IN THE SUPREME COURT OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

In the matter of an application for Special Leave to Appeal to Supreme Court under and in terms of Articles 128(2) of the Constitution of 1978 read with the Supreme Court Rules of 1990 against the Order of the Court of Appeal dated 17.09.2010 in C.A. (writ) No. 535/2010.

SC APPEAL No. 150/2010
SC (SPL) LA Appl. No. 188/10
CA (Writ) No. 535/10

DFCC Bank,
No. 73/5, Galle Road, Colombo 03.

1ST RESPONDENT-APPELLANT

-Vs-

Weliwita Don Kusumitha Mudith Perera,
No. 112, Sewagama, Polonnaruwa.

PETITIONER-RESPONDENT

1. Mrs. Induni Karunananda,
   Attorney-at-Law,
   Legal Officer-DFCC Bank,
   No. 73/5, Galle Road,
   Colombo 03.

2. A.N. Fonseka,
   General Manager-DFCC Bank,
   No. 73/5, Galle Road,
   Colombo 03.

3. Sewagama Rice Products (Pvt) Ltd,
   No. 112, Sewagama,
   Polonnaruwa.

RESPONDENT-RESPONDENTS

BEFORE : Hon. Saleem Marsoof, PC., J,
Hon. Sathyaa Hettige, PC., J, and
Hon. Priyasath Dep, PC., J.

COUNSEL : Nigel Hatch, P.C., with P. Abeywickrama and S. Illangage for the Appellant.

David Weeraratne with A.K.Chandrakantha for the Respondents.

ARGUED ON : 2. 2.2012

WRITTEN SUBMISSIONS ON : 25.4.2012 and 30.5.2012

DECIDED ON : 25.3.2014

SALEEM MARSOOF J:

This appeal arises from an order made by the Court of Appeal on 17th September 2010, in the course of a writ application filed in terms of Article 140 of the Constitution in the Court of Appeal by the Petitioner-Respondent, Weliwita Don Kusumitha Muditha Perera (hereinafter sometimes referred to as "Muditha Perera"). By the said order, the said Muditha Perera was granted interim relief as prayed for in prayer (c) to the amended petition filed by him against the 1st Respondent-Appellant, DFCC Bank (hereinafter sometimes referred to as "the DFCC Bank) restraining the DFCC Bank from selling by public auction the property mentioned in Mortgage Bond bearing No. 1811 dated 25th May 2009, attested by A.M.M.Rauf, Notary Public.

It may be mentioned that the said Muditha Perera had cited three more parties as respondents to his amended petition filed in the Court of Appeal, namely, the Legal Officer and Managing-Director of the DFCC Bank, who are the 1st and 2nd Respondent-Respondents to this appeal, and the Sewagama Rice Products (Pvt) Ltd., the present 3rd Respondent-Respondent. Sewagama Rice Products (Pvt) Ltd., of which, the said Muditha Perera and one Weliwita Don Neel Perera, are Directors, admittedly borrowed a sum of Rs. 25,000,000 from the said Bank on the security of the aforesaid mortgage executed by the said Muditha Perera and the said Weliwita Don Neel Perera, who are admittedly co-owners of the property which was so mortgaged.

Pursuant to an application for special leave to appeal being filed in this Court by DFCC Bank, this Court has granted special leave to appeal against the aforesaid order of the Court of Appeal on the following questions of law set out in paragraph 17 (a)-(f) of the amended petition filed by the said Bank:-

a) Did the Court of Appeal err in law by determining that the Appellant was not a "borrower" within the meaning of the Recovery of Loans by Bank (Special Provisions) No.4 of 1990 having regard to the decision of the Supreme Court in *HNB v Jayawardena* (2007) BALJR 50;

b) Is the *ratio* of the decision of the Supreme Court in *HNB v Jayawardena* (2007) BALJR 50 that a Director of a Corporate entity who mortgages his property as security for loans obtained by that corporate entity is a borrower within the meaning of the Recovery of Loans by banks (Special Provisions) No. 4 of 1990;

c) Was the decision of the Supreme Court in *HNB v Jayawardena* (2007) BALJR 50 binding in the Court of Appeal and / or not capable of any distinction in its application to the instant case;

d) Has the Court of Appeal failed to follow the principle of binding precedent and / or *stare decisis*;

e) Has the Court of Appeal misdirected itself in law by determining that the Appellant-Respondent has established a *prima facie* case and was entitled to the interim relief having regard to all the material before the Court of Appeal including the Appellant Bank's oral and written submissions;

f) Has the Court of Appeal erred in law by determining that cogent reasons had been furnished by the Appellant-Respondent for not complying with the principle in *Ukwatte v DFCC Bank* (2004) 1 Sri LR 164.

