**<u>IN THE SUPREME COURT OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA</u>**

Hatton National Bank Ltd.,
No. 481, T.B. Jayah Mawatha,
Colombo 10.
<u>Plaintiff</u>

**SC/CHC/APPEAL/03/2012**
**HC (CIVIL) 117/2006(1)**

<u>Vs.</u>

1. Nadarajah Ganarajah
   No. 110, Bankshall Street,
   Colombo 11.
2. Chelliah Ramachandran and
3. Manohari Ramachandran
   Both of 49, Collingwood Place,
   Colombo 06.
   <u>1st to 3rd Defendants</u>

4. Llyod Rajaratna Devarajah
   49, 6/2 Collingwood Place,
   Colombo 06.
5. Vadivelu Anandasiva (Deceased)
   49, 1/2 Collingwood Place,
   Colombo 06.
6. Mrs. Karthiga Senthuran and
7. Shanmugavadivel Senthuran
   both of 49, 1/4 Collingwood Place,
   Colombo 06

and presently of P.O. Box 52, PC, 111
CPO FEEB, Oman.

8. Thuraippa Viswalingam
49, 2/1 Collingwood Place,
Colombo 06.
9. Yogeswary Raveendiran
49, 2/3 Collingwood Place,
Colombo 06.
10. Sabapathy Arunasalam Arumugan
49, 3/1 Collingwood Place,
Colombo 06.
11. Anthonypillai Mary Joseph
49, 3/2 Collingwood Place,
Colombo 06.
12. Nagalingam Santhasoruban
49, 3/3 Collingwood Place,
Colombo 06.
13. Velupillai Arulanantham
49, 3/4 Collingwood Place,
Colombo 06.
14. Thanabalasingham Krishnamohan
49, 4/4 Collingwood Place,
Colombo 06.
15. Jacob Amaranathan
49, 4/1 Collingwood Place,
Colombo 06.
16. Sivagurunathan Punithanathan
49, 4/2 Collingwood Place, Colombo 06
and presently of Le Royal Meridian
Beach Resort, P.O. Box 24970,
Dubai UAE.

17. Ramanathan Sivagurunathan
    49, 5/1 Collingwood Place,
    Colombo 06.
18. Tharshini Sivagurunathan
    of 13331 Seattle Hill Road,
    Snohimish, Washington USA.
19. Kathiravelu Sarveswaram
    49, 5/2 Collingwood Place,
    Colombo 06.
20. Dr. Selvaratnam Selvaranjan
    49, 5/3 Collingwood Place,
    Colombo 06.
21. Subramaniam Suthershan
    49, 6/3 Collingwood Place,
    Colombo 06.
22. Sornambikai Mahasivam
    of Arthisoody Veethi,
    Thirunelveli, Jaffna.
23. Thambiah Mahasivam
    49, 6/4 Collingwood Place,
    Colombo 06.

4th to 23rd Added Defendants

AND NOW

1. Chelliah Ramachandran and
2. Manohari Ramachandran
   Both of 49, Collingwood Place,
   Colombo 06.

2nd to 3rd Defendant-Appellants

3. Llyod Rajaratnam Devarajah
   49, 6/2 Collingwood Place,
   Colombo 06.
4. Vadivelu Anandasiva (Deceased)
   49, 1/2 Collingwood Place,
   Colombo 06.
5. Mrs. Karthiga Senthuran and
6. Shanmugavadivel Senthuran
   both of 49, 1/4 Collingwood Place,
   Colombo 06
   and presently of P.O. Box 52, PC, 111
   CPO FEEB, Oman.
7. Thuraippa Viswalingam
   49, 2/1 Collingwood Place,
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   49, 3/1 Collingwood Place,
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    Colombo 06.
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    49, 3/4 Collingwood Place,
    Colombo 06.
13. Thanabalasingham Krishnamohan

49, 4/4 Collingwood Place,
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15. Sivagurunathan Punithanathan
49, 4/2 Collingwood Place,
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20. Subramaniam Suthershan
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Colombo 06.
21. Sornambikai Mahasivam
of Arthisoody Veethi,
Thirunelveli, Jaffna.
22. Thambiah Mahasivam

49, 6/4 Collingwood Place,
Colombo 06.
4th to 23rd Added Defendant-Appellants

Vs.

1. Hatton National Bank Ltd.,
   No. 481, T.B. Jayah Mawatha,
   Colombo 10.
   Plaintiff-Respondent
2. Nadarajah Ganarajah 110,
   Bankshall Street,
   Colombo 11.
   1st Defendant-Respondent

Before: Hon. Justice S. Thurairaja, P.C.
Hon. Justice Yasantha Kodagoda, P.C.
Hon. Justice Mahinda Samayawardhena

Counsel: J.A.J. Udawatta with Suresh Philips, Chaminda Dheerasinghe, P. Damayanthi and H.N. Hettige for the 2nd and 3rd Defendant-Appellants.

Ikram Mohamed, P.C. with Anuradha Abeysekera and C.R. Mitrakrishnan for the 4th to 20th Added Defendant-Appellants.

Dr. Romesh De Silva, P.C. with Palitha Kumarasinghe, P.C., and V.K. Niles for the Plaintiff-Respondent.

M.A. Sumanthiran, P.C. with Vijula Arulanantham for the 1st Defendant-Respondent.

Written Submissions:

By the 2nd and 3rd Defendant-Appellants on 25.11.2022 and 17.03.2023
By the 4th to 23rd Added Defendant-Appellants on 02.12.2022 and 16.03.2023
By the Plaintiff-Respondent on 12.12.2022, 06.04.2023 and 10.04.2023
By the 1st Defendant-Respondent on 08.12.2022 and 17.03.2023

Argued on: 08.02.2023

Decided on: 12.02.2024

**<u>Samayawardhena, J.</u>**

**Background**

The plaintiff bank filed this action on 22.06.2006 in the Commercial High Court of Colombo against the three defendants jointly and/or severally (a) for the recovery of a sum of Rs. 46,829,186/72 together with interest thereon at the rate of 23% per annum from 01.08.2005 till payment is made in full, (b) an order that the land and buildings described in the schedule to the plaint be bound and executable for the payment of the said sum and interests with BTT, VAT and costs on the footing of the Mortgage Bond marked P4, and (c) an order to pay the said sum within two months of the date of the decree and in default of such payment that the said mortgaged property be sold by public auction to recover the dues to the plaintiff.

The 1st defendant is the principal debtor and the 2nd and 3rd defendants, husband and wife respectively, are the mortgagors who mortgaged their property described in the schedule to the plaint as a primary mortgage to secure the loan disbursed to the 1st defendant. The mortgaged property is an apartment complex located at No. 49, Collingwood Place, Colombo 6.

It is the position of the 1st defendant that the 2nd and 3rd defendants had previously obtained a loan from the plaintiff bank to construct an apartment complex on the same property, mortgaging it as collateral. They had defaulted in repayment, and subsequently, the mortgage was redeemed with the assistance of the 1st defendant. He further states that on behalf of the 2nd and 3rd defendants, he agreed to be the nominal borrower to obtain the loan facility relevant to this case from the plaintiff bank.

According to the 1st defendant the beneficiaries of the loan were the 2nd and 3rd defendant mortgagors and the plaintiff bank was fully aware of it. This position seems to have been accepted by the 2nd and 3rd defendants in paragraph 23 of their answer. By reiterating the averments in the answer, the 2nd and 3rd defendants in their written submissions state "*the 2nd and 3rd defendants deposited (in several installments in the year 2001) a total sum of Rs. 7,500,000 with the plaintiff and the plaintiff set off Rs. 175,000 (out of this amount paid by the 2nd defendant) against the capital of the said loan; the plaintiff allowed the 1st defendant to take Rs. 4,000,000 (out of this amount paid by the 2nd defendant) and that the plaintiff has set off the balance (out of this amount paid by the 2nd defendant) against the interest and tax and stamp duty said to be due on the said loan*". Unless the 2nd and 3rd defendants were the beneficiaries of the loan disbursed to the 1st defendant, payment of loan instalments to the bank is not expected from an innocent mortgagor. No other explanation has been provided by the 2nd and 3rd defendants for such conduct in the answer or by way of evidence. The learned High Court Judge in the judgment has accepted this position of the 1st defendant.

