

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

In the matter of an application under Article
140 of the Constitution for Mandates in the
nature of Writs of Certiorari and
Prohibition.

Nestle Lanka PLC

440, T.B. Jaya Mawatha

Colombo-10

Petitioner

CA (Writ) No. 846/08

Vs.

1. The Director General of Customs
Customs House
Colombo-01.
2. K. Ranjan
Deputy Director General of Customs
Customs House
Colombo-01.

Respondents.

BEFORE: Hon. Sathya Hettige P.C. J, President of the Court of Appeal
Hon. Anil Goonaratne J, Judge of the Court of Appeal

COUNSEL: Sanjeewa Jayawardane with Suren de Silva
for the petitioner.
A.Gnanathanan ASG with Nuwan Peiris
for Respondents.

ARGUED ON: 10/02/2010 & 14/07/2010

Written submissions on : 15/11/2010

DECIDED ON: 10//05/2011

SATHYA HETTIGE P.C, J (P/CA)

When this application was taken up for hearing on 10/02/2010 both the counsel , after a brief oral submissions , informed court that the matter could be disposed of on written submissions as the issue involved in this application is an issue of law.

The petitioner is a limited liability company duly incorporated under the laws of Sri Lanka known as Nestles Lanka (Pvt) Limited and engaged in the business of manufacturing, importing, packing, processing , distributing and dealing in food items , beverages and other goods under the internationally renowned marks and or brand names "Nespray",

“Lactogen”, “Nestomalt”, “Nescafe”, “Maggi”, “Milo” and “Kitkat”, as referred to in para 1 of the petition.

The petitioner states that Nestle SA of Switzerland owns 90.82% of the issued stated capital of the petitioner company and is the beneficial owner of Intellectual Property of the Nestle Group and the registered legal owner of the Trade Marks “Nestles”, Nescafe”, “Milo” and “Nestomalt” through its international network. The said Nestles SA SPN and Nestec SA have entered into General License Agreements with its subsidiaries in various parts of the world to proceed with its business.

A copy of the such General License Agreement dated 1st January 2006 entered into with the petitioner is annexed marked P4 to the petition and under the said agreement the petitioner has the exclusive license to use the Nestles trade mark. The petitioner purchases various Nestles branded products from Nestles companies abroad (sellers)

Petitioner states that there is no license fee or Royalties paid to the seller whatsoever on any such sales. The license fees and Royalties if any, are paid only on subsequent sales to a third party (a distinct and independent third party customer or retailer) if effected after the goods have arrived in Sri Lanka.

Petitioner’s case is that once the said seller namely the Nestles companies abroad, sells the products to the petitioner there is no further contractual relationship between the petitioner and seller abroad. And therefore the petitioner does not pay any royalties and there is no such condition or requirement in the sales transaction with the seller abroad. The petition shows that the seller of the Nestles products is not a party to the General License Agreement (GLA) marked P4. Royalties or license fees are not paid by the petitioner as a buyer either directly or indirectly as a condition of sale of goods to the petitioner.

And as such the petitioner states that the petitioner is not obliged to pay custom duty on the royalties in terms of the Article 1 read with Article 8

(1) © of schedule "E" of the Customs Ordinance as amended by the Act No 02 of 2003.

The petitioner in this application complains that despite the correct and legal position , on 17th January 2006 the petitioner received a letter from Customs Department informing the petitioner that the petitioner has not paid the customs duty and other levies on the Royalty/ license fees paid by Nestles Lanka Ltd. under the Article 8 (1) © of Schedule E of the Customs Ordinance as amended by Act 02 of 2003.

A copy of the said letter dated 17.01.2006 is annexed to the petition marked P 6.

In this application the petitioner is seeking a Writ of Certiorari to quash the said decision of the respondents manifest in the letter marked P 18 pronouncing that the Customs Duty is payable on the royalties /license fees paid by the petitioner to the licensor in terms of GLA marked P 4 in respect of the sales made by the petitioner to unrelated third parties in Sri Lanka on the basis that that the principles of natural Justice have been violated and a breach of a duty to give reasoned order . And that the decision of the respondents offends the principles of fairness, reasonableness and proportionality undermining the petitioner's legitimate expectation. The petitioner also complains that the said decision is taken by the Customs mala fide and taken without any regard or recourse to law . In the circumstances the petitioner is seeking intervention of this court to grant relief to the petitioner to redress the grievance.

In terms of the General Licensing Agreement marked P 4 the Licensor has granted the petitioner , as the Licensee, the exclusive right and license to use the Trademarks set out in the Schedule to the GLA, in Sri Lanka.

Clause 32 of the GLA (P4) which is the relevant clause , provides for the payment of License fees to the licensor.

“ in consideration of the Trademarks , Patents and Know-how licenses granted or to be granted hereunder by Licensor, the licensee shall pay to the Licensor during the term of this Agreement , license feeson the net sales of all existing and future products sold by the licensee under any of the Trademarks .

