

IN THE HONORABLE HIGH COURT OF SINDH AT KARACHI

Suit No. B-33 of 2005

KASB Bank Limited,

A banking company incorporated under the laws of Pakistan, having its Head Office at Business & Finance Center, I.I. Chundrigar Road, Karachi and place of business at Shara-e-Faisal Brance, Karachi

(PLAINTIFF)

V/S

1. M/s Trans Livia Private Limited, Having its office at Suite No. 401, 4th Floor, Shahwar Trade Center, Allama Iqbal Road, PECHS, Karachi
2. Ghulam Rabbani Luther,
Chief Executive, Trans Livia Pvt. Ltd., R/o Mouza Luther, Post Office Riazabad, Tehsil & District Multan
3. Mr. Adnan Haider Khan,
Director, Trans Livia Pvt. Ltd. R/o E-2/10, Country Club, DHA Phase V, Karachi
4. Mr. Ahmed Farraz Luther,
Dirextor, Trans Livia Pvt. Ltd., R/o Mouza Luther, Post Office Riazabad, Tehsil & District, Multan
5. Mr. Imran Abbas,
Director, Trans Livia Pvt. Ltd.,
R/o O/6-7, Floride Homes, DHA Phase V, Street No. 33, Karachi

Defendants No. 2 to 5 do business under the name and style "Trans Livia (Pvt.) Ltd.", having its office at Suite No. 401, 4th Floor, Hahwar Trade Center, Allama Iqbal Road, PECHS, Karachi

(DEFENDANTS)

In the High Court of Sindh at Karachi

Suit No. B-33 of 2005

Date	Order with signature of Judge
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1. For hearing of CMA 426/6/2006
2. For hearing of CMA 427/7/2006

Date of hearing 28.9.2006, 25.11.2006, 20.01.2007

Mr. Qutub Saim along with Mr. Jam Asif Mahmood Lar of Ahmed & Qazi for the plaintiff

Mr. M. Salim Thepdawala for defendants No. 1, 2 & 4.

Mr. Mirza Adil Baig M. Beg for defendant No. 3

Zia Perwez, J:- 1. Plaintiff a financial institution, has instituted this suit against the defendants, its customers, for recovery of Rs. 122,714,226/- under sec. 9 of Financial Institutions (Recovery of Finances) Ordinance 2001.

2. Defendants No. 12 and 4 seek permission for leave to defend the suit under provisions of Sec. 10 of Financial Institutions (Recovery of Finances) Ordinance, 2001 (CMA 477 of 2006). Defendant No. 3 has also moved similar application (CMA 476 of 2006). These applications are being disposed of by this order. Defendant No. 5 did not come forward to defend the suit though served.

3. Defendant No. 1 a private limited company, availed finance of Rs. 102,500,000/- by way of lease of 25 air-condition buses along with fabrication. The lease transaction was sanctioned vide letter of the plaintiffs dated 17.05.2004 followed by agreement between the parties dated 22.05.2004 and subsequent documents executed and provided by the defendants to the plaintiffs i.e. Continuing Guarantee dated 22.05.2004, Demand Promissory Note dated 22.05.2004, Trust Receipt dated 22.05.2004, Acceptance Receipt of Vehicles, Undertaking for insurance, Undertaking for indemnity for leased vehicles dated 30.03.2004 and Registration Books dated 30.09.2004 and Registration Certificates dated 12.01.2005 of the respective vehicles. The plaintiff extended lease finance facility to the 1st Six installments for Rs. 769,224/- each and next 54 installments of Rs. 2,218,706/- each.