In the answer, the 2nd and 3rd defendants took up the position that (a) the effect of renouncing the benefit of the *senatus consultum velleianum* and *authentica si qua mulier* was never explained to the 3rd defendant by an Attorney-at-Law as stated in the Mortgage Bond and (b) the 2nd and 3rd defendants did not intentionally renounce the privilege of *excussionis*, which they were entitled to as guarantors.

The 4th to 23rd defendants intervened in the action, claiming to be the occupants of the units within the apartment complex constructed on the mortgaged property. They allege that prior to the execution of the Mortgage Bond, the 2nd and 3rd defendants collected full consideration of the purchase price of all these units. Furthermore, they contend that, having received these funds, the 2nd and 3rd defendants secretly mortgaged the premises along with the building without their knowledge, thus placing them in grave jeopardy. This, they argue, amounts to a fraud committed on them.

In the answer, the 4th to 23rd defendants state that since the 1st defendant is the principal debtor, the plaintiff bank should recover the money from him, emphasising that the 1st defendant holds sufficient deposits in the plaintiff bank for this purpose. They pray that the Mortgage Bond be declared null and void and the plaintiff's action be dismissed.

At the trial, the Chief Manager of the Colombo region of the plaintiff bank gave evidence on behalf of the plaintiff and tendered documents marked P1 to P10. Except for the Mortgage Bond marked P4, which was recorded as a formal admission, all other documents have been marked subject to proof. The learned High Court Judge correctly noted in the judgment that there was no necessity for further proof of these documents.

I must pause for a while to state that merely because the opposing counsel routinely says “subject to proof” whenever a document is marked in evidence, it does not mean that all those documents must be proved by calling witnesses. It is up to the Court to decide whether or not a document marked “subject to proof” needs further proof. When a counsel says a document shall be marked “subject to proof”, it is necessary for him to state the basis of it, firstly, for the Court and the party producing the document to seriously consider whether it is necessary to call witnesses to prove the document and secondly, to decide which aspect of the document (such as genuineness, contents, date of receipt) requires further proof. Routine objections in general terms for “subject to proof” as a matter of practice, which is one of the main causes for the delay in concluding a trial, should be strongly discouraged. With the pre-trial conference introduced by the Civil Procedure (Amendment) Act, No. 29 of 2023 properly implemented, this undesirable practice will hopefully cease to exist.

On behalf of the 2nd and 3rd defendants, no witnesses were called. The 2nd and 3rd defendants have marked D1 and D2 through the plaintiff’s witness.

Although several intervenient defendants have given evidence and marked documents, as I will discuss later, they are irrelevant in deciding the case.

The learned High Court Judge has entered judgment as prayed for in the prayer to the plaint.

Appeals have been preferred by the 2nd and 3rd defendants, and the 4th-23rd defendants.

**Main argument of the 2nd and 3rd defendant mortgagors**

Let me now consider the appeal of the 2nd and 3rd defendants.

At the argument, the main, if not the sole, submission of learned counsel for the 2nd and 3rd defendants was based on "novation". Learned counsel admits that the 2nd and 3rd defendants gave security for the original loan agreement P3 dated 28.02.2001 entered into between the plaintiff bank and the 1st defendant. He submits that, according to the loan ledger marked P8, the original loan of Rs. 30,000,000 disbursed to the 1st defendant on 28.02.2001 was rescheduled on 30.12.2002, and on the same day, a new loan of Rs. 34,099,341/12 was granted to the 1st defendant. It is his submission that this is a novation of the original loan agreement and the 2nd and 3rd defendants did not agree to guarantee this new loan and therefore the bank is not entitled to recover any dues arising out of the new loan using the security given for the original loan.

**Was there a novation of the original loan agreement?**

In order to decide whether there is a "novation" of the old agreement, the use of terms such as "rescheduling", "restructuring", "renewing" are not decisive. The transaction is determined by the unique facts and circumstances of each individual case, not by the labels assigned to it by the parties involved.

Loan rescheduling typically involves modifying payment terms without altering the fundamental conditions of the existing agreement. This adjustment may involve changes to the principal sum alone or both the principal and interest, along with other payments. The primary aim of rescheduling is to afford the borrower additional time for repayment. The rescheduling of an existing loan, for instance, for the convenience of the borrower or as part of an internal bookkeeping arrangement to ensure conformity with standard accounting practices, does not *ipso facto* give rise to a new loan agreement.

Conversely, "novation" replaces the old contract with an entirely new one, fundamentally altering the terms and conditions and also perhaps the parties involved.

The *Black's Law dictionary* (11th edition) page 1281 defines "novation" in the following manner:

> *1. The act of substituting for an old obligation a new one that either replaces an existing obligation with a new obligation or replaces an original party with a new party. A novation may substitute (1) a new obligation between the same parties, (2) a new debtor, or (3) a new creditor.*
>
> *2. A contract that (1) immediately discharges either a previous contractual duty or a duty to make compensation, (2) creates a new contractual duty, and (3) includes as a party one who neither owed the previous duty nor was entitled to its performance. A novation rests on a contract, which must be clearly shown. It cannot be made binding by later acquiescence or ratification without a new consideration or the existence of facts that constitute an estoppel. If the novation involves the original debtor's discharge, it must be contemporaneous with and must result from the consummation of an arrangement with the new debtor.*

As Prof. C.G. Weeramantry in his book, *The Law of Contracts*, Vol II, page 718 states "*Where there is a novation of a contract, there comes into existence in the eye of the law a new and independent contract*". To effectuate this, the intention of the parties to substitute the old contract with the new contract must be unequivocally evident, avoiding speculative interpretation, as such a transition entails serious legal ramifications. Prof. Weeramantry at page 719 states:

> *A novation discharges not only the original obligation but all obligations accessory to it. Interest, penal charges, suretyships and pledges, accessory to the original contract, are thus all discharged. In the words of Lord Moulton, in explaining the similar English concept of 'accord and satisfaction by a substituted agreement', "No matter what were the respective rights of the parties inter se, they are abandoned in consideration of the acceptance by all of a new agreement. The consequence is that when such an accord and satisfaction takes place, the prior rights of the parties are extinguished. They have in fact been exchanged for the new rights; and the new agreement becomes a new departure, and the rights of all the parties are fully represented by it." [Palaniappa v. Saminathan (1913) 17 NLR 56 at 58]*

It is because of these serious repercussions, Prof. Weeramantry at page 720 states:

> *Novation is never presumed, for the law considers that a contract once established retains its binding force, and that a creditor does not intend to surrender the rights he has acquired under the earlier contract. It follows that the law will incline to the view that a later contract co-exists with, rather than supersedes, a former contract, unless the court is satisfied of an intention on the part of the parties to supersede and extinguish the earlier contract. [Voet 46.2.3; Wessels, s. 2396,2398; Karthikesu v. Ponnachchy (1911)14 NLR 486]*

This does not however mean that there must be an express agreement entered into between the parties for novation to take effect. A novation can be inferred provided there is strong evidence that the parties intended to replace the original contract with a new one. In *Karthikesu v. Ponnachchy* (1911) 14 NLR 486 at 487, Chief Justice Lascelles stated:

> *Maasdorp (vol. IV., p. 165) states the law on this point as follows: By our law differing in that respect from the Roman law, novatio may take place, not only by express agreement, but also tacitly or by implication, the consent of the parties to the novatio being implied from the circumstances and the conduct of the parties. In the latter event, however, the inference must be so probable and conclusive as to make it quite clear that the parties intended to recede from the original obligation and to replace it by another – in fact, it must be a necessary inference, the new obligation being inconsistent and incompatible with the continued existence of the original obligation.*

The substitution of the original contract with a new contract as an indispensable element of novation has been emphasised by the Courts of other commonwealth jurisdictions as well.

