

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

In the matter of Dimo International Limited of 65,
Etiwanda Road, Colombo-14.

In the matter of an application for winding up by
Court under Part IX of the Companies Act, No. 17 of
1982.

C.A. L.A. Case No.33/2004 with
L.A. 265/2002

D.C. Colombo Case No.5153/SPL

Lanka Polymers (Pvt) Limited

PETITIONER

AND

National Development Bank of Sri Lanka

CREDITOR-PETITIONER

Lanka Polymers (Pvt) Limited

PETITIONER-RESPONDENT

1. Ranjeevan Seevaratnam
2. Anthony Nimal Fernando
3. Saravanapavan Srikananathan
4. Mohamed Riyaz Mihular

Some of the Partners of Ford Rhodes Thornton &
Company

LIQUIDATORS

AND NOW

Manik Joseph Cecil Santhiapillai

SUPPORTING-CREDITOR-PETITIONER

-Vs-

National Development Bank of Sri Lanka

CREDITOR-PETITIONER-RESPONDENT

Lanka Polymers (Pvt) Limited

PETITIONER-RESPONDENT-RESPONDENT

1. Ranjeevan Seevaratnam
2. Anthony Nimal Fernando
3. Saravanapavan Srikananathan
4. Mohamed Riyaz Mihular

Some of the Partners of Ford Rhodes Thornton &
Company

LIQUIDATORS-RESPONDENTS

1. Hongkong and Shanghai Banking Corporation
Limited
2. C.H. Clauss
3. Fibre World (Pvt) Limited
4. Board of Investment of Sri Lanka
5. Abans Environmental Services (Pvt) Ltd
6. Sampath Bank Limited
7. I.G.V.K. Ganegama
8. Employees' Trust Fund Board
9. Upali Ponnampereuma

SUPPORTING-CREDITORS-RESPONDENTS

AND NOW

In the matter of an Application for Leave to Appeal
in terms of Section 754 read together with Section
757 of the Civil Procedure Code.

Manik Joseph Cecil Santhiapillai

No. 01, Pedris Road,

Colombo 03.

SUPPORTING-CREDITOR-PETITIONER-
PETITIONER

-Vs-

National Development Bank of Sri Lanka

No.40, Nawam Mawatha,

Colombo 02.

CREDITOR-PETITIONER-RESPONDENT-
RESPONDENT

Lanka Polymers (Pvt) Limited

No.246, Negombo Road,

Wattala.

PETITIONER-RESPONDENT-RESPONDENT-
RESPONDENT

1. Ranjeevan Seevaratnam
2. Anthony Nimal Fernando
3. Saravanapavan Srikananathan
4. Mohamed Riyaz Mihular,

Some of the Partners of Ford Rhodes Thornton & Company,

No. 32A, Sir Mohamed Macan Markar Mawatha,
Colombo 03.

LIQUIDATOR-RESPONDENT-RESPONDENTS

1. Hongkong and Shanghai Banking Corporation Limited,

No.24, Sir Baron Jayatilaka Mawatha,
Colombo 01.

2. C.H. Clauss,

No.762, Yatihena,
Malwana.

3. Fibre World (Pvt) Limited,

Lot 10, Block B, B.E.P.Z.
Malwana, Biyagama.

4. Board of Investment of Sri Lanka,

17th Floor, West Tower,
World Trade Centre, Echelon Square,
Colombo 01.

5. Abans Environmental Services (Pvt) Ltd.,

No.141, Kirula Road,
Colombo 05.

6. Sampath Bank Limited,

No.55, D.R. Wijewardena Mawatha,
Colombo 10.

7. I.G.V.K. Ganegama,

Proprietor,
Sarana Auto Seat Manufacturers,

Sarana Cushion Works and Sarana Seat Accessories Shop,

No.20/2,1st Lane,

Kandy Road, Wedamulla,

Kelaniya.

8. Employees' Trust Fund Board,

Legal & Employer Division,

No.122, Nawala Road,

Narahenpita,

Colombo 05.

9. Upali Ponnampereuma, Attorney-at-Law

on behalf of 60 employees of Dima International Limited,

No. 34/1/35, Lawyers Office Complex,

St. Sebastian Hill,

Colombo 12.