4. The defendants paid initial installments of Rs. 2,000,382/- up to 25.02.2005 towards their financial obligation to the plaintiffs but defaulted in payment of subsequent installments due. The insurance policies covering the leased vehicles also expired and defendants failed to renew the same as per terms of agreement. Despite repeated letters to settle their outstanding liabilities and even after service of legal notice, the defendant fails to discharge their financial obligations hence the plaintiff filed the present suit.
5. Defendants No. 1, 2 & 4 in their application (CMA No. 477 of 2006) admitted the availing of facility and subsequent default in payment of installments due to losses. They claimed to have applied to the plaintiff Bank for rescheduling vide letter of defendant No. 1 dated 1.3.2005 but no reply was received. The defendant No. 1 in such circumstances entered into an agreement with M/s. Mass Transit (Pvt.) Ltd. dated 2.6.2005 whereby the shares of defendant No. 1 company with its liabilities were transferred in the name of M/s Mass Transit including liability to be paid to the plaintiff and consequently the buses were also to be handed over to M/s Mass Transit. However, on 2.6.2005 the plaintiff bank took physical possession of the buses and filed to present suit M/s Mass Transit had also applied to Security Exchange Commission to transfer the shares in its name and has requested the plaintiff bank for transfer of the liability against the defendant No. 1. The defendants have also disputed the validity of various articles of Lease Agreement dated 22.5.2004 being violative of the principle of natural justice, the Law of Contract and General Clauses Act. For which defendant No. 1 after execution of the same, asked for modification, which was not considered by the plaintiff bank. The defendants have stated that the plaintiff is not entitled to claim additional rent in view of promissory note dated 22.5.2004. It is submitted that the promissory note is not valid due to under stamping while the letter of guarantee was executed to the extent off the mortgage property and thus the plaintiff cannot invoke the personal guarantee in presence of secured guarantee. The defendants have denied of having received notice dated 26.10.2005. Subsequently, the plaintiff bank auctioned of the buses under sec. 1t of the Ordinance 2001 without any notice to the defendants is illegal and arbitrary. The plaintiff bank has failed to show present market value of the leased buses and the fact that whether sale of the same shall discharge the liability of loan financing. The defendants have admitted the amount of finance and the amount paid but has disputed the amount of Rs. 122,714,226 as shown in clause 15 (c) of the plaint. The defendants have said that they are ready to settle the matter amicably but the plaintiff-Bank is not ready for the same. The defendants pleaded that substantial question of law and facts are involved and the matter requires evidence.
6. Defendant No. 3 in his application has narrated the same facts as stated by defendants Nos. 1, 2 and 4 in their application.. In addition, he stated

that vide letter dated 12.3.2004 the plaintiff communicated the offer, which was valid for 15 days, to the defendant No. 1 but there is nothing on record to show that the offer was ever accepted. It is further stated that defendant No. 3 resigned from defendant No. 1 Company in March and hence he has no concern with the dispute which started from April, 2005, as reflected in the correspondence. No notice has been served upon defendant No.3 and there is nothing due and outstanding against him. Defendant No.3 also claims to have instituted Suit bearing No. 1488 of 2005 against the plaintiff and defendants Nos. 1 and 2 for declaration, injunction and damages/ compensation which is pending adjudication before this Court.

7. Plaintiff also filed replication in reply to the application filed by defendants Nos. 1,2 and 4 and defendant No. 3 in which it has controverted the averments stated by the defendants in their applications
8. I have heard the arguments advanced by the learned counsel appearing for the parties, and with their assistance have perused the material available on record.
9. Plaintiffs disclosed the details in support of the claim as per statement set forth in paragraph No. 15 of the plaint, however, as auction proceeds were realized subsequent to the institution of this suit, parties were allowed to file their respective statements in pursuance of sec. 9 (3) and 10(4) of the Financial Institutions Ordinance 2001 vide order dated 12.6.2007 and taken on record on 21.6.2007.
10. Mr. M. Salim Thepdawala, learned Advocate for defendants Nos. 1,2 and 4 has contended that the defendants having entered into a lease are not liable to make payment of any amount to the plaintiff beyond the period for which they retain the possession of the leased buses. After entering upon the possession of the leased buses, the plaintiffs are not entitled to recover any amount as agreed between the parties except for the period the buses remained in possession of defendants.
11. To elaborate his contentions learned counsel referred to the salient features of a financial lease and an operating lease. After distinguishing the two types of leases, as discussed in detail herein below, learned counsel proceeded to argue that the defendants have already made payment of a substantial portion plaintiffs is misconceived and the claim is exaggerated. That the item/description "agreed loss value", as set forth at Serial No. 12 parties, is illegal in view of the fact that the lease stood terminated when the plaintiffs entered into possession of the buses and thus the description as mentioned at Serial No.12 of the schedule has become extraneous and redundant hence it is illegal and unenforceable. That the buses were obtained on lease by the