At the hearing, learned Counsel agreed to confine the argument to the two substantive questions set out above as (a) and (f).

Although I was one of the Judges of the Divisional Bench of this Court that heard and decided *HNB v Jayawardena* (2007) BALJR 50, which is expressly referred to in some of the questions on which special leave was granted, and most notably in question (a) above, learned Counsel also graciously stated at the commencement of the hearing that they had no objections whatsoever to my being a member of the Bench that heard this appeal.

The two main questions for consideration at the hearing were questions (a) and (f), which are both substantive questions of law. I shall now consider these questions in turn.

Is the Appellant a "borrower"?

The question is whether the Appellant Muditha Pererea is a "borrower" within the meaning of the Recovery of Loans by Bank (Special Provisions) Act No.4 of 1990, as subsequently amended, having regard to the decision of the Supreme Court in *Hatton National Bank v Jayawardena* (2007) BALR 50.

To answer this question, it would be necessary to look closely at the material facts of this case, but I consider it useful to first explain very briefly the importance of this question from the perspective of its legislative and legal antecedents.

Prior to the enactment of the Recovery of Loans by Bank (Special Provisions) Act of 1990, any Bank that lent money on the security of a mortgage had to rely on the provisions of the Mortgage Act No. 6 of 1949, as subsequently amended, to obtain a "hypothecary decree" from Court in terms of Section 48(1) of the Act to have the mortgage enforced. S.N.Silva CJ in his erudite majority judgment in *Ramachandran and Others v Hatton National Bank* (2006) 1 Sri L.R. 393 at page 399, described the Mortgage Act as a "piece of erudition", after explaining in his immaculate style how our own Common Law founded on Roman-Dutch law differed both from Roman Law and English law in regard to the ability to sell the secured property without recourse to court at pages 395 to 399 of his judgment, and went on to highlight the features of the Mortgage Act of 1949 and the concept of the "hypothecary action" it introduced. It is not necessary for the purposes of this decision, to repeat his very useful exposition of the law found in those pages.

What is material for this decision is to consider, as a Five Judge Bench of this Court (S.N. Silva CJ., Bandaranayake J., Jayasinghe J., Udalagama J., and Dissanayake J.), did in *Ramachandran's case,* the category of persons against whom the *parate* execution provisions of the Recovery of Loans by Bank (Special Provisions) Act of 1990, will operate. This is because it is only against a person belonging to such a class that the Board of Directors of a Bank may pass a resolution authorising sale by public auction any property mortgaged to the bank by him as security for any loan in respect of which default has been made in order to recover the whole of the unpaid portion of such loan, together with the money and costs recoverable under section 13 of the said Act. In *Ramachandran's case,* the majority of the judges favoured a strict interpretation of the provisions of the Act in keeping with the Rule of Law and the existing legal position, to restrict the said class to those who had borrowed money by mortgaging property owned by them to exclude from this category mere "guarantors" who were not party to the loan agreement with the Bank. However, Shirani

Bandaranayake J. (as she then was), in her dissent, favoured a broader interpretation to include "third party mortgagors" who were not party to the loan provided by the Bank.

It is also important to understand the legal reasoning on the basis on which this Court arrived at its majority decision, as that decision is binding on the Bench before which this appeal was argued. S.N. Silva CJ in *Ramachandran's case,* sought to identify the category of persons against whom *parate* execution was intended to be provided by the Act as follows at page 404 of his judgment :-

