISTORY AND BACKGROUND OF DIRECTOR/INTERESTED DIRECTOR IN THE CORPORATE SECTOR

Company law History in Pakistan

- Company Act, 1913: Consolidated Act for companies was issued in 1913 which was adopted in Pakistan after independence. The companies' law was administered by the provinces until 1973 when the new Constitution of Islamic Republic of Pakistan placed the companies' law in concurrent list and therefore, was taken over by the Federal Government except that the companies operating within the provinces could be regulated by the Provincial Government.

5 http:// books.google.com.books last visited on `10/02/2010

- Companies Ordinance 1984: Companies Ordinance, 1984 was promulgated on 8th October, 1984 that repealed previous Companies Act, 1913.
- In 1993, a committee headed by Mian Mumtaz Abdullah, chairman erstwhile Corporate Law Authority was formed, which furnished its report and some of its recommendations were implemented through an Ordinance by caretaker government but the Ordinance lapsed without placing the recommendations before the parliament.
- In 1996, a commission headed by Mr. Justice (R) Shafi ur Rehman was constituted who reviewed the Ordinance and furnished its report to the Federal Government.
- In January 2001, a Committee consisting of Mr. Abdul Rehman Qureshi,Commissioner, Mr.M.Zafar ul Haq Hijazi, Commissioner, Mr.Muhammad Hayat Jasra, Executive Director and Nazir Ahmed Shaheen, Additional Registrar of Companies was constituted, which furnished its report to the SECP (Amendment) Ordinance 2002 was promulgated on the basis of this report.
- The Companies Ordinance, 1984 has been amended in the years 1991, 1999 and 2002 and by Finance Act, 2008 to cater the needs of ever expanding sectors. However, these amendments were in piecemeal and narrowly focused for which there was considered an urgent need to carry out a holistic examination of the Ordinance in order to assess the relevance of its objectives in the current economic scenario and to bring it to the extent of its harmonization with international best practices. To embark on this essential exercise, the Securities and Exchange Commission of Pakistan (SECP) established the Corporate Laws Review Commission (CLRC) in the year 2006 under the able leadership and guidance of Former Chief justice of Pakistan, Mr. Ajmal Mian and other prominent persons from different fields. The CLRC members met various stakeholders throughout Pakistan and discussed various important issues pertaining to the Ordinance. The CLRC prepared a concept paper which aims to facilitate for the review of the Ordinance.[7]

6 **Practical approach to the Companies Ordinance by Nazir Shaheen,Third Edition, 2007, published by Federal Law House (P.2),**

7 Ownership in a company is actually in the hands of shareholders. They are the real owners of the company shares and the assets concerned. Directors, Managers and other senior Executives are trustees of the shareholders and investors' interests. They have to run the business of the company in a smooth and fair way. Therefore, it is very crucial that the precious investment of the shareholders and investors be protected from any malpractices. This will lead to protect the shareholders from insolvency on the one hand and the company from bankruptcy on the other hand. In order to protect the shareholders interests, "Section 245 of the Companies Ordinance, 1984 provides that every listed company shall, within one month of the close of the first, second and third quarter of its year of accounts; transmit to its members its accounts at the end of each quarter. The Commission has received proposals from few listed companies suggesting that sending periodical accounts to all the shareholders by mail is a costly and cumbersome exercise and the objective of the statutory provisions in the said Section 245 would be achieved if it is allowed to place quarterly accounts of companies on their website instead of transmitting the same to the shareholders by post.

- This would also ensure timely availability of the information to the shareholders and investors..

- The Commission has examined the proposal having regard to the relevant statutory provisions and the rights of shareholders and after due consideration, it has been decided that a listed company may place its quarterly accounts on its website which will be treated compliance of the provisions of Section 245 of the Companies Ordinance, 1984 subject to fulfillment of the conditions mentioned in the SECP Circular NO. Of 2004"[8]

8 SECP Circular No.19 of 2004 available at http://www.paksearch.com/Government/SBP/FOREX/Secp/2004/Cir/cir19.htm last visited on 17/7/2009

Board of Directors is ultimately responsible for the smooth functioning of the company. To protect the share holders' interest and the company to run its business smoothly, it is very important to have an effective law on the director's transaction as well as its implementation in the interests of all stockholders and the company on the other hand..

This is why every jurisdiction in the world including Pakistan has always given due importance to have a law on the director's transaction/conflict of interest and insider trading.

1.5 TERM OF OFFICE OF DIRECTORS, RETIREMENT AND THEIR REMOVAL

(1) "A director elected under section 178 of the Companies' Ordinance, 1984 shall hold office for a period of three years unless he earlier resigns, becomes disqualified from being a director or otherwise ceases to hold office.

(2) Any casual vacancy occurring among the directors may be filled up by the directors and the person so appointed shall hold office for the remainder of the term of the director in whose place he is appointed" 9.

1.5.1 RETIREMNT OF DIRECTORS

"Section 180 of the Company law provides that on the date of the first annual general meeting of a company all directors of the company who are subject to election shall stand retired from office and thereafter all such directors shall retire on the expiry of the term, however, that the directors will remain in office until their successors are elected:

9 Section 180 of the Company Ordinance, 1984

Further that directors so continuing to perform their functions shall iniate immediate s teps to hold the election of directors and in case of any obstacle report the circumstances of the case to the Registrar within fifteen days of the expiry of the term laid down in section 180 of the Companies ordinance"10.