SUPPORTING-CREDITOR-RESPONDENT-RESPONDENTS

BEFORE : A.H.M.D. Nawaz, J.

COUNSEL : K. Kang-Isvaran, P.C. with N.R. Sivendran, K. Pirabakaran, Shivan Kang-Isvaran and Lakshman Jayakumar for the Supporting-Creditor-Petitioner-Petitioner

Romesh de Silva, P.C. with Geethaka Goonewardene for the Creditor-Respondent

M.A. Sumanthiran, PC with Ermeza Tegal for the Petitioner-Respondent-Respondent

Shehara Karunaratne for the Liquidator-Respondent-Respondents

A.H.M.D. Nawaz, J.

The question that arises in these proceedings is whether the National Development Bank (hereinafter sometimes referred to as "the NDB") surrendered its security, which had been granted to it by the Company that was wound up namely Nimo International Limited (hereinafter sometimes referred to as "the NIMO"). By way of two mortgage bonds bearing Nos.27 and 28, the NIMO had mortgaged their property to the National Development Bank on 10.11.1995 and it is not disputed that the secured property was sold by the liquidator consequent to an order made by the winding up Court.

The facts immanent in the case are also germane to the principal arguments advanced before this Court and the pith and substance of the respective arguments for the contending parties can be extracted in a nutshell. The learned President's Counsel for the NDB contended that the NDB as a secured creditor was *ipso facto* entitled to be paid by the Liquidator, prior to and in preference of the persons mentioned in Section 347 of the Companies Act No.17 of 1982-the Act that governs the insolvency proceedings in question.

Mr. Romesh de Silva, President's Counsel for the NDB argued that the amount claimed by the NDB as secured are monies arising out of the sale of properties mortgaged to the NDB by the Company and that such monies cannot form part of the pool constituting the monies realized by the Liquidator on the sale of the Company's assets upon the direction of Court and should therefore be paid to NDB, prior to and in preference to all other creditors who have made claims.

Mr. Kanag-Isvaran, the learned President's Counsel submitted on behalf of the Supporting-Creditor-Petitioner-Petitioner (Manik Joseph Cecil Santhiapillai) that once the mortgaged properties were sold by the liquidators, pursuant to an order of the winding up Court dated 24th March 1999, all the proceeds of the sale would form the pool of the assets of the Company as realized by the Liquidator and should be available for

distribution to the Creditors of the Company under and in terms of Section 347 of the Companies Act No.17 of 1982 as ordered by Court.

The nub of the argument of the learned President's Counsel was that by virtue of the fact that the NDB had already surrendered its rights as a secured creditor, it cannot now be heard to argue otherwise. In other words by having participated at the winding up proceedings, the NDB had relinquished its rights as a secured creditor and it should be treated as one of those in the queue of unsecured creditors. This forceful argument emanates from insolvency law and it is this principle that should be applied in regard to the claims of the NDB-so strongly contended the learned President's Counsel for the Supporting-Creditor-Petitioner-Petitioner. So extracted in another way, the issue before this Court crystallizes thus: Was the NDB then a secured creditor who voluntarily surrendered its security and was proving for the whole debt as if it was unsecured?

In both the written submissions of the Supporting-Creditor-Petitioner-Petitioner and oral submissions of the Supporting-Creditor-Petitioner-Petitioner (Manik Joseph Cecil Santhiapillai) as well as those of the Creditor-Petitioner-Respondent-Respondent (National Development Bank of Sri Lanka or the "NDB") that were made before this Court, the following facts material to the resolution of the quintessential issue I have highlighted above emerged.

In order to complete the narrative let me therefore set out the chronology of events over which parties are not at variance.

Chronology of Events

By a Petition dated 30th June 1998 Lanka Polymers (Pvt) Limited (the original Petitioner in the District Court-'Lanka Polymer') sought an order to wind up DIMO International Limited (DIMO) under the Companies Act No. 17 of 1982 on the ground that DIMO was unable to pay its debts and it was just and equitable that the winding-up be allowed-*vide* Vol.I Page 42 of the Brief.