Provided that no license fees shall be due on sales made to any affiliates of the licensee.

Net sales is defined as licensee’s sales of products to unrelated parties.

The petitioner contends that therefore the license fee is paid to the Licensor . The petitioner purchases Nestles branded products from various companies abroad . And as such there is no license fee or royalty paid to the seller, whatsoever, on any of the sales. As there is no payment of license fees to the overseas seller on the import transaction the question of addition of the license fee to the transaction cost does not arise in law. It was argued by the petitioner’s counsel that the overseas seller sells the products to the petitioner and there is no condition of sale with regard to any license fee. The royalties / license fees are not paid by the petitioner as a buyer either directly or indirectly as a condition of sale of the goods to the petitioner.

The respondents submit that the petitioner has submitted a false declaration (VDF) to the Customs in violation of section 51 and 52 of the Customs Ordinance . In that the petitioner has failed to declare the Royalty payment which is a part of Customs value in the Value Declaration Form.

It is important to consider the provisions contained in Clause © in Article 8 .1 of Schedule “E” of the Customs Ordinance as amended by Customs (Amendment) Act No 2 of 2003 which provides as follows:

“ Royalties & License fee related the goods which the buyer must pay either directly or indirectly as a condition of sale of the goods being valued to the extent that such royalties and fees are not included in the price actually paid or payable.”.

It was contended by the respondents in terms of the above clause that the payment of Royalty and license fees should be included in the price actually paid or payable.

Article 8.1 © Schedule E does not specify to whom the payment of license fee should be made. Instead it provides that the buyer must pay directly or indirectly as a condition of sale.

The elements of Article 8.1 © can be described as

- A) Royalties and license fees
- B) Related to the goods being valued
- C) Buyer must pay either directly or indirectly
- D) As a condition of sale of the goods being valued
- E) To the extent that such royalties and fees are not included in the price actually paid or payable.

Is the interpretation given by the petitioner to Article 8.1 © of Schedule "E" correct or incorrect?

Learned counsel for the petitioner strongly submitted and stated in the detailed written submissions that the royalties and license fees **should not be included** in the price actually paid or payable.

Article 8.1 © of Schedule "E" specifically and clearly provides that whatever royalties and license fees are paid and not included should be added to the price actually paid and payable.

However, the petitioner's position is that there is no obligation or requirement of law to add such royalties / license fees to the price actually paid or payable in determining the value of the goods in terms of Article 1 of Schedule E. Mr. Jayawardane submitted that there was no inquiry whatsoever conducted by the Customs to ascertain the correct value of the goods in terms of section 51 A (2) of the Customs Ordinance. In terms of the provisions in section 51A (2) if the Customs Officers are not satisfied with particulars in the Bill of Entry or if there is an under-valuation

/ misdescription the Customs is legally obliged to follow the procedure set out in the above section.

Section 51 A (2) reads as follows.

“ If an officer of Customs is satisfied as a result of an examination or investigation , or an audit carried out under section 128 A at any time prior to or after the clearance of the goods that the value declared by the importer or his agent under an Article of Schedule “E” under which value was initially accepted is not appropriate the officer of Customs may amend the value in accordance with appropriate Article of Schedule ‘E’.”

Under the above provisions the procedure set out in section 51 A of the Customs Ordinance has to be followed by the customs officers. Section 51A requires the importer or his agent or any other party connected with the importation of goods to furnish such other information including documentary or other evidence in proof of the fact the declared customs value represents the total amount actually paid or is payable for the imported goods

Section 51A (2) reads “ After receipt of further information or in the absence of any response , if the officer of customs still has reasonable doubt as to the truth or accuracy of the declared customs value it shall be deemed that the customs value of the imported goods in question cannot be determined under the provisions of Article 1 of Schedule “E” and the importer if so requests shall be informed by the officer in writing of the grounds for such doubt and be afforded an opportunity to be heard”

Thereafter the customs officer must proceed to determine the customs value in accordance with the other provisions of Schedule E and **amend the value in the CUSDEC as appropriate .**

There is also provision that if an importer who is dissatisfied with a decision of the Customs officer under section 51 A may within 10 days of the notice

of the decision has a right of appeal to the Director General of Customs. The complaint of the petitioner is that the respondents have failed to act in terms of the above provisions which are mandatory and never held any inquiry to ascertain the correct value of the goods. This, petitioner says, is a procedural illegality.

In the case of **Fonterra Brands Lanka (private) Ltd v Director General of Customs CA 801 of 2007** it was held

“ The provisions of the Customs (Amendment) act no 2 of 2003 should be understood and worked in such a way so as to avoid friction and without causing hardship to the importers”.

It must be stated that if the statute has laid down and required the customs officers to follow certain procedure in a particular manner that procedure must be followed. The petitioner complains the respondents up to date have failed to inform the petitioner as to what is the exact value of the goods. In terms of the provisions in Customs (amendment) Act No 2 of 2003 the customs officer is under a legal duty to inform the basis of the determination. Without such determination being informed the importer is unable to exercise the right of appeal to the Director General of customs if he is not satisfied with the decision. The failure on the part of the customs officers to give reasons for their decisions amounts to breach of principles of natural justice. It is the duty of the customs officers to take a decision in terms of section 51A of Act no. 2 of 2003 in accordance with principles of natural justice.