In *Kabab-Ji SAL v. Kout Food Group* [2021] UKSC 48, the appellant entered into a franchise development agreement with a Kuwait company. Later, the Kuwait company became a subsidiary of the respondent. A dispute arose under the franchise development agreement, which the appellant referred to arbitration. The arbitration was commenced against the respondent only, not against the Kuwait company, on the basis that the respondent became a party to the agreements by the novation of original agreements. The Supreme Court of the United Kingdom was not inclined to accept this argument. Making a distinction between novation and assignment it was held at paras 60 and 61:

*60. Under English law contractual rights may be transferred by an assignment of those rights. An assignment cannot, however, transfer contractual obligations. Both contractual rights and obligations may be assumed by a third party where there is a novation. A novation involves the substitution of one contracting party by another with the consent of all parties. It does not involve a transfer of rights and liabilities but rather the discharge of the original contract and its replacement with a new contract, typically on the same terms but with a different counterparty: see generally Chitty on Contracts, 33rd ed (2019), Vol 1, paras 19-087 - 19-090.*

*61. The main differences between assignment and novation were summarised by Aikens J. in Argo Fund Ltd v. Essar Steel Ltd [2005] EWHC 600 (Comm); [2006] 1 All ER (Comm) 56, at para 61 as follows:*

*"…there are four main differences. First, a novation requires the consent of all three parties involved…But (in the absence of restrictions) an assignor can assign without the consent of either assignee or the debtor. Secondly, a novation involves the termination of one contract and the creation of a new one in its place. In the case of an assignment the assignor's existing contractual rights are transferred to the assignee, but the contract remains the same and the assignor remains a party to it so far as obligations are concerned. Thirdly, a novation involves the transfer of both rights and obligations to the new party, whereas an assignment concerns only the transfer of rights, although the transferred rights are always 'subject to equities'. Lastly, a novation, involving the termination of a contract and the creation of a new one, requires consideration in relation to both those acts; but*

> *a legal assignment (at least), can be completed without the need for consideration."*

In a more recent case of *Musst Holdings Ltd. v. Astra Asset Management UK Ltd. & Another* [2023] EWCA Civ 128 at para 82, Justice Falk states that a variation of terms is not a novation.

> *A novation is not a variation. A varied contract remains in place. In contrast, a novation is the replacement of a contract by a new contract between different parties.*

Section 62 of the Indian Contract Act, 1872 reads as follows:

> *62. Effect of novation, rescission, and alteration of contract.—If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract, need not be performed.*
>
> *Illustrations*
>
> *(a) A owes money to B under a contract. It is agreed between A, B and C that B shall thenceforth accept C as his debtor, instead of A. The old debt of A to B is at an end, and a new debt from C to B has been contracted.*
>
> *(b) A owes B 10,000 rupees. A enters into an arrangement with B and gives B a mortgage of his (A's) estate for 5,000 rupees in place of the debt of 10,000 rupees. This is a new contract and extinguishes the old.*
>
> *(c) A owes B 1,000 rupees under a contract. B owes C 1,000 rupees. B orders A to credit C with 1,000 rupees in his books, but C does not assent to the arrangement. B still owes C 1,000 rupees, and no new contract has been entered into.*

This section underscores the necessity of having a complete substitution of a new contract in place of the old with the assent of all the parties as an essential prerequisite for the novation of a contract.

In *Lata Construction v. Rameshchandra Ramniklal Shah* [2000] 1 SCC 596, the Supreme Court of India held:

> *One of the essential requirements of 'Novation'; as contemplated by Section 62, is that there should be complete substitution of a new contract in place of the old. It is in that situation that the original contract need not be performed. Substitution of a new contract in place of the old contract which would have the effect of rescinding or completely altering the terms of the original contract, has to be by agreement between the parties. A substituted contract should rescind or alter or extinguish the previous contract.*

In *Ramdayal v. Maji Devdiji* (AIR 1956 Raj 12) Justice Modi held at para 7:

> *"62. If the parties to a contract agree to substitute a new contract for it, or to rescind or alter it, the original contract need not be performed."*
>
> *A plain reading of this section shows that in order to have a novation, the parties to a contract must agree to the extinguishment or discharge of the old debt or obligation. There can be no novation until this has been accomplished. A novation may take place by the introduction of new parties or new terms into the contract. The test; therefore, is what was the intention of the parties, or, in other words, whether they intended to bring about a new or altered contract between themselves.*

In *ALH Group Property Holdings Pty Ltd. v. Chief Commissioner of State Revenue* [2012] HCA 6, Chief Justice French, Justices Crennan, Kiefel and Bell in the High Court of Australia held at para 12:

> *A novation, in its simplest sense, refers to a circumstance where a new contract takes the place of the old [Olsson v. Dyson (1969) 120 CLR 365 at 389; [1969] HCA 3]. It is not correct to describe novation as involving the succession of a third party to the rights of the purchaser under the original contract. Under the common law such a description comes closer to the effect of a transfer of rights by way of assignment. Nor is it correct to describe a third party undertaking the obligations of the purchaser under the original contract as a novation. The effect of a novation is upon the obligations of both parties to the original, executory, contract. The enquiry in determining whether there has been a novation is whether it has been agreed that a new contract is to be substituted for the old and the obligations of the parties under the old agreement are to be discharged.*

In *Ran Banda and Others v. People's Bank* [2004] 2 Sri LR 31, the loan was rescheduled by the bank with the agreement of the 1st defendant debtor. When the bank took steps to recover the loan upon failure to pay as agreed, the 1st defendant debtor and the 2nd and 3rd defendant guarantors resisted it on the basis that novation of the old loan agreement took place with the reschedulement of the old loan and the bank cannot enforce the terms of the old loan agreement to recover the dues of the new loan. This argument was rejected by the Court of Appeal. Justice Amaratunga stated at pages 33-34:

> *The defendant-petitioners in their joint application and in their affidavits took up the position that the Bank had no right to seek to recover any sum of money upon the agreement P2 and that the 2nd*

*and 3rd defendants were not liable to pay anything to the Bank as the said document P2 had become invalid. The basis upon which the defendants claimed that the original written contract P2 had become invalid was that when the Bank re-scheduled the loan the former debt was extinguished and a new debt created by the rescheduled agreement V2A has come into existence and that this new contract made the former written contract unenforceable. In short, the contention of the defendants was that the new arrangement brought into existence by the re-scheduled arrangement amounted to what is known to the law of contract as 'novation'. This concept of novation, which is a part of the modern law of contract, both English and the Roman Dutch, had its origins in the Roman Law. To put it in the simplest possible way, in the modern law, 'novation occurs whenever an existing obligation is discharged in such a manner that another obligation is substituted in its place.' Wessels-Law of Contract Vol 2, 2nd Ed., 1951, page 658 para. 2369. Novation proper takes place if a new contract to take the place of the old is established between the same parties without the intervention of a third party. When this happens, the later obligation extinguishes the former.*

*The law presumes that once a contract is established, it retains its binding force and that a creditor does not intend to renounce rights which he has acquired. Hence where two parties to a contract make a later agreement, the law will presume rather, that they intended both agreements to have equal force than that the latter should supersede the former. A mere change in the method of payment does not affect the substance of the contract, though it may affect the manner of its execution. Mere extension of time to the debtor does not affect the substance of the obligation and will therefore not be construed to be a novation having the effect of*

> *releasing the sureties. Wessels – paragraphs 2396, 2411 and 2415.*
>
> *Document V2A clearly indicates that the re-scheduled arrangement was made at the request of the debtor, the 1st defendant. It merely gave him extended time for payment and a concessionary rate of interest in respect of the balance of the loan remaining unpaid as at the date of the re-schedule agreement. It did not bring into existence anything unfavourable to the guarantors. In fact, the concessions granted to the debtor were beneficial to the guarantors as well. Condition No 4 in the re-scheduled agreement preserves the Bank's rights to have recourse to the conditions of the original agreement in the event of the failure of the debtor to act in accordance with the conditions of the re-scheduled arrangement, and this in my opinion completely negatives any intention on the part of the Bank to make the re-scheduled arrangement to take the place of a new contract – a new obligation extinguishing the existing contract. Further the absence of the participation of the guarantors for the re-scheduled agreement is significant. It is clear evidence that the Bank considered that the re-scheduled arrangement was an arrangement within the framework of the existing contract and not in substitution therefor.*

In *Luxman Perera v. Union Bank of Colombo Ltd* [2019] 2 Sri LR 395, the 1st respondent bank filed action in the Commercial High Court to recover a sum of Rs. 5,162,341/53 and interest alleged to be due to it from the 2nd respondent Company upon certain credit facilities which it had granted to the 2nd respondent at the request of the appellant and the 3rd respondent, who were the directors of the 2nd respondent. The appellant and the 3rd respondent were also made defendants to the action under a "Joint and Several Personal Guarantee" dated

16.03.1998, which they had signed at the time of granting the facility. In the year 2000 the 2nd respondent went into arrears in making its repayments, and at the request of another director, the 1st respondent bank "restructured" the outstanding amount subject to the terms and conditions of an offer letter, which was signed and accepted by the appellant on 16.07.2001. The 2nd respondent continued to default on its repayments, and in 2002 the bank sent several reminders followed by a letter of demand. On 06.02.2007 the bank instituted legal action for the recovery of the total amount outstanding and interest.