1.5.2 REMOVAL OF DIRECTORS

"Company law also provides a provision for removal of a director. For example, a director may be removed by resolution in general meeting appointed under section 176 or section 180 or elected in the manner provided for in section 178 of the Companies ordinance, 1984[11]

1.6 REPRESENTATION OF NON-EXECUTIVE AND INDEPENDENT DIRECTORS ON THE BOARD

"**Code of corporate governance, 2002 requires that all** listed companies shall ensure effective representation of independent non execute directors, including those representing minority interests, on their Boards of Directors meaning by that that the Board as a group includes core competencies considered beneficial in the situation of each listed company. The Board of directors of each listed company should include at least one independent director on behalf of intuitional equity interest of a banking company, development of financial institution, or Banking Financial Institution, Mudaraba Company, leasing company or investment bank mutual fund or insurance company.

10 Section 177 of the Company Ordinance, 1984.

11 Sections 181 of the Company Ordinance, 1984.

Explanation: To explain this clause "Independent director" means a director where he has no family relationship with the listed company or its promoters or directors and who does not have any other concern, whether pecuniary or otherwise, with the listed company, its associated companies, directors, executives or related parties. The test of independence principally can be judged from the fact whether such
Person can be reasonably supposed as being able to exercise independent business judgment without being subservient to any clear form of interference." [12]

1.7.6 NON EXECUTIVE DIRECTORS (U K)

"The primary purpose of appointing non executive directors is to bring to bear an independent judgment such as on strategy, performance, resources standards of conduct and key appointments. Each of these items needs further interpretation in the light of objectives of a company. It can easily be surmised that the interrelationship of these items will be different for a company that aims at profit maximization and the one that aims at profit optimization. However, "the Cadbury committee"[13] recommended that the majority of non-executive directors should be independent of management and free from any business and other relationship with the company concerned. Indeed, according to the committee, the non executive directors should be requested to disclose their interest in the directors' report."[214]

"It is not clear, however, that why the committee did not object to their having shareholding rights, although according to the committee these directors must not participate in share option schemes and not be eligible for any pension scheme operated by a company. This recommendation might provoke controversy in that non-executive directors might not be able to maintain their neutrality sufficiently or at least it may be difficult to convince outsiders that they remain totally unbiased.

12 ibid

13 **The Cadbury Report, titled financial aspects of corporate governance, is a report of a committee chaired by Adrian Cadbury that sets out recommendations on the arrangement of company boards & accounting systems to mitigate corporate governance risks & failures. The report's recommendations have been adopted in varying degree by the European Union, the United states, the world Bank,& others. http://en.wikipedia.org/wiki/cadbury_Report last visited on 16/07/2009**

14 : corporate governance & corporate control edited by Saleem Sheikh & Prof: William Rees (P.248&249) London: Cavendish,1995

As to the executive directors, the committee recommended that their service contracts should not exceed three years without shareholder approval. Like the non-executive directors, the executive directors would be required to make a full and fair disclosure of their total emoluments and salaries including pension contributions and stock options. The committee also recommended that they should be required to give separate figures for salaries and performance related elements

Executive director's pay should be subject to the recommendation of the remuneration committee made up wholly or partly mainly of non-executive directors.
The provision that executive directors' contracts should not exceed three years without shareholders approval indicates that shareholders, according to the committee, should be given a significant degree of control over such directors' appointment and that such directors must remain accountable to the shareholders.

Unless the current company's legislation is amended to this effect, it is not clear how this recommendation of the committee may in reality be implemented, unless the code is voluntarily implemented by companies along the lines done so by the London Stock Exchange."15

1.7.7 TEST FOR TRUE INDEPENDENCE OF DIRECTORS.

"For the purpose of measuring true independence, three terms are used interchangeably, though each has a different and distinct meaning. Outside and non-executive directors have a synonymous connotation of not being involved in the day-to-day operations of a company. But, none of them is a guarantee of true independence."[16]

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15 corporate governance & corporate control edited by Saleem Sheikh & Prof: William Rees (P.248&249) London: Cavendish, 1995

16 http://www.secp.gov.pk/rc/RoleOfDirectors/ASIANBOARDS.pdf...last visited on 27th june,2009

"The most obvious test for independence would be to establish the break in family relations with the controlling shareholder or with management. The second test would be to establish the break in social relations (e.g. relations established through god-parent ties such as standing as principal sponsors in baptisms or christenings or weddings of children; school or university fraternity relationships; school affiliations; hometown affiliations, etc.) which have tremendous import in societies where such relations bring with it certain informal obligations based on such notions as loyalty, honour (or shame), face-saving, fraternal kinship, and the like."[18]

"Limited surveys of Asian CEOs reveal that 40% of respondents define true independence as "having no family or social relationship with the controlling shareholder. While this would establish a true break with the controlling shareholder, it is noted that the majority (60%) do not feel compelled to establish a break with such relationships in order to act independently. Instead, 30% of the respondents in the same poll define true independence as the situation where there exists no business relationship or financial contract(s) with the company. Another 32% equate independence with having no executive role in the company. The balance of 37% speaks of independence as an individual trait regardless of the relationship with the controlling shareholder."[19]

"Thus, the possibility of family or social relationships is not viewed as a hindrance to independence provided one of the above three conditions exist in fact.

In India, the definition of independence is also linked to the remuneration of directors: Independent directors are those who do not derive the majority of their current income from the company and are therefore not beholden to it for their own financial well-being."[20]

"The Asian corporations are predominantly family-owned and controlled corporations' places strong emphasis on relationships - both social and business. Thus, the true test of independence would be found in the degree of removal in the relationship to the controlling shareholder by the so-called independent director."[17]

-18 ibid

19 ibid

20 ibid

17 ibis

CHAPTER 2

LAWS DEALING WITH INTERESTED DIRECTOR TRANSACTION

2.1 EXISTING LAWS ON THE INTERESTED DIRECTOR TRANSACTION IN PAKISTAN.

The following laws exist in Pakistan for the regulation of corporate sector in Pakistan including interested director transaction and insider trading.