> "The submissions of Counsel for the Petitioner [in *Ramachandran's* case], is that the class of persons is clearly identified in the provisions of the Act commencing from Section 2 itself. Section 2(1)(a) requires 'every person to whom any loan is granted by a Bank on the mortgage of property' to register with the Bank the address to which a notice to him may be sent. I am inclined to agree with this submission since a Resolution of the Board to sell by Public Auction, as empowered by Section 4, has to be dispatched to this address in terms of Section 8. Similarly, the notice of sale in terms of Section 9 should be dispatched to that address.
>
> *There is a clear link in the provisions between the taking of a loan and the mortgage. The law will apply where a mortgage is given by the person to whom the loan is granted. In Sections 7, 14, 15, 16 and 17 this person is identified as the 'borrower'. The borrower is none other than the person to whom a loan is granted and who is required in terms of Section 2 to register his address with the Bank.* In terms of Section 14 where the mortgaged property is sold and an amount in excess of what is due to the Bank is recovered, such amount has to be paid by the Bank to the borrower. This clearly established that it is only the property mortgaged by a borrower that could be sold by a Bank to recover a loan granted to him. If the provisions are extended by a process of interpretation to cover a mortgage given by a guarantor, Section 14 will bring about a preposterous result in which the guarantor's property is sold and the excess recovered is paid by the Bank to the borrower. It is when confronted with their unanswerable contention, that the Counsel for the Banks submitted that the term borrower should be interpreted to include any debtor and that where a loan is in default the guarantor would be a debtor. *The words 'borrower', 'guarantor' and 'debtor' have specific significance attaching to them in legal proceedings. These distinctions cannot be removed and the application of the special provisions law extended to encompass guarantors in view of the serious implications of its provisions as revealed in the preceding analysis*." (*Emphasis added*)

It is the submission of the learned Counsel for Muditha Perera, who claims to be a "third party mortgagor" against whom the provisions of the Recovery of loans by Banks (Special Provisions) Act would not operate, that the majority decision in *Ramachandran's* case is applicable to the facts and circumstances of his case, while learned President's Counsel for the DFCC Bank submits that the decision of this Court in *Hatton National Bank v Jayawardena* (2007) BALJR 50 is applicable. In the latter case, this Court (Jayasinghe J., Thilakawardane and Marsoof J.), considered the special circumstances of that case appropriate to lift the veil of incorporation of Nalin Enterprises (Pvt) Ltd., which was the corporate body that had obtained the loan from the Bank in question, to ascertain whether the two guarantors who were Directors of the said company constituted the *alter ego* that would indirectly benefit from the non-payment of the loan.

In the impugned decision of the Court of Appeal, that court (Rohini Marasinghe J.) considered both decisions in the context of an application for interim relief to restrain the holding of an auction to sell by public auction, the immovable property of the Petitioners-Respondents. Having done so, her Ladyship went on to analyse the factual position in the light of the applicable law, and observed as follows:-

> "The 1st Respondent Bank had called upon the Company and the mortgagor to enter into the Mortgage Bond to grant security. Accordingly, the Petitioner [Muditha Perera] has mortgaged the immovable property mentioned in the relevant Bond as security for the repayment of the loan. *It is a clause in the Bond that the Company should not utilize any portion of its funds in the loan to the benefits of its shareholders. According to the attestation clause the Bank as the obiligee has agreed to pay the sum in the loan to the 4th Respondent Company [Sewagama Rice Products (Pvt) Ltd.] as the obligor. The Petitioner stated the legal person who borrowed the money is the 4th Respondent Company.* It was the Petitioners position that the Divisional Bench of the Supreme Court that interpreted the Act No. 4 of 1990 in *Ramachnadra and Ananda Siva v Hatton National Bank* 2006 1 SLR 393 had clearly ruled that the Bank can levy *parate* execution of immovable property in a mortgage Bond *only if the property belonged to the borrower and thus as the petitioner is not the borrower*, the resolution passed to sell the mortgage property in Bond No. 1811 is illegal and is of no force and avail in Law."

The Court of Appeal went on to make the following pertinent observation, in regard to the submissions made by learned Counsel:-

> The English Courts have upheld the principle in *Solomn v Solomn & Company* 1897 AC 22, to mean that the rights and liabilities of Directors are different to those of the shareholders. The position of the Petitioner was that the Bond No. 1811 clearly shows the borrower was the 4th Respondent Company, and the Petitioner was Guarantor. Nowhere does the English Law inclusive of Company Law deems a Managing Director of a Company as a borrower of a loan solicited and granted to the Company by a Bank or a person, although the Managing Director had given a security by way of mortgage binding himself jointly and severally with the Company. The Petitioner urged that in the subsequent case of *HNB v Jayawardene 2007 1 SLR 181* is either *obiter* or could be distinguished *and cannot be accepted as a general proposition of Law which makes a Managing Director who had given a mortgage of immovable property as a surety is considered a borrower of the Company*. He also relied on the English cases cited in the Judgment which he explained in his submissions. He also stated that in the Case of *HNB v Jayawardane*, Justice Jayasinghe had said that the Directors in that case had been borrowers in fact with Nalin Enterprises and had benefited with the Loan facility. Thus as the judgment does not reveal the relevant mortgage documents in the case, the decision could be correct if the loan mentioned in the Bond of the case had been solicited both by the Company and Directors and had been granted to both without any restriction on them to use the money in the loan.