The learned District Judge at the time made Order on 10th July 1998 appointing Messrs. Ford Rhodes and Thornton as Provisional Liquidator and directed that the Provisional

Liquidator report to Court on the moveable and immoveable properties of the Company and also directed that the Provisional Liquidators must protect and take care of the properties of the Company-*vide* Vol.II page 561 of the Brief (English Translation at Vol.II page 596 (a) of the Brief). Thus the assets of the Company, thereby passed into the custody and possession of the Provisional Liquidator. In fact Section 271 of the Companies Act No. 17 of 1982 provides that at any time after the presentation of the winding-up petition and before the making of the winding-up order, a provisional liquidator (who may be the official receiver) may be appointed by court which may also restrict his powers.

In *Re Silver Valley Mines* (1882) 21 Ch D 381 Cotton LJ described the position of liquidator thus:-

".....He is not in the ordinary sense a trustee. He is a person appointed by the Court to do a certain class of things; he has some of the rights and some of the liabilities of a trustee, but is not in the position of an ordinary trustee. Being an agent employed to do business for a remuneration, he is bound to bring reasonable skill to its performance....."

Thus as the immemorial appellation "receiver" suggests, the liquidator sets out to receive what belongs to the company by taking control of the company for the purpose of marshalling the company's assets and distributing them according to their priority-For some interesting insights into the question whether the duty owed by the receiver when exercising the power of sale or the power to carry on the business is one of good faith, due diligence, or reasonable care-see Len Sealy, "Mortgagees and Receivers-A Duty of Care Resurrected and Extended" (2000) Cambridge Law Journal 31; S. Frisby, "Making a Silk Purse Out of a Pig's Ear-*Medforth v. Blake*" (2000) 63 Modern Law Review 413.

The order made by the learned District Judge of Colombo and dated 10th July 1998 is also consistent with the provisions of Section 275 of the Companies Act No. 17 of 1982, which reads as follows:-

"Where a winding up order has been made or where a provisional liquidator has been appointed, the liquidator or the provisional liquidator, as the case may be, shall take into his custody or under his control all the property and things in action to which the company is or appears to be entitled."

The NDB made an ingress into the case by its petition made in August 1998 and as is plain the NDB did not give notice as required under the Winding Up Rules. Be that as it may, the NDB entered its appearance as an 'Intervenient-Petitioner' and pleaded, *inter alia*, that;

"The Intervenient Petitioner pleads that the Intervenient-Petitioner as entitled to it by Law is preferably taking steps under parate execution procedure to sell the Mortgaged Property dues."

Pursuant to NDB's Petition of August 1998 being supported on 14th August 1998, the learned District Judge of Colombo Mr. Ambepitiya made order staying all proceedings in the matter upon a deposit of Rs.38,000.00 by the NDB.

On 12th October 1998, the Hong Kong and Shanghai Banking Corporation Limited (HSBC) petitioned Court that it was also a creditor of DIMO and that it had sent a Statutory Demand under Section 256 of Act No. 17 of 1982, but before it could present an application to wind up the Company as a creditor, Lanka Polymer-the original Petitioner, had invoked the jurisdiction of the District Court-*vide* Vol.I page 102 of the Brief.

On 13th October 1998 Lanka Polymer petitioned the then learned District Judge of Colombo Mr. Salam (as His Lordship then was) seeking an order to stay the steps taken by the NDB to effect *parate* execution of the assets of the Company sought to be wound up-*vide* Vol.II pages 567, 568 of the Brief.

When the matter came up in the District Court on 16th October 1998, the learned Counsel for the NDB submitted that it was entitled to sell by public auction pursuant to the provisions of Act No. 2 of 1979 as amended by Act No. 10 of 1990 and Act No. 19 of 1992-It would appear that the aforesaid Acts that are reflected in the proceedings in Vol.II pages 569/572 of the Brief-more particularly at page 571 may not represent the Acts enabling *parate* execution.

Upon a perusal of the proceedings it is apparent that the Counsel for HSBC submitted that prejudice would be caused to the other Creditors if the proposed sale by NDB was permitted to proceed and that NDB had claimed as a secured Creditor in the winding up application-*vide* Vol.II pages 572-575 of the Brief.

On 29th October 1998 the learned District Judge Mr. Salam (as His Lordship then was) made order permitting NDB to file objections against Lanka Polymer's Petition of 12th October 1998-*vide* Vol.II pages 577 578 of the Brief.