- Companies Ordinance, 1984.
- Code of Corporate Governance 2002
- Securities and Exchange Ordinance, 1969
- SBP's Prudential Regulations for Corporate/Commercial Banking
- Listing Regulations of KSE, LSE, and ISE
- Decisions of the Superior Courts

2.2 SAFEGUARDS PROVIDED AGAINST THIS CRIME IN THE CORPORATE SECTOR

In a company, the position of a director is a crucial one and is not easy to be grasped. The company's ordinance does not make efforts to define their position well. Companies Ordinance and the courts untidily make a strenuous effort to regulate the working of the director in an appropriate way. The flaws and loopholes, which were there in companies' ordinance, have been adequately diminished by the court and this process is still continuing for the better development of the corporate law.

The position of the director is very important in a company and its powers are susceptible to be abused. That is the reason that a lot of provisions of the company ordinance are there to regulate the working of the directors, but one thing should also be kept in mind that the laws, rules and the provisions should not be so restrictive that high position personal hesitate to hold

the office of the directors, but the check and balance theory is a better representation of good governance of the company.

General Safeguards against interested director transaction

1. "The success of a company depends to a large extent on the competence and the integrity of its directors. It is, therefore, necessary that the management of the company should be in proper hands."[21]

2. This is the reason that appointment of the directors is strictly regulated by the law to prevent the undesirable person to hold the office. As for instance appointment of directors for short term does not permit the directors to perpetuate him.[22]
3. Where a director remains absent from three consecutive meetings of the board or does not attend any meeting within the span of three month, he will be stood removed.[23] (a) the BoD is not competent to do what the Ordinance, memorandum and articles requires to be done by shareholders in general meeting
4. The safeguard which is available against the extensive powers of the directors is (a) the BOD is not competent to do what the Ordinance,memorandum and articles to be done by shareholders in general meeting(db) and in exercise of their powers the directors are subject to the provision of the Ordinance, memorandum and the articles and other regulations made by the company in general meeting. Therefore, the Ordinance tries to demarcate the area of proper management, control and proper shareholder control.[24]

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21 AIR 1934 all 855

22 Sections. 180 of the Companies Ordinance, 1984.

23 Section.188 of the Companies Ordinance, 1984.re

24 Section 196 of the Companies Ordinance, 198

5. Shareholders can usurp the powers of the directors and also can remove them from their offices by changing the articles of the company.[26] As observed by Lord Justice Greer, the company is a separate entity and the powers are divided among the shareholders and the directors. If the directors act outside their powers but within those of the company, the members can ratify, and make such act valid. But if they act ultravires the company, the member can not ratify or acquiesce in such act, article being a contrary to such act of director.[25]
6. As observed by Lord Justice Greer, the company is a separate entity and the powers are divided among the shareholders and the directors. If the directors act outside their powers but within those of the company, the members can ratify, and make such act valid. But if they act ultravires the company, the member can not ratify or acquiesce in such act, article being a contrary to such act of director.[25]

7. Another important safeguard to regulate working of a director is that if any of the directors is wrongfully excluded from acting as a director, he can approach to the civil court for an injunction and reinstatement.[27]
8. Where directors are elected at the general meeting but not in conformity with the article of association, their election is void. And they can remain as directors only until they are validly replaced in accordance with the articles.[28]
9. A shareholder having 20% of shareholding can apply that the election of the directors to be declared void if he satisfies the court that some material irregularity occurred.[28] Where the precondition that the members of the company should have paid the dues of the company before voting for election had not been met by the members who voted in the election, the election was set aside and fresh election was ordered.[29]

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25 AIR (1916) 1 ch 532

26 AIR (1935) 2 KB 113 1882 (23) CH.D.1

27 AIR (1924) 51 CAL 916

28 Section 179 of the Companies Ordinance, 1984.

29 PLD 1961, LAH 723

10. The act of director as well as the meeting of directors attended by him shall be invalid on the ground of defect as soon as such defect has come to notice; the director shall not hold his office till the defect has been rectified.[30]

11. The directors are not entitled to use their power of issuing shares for the purpose of merely retaining control of the company's affairs or defeating the wishes of the existing shareholders.[31]
12. The assets of the company cannot be disposed of by a resolution of the directors only. They can only be disposed of after the resolution the shareholders passed at a special meeting called for the purpose of winding up the company. A resolution of the directors for the purpose of such disposal is ultravires.[32]
13. Directors are not entitled to any remuneration, as a matter of right, unless the articles provide for it and fix the amount. In the absence of a provision of that nature, any remuneration given to them is in the form of gratuity. In a going company, a general meeting may vote a gratuity beyond the amount prescribed in the articles, but upon the liquidation this cannot be done. If the appointment of the director has been made invalidly, he cannot get any remuneration although he may have served for a long time. If the article provides that the directors will gain the remuneration at the rate of so much per annum, he will be entitled to that proportionate amount[33]

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30 Sections 185 of the Companies Ordinance, 1984.

