JUDGMENT SHEET
IN THE ISLAMABAD HIGH COURT, ISLAMABAD
JUDICIAL DEPARTMENT

F.A.O.No.119/2016
Aehsun M.H. Shaikh and others
Versus
Appellate Bench No.IV, Securities & Exchange Commission of Pakistan and another

Date of Hearing:	22.10.2019
Appellant by:	Mr. Faisal Iqbal Khan, Advocate
Respondents by:	Mr. Shahzad Ali Rana, Advocate for the S.E.C.P.

MIANGUL HASSAN AURANGZEB, J:- Through the instant appeal, the appellants, impugn the order dated 28.09.2016 passed by respondent No.1 (Appellate Bench, Securities and Exchange Commission of Pakistan) dismissing their appeal under Section 33 of the Securities and Exchange Commission of Pakistan Act, 1997 against the order dated 11.05.2016 passed by respondent No.2 (Executive Director, (Corporate Supervision Department) Securities and Exchange Commission of Pakistan). Vide the said order dated 11.05.2016, a fine of Rs.13,00,000/- in aggregate was imposed on the appellants. Appellants No.2, 6 and 7 were fined Rs.3,00,000/- each whereas appellants No.1, 3, 4 and 5 were fined Rs.1,00,000/- each.

2. The facts essential for the disposal of the instant appeal are that the appellants are the Directors/officials of M/s Azgard-9 Limited **("Azgard-9")** which is a public limited company engaged in the business of spinning, weaving, dyeing and stitching garments as well as in the import and export of fabric. M/s Montebello S.R.L. **("Montebello")** is a company incorporated under the laws of Sweden and is a wholly owned subsidiary of Azgard-9. It is engaged in the business of buying and selling of fabric. Azgard-9 has been exporting fabric from Pakistan and selling it in the European markets through Montebello.

3. Apparently, on 12.06.2014, a bankruptcy petition with respect to Montebello was filed in Italy, and on 22.12.2014, a Court in Italy passed an order to seal the said company and appoint a trustee.

4. The annual audited financial statements **("Accounts")** of Azgard-9 for the year ending on 30.06.2014 and the subsequent interim Accounts

for the periods ending on 30.09.2014, 31.12.2014 and 31.03.2015 showed that Azgard-9 had not disclosed the factum as to Montebello's bankruptcy. On the contrary, in the said Accounts and interim Accounts, Azgard-9 had shown huge amounts as trading transaction and goodwill for Montebello. Azgard-9's Accounts for the periods ending on 30.06.2014 and 30.09.2014 had shown long term investments in Montebello.

5. On 09.10.2015, the Corporate Supervision Department of Securities and Exchange Commission of Pakistan **("S.E.C.P.")** issued a notice under Section 492 read with Section 476 of the Companies Ordinance, 1984 **("the 1984 Ordinance")** to the appellants calling upon them to show cause within fourteen days as to why a penalty should not be imposed on them for contravening the said provisions of the 1984 Ordinance. In the said show cause notice, it was alleged that the appellants had not disclosed material information about Montebello's status and operations in Azgard-9's annual audited accounts for the year ending on 30.06.2014 and the subsequent interim Accounts. The proceedings pursuant to the said show cause notice culminated in the order dated 11.05.2016, whereby respondent No.2 imposed a fine of Rs.1,300,000/- on the appellants. The appellants' appeal against the said order dated 11.05.2016 was dismissed vide respondent No.1's order dated 28.09.2016. The said concurrent orders have been assailed by the appellants in the instant appeal under Section 34 of the S.E.C.P. Act.

6. Leaned counsel for the appellants, after narrating the facts leading to the filing of the instant appeal, submitted that on 10.11.2015, the appellants had submitted a reply to the show cause notice dated 09.10.2015, and submitted that Montebello's management at Italy was kept at the minimum to save costs; that the Director/Chief Finance Officer of Montebello and his team used to look after the operations, accounts and finances of the said company; that Azgard-9 had prepared its annual, half yearly and quarterly financial statements on the basis of Montebello's annual audited financial statements and unaudited half yearly and quarterly Accounts provided by its local management; that since 2012, Montebello's operations had showed a downward trend due to economic rescission; that Azgard-9 had asked

an independent Chartered Accountant's firm to prepare projections of Montebello's operations in order to assess the fair value of investment in Montebello appearing in Azgard-9's books; that in the years 2013 and 2014, a provision for impairment was adjusted in Azgard-9's books in accordance with the recommendations of the Chartered Accountant; that the management of Montebello did not inform the appellants as to the bankruptcy proceedings; that it was in September, 2015 that the appellants came to know through former employees of Montebello that it was not being managed properly; that the local management, including the Director/Chief Finance Officer of Montebello had left without a proper notice; and that since the appellants and/or Azgard-9 had no information as to the bankruptcy proceedings against Montebello, the required adjustments had not been made in Azgard-9's consolidated financial statements.

7. Learned counsel for the appellants further submitted that on 30.09.2015, an application had been filed on behalf of Azgard-9 before the S.E.C.P. for an exemption from the preparation of consolidated financial statements under Section 237(8) of the 1984 Ordinance; that no order was passed on the said application; that the penalty imposed on the appellants by respondent No.2 is very harsh and disproportionate; and that at best, respondent No.2 could have imposed a penalty/fine under Section 237(9) of the 1984 Ordinance, but not under Section 492 of the said Ordinance. Learned counsel for the appellants prayed for the appeal to be allowed in terms of the relief sought therein.

