



BREACH OF CONTRACT: RECOVERING LOSSES

**Case Study on Commercial Dispute Resolution in
Pakistan**



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“Breach of Contract: Recovering Losses”: Case Study on Court Settlement of Commercial Disputes in Pakistan

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This case study is part of the project being undertaken by Policy Research Institute of Market Economy (PRIME) with support from Atlas Network. The aim is ‘Making Pakistan a Trusted Business Partner’ through improving Pakistan’s ranking and score in ‘Enforcing Contracts’ and to improve the overall ranking of the country in the World Bank’s Doing Business Index over 2016-18.

A lengthy, cumbersome and costly mechanism to seek enforcement of contracts is detrimental to the business environment of a country. Investors shy away from such economies where rule of law is weak and uncertainty looms large. Therefore it is important for achieving a favourable investment climate in the country that business contracts get honoured and where a dispute arises, it can be settled at a suitable cost and time duration.

All names mentioned in the case herein have been changed to protect privacy. Real court cases, where an order has been passed, have been picked for illustrating the nature of disputes and the issues with the contract enforcement mechanism in Pakistan. The case studies do not mean to comment on the justness or unjustness of the arguments presented by any party to a case.

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Summary

SK Mills (Sugar manufacturing mills) entered in a contract for the sale of sugar with Nasir and Ali. Nasir and Ali made the full payment in advance to the SK Mills for the delivery of sugar. However, the SK Mills failed to deliver the sugar as per the delivery order; thus signing a new forward contract. The delivery kept on getting delayed each time causing both the parties to sign a new forward contract. Soon Nasir and Ali defaulted on the forward contracts and faced the loss of clientele. Consequently, a lawsuit was filed against the SK Mills in the High Court of Sindh with regards to non-delivery of sugar as per the delivery order. Moreover, Nasir and Ali also demanded the fulfilment of specific terms of the agreement and additionally claimed damages amounting to Rs. 1,000,000,000. Moreover, they requested for the temporary injunction (where court prohibits the defendants from doing a specific act in this particular case; the court directed the SK Mills not to sell sugar to the extent of other party's claim nor create any third party interest till the disposal of the suit). On the other hand, SK Mills claimed that there is no remaining obligation for the supply of sugar to the other party and that there was no rescheduling of the said agreements because the other party did not produce any document which shows that the agreements were ever rescheduled. The High Court on the other hand, dismissed the application of SK Mills and the case ended in favor of Nasir and Ali.

Background

Nasir and Ali had business relations with SK Mills for over 13 to 14 years. In the year 2011-12, they entered into six agreements with SK Mills for the supply of 8917 metric tons of sugar for which the full payment amounting to Rs. 375,500,000 was made in advance. The payment was acknowledged by SK Mills and resultantly they issued post-dated cheques as a security. However, later in the same year SK Mills approached Nasir and Ali requesting for the reschedule of sugar deliveries and repayment since the crop had been struck by natural disaster and promised the delivery of sugar in the upcoming seasons. Nasir and Ali agreed to the rescheduling of the deliveries on the forward contracts. Nevertheless, SK Mills failed to deliver the said amount of sugar to them and again requested for rescheduling of deliveries on their forward contracts. In total, the rescheduling of the deliveries took place thrice.

Dispute

Despite the flexibility shown to SK Mills, they failed to deliver the said quantity of sugar to Nasir and Ali incurring further losses in the form of default on forward contracts. Resultantly in 2013, Nasir and Ali filed a lawsuit against SK Mills for the breach of the contract in Sindh High Court. In addition, two more applications were filed against SK Mills in 2014, one regarding the recalling of the modification made in the injunction order by the court and the second against the mala fide application of SK Mills. On the other hand, SK Mills filed an application claiming that there was no remaining obligation for the supply of

sugar to Nasir and Ali and that since they have calculated and claimed the damages in the suit therefore no interim injunction could be granted.

High Court Proceedings

A year after the initial start of the trial, all four lawsuits were consolidated on 24th February 2014 whereby both the parties presented their pro and contra evidences. In the process the court appointed Nazir for inspections to confirm whether or not SK Mills were creating any third party interests with regards to the sale of sugar. The high court issued various other interlocutory orders during the trial.