At the trial, the appellant's defence was that in 2001 the 2nd respondent Company did not reschedule the existing loan repayments but obtained a new credit facility. The appellant argued that he only became a surety for the 1998 loan, and not for the loan obtained in 2001, and the Guarantee Bond having been executed in 1998, the claim for recovery of money in respect of the same in 2007 was prescribed. It was also argued that the 1998 guarantee bond was executed for a specific loan, and could not be extended to cover future uncertain monies. The Commercial High Court entered judgment in favour of the 1st respondent bank and the appellant appealed to the Supreme Court.

The Supreme Court dismissed this argument, despite the presence of evidence that could suggest a novation of the prior loan agreement. Justice Aluwihare reasoned out the said conclusion in the following terms at pages 401-402:

> *There is no dispute that it was the abovementioned request letter marked "P6" that prompted the Plaintiff-Bank to send a new offer letter in June 2001 marked "P7." In the said letter the Plaintiff-Bank has clearly indicated that "We, the Union Bank of Colombo, are pleased to restructure the outstanding pertaining to Emm Chem (Pvt) Ltd on terms and conditions stipulated below." According to the*

*said letter, the outstanding amount was restructured as "Term Loan 1" and "Term Loan 2". Even at the end of the letter "P7", the Plaintiff-Bank has stated "Please note that this is the second re-schedulement of the outstandings and therefore request you to strictly adhere to the rescheduled payments".*

*It is also important to note that under the heading "Security", the Plaintiff-Bank has specifically referred to "personal guarantee for Rs. 7,000,000/= of Mr. Lakshman Perera and Mr. Surenthiran together with net worth investments". The 2nd Defendant-Appellant argued based on this reference that "P7" was a new and distinct loan which required a new personal guarantee. In contrast, the Plaintiff-Bank claimed that it was not a request for 'fresh guarantee' but a cross-reference to the already existing guarantee bond executed in 1998. I am inclined to believe that it was a cross-reference, as it specifically refers to the 2nd and 3rd Defendants who were the sureties in the 1998 Guarantee Bond. If the Plaintiff-Bank was requesting fresh guarantee, there would not have been any necessity to specifically refer to the 2nd and 3rd Defendants' names. The Plaintiff-Bank could have easily followed the requirements in the Board Resolution marked "P4" which only requires the signature of "any two directors of the Company."*

*Apart from these contentions, the 2nd Defendant-Appellant also sought to argue that the 2001 facility was a new loan based on the ledger accounts marked "P12." In the said ledger account, there is an entry to the effect 'full recovery of the loan granted'. According to the 2nd Defendant-Appellant, this entry proves that the 1998 loan had been fully repaid and nothing was remaining. If the 1998 loan was 'fully recovered", the 2nd Defendant-Appellant argued that there could be no continuation of the same. Thus, the 2001 loan could only be construed as a 'new loan'.*

*However, immediately underneath the said entry are two further entries to the effect: "Term Loan 1" and "Term Loan 2". When asked to explain the three entries, Mr. Ned Gomez–Head of Operations of the Plaintiff-Bank, in his evidence stated that the said entry "full recovery of the loan granted" was not made pursuant to any physical money being deposited by the $1^{st}$ Defendant Company. Instead, it has been made for accounting purposes and to cross-reflect that it was the same outstanding amount of the aforesaid loan, that had been rescheduled as "Term Loan 1" and "Term Loan II". He also gave evidence that no cash was released with regard to "Term Loan I" and "Term Loan II". All these clearly indicate that, contrary to what is claimed by the $2^{nd}$ Defendant, the 2001 arrangement was not a new loan. What the $2^{nd}$ Defendant-Appellant attempts to characterize as a 'new loan' is the amount which the $1^{st}$ Defendant-Company was anyway duty bound to repay.*

*Throughout trial, the two witnesses on behalf of the Plaintiff-Bank have consistently maintained that no new loan was granted to the $1^{st}$ Defendant-Company and that the action was instituted to recover the outstanding amount with interests of the same continuing loan.*

*The $2^{nd}$ Defendant-Appellant's position is that "Term Loan I" and "Term Loan II" were two new loans granted to the $1^{st}$ Defendant-Company and one for which the Plaintiff-Bank never obtained fresh security. It would be difficult to believe that, in the circumstances where there had been default and delay in paying the monies that were due, the Plaintiff-Bank would have even considered making the restructured banking facilities available without security of the existing bank guarantee.*

> *All these factors cumulatively indicate that there was only one continuing loan—i.e. the loan obtained in 1998. It was the same loan for which the 2nd Defendant-Appellant along with the 3rd Defendant had signed a guarantee bond.*

As previously noted, there shall be *consensus ad idem* (meeting of minds) among contracting parties for novation to come into effect.

*Chitty on Contracts,* 33rd ed (2018), Vol 1, para 19-087 states:

> *Novation takes place where the two contracting parties agree that a third, who also agrees, shall stand in the relation of either of them to the other. There is a new contract and it is therefore essential that the consent of all parties shall be obtained: in this necessity for consent lies the most important difference between novation and assignment.*

In *Musst Holdings Ltd v. Astra Asset Management UK Ltd (supra)*, the Court of Appeal of the United Kingdom stated at para 56:

> *The consent of all parties is required for a novation. Consent can either be provided expressly or can be inferred from conduct. Whether consent has been provided is a question of fact. For example, in Re Head [1894] 2 Ch 236 a transfer of funds from a current to a deposit account following the death of a partner in a banking partnership was held to amount to a novation of liability to the surviving partner.*

In *Sri Lanka Co-operative Marketing Federation Ltd v. Ambewela Livestock Co Ltd* (SC/CHC/APPEAL/54/2007, SC Minutes of 27.03.2014), rejecting the plea of novation, Justice Ekanayake observed:

> *Further, it would be pertinent to note that it is only the description of the name of the creditor that got changed but certainly not the nature and character of the debt. More specifically, Lanka Milk Foods (CWE) Limited has taken over only the operation and management of the said Company (see P35). In order to prove novation the defendant had to establish in evidence the intention of the creditor to discharge the debtor from the obligation. In the case before us, no such evidence was led at the trial. The express and declared will of the creditor is required in order to constitute novation. In this case the defendant has completely failed to produce such evidence. In the circumstances, the defendant in this case cannot avoid liability on the basis that there has been novation.*

In *Attorney General v. Perera* (1908) 12 NLR 161, the Supreme Court held that the mere variation of terms in a contract does not constitute a novation.

In *Mohamedally v. Misso* (1957) 56 NLR 370 it was held that the execution of subsequent additional security on a promissory note does not discharge any obligation unless the intention to provide substitute security, as opposed to additional security, is clearly established. This view was later upheld by the Privy Council in the appeal, *Mohamedally v. Misso* (1957) 58 NLR 457.

I must refer to the judgment of Justice Suresh Chandra in *Hatton National Bank v. Rumeco Industries Ltd* [2011] 2 BLR 329 which is often relied upon by the guarantors on the question of reschedulement and novation since those concepts are referred to in the judgment. In that case, the plaintiff bank instituted action against three defendants to recover the dues to the bank on a term loan given to the 1st defendant in 1995. This loan was secured by two Mortgage Bonds. *Ex-parte* judgment was entered against the 1st and 2nd defendants. Only the 3rd defendant contested the case. At the *inter-partes* trial, contrary to the pleadings, the bank presented a different case against the 3rd defendant. The 3rd defendant is said to have given a personal guarantee in 1992 regarding some previous loan, which had nothing to do with the term loan given to the 1st defendant in 1995. The District Court, the High Court and the Supreme Court were unanimous in holding that the 1995 loan was on a new term loan agreement and not a rescheduling of the loan given to the 1st defendant in 1992 and therefore the personal guarantee given by the 3rd defendant in respect of the 1992 loan cannot be made use of to recover the dues arising out of 1995 term loan which was secured by separate two Mortgage Bonds. These are unique facts peculiar to that case.