31- AIR (1920) Icl 77

32 AIR 1938 Rang.447

33 AIR 1922 WN 237

but if it is a payment for a year, he can not get it if he does not serve for the whole year. But this can not, however, be done after the company has gone into liquidation.[34] But where remuneration is allowed, it may be proved as a debt on winding up in competition with the ordinary creditors.[35]

13. Where shareholders know that their directors have been exceeding their legal powers and take no steps in the matter but allow the things done to remain unimpeached for years, they must be taken to have retrospectively sanctioned what has been done.[36]

14. Directors can not appoint one of them to an office of profit or delegate powers to a managing director, unless expressly empowered by an article or by a special resolution of the company.[37]

15. Certain contingencies have been provided in sections187, 190 of the Companies Ordinance, 1984 and other contingencies may decide in articles on the happening of which the person becomes ineligible to have the office. The BoD can not waive the effect of the event which, when it happens, results in the director ceasing to be director.

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34 AIR (1915) 2Ch.186

35 AIR (1898) 1ch.324

36 AIR 1930 BOM.267.

37 Section 192 of the Companies ordinance, 1984

16. A quorum for the meeting of the directors of the company shall not be less than one-third of their numbers or four, whichever is greater. The directors of the public company are bound to meet at least twice a year. If the directors do not follow these two conditions, penalty has been provided in the Ordinance[38]

17. The director cannot borrow loans, whether directly or indirectly, from the company of which he is a director[39]

2.3 CRIMINAL AND CIVIL LIABILITIES FOR THOSE WHO VIOLATE THOSE LAWS.

A director of a company may incur liability in various ways, namely:

(a) **Firstly**, they may become liable to pay damages.

(b) **Secondly**, in certain circumstances they may become criminally liable.

(c) **Thirdly,** they may become liable to fine.

Each of these is discussed below:-

In the first, they may become liable to pay damages:

(a) to outsiders for contracts when they exceed their authority or when they contract in their own name; for torts (i.e. wrong doing such as the infringement of a patent) or for untrue statements in the prospectus; and

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38 Section.193 of the Company's Ordinance, 1984.

39 Section.195, of the company's Ordinance, 1984.

(b) to the company for negligence as agents or for misfeasance or breach of trust e.g. breach of articles resulting in loss to company, application of the company' funds to ultra vires purpose, secret commission

If it appears during the course of winding up that there has been misfeasance or breach of trust, the court may on the application of liquidator or any creditor or contributory examine into conduct of such person and compel him to pay damages. Misfeasance is a breach of duty not involving misapplication of the company's fund, but resulting in loss in company. A director who has been rendered liable is, however, entitled to contribution from his co-directors equally liable.[40]

Secondly, in certain circumstances the director may become criminally liable, namely:-

(a) They are liable to fine and imprisonment for destruction or falsification of book of accounts, etc.[41]

(b) They are liable for prosecution by the Court during the winding up of a company if they are guilty of a criminal offence.[42]

(c) They are liable to fine and imprisonment for willfully making false statement in any accounts, reports, certificates, etc[43].

Thirdly, the directors may also become liable to fine if they do not comply with certain provisions of law. If law attaches a duty to the director the violation of which render the director guilty, the director can not escape that guilt by any way, i.e. by inserting provision of exemption from that liability in articles or by contract or otherwise.

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40 Section 412 of the Company's Ordinance, 1984

41 Section. 417 of the Company Ordinance, 1984.

42 Section .418 of the Company Ordinance, 1984.

43 Section .492 of the Company Ordinance, 1984.

MEASURES TAKEN BY DIFFERENT JURISDICTIONS TO CURB THIS MENACE

The importance of controlling insider trading has assumed international significance as overseas regulators try to boost the confidence of domestic investors as well as international investment community. Reports from the international press confirm a propagation of law-making and regulatory actions within just the last several months in countries all over the world aimed at curbing insider trading.[44] For example, in 1998 alone:

Hong Kong regulators unveiled new measures to combat insider trading, including the introduction of new electronic surveillance capability;

Malaysia amended to its securities laws, for the first time giving investors a private right of action against insider traders;
In its efforts to curb insider trading, the Securities and Exchange Board of India enacted rules and regulations that is mandatory for corporate deals to be reported to stock exchanges within 15 minutes of finalizing;

Vietnam promulgated a law establishing its first public securities market, which includes prohibitions on insider trading/interested director transaction.

Egypt announced that it is working on a comprehensive reform of its regulation of the Cairo Stock Exchange, to bring it at par with world standards;

The Netherlands Securities Board has started a study to know whether the Amsterdam Exchanges have sufficient systems in place to detect and investigate insider tradmg interested director transaction.

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44 www.sec.gov/news/speech/speecharchive/1998/spch221.htm visited on 14th March, 2010

These developments indicate a new era of universal recognition that insider trading, in the words of the SEC's Chairman Levitt, "has utterly no place in any fair-minded law-abiding economy.[45]

There is a consensus on the fact that the Board of Directors is the supervisor and policymaker in all most all jurisdictions of the world. They are entrusted with the power to manage the affairs of the company. They are the trustees of the company on the one hand and agents of the shareholders, creditors and investors on the other hand. So long as they perform their duties in accordance with their respective laws and code of corporate governance ,inter alia, obedience to insider trading /interested director laws, the company will run its business in a better way and more and more investors will come forward for investment. Resultantly the overall economy of that particular country will increase. And where the directors do not comply with their company laws and good corporate governance laws, there will be neither investor's confidence nor overall development of corporate culture, resultantly a clear decline in their economies.