High Court Order

On 20th September 2013, the High Court ordered SK Mills not to create any third-party interests and also ordered a spotinspection of the premises and directed the Nazir of the Court to comply with the same. The Nazir conducted the inspection, with police aid, and submitted a report on 8th October 2013 before the Court, wherein it was stated that 4027 Bags containing Sugar (50 Kg each), in addition with 924 Bags (50 Kg each) were found at the premises of SK Mills. Thus, the High Court granted the interim injunction as per the request of Nasir and Ali whereby the SK Mills were ordered not to sell sugar to the extent of other party's claim i.e. 21542 metric tons nor create any third-party interest till the disposal of the suit.

Nasir's and Ali's Appeal

Nasir and Ali had learnt from reliable sources that the SK Mills were unlawfully creating third party interests in the said property despite the stay order by court. Therefore, they filed another suit for the appointment of receiver and another spot inspection application. On the appeal of Nasir and Ali the court again allowed for the spot inspection and ordered notice on the receivership application. Consequently, Nazir once again conducted an inspection of the SK Mills and submitted his report on 16th December 2013 whereby it was concluded that the earlier stock of 924 bags and 4027 bags (50 Kg each) were lying at the mill and along with that a fresh produce of 36320 bags (50 Kg each) were also lying there. Despite the court orders, SK Mills were continuing to sell the sugar and creating third-party interest. Thus Nasir and Ali filed another application for contempt and inspection and the court once again issued the order of injunction. The injunction restrained SK Mills from selling sugar to the third-party including, but not limited to, the sugar crop for the year 2013-14. However, on 9th January 2014, the court changed the order on the application filed by the SK Mills whereby the restraining order does not apply on the sugar crop of 2013-14. Thus Nasir and Ali urged that the order of interim injunction cannot be implemented to the extent of 21542 metric tons of sugar if the sugar crop for the period 2013-14 is not considered. Thus they filed another application for recalling the phrase that "the restraining order does not apply on the sugar crop for the year 2013-14".

Defence Argument

The learned counsel for SK Mills argued that the court has rightly passed the order to clarify that the interim injunction does not apply to the sugar crop of the period 2013-14. They urged that as such the order is not liable to be reviewed because it is beyond the scope of section 114 of order XLVII as it does not disclose any discovery or evidence which, after the exercise of due diligence, was not within the knowledge of the other party. Moreover, they contended that the other party misled the court by claiming that 21542 metric tons of sugar was lying at the premises of SK Mills whereas the report of Nazir showed that only 247.55 metric tons of sugar was found at the factory which also does not belong to the crop season of 2011-12. Thus the other party cannot be allowed to benefit from its own misleading statements. Since the said quantity of sugar was not present in the period 2011-12 therefore the plea to confiscate the said amount of sugar is unwarranted.

SK Mills' Appeal

SK Mills pleaded that no case for grant of interim injunction is made out as no illegality prima facie exists. Moreover no irreparable loss will be caused to the other party if the injunction is refused. They contended that at most if the other party succeeded in the titled suit then monetary compensation will provide complete redress. Thus, they prayed for the dismissal of the initial suit by Nasir and Ali with cost.

Judgment of High Court

Following the appeals of both parties, the High Court passed its final judgement on 21st March 2014 whereby it recalled the modifications that it made to the initial interim injunction. In other words, the phrase "the restraining order does not apply on the sugar crop for the year 2013-14" was taken back. Furthermore, the application of SK Mills was dismissed. To the extent of injunction orders the case ended in favour of Nasir and Ali.

Commentary

This case study illustrates the level of apathy in the society as regards to honoring the writ of courts of law. The defendant in this case had been ordered by the highest provincial court to not create any third-party interests in its inventory. Yet, in clear contravention of the court order, the party proceeded to do as they pleased.

Furthermore, as the Honorable Justice had noted in his judgment, the defendants had the audacity to intentionally mislead the court into believing that the sugar had been supplied to the plaintiff as per contract whereas all documentation countered their claims before the court.

On the surface, it seems that the case has been resolved in a suitable time (under 6 months), but the fact of the matter is that this was only a hearing for the grant of a temporary injunction. For deciding this issue alone, the court had sequentially granted three decisions.