The facts of the instant case are quite different. In the instant case, there is no affirmative evidence for this Court to come to a definite conclusion that the original loan agreement dated 28.02.2001 marked P3 was replaced with a new loan agreement on 30.12.2002.

Let me quote the evidence which the 2nd and 3rd defendants rely on to argue that there is a novation.

This is part of the cross-examination of the plaintiff's witness (the Chief Manager of the Colombo region of the plaintiff bank) by the counsel for the 2nd and 3rd defendants:

> *Q: Now answer my question. In the 5th column [of the loan ledger marked P8] there is a heading balance outstanding on 30.12.2002, there is balance outstanding NIL shown in the 5th column?*
>
> *A. No, balance outstanding is Rs. 34, 099, 341.12.*
>
> *Q. What does the NIL stand for?*

*A. The balance outstanding is Rs. 34, 099, 341.12.*

*Q. A word found in the same column just above that, there is a word NIL?*

*A. There is an interim figure given for the day but it is not the end of the balance.*

*Q. So, the balance outstanding is NIL because Rs. 29, 825, 000/00 is shown as recovered in column 4?*

*A. It is not recovery. It is a re-schedulement.*

It is because of the use of the word "reschedulement", the 2nd and 3rd defendants say there is a novation.

Quoting the above evidence, learned counsel for the 2nd and 3rd defendants states:

*As admitted by the plaintiff's witness that this is a re-schedulement. The said witness being a senior banker of HNB has clearly used the word "re-schedulement". This amounts to a novation and the guarantors will be discharged.*

This argument is unsustainable. As I stated previously, a reschedulement of a loan does not necessarily amount to a novation of the existing loan agreement. The term used in *Luxman Perera's* case discussed above was "restructuring", which is stronger than "rescheduling" but the Supreme Court was not inclined to go by the label given by the parties.

Although the loan ledger marked P8 indicates "Nil" in the 5th column under the heading "CAPITAL Balance O/s (Rs)" on 30.12.2002, in the last column on the same date under the heading “TOTAL OUTSTANDING (RS)”, it is stated “34,099,341.12”.

The witness explained this in his evidence in the following manner.

> *Q. And on 30.12.2002, the balance outstanding is shown as Nil and the same day it is thereafter made Rs. 34,099,341.12?*
>
> *A. That is balance at the end of the day.*
>
> *Q. Because the bank has given a loan for Rs. 34,099,341.12 and then from that amount recovered the capital due from the original loan of Rs. 30,000,000.00?*
>
> *A. I do not agree.*
>
> *Q. That is what is shown in the ledger called Loan Ledger Sheet?*
>
> *A. The capital of Rs. 29,325 million plus the interest of Rs. 4,203,720 plus the charges of Rs. 70,620.38 was rescheduled and capitalized. <u>And a fresh loan of Rs. 34 million those are internal book keeping arrangements</u>. We capitalized the interest on the request of the applicant. And that is how you can see it is a total of these three items. Rs. 29,825,000, Rs. 4,203,720.74 and Rs. 70,620.38. It was accrued as charges at that particular date.*
>
> *Q. And thereafter, the bank has charged interest on this fresh loan?*
>
> *A. The loan was capitalized. So the capital interest is charged.*
>
> *Q. So, there is a fresh capital amount of Rs. 34,133,719.32 and this case is based on that capital amount? Is that correct?*
>
> *A. Yes.*

*Q. I put it to you that you have already answered that this mortgage bond was given to support the loan of Rs. 30 million set out in the document marked P2?*

*A. Yes.*

*Q. So, now you are showing a different loan of Rs. 34,133,719.32 which came into existence on 30.12.2002?*

*A. <u>I do not agree. I confirmed that is the same loan. It is a continuation</u>.*

It was not a fresh loan given on 30.12.2002. It is an "internal bookkeeping arrangement" whereby the capital outstanding, the interest and the charges were rescheduled and capitalized on the same terms as agreed upon in the original loan agreement P3. This has been identified in the loan ledger P8 as "Reschedulment entries pertaining to the loan". It cannot be equalised to reschedulement of the loan with new terms. According to the witness, it is a continuation of the original loan agreement.

As seen from the loan ledger, both before and after rescheduling, the total outstanding remains the same.

The entry showing a "Nil" balance did not result from an actual payment to the bank. Furthermore, the notation of Rs. 34,133,719/32 under "granted" does not signify cash disbursement to the 1st defendant on 30.12.2002. No money was given to the 1st defendant on that date or any subsequent date.

If the contract was novated, the original debt should have been substituted by a new debt as opposed to a mere continuation of the original loan agreement. This is confirmed in *Cheshire, Fifoot, and*

*Furmston's Law of Contract* (Oxford University Press, 16th edn 2012) at 652-653 in the following way:

> *Novation is a transaction by which, with the consent of all the parties concerned, a new contract is substituted for one that has already been made. The new contract may be between the original parties, such as where a written agreement is later incorporated in a deed; or between different parties, such as where a new person is substituted for the original debtor or creditor… Thus novation, unlike assignment, does not involve the transfer of any property at all, for it comprises, (a) the annulment of one debt and then (b) the creation of a substituted debt in its place.*

*Chitty on Contracts,* 33rd edn (2018), Vol 1, para 22-031 states:

> *Novation is a generic term which signifies: "….that there being a contract in existence, some new contract is substituted for it, either between same parties (for that might be) or between different parties; the consideration mutually being the discharge of the old contract." (Scarf v. Jardine (1882) 7 App. Cas. 345, 351; The Tychy (No.2) [2001] 1 Lloyd's Rep. 10, 24)*

If this internal bookkeeping arrangement or rescheduling is to be considered as a new loan replacing the old loan as learned counsel for the 2nd and 3rd defendants suggest, the new loan has been given to the 1st defendant without any security because the old loan given with security could not be paid. This is unthinkable in the commercial world.

In *Musst Holdings Ltd v. Astra Asset Management UK Ltd (supra)* the Court of Appeal of the United Kingdom held that a novation will only be inferred from conduct if that inference is required to give business efficacy to what happened. Justice Falk held at para 57:

> *However, a novation will only be inferred from conduct if that inference is required to give business efficacy to what happened. As Lightman J. explained in Evans v. SMG Television Ltd [2003] EWHC 1423 (Ch) at [181]: "The proper approach to deciding whether a novation should be inferred is to decide whether that inference is necessary to give business efficacy to what actually happened (compare Miles v Clarke [1953] 1 WLR 537 at 540). The inference is necessary for this purpose if the implication is required to provide a lawful explanation or basis for the parties' conduct."*

Internal bookkeeping adjustments or rescheduling made for convenience and clarity, without altering the conditions of the original loan agreement, cannot be deemed as novation, thereby creating a new contract. A "mere change of method of payment" or "mere extension of time to the debtor to make payment" are not incidents of substantial alteration that warrant the characterisation of novation or the creation of a new contract.

I hold that the 2nd and 3rd defendants failed to establish that the previous loan was settled and that a new loan with fresh terms (excluding the Mortgage Bond P4) was granted on 30.12.2012, thereby establishing a novation of the old loan agreement.

The plea of novation of the 2nd and 3rd defendants must fail.

**Can the plea of novation be taken up for the first time in appeal?**

It is admitted that the plea of novation was not taken up by the 2nd and 3rd defendants in the answer, did not raise as an issue at the outset of the trial, did not raise as an issue during the course of the trial, and did not state in the petition of appeal. It was raised for the first time at the argument before this Court – to be specific in the written submissions filed after the matter was fixed for the argument. Can this be done?