8. On the other hand, learned counsel for the S.E.C.P. submitted that the concurrent orders passed by the respondents do not suffer from any legal infirmity; that since Montebello is Azgard-9's wholly owned subsidiary, the appellants' stance that they did not know about the bankruptcy petition and the bankruptcy order against Montebello is not believable; that the appellants deliberately showed a huge investment in Montebello in Azgard-9's consolidated financial statements in question in order to lure investment in Azgard-9; that since Azgard-9 is a public limited company, it should not have withheld information as to Montebello's bankruptcy in its consolidated financial statement; that the intent behind Section 492 of the 1984 Ordinance is

to protect investors, etc. against misstatements in the consolidated financial statements; that accurate and reliable financial reporting is the bedrock upon which Pakistan's market are based; that false financial information or inadequate information with material omission shudders the investors' confidence and erodes the integrity of the markets; that a penalty under Section 237(9) of the 1984 Ordinance can be imposed if a company does not file consolidated financial statement or if the requirements of Section 237 of the said Ordinance are not complied with by a company; that on the other hand, a penalty under Section 492 of the 1984 Ordinance can be imposed where a company, in its consolidated financial statements, makes a statement which is false and incorrect in any material particular; and that the appellants, by not disclosing the factum as to Montebello's bankruptcy in its consolidated financial statements for the periods ending on 30.06.2014, 30.09.2014, 31.12.2014 and 31.03.2015 rendered themselves liable to be penalized under Section 492 of the 1984 Ordinance. Learned counsel for the S.E.C.P. prayed for the appeal to be dismissed.

9. I have heard the contentions of the learned counsel for the contesting parties and have perused the record with their able assistance.

10. The facts leading to the filing of the instant appeal have been set out in sufficient detail in paragraphs 2 to 5 above, and need not be recapitulated.

11. It is an admitted position that Montebello is Azgard-9's wholly owned subsidiary. Although Montebello is incorporated under the laws of Sweden, most of its business operations were in Italy. It is also not disputed that on 12.06.2014, a bankruptcy petition was filed against Montebello. On 22.12.2014, a Court in Italy passed a bankruptcy order against Montebello.

12. The appellants' stance is that they did not know about the bankruptcy petition as well as the bankruptcy order against Montebello. Azgard-9, in its reply dated 10.11.2015 to the show cause notice dated 09.10.2015, took the position that the local management, including the Director/Chief Financial Officer of Montebello had left *"without any proper notice or communication"*. Azgard-9's reply to the

said show cause notice shows that it was in September, 2015 that it came to know about the bankruptcy order against Montebello. I would tend to agree with the learned counsel for the respondents that the appellants' contention that they did not know about the bankruptcy proceedings and order against Montebello until September, 2015, is unbelievable. The appellants cannot expect from this Court to believe that the appellants and/or Azgard-9, as prudent persons of business, did not know about the bankruptcy proceedings and order against its wholly owned subsidiary through whom they managed their sales in Europe.

13. Since Azgard-9 is a public limited company, the consolidated financial statements (annual, half yearly and quarterly financial statements) filed by it are a matter of public record. It is an admitted position that Azgard-9, in its Accounts for the period ending on 30.06.2014 and 30.09.2014, had shown trading transactions to have been carried out by Montebello in huge amounts. The said Accounts had also shown long term investments and impairment with respect to Montebello. The said Accounts in addition to Azgard-9's Accounts for the periods ending on 31.12.2014 and 31.03.2015 had shown the goodwill for Montebello. By not disclosing the factum as to the bankruptcy petition and the bankruptcy order against Montebello in the said Accounts of Azgard-9, material information was concealed by the appellants.

14. As regards Azgard-9's application dated 30.09.2015 for exemption from the preparation of financial statements under Section 237(8) of the 1984 Ordinance, the same was filed after the non-disclosure as to the bankruptcy proceedings and the bankruptcy order against Montebello. By this time (i.e., when the said application dated 30.09.2015 was filed), the non-disclosure in question had already been made by Azgard-9. The mere filing of the said application, therefore, does not insulate the appellants from a penalty for the said non-disclosure.

15. As regards the question whether a penalty could only be imposed on the appellants under Section 237(9) of the 1984 Ordinance, suffice it to say that the said provision provides that if a holding company fails to comply with any requirement of Section 237, every officer of the

holding company shall be punishable with a fine which may extend to Rs.50,000/- in respect of each offence unless he shows that he took all reasonable steps for securing compliance by the holding company of such requirements and that the non-compliance or default on his part was not willful and intentional. Now, penalty under Section 237(9) of the 1984 Ordinance can be imposed if a holding company in its consolidated financial statements does not disclose the financial statements of its subsidiary. In the case at hand, Azgard-9, in its Accounts, did disclose the financial statements of Montebello, but as per the respondents, such financial statements contained a material concealment regarding the bankruptcy petition and order against Montebello. For providing false or incorrect particulars regarding a material fact in a company's returns, report, certificate, balance sheet, profit and loss account, income and expenditure account, prospectus, offer of shares, books of account, information or explanation required by or for the purposes of any of the provisions of 1984 Ordinance, the persons responsible can be punished with a fine not exceeding Rs.500,000/- under Section 492 of the 1984 Ordinance. By not disclosing the factum as to the bankruptcy proceedings and order against Montebello, the appellants concealed vital information in its Accounts for the periods ending on 30.06.2014, 30.09.2014, 31.12.2014 and 31.03.2015, and therefore rendered themselves liable to the imposition of a penalty under Section 492 of the 1984 Ordinance.

16. In view of the above, I do not find any merit in this appeal which is accordingly dismissed.

(MIANGUL HASSAN AURANGZEB)
JUDGE

ANNOUNCED IN AN OPEN COURT ON _____/2019

(JUDGE)

Qamar Khan*

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