defendants in pursuance of their agreement under Urban Transport Scheme with the City District Government Karachi. That in pursuance of the terms of the agreement, the City District Government Karachi was liable for making payment of interest/subsidy to the extent of 9% mark-up for air conditioned buses and 6% for non- air conditioned buses. Plaintiffs failed to join the contributory of the defendants i.e. City District Government Karachi as a party to the suit, as such the suit is not maintainable. That the defendants also entered into the agreement whereby M/s. Mass Transit (Pvt.) Ltd. who negotiated and then expressed their consent to take over all the liabilities with respect to the said buses but plaintiffs failed to extend due cooperation and thus defendants are not liable for payment of the amount. To substantiate his arguments he has referred to the contents of plaint and Annexures thereto in addition to the documents filed along with the application. In support of his contention learned counsel also filed written arguments and placed reliance on Allied Bank of Pakistan Limited V/s ADBP (2002 CLD 1707), Habib Bank Limited V/s Schon Textiles Limited (2001 YLR 1244), Yusra Textile Corporation V/s PICIC Commercial Bank Limited (2003 CLD 905) [Lahore]. Orix Leasing Pakistan Limited V/s New Malik Foundry and Engineering Works (2003 CLD 1779) and so also has referred to Banking Tribunals Ordinance (LVIII of 1984) and Bharat. S Lease Financing and Hire Purchase 4th Edition, by Dr. J.C. Verma and Lease Financing and Hire Purchase 4th Edition by Vinod Kothari.

12. Mr. Mirza Adil Beg, learned counsel for defendant No. 3, while adopting the above arguments of Mr. M. Salim Thepdawala, further contended that the defendant No.3 has resigned as Director of defendant No.1 on 7.4.2005 and thus is not liable and has no obligation to make any payment.
13. While opposing the application Me. Qutubuddin Saim, learned counsel for the plaintiffs, has placed reliance on the terms of the agreement between the parties and has pointed out the essential characteristics of the financial lease as opposed to the operative lease. He denied the contentions of learned counsel for the defendants that the City District Government Karachi was a necessary party on the ground that the agreement, on the basis of which the plaintiff finance the lease, was only between the parties to the present suit and the City District Government Karachi was not a signatory to the said agreement. That the plaintiffs performed their part of the contract strictly in accordance with the law in discharge of their obligations. He also referred to the specific documents executed by the defendants i.e. Continuing Guarantee, Letter of Continuity, Promissory Note, Trust Receipt, Acceptance Receipt of vehicles, undertaking in addition to 64 post dated cheques the contract covered by the lease agreement between the parties to discontinue the agreement or to treat the transaction as an operating lease and it was strictly a finance lease. That the rights of the plaintiffs in case of default

in making payment of the amount of lease on the due dates has specified in agreement invoking the mechanism provided by the agreement itself which was executed by free will and consent of the parties. He also placed reliance on the replication filed by the plaintiff.

14. Before proceeding further to appreciate the arguments advanced by the learned counsel, distinction between financial lease as opposed to operating lease may be examined as follows:-

Financial Lease	Operating Lease
Financial Lease is a long term lease on fixed assets, the same may not be cancelled by either party.	Operating Lease is a non-pay-out lease which may be cancelled by the lessee prior to its expiration.
In Financial Lease the leasing company buys the equipment and leases it to the lessee.	The sum of all the lease payments by the lessee does not necessarily fully provide for the recovery of the assets cost.
It is a full payout lease involving obligatory payment by the lessee to the lessor that exceeds that purchase price of the leased property and financial cost.	In operating lease sphere of operation is limited which generally cover those goods which could be needed by different users.
It is a full payout lease involving obligatory payment by the lessee to the lessor that exceeds that purchase price of the leased property and financial cost.	In operating lease sphere of operation is limited which generally cover those goods which could be needed by different users.
Financial Lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Lessor is only a financier and is not interested in the assets.	In Operating Lease, the lessor will have the continuing interest in the leased equipment and thereby undertakes to bear the maintenance etc. Lessor retains the usual risks and rewards that come from the ownership of the assets.
The Financial Lease is not cancelable by the lessee prior to its expiration date.	The Operating Lease is cancelable by the lessee prior to its expiration.
The Financial Lease provides for maintenance services at the cost of lessee.	The lessor provides services, maintenance and insurance.
The asset is fully amortized over the life of the lease.	Under such lease the equipment cost is not fully amortized over the leased tenure.