A pure question of law can be raised for the first time in appeal but not a question of fact or a question of mixed fact and law (*Ranaweera v. Commissioner of Inland Revenue* (1965) 70 NLR 564 at 566, *Jayawickrema v. David Silva* (1973) 76 NLR 427 at 430, *Rev. Pallegama Gnanarathana v. Rev. Galkiriyagama Soratha* [1988] 1 Sri LR 99 at 120, *Candappa v. Ponnambalampillai* [1993] 1 Sri LR 184 at 189, *Janashakthi Insurance Co. Ltd. v. Umbichy Ltd.* [2007] 2 Sri LR 39 at 45, *Lebbai v. Mohamed Abiyar and Others* [2021] 1 Sri LR 22).

As I held in *Wijesinghe v. Wickramaratne* (SC/APPEAL/154/2017, SC Minutes of 21.11.2022):

> *A party to an action cannot change his position as he pleases to suit the occasion. Firstly, a party cannot present by way of issues a different case from what he has pleaded in his pleadings. However, if the opposing party does not object, the Court can accept the issues since once issues are raised, pleadings recede to the background. Secondly, once issues are raised and accepted by Court, a party cannot present a new case when leading evidence at the trial from what he has raised by way of issues. Thirdly, once the judgment is delivered by the trial Court, a party cannot present a new case before the appellate Court from what was presented before the trial Court, unless any new ground is on a pure question of law and not on a question of fact or on a mixed question of fact and law.*

The plea of novation is not a pure question of law. It is a mixed question of fact and law.

Learned counsel for the 2nd and 3rd defendants, citing *Somawathie v. Wilmon* [2010] 1 Sri LR 128 seems to suggest that there is no blanket prohibition for a question of fact or mixed question of fact and law to be raised for the first time in appeal. In *Somawathie's* case, the High Court set aside the judgment of the District Court on the basis that the deed of gift the plaintiff relied on had not been accepted by the donee on the face of the deed. The Supreme Court set aside the judgment of the High Court and restored the judgment of the District Court on the basis that whether the donee accepted the gift constitutes a question of both fact and law, and thus cannot be raised for the first time in appeal. Justice Bandaranayake (as Her Ladyship then was) stated at pages 135-136:

> *It was not disputed that no issue was raised on the non-acceptance of the Deed of Gift. It is also to be noted that the respondent had not contested the validity of the Deed of Gift as to whether there was acceptance by the donees, at the time of the trial in the District Court. Since no such issue was raised, the District Court had not considered the said non-acceptance of the Deed of Gift and therefore there was no material before the High Court on the said issue. In the circumstances, the High Court was in error when it considered the question of non-acceptance of the Deed of Gift, which was at most a question of mixed law and fact.*

In *Musst Holdings Ltd v. Astra Asset Management UK Ltd* (*supra*), the Court of Appeal of the United Kingdom highlighted the role of the trial Judge in deciding whether a novation can be inferred from the parties' conduct:

> *The question whether a novation can be inferred from the parties' conduct is a question of fact, with which this court will not lightly interfere. The judge had the benefit, which we do not, of a consideration of all the evidence. It is quite clear from his decision that he took careful account of the evidence as a whole in reaching his conclusions. This was not simply a question of looking at a few emails and invoices and determining that they amounted to an*

> *offer and acceptance. The judge explained that he was considering the documents to which he referred in their context. As Musst correctly emphasised, this was an evaluative exercise. The comment made by David Richards LJ in UK Learning Academy v Secretary of State for Education [2020] EWCA Civ 370 at [41] bears repeating: "As has been frequently said, the trial judge is in the best position to assess the evidence not only because the judge sees and hears the witnesses but also because the judge can set the evidence on any particular issue in its overall context. This is true also of an assessment of what a particular document would convey to a reasonable reader in the position of the party who received it, having regard to all that had preceded it."*

The proposition that a question of fact can be raised for the first time in appeal is mainly based on the old decision of the House of Lords in *The Tasmania* (1890) 15 App. Cases 223 at 225 where Lord Herschell stated:

> *It appears to me that under these circumstances, a Court of Appeal ought only to decide in favour of an appellant on a ground there put forward for the first time, if it be satisfied beyond doubt, first, that it has before it all the facts bearing upon the new contention, as completely as would have been the case if the controversy had arisen at the trial; and next, that no satisfactory explanation could have been offered by those whose conduct is impugned, if an opportunity for explanation had been afforded them when in the witness box.*

In the Supreme Court case of *Appuhamy v. Nona* (1912) 15 NLR 311 at 312, Justice Pereira raised some doubt about the acceptability of the above position in the context of procedure we adopt in Sri Lanka where a civil trial is conducted on identified issues. His Lordship stated that the new point to be entertained in appeal "*it might have been put forward in the Court below under some one or other of the issues framed*".

> *I am not sure that this ruling would apply to a system of procedure in which the framing of issues at the trial is an essential step except to the extent of admitting a new contention urged for the first time in the Court of Appeal, which, though not taken at the trial, is still admissible under some one or other of the issues framed. Under our procedure all the contentious matter between the parties to a civil suit is, so to say, focused in the issues of law and fact framed. Whatever is not involved in the issues is to be taken as admitted by one party or the other, and I do not think that under our procedure it is open to a party to put forward a ground for the first time in appeal unless it might have been put forward in the Court below under some one or other of the issues framed, and when such a ground, that is to say, a ground that might have been put forward in the Court below, is put forward in appeal for the first time, the cautions indicated in the case of the Tasmania may well be observed.*

Justice Pereira did not entertain the question of fact raised for the first time in that appeal.

The cumulative effect of these two leading decisions (i.e. *The Tasmania* and *Appuhamy v.* Nona) is that a question of fact can be raised for the first time in appeal if:

(a) "*it might have been put forward in the Court below under some one or other of the issues framed*"; <u>and</u>

(b) "*if it is satisfied beyond doubt*" that

(i) "*it [the appellate Court] has before it all the facts bearing upon the new contention, as completely as would have been the case if the controversy had arisen at the trial*"; <u>and</u>

(ii) "*no satisfactory explanation could have been offered by those whose conduct is impugned, if an opportunity for explanation had been afforded them when in the witness box*".

Later cases such as *Arulampikai v. Thambu* (1944) 45 NLR 457, *Setha v. Weerakoon* (1948) 49 NLR 225, *Ranaweera Menike v. Rohini Senanayake* [1992] 2 Sri LR 180 at 191, *Somawathie v. Wilmon* (*supra*) followed the above two decisions.

In *Leechman Co. Ltd v. Rangalle Consolidated* [1981] 2 Sri LR 373, Justice Soza stated at page 391:

> *Where the point depends upon a question of fact which is disputed and should be determined on evidence, then it cannot be taken up for the first time in appeal <u>unless the facts necessary for the determination appear in the evidence and are not in dispute at all</u>.*

The same approach was adopted by the apex Court of Australia in *Water Board v. Moustaka* (1988) 62 ALJR 209 where Chief Justice Mason and Justices Wilson, Brennan and Dawson, after a careful consideration of precedent on the matter held at para 13:

> *More than once it has been held by this Court that a point cannot be raised for the first time upon appeal when it could possibly have been met by calling evidence below. Where all the facts have been established beyond controversy or where the point is one of construction or of law, then a court of appeal may find it expedient and in the interests of justice to entertain the point, but otherwise the rule is strictly applied.*

As I stated previously, the question of novation or at least the question of reschedulement which are not pure questions of law, were <u>never raised as issues in the trial Court</u>. The 2nd and 3rd defendants do not say that those questions could have been put forward under any of the issues raised at the trial. I am not satisfied "beyond doubt" that this Court has "before it all the facts bearing upon the new contention, as completely as would have been the case if the controversy had arisen at the trial" Court. The 2nd and 3rd defendants did not even attempt to raise an issue on the question of novation at least during the course of cross-examination. If such an issue was raised, I have no doubt that the plaintiff bank would have led specific evidence to counter that position. The 2nd and 3rd defendants cannot say that the proceedings bear all the evidence which the bank could have led on novation, if the question of novation was raised as a specific issue in the trial Court.

On the facts and circumstances of this case, the question of novation could not have been raised for the first time in appeal.