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45 ibib

CHAPTER 3

3.1 DISCLOSURE REQUIREMENT FOR DIRECTORS.

Disclosure and transparency: "Corporations and companies should explain and disclose the roles and responsibilities of Board of Directors and Management to provide shareholders with a level of accountability transparency. They should also implement procedures to independently verify and safeguard the authenticity of the company's financial reporting. Disclosure of material matters concerning the entity should be timely and balanced to ensure that all investors have access to clear and factual position and information."[73]

"The company's ordinance 1984 has provided the following disclosure requirements for directors, namely:-

(1) The director of a company who is either directly or indirectly interested in any contract or arrangement entered into, or to be entered into, by or on behalf of the company shall disclose the nature of his interest at a meeting of the directors and a director shall be deemed to be interested or concerned if any of his relatives, as defined in the Explanation to sub-section (1) of section 195, company's ordinance, 1984 is so interested or concerned.

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(2) The disclosure in question to be made by a director shall be made.-

in the case of a contract entered into, at the meeting of the directors at which the question of entering into the contract or arrangement is first taken into consideration or, if the director was not, on the date of that meeting, concerned or interested in the contract or arrangement, at the first meeting of the directors held after he becomes so concerned/ interested; &

in the case of any other contract or arrangement, at the first meeting of the directors held after the director becomes concerned / interested in the contract or arrangement.

If a director fails to comply with the above requirements shall be liable to a fine which may extend to five thousand rupees."[46]

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46 http://en.wikipedia.org/wiki/Corporate_governance last visited on 20/3/2010

3.2 INTERESTED DIRECTOR IS PROHIBITED TO PARTICIPATE OR VOTE IN PROCEEDINGS OF DIRECTORS.

(1) "A director of a company is prohibited to participate in the discussion of, or vote on, any contract or arrangement entered into, or to be entered into by or on behalf of the company, if he is directly or indirectly, concerned or interested in the contract or arrangement, nor shall his presence count for the purpose of forming a quorum at the time of any such discussion or vote; and votes, his vote shall be void."[47]

(2) "The above provision shall not apply to -

(i) a private company which is neither a subsidiary nor a holding company of a public company;

(ii) any contract of indemnity against any loss which the directors, or any one or more of them, may suffer by reason of becoming or being sureties or a surety for the company;

(iii) any contract or arrangement entered into or to be entered into with a public company, in which the interest of the director aforesaid consists solely in his being a director of such company and the holder of not more than such shares therein as are requisite to qualify him for appointment as a director thereof, he having been nominated as such director by the company referred to in sub-section 1.

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47 Section 216 of the Company's Ordinance,1984

48 ibid

(3) Every director who knowingly contravenes any of the above mentioned provisions shall be liable to a fine which may extend to five thousand rupees."[48]

DECLARING A DIRECTOR TO BE LACKING FIDUCIARY BEHAVIOR.

"The Court may declare a director to be lacking fiduciary behavior if he voilates the provisions of section 214 or sub- section (1) of section 215 or section 216 of the companies ordinance,1984 and the making a declaration the Court shall afford the director concerned an opportunity of showing cause against the proposed action."[49]

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48 ibid

49 Section 217 of the Company's Ordinance, 1984

3.4 DISCLOSURE OF INTEREST BY DIRECTORS WHILE MAKING APPOINTMENTS.

(1) "The company shall expose and attach to the report referred to in section 236 of the Company Ordinace, 1984, an abstract of the terms of the appointment or contract or variation, together with a memorandum clearly specifying the nature of the concern or interest of the director in appointment of a chief executive, managing agent, whole time director or secretary of the corporation/company in which any director of that company is in any way interested or contract or variation."[50]

(2) "And where a company makes a contract for the appointment of a chief executive of the company, or varies any such contract, the company shall send a copy of the terms of the appointment or contract or variation to every member of the company within twenty-one days from the date of the appointment or of making the contract or varying the contract and if any director of the company is interested in the appointment or contract or variation, a memorandum clearly specifying the nature of the interest of such other director in the appointment of contract or variation shall also be sent to every member of the company/corporation with the abstract."[51]

(3) "In case a director becomes interested as stated above in any such contract, the abstract and the memorandum thereof referred therein shall be sent to every shareholder of the company/corporation within twenty-one days."[52]

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50 Section 218 of the Company's Ordinance, 1984

51 ibid

52 ibid

(4) "And all contract entered into by a company/corporation for the appointment of a director shall be kept at the registered, office of the company; and shall be open to the inspection of any member of the company at such office as in the case of the register of members of the company".[53]

(5) "The provisions of this section shall apply in relation to any resolution of the directors of a company appointing a managing agent, a secretary or a chief executive or other whole-time director, or varying any previous contract or resolution of the company concerning to the appointment of a managing agent, a secretary or a chief executive or other whole-time director."[54]

3.5 MAINTAINING A REGISTER OF CONTRACTS, ARRANGEMENTS AND APPOINTMENTS.

(1) "It is mandatory for a company to have a register wherein contracts, arrangements or appointments shall be entered, to which section 214 or section 215 or section 216 or section 218 of the companies ordinance,1984 applies, including the following particulars to the extent they are applicable in each case, namely-.-

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(a) Date of the contract, arrangement or appointment;

(b) names of the parties concerned;

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53 ibid

54 ibid

(c) Terms and conditions of the contracts

(d) The date on which it was presented to the directors;

(e) The names of the directors who votes in favor and against the contract, arrangement or appointment and the names of neutral persons

(f) The name of the director or officer concerned/ interested in the contract, arrangement or appointment."[55]

3.6 REGISTER OF DIRECTORS' SHAREHOLDINGS.

As per company law, a register is to be maintained wherein the number and descriptions of the shares holding by the directors and employees shall be laid down.