It is in these circumstances, that the Court of Appeal concluded that Muditha Perera had established a *prima facie* case and that he is not the borrower within the principle of *Ramachandran's* case, and that *Jayawardane's* case can be distinguished. The Court of Appeal accordingly granted interim relief restraining the conduct of the auction of the mortgaged property, on the following basis:-

> If the Bank's Resolution to sell the property in bond No. 1811 is outside the jurisdiction granted to a Bank under Act No. 4 of 1990 all subsequent steps will be of no avail in law and therefore are null and void. I am satisfied that the Petitioner has established a *prima facie* case and I am of the opinion that irreparable loss and damage would be caused to the Petitioner if an interim order is not granted to stop the auction at least till the next date. This order is made inter partes with the Learned President's Counsel for 1, 2 and 3 Respondents making lengthy submissions on law and facts. I make this order especially because the points of Law raised by petitioner are of very substantial importance.

I am in agreement with the submission of the learned Counsel for Muditha Perera that in all the circumstances of this case, as would appear from the various passages of the order of the Court of Appeal I have chosen to quote in this judgment, there is no basis to apply the obviously narrow principle laid down in *Hatton National Bank v Jayawardane*. As has been observed by Gower and Davies, *Principles of Modern Company Law*, (Eighth Edition 2008), pages 208-209,

> The doctrine of lifting the veil plays a small role in British company law, once one moves outside the area of particular contracts or statutes. Even where the case for applying the doctrine may seem strong, as in the undercapitalised one-person company, which may or may not be part of a larger corporate group, the courts are unlikely to do so. As Staughton L.J. remarked in *Atlas Maritime Co SA v Avalon Maritime Ltd.* The Coral Rose [1991] 4 All ER 769 at 779, "The creation or purchase of a subsidiary company with minimal liability, which will operate with the parent's funds and on the parent's directions but not expose the parent to liability, may not seem to some the most honest way of trading. But it is extremely common in the international shipping industry and perhaps elsewhere. To hold that it creates an agency relationship between the subsidiary and the parent would be revolutionary doctrine."

I accordingly answer substantive question (a) above in the negative, and hold that**,** in all the circumstances of this case, the Court of Appeal did not err in law by determining on a *prima facie* basis, for the purposes of considering interim relief, that the Appellant was not a "borrower" within the meaning of the Recovery of Loans by Banks (Special Provisions) No.4 of 1990 having regard to the decision of the Supreme Court in both *Ramachandran and Others v Hatton National Bank* and *HNB v Jayawardena.*

Are the Members of the Board of Directors Essential Parties?

I now have to consider substantive question (f) on the basis of which leave to appeal was granted by this Court against the impugned order of the Court of Appeal, which is whether the said court erred in law by determining that cogent reasons had been furnished by Muditha Perera for not complying with the principle in *Ukwatte v DFCC Bank* (2004) 1 Sri LR 164.

It is convenient to first refer to the approach of the Court of Appeal to this question, which is revealed by the following passage in its order:-

> "Counsel for the Respondent raised a legal objection citing the case of *Ukwatte v DFCC Bank* 2004 (1) Sri LR 164, to the effect that the Petitioner [Muditha Perera] is not entitled to a writ of *certiorari* because the writ must be prayed against the Board of Directors. Although on the face of it, it is a valid legal objection, the Petitioner has given sufficient reasons in the petition as to why he did not make the members of the Board

Respondents to this application. In paragraph 31 supported by the affidavit he states that he had requested the Branch Manager of the 1st Respondent Bank at Polonnaruwa, for a true copy of the Resolution passed by the Bank and the Petitioner had been informed that no such Resolution had been passed prior to the date of P13. The Petitioner had then gone to the head office of the 01st Respondent to ask for the copy and thereafter he had sent the letter P15 through his Attorney-at-Law requesting the names of the Board stating that information is necessary for him to file legal action. The Petitioner stated the information was not given and the Counsel for the 1, 2, 3rd Respondents [DFCC Bank and its officers] stated that they are not bound to give the information requested. Thus when information is exclusively within the knowledge of 1st Respondent and it is not provided by the 1st Respondent Bank when requested, I am of the view that the Petitioner can file an application for writ of certiorari citing the 01st Respondent only and obtain the relief as the Board of Directors are only expressing the decision of the 1st Respondent."