The respondents also have contended that the under valuation or failure to state the correct value in the Bill of Entry is a fraud on the part of the petitioner or suspected fraud is established. It appears that the allegation of fraud against the petitioner has not been established. There is no affidavit filed before this court in proof of fraud. There is no material or evidence placed before the court that any investigation had been conducted in to such allegation. Therefore I reject that argument of the respondents that there is suspected fraud on the part of the petitioner. In any event

failure to state the correct value of the goods or any under-invoicing declared in the CUSDEC does not amount to a fraud or false declaration without proof being adduced.

I have carefully considered the CUSDECS annexed and marked P17A(i) – P 17A(xxiii) submitted by the petitioner answering cage 16 (e) of the CUSDEC wherein it is stated that “ **yes, however, the Royalty/License fees are not paid in accordance with Article 8(1) and 8(2) of Schedule E.**

Didn't the Customs accept and admit the said CUSDECS and the fact the Royalties/ License fees are not paid in accordance with Article 8(1) (c) of Schedule E as contended by the petitioner. If so there is no obligation or requirement to include such Royalties/ license fees to the price of goods actually paid or payable in terms of Article (1) Schedule E.

In the case of Toyota Lanka (Pvt) Ltd. V Director General of Customs SC Appeal No. 49/2008 (CA No. 2118/2005) at page 11 of the judgment

It was held that “ ..These mandatory consequences of forfeiture that the penal in nature demonstrate that the words “ but if such goods shall not agree with the particulars in the bill of entry” apply to a situation of concealment and evasion to pay duties as distinct from a situation of misdescription and underpayment of duties. In the latter situation the proper course would be to require the person to pay the “duties and dues which may be payable” being the statutory obligation of the importer in terms of section 47 or in the event of a short levy to recover the amount due in terms of section 18(2) and (3) or 18 A”

At page 14 of the judgment it was held that,

It was held that " I am further of the view and hold that the forfeiture provided for in section 47 would not apply to a situation of a disputed classification of goods or an underpayment or short levy of duties or dues. In such event the proper course would be a requirement for payment of the amount due prior to delivery of goods or the recovery of the amounts due in terms of section 18 .."

In that case court also held that " There is no provision for a forfeiture of goods by operation of law in the event of an alleged undervaluation."

I observe that there is no evidence of any evasion of payment of duty or concealment on the part of the petitioner and therefore I come to conclusion that the customs officers have failed to follow the law in taking steps to ascertain the exact value and recover any additional duties.

AS such it was contended by the learned counsel for the petitioner that in order for the royalty payments to be subject to customs duty in terms of Article 8 (1) (c) of Schedule E of the Law, the royalty payment must be paid directly or indirectly as a condition of sale between the seller and the buyer. It must be noted that there is no allegation of smuggling of goods with stealth nor evasion of the payment of duties since the duties have been already paid by the petitioner. No inquiry has been held as to any suspected fraud on the part of the petitioner. I agree with the submissions of the learned counsel for the petitioner on that issue.

Did the customs officer have any doubt about the details stated in the declaration at the time of examination of the CUSDEC initially before

releasing the goods. It appears that the petitioner could not exercise his rights given in the statute since the customs officer failed to follow the procedural steps contained in section 51A of the Law.

In the circumstances it seems to me that the impugned order marked P 18 does not contain the precise value or and an amendment of the CUSDEC and therefore the order marked P 18 is bad in law.

Now I will deal with the written submission of the learned Additional Solicitor General filed by way of motion dated 15th June 2010 wherein the respondents drew the attention of court to a similar issue (advisory opinion) that has been determined by the Technical Committee of the World Customs Organization.

It is the contention of the petitioner that the facts in this application are distinct and different from the facts that were reviewed by the Technical Committee of WCO. In that the royalty payment involved in the example that was considered "I" was under obligation to pay to obtain the right to use the trade mark which was affixed to the sportswear. I observe therein that there was a condition of sale between the seller and the buyer "I". It is my view that the advisory opinion that was discussed in that example has no relevance to the issues to be determined before this court.

In the circumstances I am of the view that the petitioner's application for a writ as sought should be granted.

Accordingly the court issues a Writ of Certiorari and quash the order and or the determination marked P 18 as per paragraphs "C", "D" and "h" of the prayer and a Writ of Prohibition on the 1st and 2nd respondents as per

paragraphs "e" and "f" of the prayer of the petition. However, the judgment of this court will not affect the rights of the respondents to recover any additional customs duties from the petitioner after due inquiry in accordance with the law.

I order no costs.

PRESIDENT OF THE COURT OF APPEAL

Anil Goonaratne J,

I agree.

JUDGE OF THE COURT OF APPEAL.