On 29th October 1998 the learned President's Counsel appearing for the NDB also submitted to Court that the NDB would not seek a dismissal of the Petition to wind up the Company since other Claimant Creditors supported the application to wind up the Company and the Court made Order refunding the sum of Rs.38,000.00 deposited by NDB in seeking a dismissal of the application to wind up the Company-*vide* Vol.II pages 578 of the Brief.

The NDB by its Statement of Objections of 12th November 1998 to Lanka Polymer's Petition of 13th October 1998 pleaded that it was entitled in law to sell by *parate* execution the property mortgaged to it and moved that the Petition of 13th October 1998 be rejected and/or dismissed.

Thereafter when the matter was taken up before the learned District Judge on 19th March 1999, the Court observed that all parties before Court, save NDB, were in agreement to wind up the Company-*vide* Vol.III pages 581-583 of the Brief.

The learned District Judge on 24th March 1999 (*vide* Vol.II pages 585 587 of the Brief) made Order winding up the Company.

The order of the then learned District Judge of Colombo, vis-à-vis the NDB, goes as follows:-

"The only intervenient creditor who opposes this application for winding up the company is the National Development Bank. The National Development Bank quite apart from being a secured creditor on an indenture of mortgage is the only party to voice the opposition and in relation to the relief sought to wind up the company, as against the majority of the creditors who stand together to clamour for a winding up.

As far as the position taken up by the National Development Bank is concerned the court should observe that it is not only unreasonable but also impracticable, in that they have sought a dismissal of this action to enable them to proceed with parate execution which under way (sic).

...It is pertinent at this stage to note that, in the event of a dismissal of the Petition in this case the National Development Bank will gain access free of any obstacle to the roads to parate execution, to the exclusion of other creditors which will undoubtedly work serious injustice to the other creditors.

In these circumstances it is the considered view of this court that a winding-up order should take preference in this case to the claim made for dismissal made by the National Development Bank..."

It was in this tenor that the learned District Judge made his winding up order ordering the liquidation of the company.

The Liquidators thereafter discharged their duty of selling the assets of the Company (including the assets mortgaged to the NDB) on 27th January 2000. The Liquidators' Report of 20th November 2000 states as follows:-

"An amount of Rs. 39, 6 71, 000/= has been collected by the liquidator after the sale of assets of Dimo International Limited on 27th January 2000."

The report set out a breakdown of the proceeds of sale.

- Buildings..... Rs.35,000,000/-
- Machinery..... Rs.4,100,000/-
- Furniture & Fittings..... Rs.571,000/-

Item 2 of the report stated that the above amount less the liquidators fees and expenses is available for distribution among the creditors of Dimo International Limited.

Item 3 of the report was to this effect:-

"A list of creditors of Dimo International Limited as accepted by the liquidators is attached herewith setting out the general creditors, preferential creditors as laid down in Sections 345 & 346 of Companies Act No 17 of 1982 (list attached-Secured, Statutory and unsecured creditors."

If one peruses the list or schedule attached, one finds the NDB as the only secured creditor of the liquidated company.

Messrs Ford, Rhodes, Thornton & Co notified in item 4 of the Report that the liquidators had been informed by a secured creditor, M/s. National Development Bank, Navam Mawatha, Colombo 02 that preference should be given to them as secured creditors over the claims of all of the creditors.

In the circumstances, the Liquidators by their Report of 20th November 2000 (vide Vol.I pages 226 228 of the Brief) sought direction from Court on the following question(s):-

"We seek the court direction whether we as liquidators should give preference to National Development Bank as a secured creditor having mortgage rights over building and machinery sold by the liquidator over creditors as laid down in section 347 of Company Act No. 17 of 1982.

The liquidator seeks approval of the Honourable Court to distribute the funds of Dimo International Limited to the creditors of the said company as laid down above with specific court permission regarding secured creditors and preferential creditors as per section 346 of the Companies Act No. 17 of 1982 as enumerated by the liquidator above."