<p>The lessee has the use of the asset for 75% or more of the estimated economic life of the lease property</p>	<p>Such lease is usually for a short period i.e. less than 75% of the estimated life of the asset, which period may not be adequate to recover to the full extent the investment on the asset.</p>
<p>The present value at the beginning of the lease term of the minimum amounts payable under the lease (exclusive of amounts payable for insurance, maintenance and similar normal outgoings) is at least equal to 90% of the cost of the leased assets net of investment grants.</p>	
<p>The lessor makes payment for the cost of the asset and remains the owner of such equipment and permits the use of equipment to the lessee for a specified period of time against the rentals.</p>	
<p>During the period of lease, the lessee must fulfil the lease obligations irrespective of the fact whether the asset remains in use or becomes obsolete.</p>	
<p>In case of default committed by the lessee in payment of lease money the lessor has recourse to the leased asset as the owner.</p>	

15. From the above, it is clear that the operating lease is a non-pay-out lease in which the lessor's obligations may include services attached to the leased property such as maintenance, repair and technical advice. A good example of an operating lease is a lease for telephone service wherein the Telephone Department renders all such services for the leased telephone equipment against fixed uniform rentals from the users. Furthermore, the operating lease generally covers those goods which could be needed by different users which includes goods that are not peculiar to one kind of industry i.e. the things that many different kinds of lessees can use, like air conditioners, which could be used in offices, hospitals, laboratories and cars, etc. Thus the equipments/machineries, like the buses which are the subject-matter of this suit, cannot be included in the category for operating lease. Furthermore, the terms and conditions of the agreement, which is an admitted document and has been executed with the consent of the parties, clearly stipulate the conditions of a financial lease. Reference is made to the book Lease Financing and Hire purchase. Authored by Dr. J. C. Verma. In view of

the above and after going through the terms and conditions of the agreement it is established that the transaction involves a finance lease and thus the contention of learned counsel for the defendants that this is an operating lease is misconceived.

16. It may also be pertinent to note that normally the rentals or charges for any machinery is maximum for a new machine and may decrease over the period of its use however in the instant case the installments are in the following manner:-

Rs. 769,224 for first 6 months

Rs. 2,218,706 for remaining 54 months

17. The above manner of arrangement of lease charges further confirms that the intention of the plaintiff was not to discontinue the lease but the amount of installments were kept on the lower side to facilitate and encourage the defendants to smooth out the hurdles faced during the initial phase of business and thereafter the subsequent amount of installments was enhanced expecting the smooth flow of funds resulting from established business operations.

18. The defendants are entitled to protection of all their rights under financial lease provided they also discharge their obligations to make timely payments. In the instant case after making the initial payments defendants committed default in payment of eight installments (from January to June, 2005) which became due and payable on expiry of each month. While penalty for late payment has been provided for, the present case does not pertain to late payment but failure of six consecutive installment which reads as follows:-

“Article 10- Default and termination”

- (1) KASB shall have the right to forthwith and without notice terminate this lease and to repossess the vehicle on the occurrence of any of the following events:-
- a) for failure refusal or inability on the part of the lessee to pay any rent, charge or other sum payable hereunder;
 - b) for a breach of any of the terms or conditions of this lease agreement by the lessee;
 - c) for any attempt on part of the lessee to transfer, sell, alienate, sub-let, create a license or a lien, mortgage, create hypothecation or any third party interest in or over the vehicle or to part with its physical or constructive possession;
 - d) if the insurance cover in respect of the vehicle is cancelled in part or whole;
 - e) in the event of any proceedings, voluntary or involuntary, in bankruptcy, winding up or insolvency involving the lease;

- f) if the lease suspends or ceases its business;
- g) any levy or execution or attachment upon the lessees assets and the vehicle is affected;
- h) in any other event where KASB reasonably suspects that the vehicle, or KASBs, tilte thereto, is endangered or likely to be endangered.”

