Supreme Court of India
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Asea Brown Boveri Ltd vs Industrial Finance Corporation ... on 27 October, 2004
Author: R Lahoti
Bench: R Lahoti
CASE NO.:

Appeal (civil) 3574 of 1998

PETITIONER:

Asea Brown Boveri Ltd.

RESPONDENT:

Industrial Finance Corporation of India & ors.

DATE OF JUDGMENT: 27/10/2004

BENCH:

R.C. Lahoti, CJI

JUDGMENT:

J U D G M E N T

This is an appeal under Section 10 of the Special Courts (Trial of Offences Relating to Transactions in Securities) Act, 1992 (hereinafter 'the Act', for short), feeling aggrieved by an order dated 28.7.1998 whereby rejecting an objection petition preferred by the appellant, the Special Court has directed the appellant to hand over possession of all the 56 cars to the custodian within one week from the date of the order.

The Industrial Finance Corporation of India (hereinafter 'IFCI', for short) is a Corporation constituted under the Industrial Finance Corporation of India Act, 1948 and carries on the business of financing moneys to various borrowers. Vide agreement dated 4.12.1990, the appellant entered into a Lease Finance Agreement with M/s. Fairgrowth Financial Services Limited (hereinafter 'Fairgrowth', for short), the respondent No.

3. Pursuant to the letter of offer dated 26.7.1990 under this lease finance agreement, the appellant had taken lease finance of total 57 cars out of which one car was foreclosed in or about January, 1992, leaving 56 cars under lease finance with the appellant.

The case of the appellant as regards these 56 cars and the relationship of the appellant and respondent No. 3 in so far as these cars are concerned is stated as follows. The Appellant Company deposited total security amount on the 56 cars of Rs. 20,97,447.25 paise. The total rental payable by the Appellant Company for 5-year period amounted to Rs. 85,35,379/-. The total purchase price of 56 cars is Rs. 84,80,664/-. As per the terms of the lease finance agreement mutually agreed into by the parties, the Appellant Company was required to pay 25% of the purchase price of the cars as security deposit carrying interest @ 5% per annum compounded half yearly, a lease management fee of 1% and lease rental of Rs. 15/- per thousand Rupees per month of the cash price of the assets which was later revised to Rs. 16/- per thousand Rupees per month by a subsequent letter."

It is further alleged that it was the tacit understanding between the parties that the cars were to be transferred to the Appellant Company at the end of initial lease period of 5 years for which the parties agreed in their agreement by stating that the terminal fee will be 20%, meaning thereby that on payment of 20% of the cost price of the cars the said cars would be transferred by the Lessee Company to the Appellant Company or their nominee. The term terminal fee is a well known term in Lease Finance Transaction and has no other connotation than the amount payable for transfer of the leased asset. This lease finance agreement was entered into on 4th December, 1990."

Fairgrowth became a notified party under sub-Section (2) of Section 3 of the Act due to certain illegal transactions covering the period between 1.4.1991 and 6.6.1992. The transaction entered into on 4.12.1990 pursuant to letter of offer dated 26.11.1990 is not referable to the period during which the alleged illegal transactions were entered into by Fairgrowth.

The Central Government appointed IFCI as the custodian, under sub-Section (1) of Section 3 of the Act, over the properties belonging to Fairgrowth. The Appellant Company continued to make payment to IFCI in place of Fairgrowth as per lease finance agreement. An amount of Rs. 30,96,948.30 paise was paid by the appellant to Fairgrowth till December, 1992. An amount of Rs.44,61,273/- was paid by the appellant to the custodian IFCI. Thus the total lease rentals actually paid by the appellant company are Rs.75,31,842/- till May, 1997 whereas the rentals which were payable by the appellant company were Rs.85,34,379/- only.

According to the appellant company under lease finance agreement, it had made a security deposit with Fairgrowth on which an interest of 5% per annum compounded half yearly was to be paid. The appellant made a communication to the custodian clarifying that the appellant would be entitled under the agreement to the amounts on account of security deposit and interest accrued thereon at the time of buyback or purchase of lease assets by the appellant. On 9.4.1997, the appellant forwarded a cheque of Rs. 17,800/- in full and final settlement of dues under lease finance agreement dated 4.12.1990. According to the appellant, the payment of this amount squared up fully and finally its liability for payment subject to adjustment of security deposit and interest agreed thereon and all that remained to be done thereafter was to transfer the said 56 cars in favour of the appellant company after cancellation of the hypothecation which obligation was to be discharged by the custodian which had taken over the properties of Fairgrowth.

A perusal of the detailed order passed by the Special Court shows that the Special Court refused to treat the transaction between the appellant and Fairgrowth as one of lease finance and instead treated it to be a transaction of lease only i.e. the appellant holding 56 cars as lessee of Fairgrowth. The principal reason which prevailed according to the Special Court is that in its application, the appellant had stated the transaction to be of "lease" and not of "lease finance". Thus the Special Court has rigidly applied the rules of pleadings but a perusal of the order shows that there has been no effort to scrutinize and interpret the documents evidencing the transaction so as to determine the real nature thereof.