"The said register shall remain at the registered office of the company and shall be open to inspection subject to such reasonable restrictions as the company may by its articles or in general meeting impose."[56]

The Securities and Exchange Commission of Pakistan (SECP} and the registrar may at any time can order a certified copy of the said register or any part thereof[57]

55 **Section 219 of the Company's Ordinance, 1984**

56 Section 220 of the Company's Ordinance, 1984

57 ibid

The said register shall also be kept open at the commencement of the annual general meeting of the company and also accessible during the continuance of the meeting to any person attending the meeting.[58]

If sub-section (7) mentioned above is violated, the company shall be liable to a fine which may extend to one thousand rupees, or if any inspection required under this section is refused or and copy required hereunder is not sent within a reasonable time, the company and every officer of the company who is knowingly and willfully in default shall be liable to a fine which may extend to ten thousand rupees.[59]

Keeping in view the above provision of law which regulates the discloser requirements for directors and stockholder are very clear and manifest. This is an impressive check and balance on the interested director transaction. If the regulations are strictly implemented in letter and spirit, it will obviously control this menace.

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58 ibid

59 ibida

3.8 TRADING BY DIRECTORS AND OTHER OFFICERS.

(1) "It is mandatory for a director or employee of a listed company or any person who is the beneficial owner of more than ten per cent of its listed equity securities makes any gain by trading of any such security within a period of less than six months, such director or person tender the amount of such gain to the company and at the same time send an intimation to this effect to the Security and Exchange Commission of Pakistan:"[60]

(2) "\If a director or any person who is beneficial owner in the company fails to tender, or the company fails to recover, any such gain as is mentioned in sub-section (1) mentioned above within a period of six months after its accrual, or within sixty days of a demand such gain shall go to the Security and Exchange Commission of Pakistan.61

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60 Section 224 of the Companies" Ordinance, 1984

61 ibid

CHAPTER 4

COMPARATIVE STUDY OF THE SUBJECT MATTER

To avoid interested director transaction/insider trading, every jurisdiction in the world has tried its best to have a comprehensive and impressive law on the interested director transaction/insider trading. However, out of which an overview of the United Kingdom, Unites States, Hong Kong and Singapore is given below:-

4.1 INSIDER TRADING LAW IN THE UNITED KINGDOM

The law of insider trading in Europe has been provided in Article 1-4 of the Insider Dealing Directives (IDD) and article 1-4 of the Market Abuse Directives (MAD).[62] However the research report by the British Institute of International and Comparative Law on the Implementation of European Union Directives on Insider Trading and market abuse deals with five member states of EU viz the UK, Germany, France, Spain, and Netherlands. We will restrict our discussion to UK law about Insider Trading. The crux of the Directives that all the member states must implement these directives in compatible way because if there occurs differences in this regard that will harm the basic idea of single market.[63] Although it was necessary to implement the directives equally by all the member countries but in reality there occurred differences in the application of the directives such as the difference over the definition "who is insider?"[64]

62- Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on Insider dealing and market abuse ,OJ 2003 L96, Page. 16

63 EU Directive Report, the British Institute of International & Comparative Law 2005

64- European Union Directive Report foreword by Michael Snyder

"Before the enforcement of EU Directives, the law which was dealing with insider dealing law in the United Kingdom (UK) was the Criminal Justice Act 1993. It incorporates the comprehensive definition "insider" and "insider information" which were not in accord with the EU Directives. But afterwards it becomes very difficult to practice insider trading under the criminal law. Then the Financial Services and Market Act 2000 (FSMA) came into force and reformed the financial service authority (FSA) of its regulated powers. The FSMA gave up powers to FSA to impose civil sanction including fines upon those involving insider dealing. The behavior of FSA was somewhat different from what is taken by the criminal law. The Market Abuse Directives (MAD) was finally implemented in UK through the Financial Services and Market Act 2000, Regulations 2005 and also through changes to FSA rules."[65] Section 118(c) of FSMA, deals with" insider information" and defines it as information which is not generally available as opposed to EU definition of" information which has not been made public".

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65 FSMA 2000(market abuse) regulations 2005,S.2005381

. Section 118(b) defines an insider as follows:

An insider is any person who has inside information –

1 Because he is a member of an administrative ,management or supervisory body of a company of qualifying investments

2 Or is holding in the capital of an issuer of qualifying investment

3 Is involved in criminal activities

4 As a result of having access to the information through the exercise of his employment, profession or duties

5 Or he has obtained such in formations by other means and which he knows to be inside information.[66]

6 In addition to this section, 118(b) FSMA includes "secondary insiders" to mean a person who has inside information "which he has obtained by other means and which he knows could reasonably be expected to know is inside information". The above explanation shows that meaning of insider, inside information and market abuse is quite comprehensive. In UK both criminal and civil penalties are available.

4.2 INSIDER TRADING LAW IN THE UNITED STATES OF AMERICA

Insider trading is usually linked to negative meaning (illegal) but it actually refers to both legal and illegal behavior. Legal insider trading happens when the insider in a corporation buy and sell the stock in their own company. But the term "Insider Trading" which is commonly known that is illegal. The law of illegal insider trading developed in an almost a century in the United States.[67]

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66 Section 118 FSMA,2000 available at http://books.google.com.pk/books last visited 18/3/2010.

67 US SEC, insider trading. Available at www.sec.gov/answers/insider.htmlast visited onn 3/9/2009

It can also be stated as "this is a trading that takes place when those having secret information about important events employ the special benefit of that knowledge to gain profits or keep away from losses on the stock market, to the disadvantage of investors who buy and sell the stock with out the advantage of "inside" information.[68]

According to the directors of SEC Insider trading occurs when trading in a security is undertaken, while the person trading is in possession of material and secret information about the security. Insider trading violation can also include "tipping "such information to persons who misappropriate that information.