Any of the above events shall be deemed to be an event of default whatever the reason for its occurrence may be and whether it is voluntary or involuntary or occurs as a result of any or Court order of law or regulation or otherwise.

- 2) In the event of the termination of this lease, KASB shall have no liability to the lessee whatsoever but KASB, its agents and representatives shall have the right to enter the lessees property on or in which the vehicle is or is believed to be situated, and the lessee hereby consent that KASB, its agents or representatives shall repossess the vehicle and to dispose of the vehicle either by public auction or private treaty at the risk of the lessee or to give the same on lease to another party on such terms recovering the Agreed Loss Value. The lessee shall continue to be liable for the shortfall in the recovery towards the Agreed Loss Value. This shall be without prejudice KASBs rights to recover all other outstanding amounts due from the lessee in terms of this agreements, including all costs and expenses incurred on repossession, parking and sale of the vehicle, which the lessee shall stand liable to pay to KASB.
- 3) In the event of termination under sub-clause (1) above, Article 7(5) or on the failure of the lessee to surrender the vehicle in accordance with Article 9 hereof, KASB shall be entitled to recover all the amounts from the lessee is due under this agreement. In addition to the said sums payable by the lessee to KASB, the lessee shall also pay to KASB the full amount of the Agreed Loss Value of the vehicle. Such payments shall be without prejudice to KASBs right to seek other rights, remedies and recourses against the lessee for breach of contract.”

- 20. There is nothing on record to show that the defendants made any payment after 25.02.2005.They also failed to get the insurance policies of the leased vehicles renewed on expiry of the insurance policies. These were obligations on the part of defendants and by their acts and omissions, plaintiffs became entitled to act in pursuance of the terms agreed to between the parties.
- 21. The Plaintiffs were thus within their rights to act according to the terms of the agreement and effect recovery of the amount in pursuance of the provisions of Financial Institutions (Recovery of Finance) Ordinance 2001. The defendants Nos. 2 to 5 have also executed their personal guaranteed.

22. The lessor provided finance only for lease of specific machinery, vehicles in the instant case, and to keep themselves indemnify against losses expected to be incurred in the event of such failure to make payment, the agreed loss value has been stipulated at item No. 12 of the agreement duly signed by both the parties which prescribed as under:-

1. Years Rs. 102,500,000
2. Years Rs. 86,049,871
3. Years Rs. 68,094,018
4. Years Rs. 48,256,740
5. Years Rs. 26,340,901
6. Years Rs. Nil

(1) Agreed Loss Value means the value of loss of KASB in relation to this lease agreement and the vehicle at any point of time due to default and/or termination of this lease agreement prior to the completion of the term and as stipulated in this item 12.

(2) The year in this item means a period of twelve (12) calendar months calculated from the commencement date of this lease agreement. Where default or early termination occurs in between the above years, the amount of Agreed Loss Value shall be calculated proportionately based on the number of monthly lease rentals paid during the relevant year.

23. Plaintiff has entered into the possession of leased buses only after default was committed by the defendants in payment of several installments due. The benefits under the agreement have been enjoyed by the defendants only till the filing of the suit though the agreement was executed and acted upon by the parties. The defendants derived further benefit under the same by enjoying the possession of the buses for significant period and failed to pay the installments due and payable which gave rise to invoking of the clauses and conditions resulting from consequent upon such default. In such an eventuality the agreement specifically provided safeguards to the plaintiff for recovery of the amount as provided at S. No. 12 of the schedule to the agreement. In such circumstances, merely saying that the agreement is illegal without substantiating the same on the basis of facts and law in support of such allegation cannot be considered. The statement filed on behalf of the plaintiff show that they have auctioned the buses after due advertisement for a sum of Rs. 33,693,000.