**Peripheral arguments**

Learned counsel for the 2nd and 3rd defendants raised the following two arguments as well:

(a) The 2nd and 3rd defendants did not renounce the benefit of the "*beneficium ordinis seu excussionis*".
(b) The renouncing the benefit of the "*senatus consultum velleianum*" and the "*authentica si qua mulier*" was never explained to the 3rd defendant.

Let me now consider them in brief.

**Beneficium ordinis seu excussionis**

The *beneficium ordinis seu excussionis* is a privilege whereby a surety is entitled to claim that "*as his liability is of an accessory character, it shall not be enforced against him until the creditor has unsuccessfully endeavoured to obtain satisfaction from the principal debtor*". (*Wijeyewardene v. Jayawardene* (1917) 19 NLR 449 at 452-453, *Wijeyewardene v. Jayawardene* (1923) 24 NLR 336, *Seneviratne v. State Bank of India* [2014] 1 Sri LR 320 at 333)

Learned counsel for the 2nd and 3rd defendants, relying on this principle argues that the plaintiff bank has no right to recover the dues from the 2nd and 3rd defendants without first taking all the steps to recover the dues from the principal debtor, the 1st defendant.

This privilege is available to sureties under the common law. Roman-Dutch law is considered as the common law of Sri Lanka because it is the residuary law filling in the gaps only when the statute laws and special laws are silent. The Mortgage Act, No. 6 of 1949, as amended, being a statute enacted by the legislature would supersede any common law principles pertaining to mortgage of properties.

As the long title of the Act indicates, it is "*an Act to amend and consolidate law relating to mortgage*". In *Ramachandran and Others v. Hatton National Bank* [2006] 1 Sri LR 393 at 399, it was observed by Chief Justice S.N. Silva that "*the Act itself is a piece of erudition. It takes over the concept of Roman Law of Hypotheca whereby a real security is created over property with the mortgagor remaining the owner in possession of the property and provides a specific remedy to obtain an order from Court declaring the mortgaged property to be bound executable for the money due and for a judicial sale of the property*." The Mortgage Act prescribes both the substantive law and the procedure relating to actions based on mortgage bonds and their enforcement (*Brunswick Exports Ltd. v. Hatton National Bank Ltd.* [1999] 1 Sri LR 219 at 223).

According to section 4, Part II of the Mortgage Act containing sections 4-62 is applicable to:

(a) a mortgage of land,
(b) to any action to enforce payment of the moneys due upon a mortgage of land, and
(c) to any hypothecary action in respect of any land.

According to section 2, "hypothecary action" means "*an action to obtain an order declaring the mortgaged property to be bound and executable for the payment of the moneys due upon the mortgage and to enforce such payment by a judicial sale of the mortgage property*".

Section 34 of the Civil Procedure Code enacts that every action shall include the whole claim and if the plaintiff omits to do so (except with the leave of the court obtained before the hearing), he shall not afterwards sue for the remedy so omitted. It further states that for the purpose of this section, an obligation and a collateral security for its performance shall be deemed to constitute but one cause of action.

Section 7 of the Mortgage Act provides an exception to section 34 of the Civil Procedure Code.

> *7(1). Notwithstanding anything in section 34 of the Civil Procedure Code, a claim to enforce payment of the moneys due upon a mortgage may be joined to a claim in a hypothecary action, or a separate action may be brought in respect of each such remedy.*

A close scrutiny of sections 2,4 and 7 referred to above reveals that there are two actions available to a mortgagee. One is a hypothecary action. The other is an action to claim recovery of the debt secured by the mortgage. He can claim both in one action or file separate actions for each. (*Ahamado Muheyadin v. Thambiappah* (1948) 51 NLR 392 at 395) In the instant case, the plaintiff bank has joined both claims in the same action.

Section 46 of the Act is an important section.

> *46. No decree in any hypothecary action upon any mortgage of land which is created after the coming into force of this section, and no decree in any action for the recovery of any moneys due upon any such mortgage, shall order any property, whatsoever, other than the mortgaged property to be sold for the recovery of any money found to be due under the mortgage, and no property whatsoever, other than the mortgaged property, shall be sold or be liable to be sold in execution of any such decree.*
>
> *In this section "action for the recovery of moneys due upon a mortgage" includes any action for the recovery of any debt secured by a mortgage whether the cause of action sued upon arises by reason of the mortgage or otherwise.*

The two actions which the mortgagee could bring are highlighted in this section as well: (a) "any hypothecary action upon any mortgage of land", and (b) "any action for the recovery of any moneys due upon any such mortgage". Thereafter it states "no property whatsoever, other than the mortgaged property, shall be sold or be liable to be sold in execution of any such decree". The term "any such decree" covers both actions. In the result, section 46 would apply even in an action against the principal debtor as such action would be an action for the recovery of a debt secured by a mortgage.

Section 46 stipulates that a decree in a hypothecary action or any action for the recovery of money due on the mortgage must be limited to the mortgaged property. The prior position under Roman Dutch Law was that the creditor was entitled to resort to the other property of the mortgagor if there was a deficiency after the sale of the mortgaged property (*Wijesekera v. Rawal* (1917) 20 NLR 126). The Mortgage Act has thus introduced a statutory limitation on the liability of the mortgagor.

In reference to section 46, in the Supreme Court case of *Mercantile Bank Ltd v. Anver* (1976) 78 NLR 481, Justice Wijesundera held at 485:

> *The words used are "no decree…shall order". They are emphatic and the prohibition is unqualified. The result is only the mortgaged land can be sold in default of payment <u>whatever be the form of action to recover the debt due on the mortgage</u>.*

Section 47 expressly removes any application of common law to the above principle.

> *47. The provisions of section 46 shall have effect notwithstanding anything in any other law or in any mortgage bond or other instrument.*

However, in terms of section 47A, the mortgagor can renounce the benefit of section 46 thereby allowing the mortgagee to sale any property of the mortgagor other than the mortgaged property to recover the dues.

> *47A(1) Where at the time of the execution of a mortgage bond in favour of a lending institution for the payment of a loan, the principal of which exceeds one hundred and fifty thousand rupees the mortgagor executes a separate instrument, attested by the*

*notary attesting the bond and by the witnesses to the bond containing–*

*(a) a special declaration on the part of the mortgagor that he renounces the benefit of section 46 and that the effect of such renunciation has been explained to him by the notary; and*

*(b) an endorsement signed by the notary to the effect that he has explained to the mortgagor the effect of such renunciation, then, in addition to the mortgaged property, any other property belonging to the mortgagor shall, subject to the provisions of subsection(2), be liable to be ordered to be sold and to be sold under the decree in an action upon the mortgage, and the provisions of section 218 of the Civil Procedure Code (Chapter 101) shall, mutatis mutandis, apply to the seizure and sale of such other property.*

*(2) In any case referred to in subsection (1), no process shall issue for the seizure and sale of any property of the mortgagor, other than the mortgaged property, until the mortgaged property is sold and the proceeds thereof applied in satisfaction of the decree.*

According to section 47A(3), "*it shall be the duty of the notary to explain to the mortgagor, that the instrument provides for the renunciation of the benefit of section 46 and that the effect of such renunciation is that, in addition to the mortgaged property, other property of the mortgagor is liable to be sold in execution of a decree in an action upon the mortgage.*"

In the instant action, when the plaintiff bank took steps to sell the mortgaged property by *parate* execution in terms of the provisions of the Recovery of Loans by Banks (Special Provisions) Act, No. 4 of 1990, the 2nd and 3rd defendants challenged it before the Supreme Court. The decision of the Supreme Court is reported in *Ramachandran and Others* *v. Hatton National Bank* (*supra*) where it was held by majority decision that the bank cannot sell the mortgaged property by *parate* execution since the 2nd and 3rd defendants are not the borrowers. The Supreme Court at pages 399-400 referred to the Mortgage Act to state that hypothecary action is the proper remedy. This hypothecary action was filed in terms of the Mortgage Act in consequent to the above Supreme Court judgment.

The Mortgage Act does not mandate that the Mortgage Bond cannot be enforced against the mortgagor until the creditor (the bank, in this case) has exhausted all efforts to obtain satisfaction from the principal debtor. The common law benefits available to a surety/guarantor have not been preserved.