I am of the view that the Court of Appeal need not have gone that far, since though the Board of Directors is the most important decision making body of the company, as Gower and Davies, *Principles of Modern Company Law*, (Eighth Edition 2008), page 366 notes, "it would be difficult to glean any similar understanding of the importance of the board from a reading of the Companies Act." This is because the determination of the role of the Board of Directors within the company to the company's constitution, which is, of course under the control of the shareholders. The fact still remains that by and large, the Board of Directors is the most dynamic organ of a modern company.

In any event, in the context of the Recovery of Loans by Banks (Special Provisions) No.4 of 1990, it is obvious that the loan that is sought to be recovered under its provisions should have been granted or advanced by the Bank, and not its Board of Directors, and section 22 of the Act defines a "Bank" primarily as a "licensed commercial bank within the meaning of the Banking Act, No. 30 of 1988" and further defines a "Board" in relation to a Bank as a "the Board of Directors of the bank or any body of persons by whatever name or designation called for the time being charged with the management or administration of such bank". Although it is envisaged by the Act that a decision to proceed by way of *parate* execution for the recovery of the loan has to be taken by the Board of Directors, it is clear that the proceeds of any auction sale pursuant to the *parate* execution would come into the coffers of the Bank, and that as provided in section 14 of the said Act, when the said proceeds exceed the value of the loan and other dues, it is the bank that is bound "after deducting from the proceeds of the sale the amount due on the mortgage and the moneys and costs recoverable under section 13, pay the balance remaining, if any either to the borrower or any person legally entitled to accept the payment due to the borrowers or where the Board is in doubt as to whom the money should be paid into the District Court of the district in which the mortgage property is situate."

In my opinion, it is the Bank that stands to gain when it exercises the right of *parate* execution, and the Board of Directors is simply its managing body that takes decisions primarily for the benefit of its shareholders. It is clear from the decision of the House of Lords in *Salomon v A. Salomon and Co. Ltd.* (1897) AC 22 that the company has a personality distinct from its shareholders and board of directors, and the same principle applies to Banking companies. I am therefore of the opinion that the decision of the Court of Appeal in *Ukwatte v DFCC Bank* 2004 (1) Sri LR 164, in which interim relief prayed for in that case was refused on the basis that the members of the Board of Directors of the Bank that passed the resolutions sought to be quashed by *certiorari,* were not cited as respondents to the writ application, is irreconcilable with the principle

enunciated by the House of Lords in *Salomon v A. Salomon and Co. Ltd*., which has been consistently and universally followed.

In any event, unlike in the *Ukwatte* decision, the relief prayed for from the Court of Appeal in prayers (b) and (c) were sought against the 1st Respondent-Appellant DFCC Bank, and not against its Board of Directors. By prayer (b) the relief sought was a mandate in the nature of writ of *certiorari* on DFCC Bank quashing the decision contained in the document P13, which is the impugned resolution of the Board of Directors of the said Bank, and the relief sought by prayer (c) was interim relief restraining the DFCC Bank from selling by public auction the property mentioned in the Mortgage Bond No. 1811 until the final determination of the application filed in the Court of Appeal.

I therefore have no hesitation in answering substantive question (f) also in the negative, and against the Appellant. I hold that the Court of Appeal did not err in law in determining that cogent reasons had been furnished by Muditha Perera for not complying with the principle in *Ukwatte Vs. DFCC Bank* (2004) 1 Sri LR 164.

Conclusions

For the foregoing reasons, I uphold order of the Court of Appeal dated 17th September 2010, and dismiss the appeal. I also remit the case to the Court of Appeal for it to expeditiously conclude this case, and direct that the order made by the Court of Appeal on 17th September 2010 restraining the DFCC Bank from selling by public auction the property mentioned in the Mortgage Bond No. 1811 shall continue until the final determination of the application filed in the Court of Appeal, unless the Court of Appeal for good reasons considers otherwise.

In all the circumstances of this case, I do not make any order as to costs.

JUDGE OF THE SUPREME COURT

Sathyaa Hettige, PC., J,

I agree.

JUDGE OF THE SUPREME COURT

Priyasath Dep, PC., J

I agree.

JUDGE OF THE SUPREME COURT