This appeal was filed on 31.7.1998. On 3.8.1998, the court passed an interim order protecting the possession of the appellant over the 56 cars.

On being noticed, the custodian has in its response filed a calculation sheet prepared by a Chartered Accountant appointed by the Special Court and, according to his calculation, an amount of Rs. 6,48,370/- was due and payable by the appellant to the respondent No. 3. as per the agreement entered into between the parties. A perusal of this calculation sheet shows that the main factor responsible for the variation in the ultimate figure of balance payable is attributable to an amount of Rs.4,89,923/- being sales tax calculated @5% on the amount of total lease rent including terminal fee which figure of sales tax the chartered accountant feels is leviable on the transaction and hence payable by the appellant. This is a highly debatable issue but need not detain us. Whether or not this amount is held to be due and payable by the appellant, it will not change the nature of transaction. The correctness of the calculation has been disputed in the rejoinder filed on behalf of the appellant wherein it is submitted that all sums due and payable under the lease finance

agreement dated 4.12.1990 were already paid and nothing was due and payable at all to any of the respondents by the appellant. Even 20% terminal fee, as purchase price of the 56 cars, had been paid and nothing had remained to be done except termination of hypothecation and transferring on paper of the ownership of the cars to the appellant which was only a matter of formality necessarily flowing from the obligation of respondent No. 3 under the agreement and accounts having already squared up. The documents show that the registration of the cars since inception stands in the name of the appellant.

During the course of hearing before this Court, it was conceded at the Bar that so far as the transaction between the respondent No. 3 and the appellant as evidenced by the agreement dated 4.12.1990 is concerned, it is a transaction of lease finance and the rights and obligations of the parties have to be worked out accordingly.

We have heard at length, the learned counsel for the parties. We also requested Shri Uday U. Lalit, Senior Advocate, to assist the Court by pointing out the correct position of law centering around lease finance transactions. We place on record our appreciation of the assistance rendered by the learned senior counsel, Shri Uday U. Lalit.

What is a lease finance? According to Dictionary of Accounting & Finance by R. Brockington (Pitman Publishing, Universal Book Traders, 1996 at page 136) :-

"A Finance Lease is one where the

Lessee uses the asset for substantially the whole of its useful life and the lease payments are calculated to cover the full cost together with interest charges. It is thus a disguised way of purchasing the asset with the help of a loan. SSAP 23 required that assets held under a finance lease be treated on the balance sheet in the same way, as if they had been

purchased and a loan had been taken out to

enable this."

(emphasis supplied)

In Lease Financing & Hire Purchase by Dr. J.C. Verma (4th Edition, 1999 at p.33), Financial Lease has been so defined :-

"Financial lease is a long-term lease on fixed assets, it may not be cancelled by either party. It is a source of long-term funds and serves as an alternative of long-term debt financing. In financial lease, the leasing company buys the equipment and leases it out to the use of a person known as the lessee. It is a full payout lease involving obligatory payment by the

lessee to the lessor that exceeds the purchase price of the leased property and finance cost.

Financial lease has been defined by

International Accounting Standards Committee as "a lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be

transferred." Lessor is only a financier and is not interested in the assets. This is the reason that financial lease is known as full payout lease where contract is irrevocable for the primary lease period and the rentals payable during which period are supposed to be

adequate to recover the total investment in the asset made by the lessor."

(emphasis supplied)

According to Lease Financing & Hire Purchase by Vinod Kothari (Second Edition, 1986, at pp. 6 & 7), a finance lease, also called a capital lease, is nothing but a loan in disguise. It is only an exchange of money and does not result into creation of economic services other than that of intermediation. The learned author has quoted T.M. Clark, one of the most authentic writers on the subject who defines lease and operating lease in the undergoing words :-

"A financial lease is a contract involving

payment over an obligatory period of specified sums sufficient in total to amortise the capital outlay of the lessor and give some profit."

"An operating lease is any other type of lease that is to say, where the asset is not wholly amortised during the non-cancellable period, if any, of the lease and where the lessor does not rely for his profit on the rentals in the non- cancellable period."

The features of the financial lease, according to the learned author are as under :

"1.The asset is use-specific and is selected for the lessee specifically. Usually, the lessee is allowed to select it himself.

2. The risks and rewards incident to ownership are passed on to the lessee. The lessor only remains the legal owner of the asset.

3.Therefore, the lessee bears the risk of

obsolescence.

4. The lessor is interested in his rentals and not in the asset. He must get his principal back along with interest. Therefore, the lease is non- cancellable by either party.

5. The lease period usually coincides with the economic life of the asset and may be broken into primary and secondary period.

6. The lessor enters into the transaction only as a financier. He does not bear the costs of repairs, maintenance or operation.