24. The remedies available to the lessor in cases of default by the lessee in the light of the development of the case-law on the point of

damages as held in the case of *Hadley v/s Bexendale* (1854), 9 Exh. 341, 156 E.R 145; *Victoria Laundry (Windsor) Ltd. v/s Newman Industry Ltd.* [1949] 2 KB 528, [1949]1 All E.R. 997; *Humphrey Motors Ltd. v/s Ells*, [1935] SCR 249; *Financings, Ltd. v/s Baldock*, [1963]1 All E. R. 443; *Buchanan v/s Byrnes* [1906], 3 CLR 704; *Hughes v/s N.L.S (Pvt.) Ltd.* [1966] W.A.R 100; *Pigott Construction Co. v/s W.J. Crowe Ltd.* [1961, 27 DLR (2d 258; *Alkok v/s Grymek*, [1968] SCR 452; *Honkong Pir Shipping Co. v/s Kawasaki Kisen Kaisha Ltd.*, [1962], 2 QB 26; *Cehave N.V. v/s Bremer Handelsgesellschaft m.b.h., the Hansa Nord*, [1976] QB 44; *Johnson vs Agnew*, [1980] AC 367, [1979] 1 All ER 883; *Moschi v/s Leap Air Services Ltd.* [1973] AC 331, [1972] 2 All ER 393; *Red Deer College v/s Micheals*, [1976] 2 SCR 324 and *Keneric Tractor Sales Ltd, v/s Langille*, [1987]2 SCR 440, makes it abundantly clear that the modern view is that when one party repudiates the contract and the other party accepts the repudiations, the contract is at this point terminated or brought to an end. The contract is not, however, rescinded in the true legal sense, i.e. in the sense of being void ab initio by some vitiating element. The parties are discharged of their prospective obligations under the contract as from the date of termination but the prospective obligations embodied in the contract are relevant to the assessment of damages as held in *Johnson v/s Agnew*, [1980] AC 367, [1979] 1 All E.R. 883; *Moshchi v/s Leap Air Services Ltd.* [1973] AC 331, [1972] 2 All ER 393. Such is the law for contracts generally and it is this law which should apply equally to breaches of chattel leases.

25. Returning to the two types of leases discussed in paragraph 14 above it can be observed that in view of the principles laid down in cases where an operating lease is extended under a written contract extending over a fixed tenure the remedy available to the lessor in case of default in payment or discontinuation of the lease by the lessee would be to lease out the property elsewhere and to recover the amount of difference. If any, from the lessee for the unexpired period of lease under written contract in addition to the higher leased charges for the period that the property remained with the lessee.
26. This view finds support from the facts that in such circumstances the leasing of the property or the chattel, as the case may be, is the normal business of the lessor. Cases involving financial lease, where the main business of the lessor is not that of hiring of machinery but it is that of providing finance for purchase of chattels or machinery to be leased out on lease suitable to the particular needs and requirements of the specific lessee. Default in such cases of financial lease can be distinguished from that in case of an operating lease for the reasons already stated in the above paragraph. However as in such cases the lessor indulges only to the extent of financing which is

his main vocation, the ordinary course to be followed to minimize the losses would be to dispose of the chattel or machinery. The amount of sale proceeds be adjusted towards the unpaid installments due for the entire tenure of the lease under contract. The balance outstanding, if any, may be recovered from the lessee to secure the agreed amount of return and the finance, as already stipulated under the terms of the agreement between the parties.

27. In the instant case the amounts and dates of each specific installments is available on record as these ascertains that the same has already been agreed between the parties, as such, no adjudication is required in this regard. The default giving rise to the present suit also attracts specific amounts mentioned at Item No. 12 of schedule to the lease agreement. These figures are also based on the amounts that the plaintiffs are entitled to recover in the event of default worked out on the basis of outstanding installments and amounts recoverable by the plaintiffs in pursuance of the agreement; hence not adjudication is required in this regard. The plaintiffs have specifically filed the statement of outstanding amount on 13.06.2007 showing the recovery effected by them by auction of the vehicles which has to be deducted from the amount of their claim.
28. For the foregoing reasons as all the figures have been settled and worked out by the parties in their agreement in specific detail at the time of agreement which also provides for agreed loss in case of default and from this amount of agreed losses the defendants are entitled to adjustments out of the auction proceeds, hence no ground for grant of leave to defend is made out.
29. In view of the above as no ground for grant of the applications for leave to defend is made out, the same are accordingly dismissed.

Leave refused.