A similar argument presented before this Court was rejected by the majority decision in *Sri Lanka Insurance Corporation Ltd v. People's Bank* (SC/CHC/APPEAL/18/09, SC Minutes of 17.03.2017) in respect of two on demand Guarantee Bonds.

> *There was no condition contained in the Guarantee Bond that the Peoples' Bank should first demand from the principal before demanding from the guarantor. When any party grants an assurance to another party guaranteeing to pay on demand, it is accepted that if the principal does not pay that the guarantor shall pay. It is only on that assurance that the Bank grants the facility which the principal requests from the Bank. That is the norm and accepted practice in the business world. If any Bank takes it to mean that it has to first demand from the principal, then file action against the principal and then only the Bank can demand and file action against the guarantor, there will be no bank who would want to grant any facility to any principal on such a guarantee.*

*Law of Guarantees by Geraldine Andrews and Richard Millet 2nd Edition at page 192 reads as follows:*

*"The fact that the obligations of the guarantor arise only when the principal has defaulted in his obligations to the creditor does not mean that the creditor has to demand payment from the principal or from the surety, or give notice to the surety, before the creditor can proceed against the surety."*

*At page 194 it reads as follows: "There is no obligation on the part of the creditor to commence proceedings against the principal, whether criminal or civil, unless there is an express term in the contract requiring him to do so…"*

Similarly, in a mortgage bond there is no condition that the mortgagee must first seek to obtain satisfaction from the debtor before bringing an action against the mortgagor. *Prima facie* the mortgagor's liability is triggered on the default of the debtor.

Even if the creditor were to first bring an action against the principal debtor, the Court by operation of section 46 would be precluded from ordering the sale of any property of the principal debtor for the satisfaction of the debt.

Section 46 clarifies the ambit of its application by specifying that "actions for the recovery of moneys due upon a mortgage" includes any action for the recovery of any debt secured by a mortgage. The intention of the legislature is to limit actions on a mortgage bond to the mortgaged property irrespective of whether the mortgagor is the debtor or a surety/guarantor.

Let me also state that the burden of proof in a hypothecary action is not burdensome. In the Privy Council case of *The Bank of Ceylon, Jaffna v. Chelliahpillai* (1962) 64 NLR 25, Lord Devlin stated at page 28:

> *The distinction between a claim to enforce payment of money due on a mortgage and a claim in a hypothecary action is clearly drawn in section 7 of the Mortgage Act, 1949, notwithstanding that by that section the two claims may be joined. <u>This action in relation to the second and third paragraphs of the prayer is simply a hypothecary action; and to succeed in it the plaintiff need prove only the validity of the bond granting the land as security and the existence of a debt so secured. How the debt was created is for this purpose immaterial</u> and the first bond is not therefore an essential part of the cause of action. It can without being pleaded be produced in evidence to prove the debt.*

Accordingly, to succeed in a hypothecary action, "*the plaintiff need prove only the validity of the bond granting the land as security and the existence of a debt so secured. How the debt was created is for this purpose immaterial*".

Therefore, section 46 of the Mortgage Act must prevail over the principle of *beneficium ordinis seu excussionis* in the event of a conflict as the former is a statute and the latter is a principle in common law. This in essence means that the mortgagors who stand as surety cannot claim the benefit of this principle as section 46 the Mortgage Act allows the creditors to sell the mortgaged property of a surety without first proceeding against the principal debtor.

This may be one of the reasons why Chief Justice S.N. Silva in *Ramachandran and Others v. Hatton National Bank (supra)* at page 399 stated:

> *I have to observe that the [Mortgage] Act itself is a piece of erudition… Although the Act contains several safeguards such as, the registration of a lis pendens, intervention of any party having interest in the land, being necessary in a proceeding that culminates in the sale of property, there are also in-built measures for expedition. If delays resulted in proceedings taken under the Act that may have been due to a failure to understand the provisions correctly and to implement them properly. It is my view that the law itself should not be condemned for these inadequacies.*

The 2nd and 3rd defendants cannot succeed on this argument.

**Senatus consultum velleianum and authentica si qua mulier**

In support of this Latin maxim, learned counsel for the 2nd and 3rd defendants states:

> *Married women were prohibited under Married Women's Property Ordinance from making contracts/securities for others without the concurrence of their husbands under the law of thesawalamai.*

It is the contention of learned counsel for the 2nd and 3rd defendants that the effect of renouncing the benefit of the said maxim was never explained to the 3rd defendant by an Attorney-at-Law although such a clause is incorporated in the Mortgage Bond marked P4.

The 2nd and 3rd defendants have signed the Mortgage Bond at four different places signifying that they understood the contents of the Mortgage Bond. Just after the last place where the 2nd and 3rd defendants signed together with the Notary, but before the attestation clause of the Notary, the following certificate is found as part of the Mortgage Bond.

> *Signed by the abovenamed MANOHARY RAMACHANDRAN in my presence and I hereby declare myself to be the Attorney-at-Law for the said MANOHARY RAMACHANDRAN and that I subscribe my name as such her Attorney-at-Law and that I have before the said MANOHARY RAMACHANDRAN set her hand to These Presents read and explained the contents of the above written instrument the nature and meaning of the benefits of the Senatus Consultum Velleianum and the Authentica Siqua Mulier and the effects of the renunciation thereof by her and that she appeared to understand the same.*
>
> *Sgd*
> *Attorney-at-Law*
> *V. Balasubramaniam*

Manohary Ramachandran is the 3rd defendant. V. Balasubramaniam, Attorney-at-Law, is not the Notary Public who executed the Mortgage Bond P4 but a different Attorney-at-Law.

The execution of the Mortgage Bond P4 was recorded as an admission and therefore it was marked in evidence without any objection. The 3rd defendant did not give evidence. The contents of the Mortgage Bond are admitted facts.

In that backdrop, the last argument is also not entitled to succeed.

**Case of the 4th-23rd defendants**

Despite the agreements between the 2nd and 3rd defendants to sell the apartment units to the 4th-23rd defendants, no deeds of transfer have been executed up to now. There is a special procedure laid down in the Apartment Ownership Law, No. 11 of 1973, as amended, regarding registration of such deeds.

Although these defendants may have a cause of action against the 2nd and 3rd defendants, they do not have a cause of action against the plaintiff bank.

Far from granting reliefs, in my view, they should not have been added as parties to the case (*Weerapperuma v. De Silva* (1958) 61 NLR 481).

The 4th-23rd defendants also state that the 2nd and 3rd defendants have not waived the privilege of *beneficium ordinis seu excussionis* belonging to them in law as guarantors, and that there is a novation of the original loan agreement and therefore the plaintiff is disentitled to enforce the Mortgage Bond given as security for the original loan.

I have already dealt with these two matters.

The appeal of the 4th-23rd defendants must necessarily fail.

**Conclusion**

The judgment of the Commercial High Court of Colombo dated 26.08.2011 is affirmed and the appeals of the 2nd and 3rd defendants, and the 4th-23rd defendants are dismissed.

The attempt by the bank to recover the dues by selling the mortgaged property by *parate* execution in terms of the Recovery of Loans by Banks (Special Provisions) Act, No. 4 of 1990, was unsuccessful due to the majority decision of the Supreme Court in *Ramachandran and Others v. Hatton National Bank (supra)* decided on 15.04.2005.

It is after the said decision, the plaintiff bank filed this hypothecary action on 22.06.2006 to recover the dues to the bank by selling the mortgaged property.

According to the loan agreement marked P3 and the loan ledger marked P8, the loan of Rs. 30 million with interest at the rate of 23% per annum and other levies were disbursed to the 1st defendant on 28.02.2001, which is more than 22 years ago. The plaintiff bank was unable to recover this loan fully up to date despite the loan being secured by a primary mortgage of an immovable property.

The 2nd and 3rd defendant-appellants each shall pay Rs. 1 million to the plaintiff bank as costs of this appeal.

The 4th-23rd defendants seem to be innocent buyers of the units of the apartment complex mortgaged to the plaintiff bank. But they have no cause of action whatsoever against the plaintiff bank.

Judge of the Supreme Court

S. Thurairaja, P.C., J.
I agree.

Judge of the Supreme Court

Yasantha Kodagoda, P.C., J.
I agree.

Judge of the Supreme Court