For further explanation Insider Trading, SEC has given the following examples:-

1 Company officers/employees who trade the company securities after learning of significant, confidential corporate events about the company/corporation

2 Law firm, banks, brokerage and painting firms are given such information to provide services to the company whose securities they trade

3 Government servants who learn such information due to their employment in the Government offices.

4 Friends, business associates, family members and other "tippers" of such officers directors or employees who trade the securities after receiving such secret information,

Other person who misappropriate and take advantage of, confidential information from their employers.[69]

6 Liability for insider trading /dealing may be criminal, civil or administrative. Justice department of U.S.A. starts criminal proceeding against the violators. The Security and Exchange Commission and its regulatory agencies initiate civil and administrative proceeding based on Insider Trading allegations.[70]

68- Remarks by Thomas C Newkrik ,available at www.sec.gov last visited on 3-3-2009

69 US SEC , insider trading. Available at www.sec.gov/answers/insider.htmlast visited on 3-9-2009

70 Terry Fleming " telling the truth slant"- William Mitchell Law review, voluim 28: 1422

4.2.2 THE FEDERAL SECURITIES ACT OF 1933 AND THE FEDERAL EXCHANGE ACT OF 1934:

In America, for the first time, the concept of federal regulation of securities was firmly established by the Federal Securities Act of 1933 and the Federal Securities Exchange Act of 1934.[115] After crash of US stock market in1929, Congress enacted Securities Act of 1933 and the securities Act of 1934, aimed at controlling the abuses believed to have the main cause to the crash. The 1934 Act addresses insider trading directly through section 16(b) and indirectly through 10(b).[71]

4.2.3 THE CADY, ROBERTS RULE:

The SEC held that the anti fraud provisions of the federal securities law imposed upon corporate insiders in possession of material secret information and positive duty to abstain from trading or to disclose such information before trading[72]

4.2.4 PREVAILING LEGAL THEORIES OF INSIDER TRADING IABILITY:

The development of modern law of insider trading is based on the importance of theories of insider trading liability ie Classical Theory, The tipping theory and the misappropriation theory.[73]

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71 www.law.uc.edu/ccl/34 actrls/rule10-b.html

72 Emily A . Malone, Journal of law and policy 327-68(2004), www.econlib.org, Thomas Geyer, insider trading: evolution prevailing theories and recent development last visited on 8-7-2009

73 www.econlib.org, Thomas Geyer, insider trading: evolution prevailing theories and recent development , www.oyez.org

Dirks v. SEC, 463 US 646(1983) 17- United States v. O'Hagan,521 US (6421997) last visited on 8-7-2009

4.2.8 INSIDER TRADING IN SARBANES OXLEY ACT 2002:

The above mentioned acts could not control the problem properly. This fact became even more prominent in the post Enron era. The former Enron CEO, Kenneth Lay on the one hand was reassuring investors and employees about improvement of his company while on the other hand he was silently throwing away large amounts of his Enron shares. Sarbanes Oxley Act 2002 (SOX) tries to solve this problem by dramatically shortening the deadlines for insiders to report any trading in the company's securities, before this (SOX) the officers and directors of a publicly traded company/corporation had forty days to report whatever they traded on the company's stock but SOX dramatically decreases the period from forty to two business days. It is also required by the SOX that the information must also be posted on company's website. Further the menace is checked by adopting the clause that there is also prohibition on insider trading pension fund black out periods as enunciated in section 306 0f SOX and any profit gained by any director or officer in violation of this section may be recovered from him by the company.[74]

INSIDER TRADING LAW/INTERESTED DIRECTOR TRANSACTION IN HONG KONG

According to Section 162 of the Hong Kong Ordinance:-

"(1) As per Hong Kong company law if a director of a company or corporation who is interested in a contract with the company shall, if his interest in such contract or proposed contract is material, declare the nature of his interest at the first meeting of the directors.

(2) The law further implies that where a director gives to the directors of a company a general notice wherein he has stated that he is to be regarded as interested in contracts of any description which may subsequently be made by the company, that notice shall be deemed to be a sufficient declaration of his interest.

(3)Moreover if a director fails to comply with the provisions of the above section shall be liable to a fine as per the ordinance. (Amended 7 of 1990 S.2)."[75]

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74 Emily A . Malone, Journal of law and policy 327-68(2004), www.econlib.org, Thomas Geyer, insider trading: evolution prevailing theories and recent development last visited on 8-7-2009

75 http://www.hklii.org/hk/legis/ord/32/index.html last visited on 10-10-2010

THE EUROPEAN COMMUNITY DIRECTIVE ON INSIDER TRADING/INSIDER DEALING

The European Directive was promulgated after prohibition of interested director's laws in France and England and went through a number of incarnations. In its final form, the Directive has an attractive structural simplicity.[76]

In short, the Directive defines "inside information" as information of a "precise nature" about security or issuer which has not been made public which, if it were made public, "would likely have a significant effect on the price" of the security[77]

It prohibits insiders from taking advantage of inside information (Article 2);[78]
It prohibits insiders from tipping or using others to take advantage of inside information[79]
It applies its prohibitions to tippees with "full knowledge of the facts"[80]
It requires each member to apply the prohibitions to actions taken within its territory with regard to securities traded on any members' market[81]
It provides that members may enact laws more stringent than set out in the Directive.[82]
It requires issuers to inform the public as soon as possible of major events that may affect the price of the issuer's securities.[83]

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76 http://www.sec.gov/news/speech/speecharchive/1998/spch221.htm visited on 14/3/2010

77 **EC Directive Article, 1**

78 EC Directive Articles 2
89 EC Directive Articles 3
80 EC Directive Articles 4
81 EC Directive Articles 5
82 EC Directive Articles 6
83 EC Directive Article 7.