7. The lessor is typically a financial institution and cannot render specialized service in connection with the asset.

8. The lease is usually full-pay-out, that is, the single lease repays the cost of the asset together with the interest."

In our opinion, financial lease is a transaction current in the commercial world, the primary purpose whereof is the financing of the purchase by the financier. The purchase of assets or equipments or machinery is by the borrower. For all practical purposes, the borrower becomes the owner of the property inasmuch as it is the borrower who chooses the property to be purchased, takes delivery, enjoys the use and occupation of the property, bears the wear and tear, maintains and operates the machinery/equipment, undertakes indemnity and agrees to bear the risk of loss or damage, if any. He is the one who gets the property insured. He remains

liable for payment of taxes and other charges and indemnity. He cannot recover from the lessor, any of the above mentioned expenses. The period of lease extends over and covers the entire life of the property for which it may remain useful divided either into one term or divided into two terms with clause for renewal. In either case, the lease is non-cancellable.

All the abovesaid features are available in the transaction entered into by the appellant. In addition, we find that the registration of the 56 cars stood in the name of the appellant from the very beginning and on payment of full amount including termination fee, as agreed upon, nothing more was needed to be done to vest the appellant with ownership and only loan documents were needed to be discharged and cancelled.

There are certain tax benefits which by styling the transaction like a financial lease become available to the lessor (financer) and the lessee (borrower) both. Accounting standards have been devised consistently with which the entries are made in the accounts so as to satisfy the requirements of tax laws and to avail the best benefits by way of tax planning to both the parties.

However, so far as the Act is concerned, we have to go by the provisions of the Act, keeping in view the real nature of the transaction ascertaining the real intention of the contracting parties in the light of the facts and circumstances of a given case. Once a party has been notified under sub-Section (2) of Section 3 of the Act then under sub-Section (3), notwithstanding anything contained in any other law for the time being in force with effect from the date of notification under sub-Section (2), any property, movable or immovable or both belonging to notified party stands attached simultaneously with the issue of the notification and becomes liable to be dealt with by the custodian in such manner as the Special Court may direct. A person is liable to be notified by reference to transaction in securities between 1.4.1991 and 6.6.1992. Any contract or agreement entered into between 1.4.1991 and 6.6.1992, in relation to any property of the notified party is liable to be cancelled, if found to have been entered into fraudulently or to defeat the provisions of the Act. Analysing the provisions of the Act, it was held in B.O.I. Finance Ltd. Vs. Custodian and others, (1997) 10 SCC 488, that the custodian under the Act is required to assist in the attachment of the notified person's property and to manage the same thereof. The properties of the notified persons, whether attached or not, do not, at any point of time, vest in him. He is merely a custodian and not a receiver nor is he a final liquidator so as to enjoy control over the properties. In other words, the position of the custodian is the same as that of the notified person himself. We are, therefore, of the opinion that the custodian remains bound by the obligations incurred by the notified party itself, if not incurred fraudulently or to defeat the provisions of the Act.

For the purpose of deciding the controversy before us, it is not necessary for us to examine whether the transaction entered into between the appellant and Fairgrowth, the respondent No. 3, would at all attract the applicability of the provisions of the Act in view of sub-section (2) of Section 3 thereof. The learned counsel for the appellant has taken a very fair stand submitting that the appellant is prepared to pay if anything is still found to be due and payable by it but in any case the 56 cars could not have been held liable and directed to be delivered to the custodian. It was a simple case of accounting. If the appellants have cleared all their payments in accordance with the agreement dated 4.12.1990, initially to Fairgrowth and thereafter to the custodian including payment of terminal fee subject to adjustment for security deposit and the interest accrued thereon, then all that had remained to be done was the transfer of ownership on paper which the custodian should have been directed to do, submitted the leaned counsel. But, as we have already noticed, the registration of the cars already stands in the name of the appellant. On a scrutiny of the accounts, if in the opinion of the Special Court, nothing had then remained to be paid by the appellant, then it was only a matter of calculation, the difference between the appellant's statement of account and the one prepared by the Chartered Accountant at the instance of the custodian being bonafide, the appellant could, at best, have been directed to pay the deficit. But in no case submitted the learned counsel for the appellant, the 56 cars could have been directed to be delivered to the custodian. In spite of having made full payment (bonafide error or dispute as to calculation excepted), direction for delivery of cars to the custodian has caused failure of justice. We find ourselves in agreement with the submission so made.

The appeal is allowed. The impugned order dated 28.7.98 passed by the Special Court is set aside. The application filed by the appellant shall stand restored on the file of the Special Court. The Special Court shall look into the accounts after affording the parties an opportunity of hearing and determine if any amount, and if so to what extent, remains still payable by the appellant to the custodian, for and on behalf of Fairgrowth, the respondent No. 3. In the event of any amount being held liable to be so paid, the same shall be paid by the appellant within the time appointed by the Special Court failing which the appellant shall be liable to be proceeded against including for attachment of property.

No order as to the costs.