The first order granted the plaintiff a temporary injunction. The same court's second order modified its original order on the application of the defendant. And in the third order, the same court, on the application of the plaintiff, overturned its previous order and reverted back to the original order. One must note, that so far, only the issue of restraining the plaintiff from creating third party interests in its inventory had been decided. The issues as to whether the sugar mill will have to perform on its contract with the plaintiff, and whether the plaintiff will be awarded damages to the tune of Rs. 1 billion as prayed for, still remain to be decided. It would not be something unusual if the settlement of these underlying issues take anywhere from 3-7 years to be decided. Thereafter, the case can go into intra-court appeal and then onwards into an appeal before the Supreme Court. Each step will further add to the time it takes to fully settle the dispute.

This case was presented directly before the High Court instead of the lower courts because the value of the suit was high enough to come under the original jurisdiction of the Sindh High Court. So this became one of the reasons for the early disposal regarding the grant of a temporary injunction. The High Court judges face a lesser pendency of cases as compared to the lower court judiciary. The reason for this is that the disparity in the sanctioned strength of judicial officers as against the posted strength gets more wide descending towards the lower rungs of the judicial system. Secondly, this case also got an expedited hearing as the issue warranted urgency and hence such matters seeking temporary injunction are heard at the start of the day before the court hears regular plaints.

All in all, the contract enforcement and commercial dispute resolution system is inefficient in the country. It is both costly and time-consuming in majority of the cases. It is a known fact that an efficient contract enforcement and dispute settlement mechanism promotes investment by influencing the decisions of economic agents. By promoting investment, good judicial institutions can also contribute to economic growth and development of a country. Indeed, an effective judiciary, by providing a structured, timely and orderly framework for dispute resolution, fosters economic growth and stability.

Moreover, efficient contract enforcement is essential to allow true freedom of contract.¹ Even where the law allows extensive freedom of contract, the benefits of this can be greatly undermined if not matched by efficient contract enforcement. Without that, the predictability of the legal framework which is highly valued by firms operating in the market would be compromised. Thus the way to improve the enforcement mechanism and dispute resolution is to make it fair and uniform for all classes in the society.

One way to ensure this is to opt for resolution through litigation which is publicly financed and administered and is carried out in a public forum and is bound by mandatory rules of process, evidence and testimony. Another way to resolve the commercial disputes could be through mediation. Mediation is a voluntary, non-binding, private dispute resolution

¹ Where freedom of contract implies that the contracts between the parties should not be hampered by external forces such as governmental interference.

process in which a neutral person helps the parties to reach to a negotiation. The main advantage of this process is that the mediator does not render any decision or order. Additionally the parties have a major say with respect to the direction of the process and complete control over the final decision. The dispute is owned by the parties and so is the decision. This makes the process not only transparent but also acceptable to the parties.

Alternatively, Alternate Dispute Resolution (ADR) mechanism could be another way of settling disputes. Under such mechanisms the disputes can be resolved at a fraction of the cost, and within a fraction of the time and rather than winning or losing, business can move beyond disputes with solutions that benefit their short and long-term commercial interests, with important corporate relationships and reputations intact.² However, great care will have to be taken to ensure that ADR is developed in a manner which is consistent with the basic principles of justice that underlie our judicial system. And if ADR is handled carefully then it holds great potential for significant improvements in the way the justice is served in the country.

If the parties to this particular case had opted for alternate dispute resolution, the matter would have been resolved within a matter of few days and moreover significant savings in litigation costs would have been realized. To the plaintiffs' benefit, if the case had gone to ADR, he would have received the supply of sugar and/or monetary compensation in lieu thereof. To the defendants' benefit, they would not have had to face a temporary injunction against them for the period that the case is being heard in the courts. But now since the case has gone to the High Court, the defendants are barred from selling their finished goods' inventory until further order by the court. For a business, tied up cash flow involves an opportunity cost, which in this case is a material amount.

While courts of law can only be set up by the legislature, ADR mechanisms can be established by the private sector too. Business associations can themselves take the lead in setting up arbitration councils and bodies for mediation and also make it mandatory for their members to add ADR mechanisms in their contracts. Under the law where Arbitration or other mechanism is provided in a contract, the parties cannot directly take their disputes to courts. That way, the business community itself will get to decide the constitution of arbitration/mediation panel. If this model can be established with success, it will also serve as an example for the government to replicate and promote. Whatever the case, in the end, it is the business community which shall have to take ownership of this initiative of ADR in Pakistan, for it to become a success.

²<http://www.supremecourt.gov.pk/ijc/Articles/7/2.pdf>