It requires members to designate an enforcement authority, to give it appropriate powers and to bind it to professional standards of confidentiality[84]

It requires members to cooperate with each other in investigation efforts by exchanging information.[85]

It leaves it up to individual members to decide on penalties for insider trading[86] and finally,

It required all members to enact legislation complying with the Directive by June 1, 1992.[87]

4.6 DISINTERESTED BOARD APPROAL: THE TRUSTEESHIP STRATEGY ADOPTED IN VARIOUS JURISDICTIONS

"In many countries in the world, like mandatory disclosure, disinterested approval is nearly universal requirement for self dealing transaction. A manager who wishes to transact with the firm must generally receive consent from her (disinterested) superiors in order to validate the said transaction. When the interested manager is CEO or director, the only superiors who can give consent are the disinterested members of the board itself. Thus, disinterested directors ordinarily evaluate high level self-dealing transaction (regardless of their ability to do so), unless the size of the transaction or the structure of the board subjects the company to another legal strategy, such as a requirement to obtain the approval of the general shareholders meeting."[88]

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84 EC Directive Articles 8&9

85 EC Directive Article 10

86 EC Directive Articles 13

87 EC Directive Articles 14

88 http://books.google.com.pk/books last visited on 13/3/2010

"In all main jurisdictions, the remedy for a conflicted transaction concluded without effective approval is either to void the transaction or to compensate the company for any resulting harm. Jurisdictions differ, however, in the extent to which they encourage one or another of these remedies. Nullification plays a greater role in the UK, whereas the damages remedy appears to be favored in the US. France and Japan walk a middle road by favoring nullification when conflicted transactions lack board approval ,but preferring a damages remedy when board approval of a conflicted transaction is defective---for example, in France SA, because shareholders have not ratified it."[89]

PROHIBITING CONFLICTED TRANSACTIONS (A COMMON EFFORT)

"Interested director transaction/Insider trading is more important class of conflicted director/managerial transact ions that jurisdictions typically try to curb it. However, there are two kinds of rules against managerial insider trading: prophylactic restrictions on short-term trading and direct bans on trades informed by material inside information. The most important prophylactic rules are restrictions on short term round trip purchase and sale or sale and purchase transactions by statutory insider of US and Japanese public companies, including directors and officers. These rules effectively prohibit short term trading by allocating the resulting profits (or losses avoided) to the corporate treasury, on the theory that these gains are likely to reflect corporate value gleaned through inside information. Major exchanges such as the London Stock Exchange adopt similar restrictions in their listing requirements for the same reasons."[90]

"Moreover, all major jurisdictions now impose some kind of direct ban on insider trading on the basis of non public information about the value of issuer securities. European countries and Japan primarily bar the officers and directors of listed companies from trading in their companies' securities prior to the disclosure of material non-public information. The US by contrast, bans insider trading on undisclosed information in any security, which includes not only the securities of public companies but also those of closely held companies.

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89 bid

90 ibid

Similarly, although all jurisdictions mandate stiff civil(e.g., disgorgement of profits and treble damages) and criminal (e.g. prison sentences)sanctions for insider trading, only the US mounts an enforcement effort large enough to apply these sanctions regularly while enforcement remains notoriously spotty in Europe and Japan."[91]

"However, it is still not clear that how effective prohibitions against insider trading really are. Even in the face of hard US enforcement, law seems to have had a limited effect on the overall volume and profitability of insider trading/interested director transaction. Studies of insider trading outside the US reach opposing results. For example, one study, based on data from 38 jurisdictions, finds that the cost of equity decreases significantly after the first prosecution for insider trading violation, apparently because even minimal enforcement increase the attractiveness of the equity market to outside investors. However, a second multi jurisdictional study concludes that legal prohibitions generally fail to control insider trading /interested director transaction effectively.[93]

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91 ibid

93 ibid

CONCLUSION

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SUGGESTIONS AND RECOMMENDATIONS

1- In order to curb Interested Director Transaction, in the first instance, the board is required to appoint an independent committee comprising of disinterested directors to monitor the transaction as well as to supervise the approval procedure. Appointing such committees will lead definitely to control alleged interested director transaction/self-dealing by directors.

2- Another Important way to eliminate interested director transaction is to adopt the method of "business judgment rule", which controls decisions made by such independent committees. However, the rule permits court of inquiry into as the committee chosen by the board is independent or not.

3- Moreover, boards may adopt a conflict of interest policy in order to provide guidance to their directors as to how to protect themselves in a situation that may result in a conflict of interest. A conflict of interest policy could exclude interested board members from receiving any economic gains from persons or firms dealing with the company and from voting on, or participating in discussion of, wherein the board member has a direct financial interest.

4- The already available laws for the interested director transaction should be enforced in letter and spirit. Because in Asian Countries especially in Pakistan, laws exist but there is the question of implementation.

5 The most effective way to control interested director transaction, special Company Tribunals may be established (i.e.ServiceTribunal,Income Tax Tribunal, Environmental Tribunal etc) on the federal level as well as in each province instead of assigning this burdensome work to ordinary Courts in order to mitigate the work of the ordinary courts.

Moreover, keeping in view the era of specialization, the judges specialized in company law should be appointed to the tribunals for applying their specialized approach while adjudicating in the matter.

6- The recently approved finance bill 2008 containing strict laws combating interested director transaction should also be implemented to discourage this corporate crime.

7- There must be a rigid check and balance by the board so that the directors do not involve in any ultra wires act or enter into any transaction wherein they have their own interest.

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