The learned District Judge Mr. Salam on 24th November 2000 (vide Journal Entry 50, Vol.I page 23 of the Brief) ordered that the Liquidator proceed in terms of Section 347 of the Companies Act No. 17 of 1982. Section 347 of the Companies Act No. 17 of 1982 only speaks of preferential payments that should be paid in priority to all other debts.

It was contended that the NDB did not challenge the Order dated 24th March 1999 to wind up the Company nor did it challenge the Order of 24th November 2000 directing the Liquidator to proceed in terms of Section 347 of the Companies Act No. 17 of 1982.

It would be observed that right along the consistent position of the NDB has been that it enjoys priority as a secured creditor over all else.

By way of this order dated 24th March 1999, the then District Judge permitted the winding up of the Company, whilst denying *parate* rights to the NDB. Undoubtedly the order dated 24th March 1999 denied access to the road to *parate* execution but it did not take away its

right to traverse the silky road in the winding up proceedings to be replenished as a secured creditor if sufficient funds become available.

A reference to Section 347 of the Companies Act, No.17 of 1982 alone in the District Judge's order dated 24th November 2000 cannot take away the statutory consequences flowing from Section 346 which in my view preserves the rights of secured creditors.

Section 346 of the Companies Act, No.17 of 1982 entails the following:-

"In the winding up of an insolvent company such rules as are in force for the time being in force under the law of insolvency or bankruptcy with respect to the estates of persons adjudged insolvent or bankrupt, shall be with regard to the respective rights of secured and unsecured creditors and to debts provable and to the valuation of annuities and future and contingent liabilities and all persons who in any such case would be entitled to prove for, and receive dividends out of, the assets of the company may take part by the winding up, and make such claims against the company as they respectively are entitled to by virtue of the provisions of this section."

Thus a secured creditor is statutorily empowered to take part in a winding up and would be entitled to stake its rights to priority as the rules of insolvency dictate. If at all, such priority could be taken away only by statute, contract or operation of law.

In this instance, the statute, rather than taking the right away confers the right to priority and before I come to contractual taking away, let me say that surrendering one's secured rights is a rule of insolvency and as Mr. Kanag-Isvaran, the learned President's Counsel pointed out, this rule of insolvency law is nowhere articulated more explicitly than in Section 358 (1)(c) of the Companies Act, No.7 of 2007, wherein the rule is set out thus:-

"A secured creditor may also surrender the charge to the general benefit of the creditors and may then claim the whole debt as an unsecured creditor in the liquidation."

Just after the then District Judge made his order directing the liquidator to act according to Section 347 (now Section 365 of the Companies Act No.07 of 2007), on 30th November 2000 (vide Journal Entry 51, at Volume 1 at page 23) on an *ex parte* motion the NDB sought an order restraining the liquidator from making payments in terms of Section 347.

On 13th December 2000, the NDB filed a petition, albeit without notice to any party, requesting Court to give priority to the NDB as a secured creditor in the distribution of assets. In fact the prayer in the petition says it all. It can hardly be classified as surrender. The prayer unequivocally and unambiguously invoked the following relief:-

- a) The Creditor-Petitioner's claim be first paid and settled from the sums realized from the sale of the assets mortgaged under Bond No.27 and 28 of the Company wound-up, prior to the liquidator's paying and setting any sums including EPF and/or ETF person to any institution; and/or
- b) That the Court be pleased to issue an interim order on the liquidators suspending and/or staying the liquidators from making any payment to any institution and/or person including EPF and ETF until final hearing and determination of this application.

This conduct does not display the hallmarks of surrendering the charge to the liquidator for the general benefit of creditors and in my view it does not betoken a claim in the liquidation as an unsecured creditor for the whole debt.

I thus take the view that relinquishment of priority rights did not take place and though it is undeniable that surrender is a rule of insolvency, the conduct of the NDB does not fall within the ambit of surrender as is recognized.

Reiterating the rule in section 358(1)(c), the current statutory regime speaks of surrendering the charge to the liquidator for the general benefit of creditors.

The words relinquish, surrender or waive, according to Garner's Dictionary of Legal Usage (Third Edition, 2011) share the sense "to give up something." Relinquish means precisely that, or sometimes more specifically "to let something out of one's control, possession, or ownership." To waive is to intentionally relinquish a known right, not by force or necessarily but by choice. The word implies a refusal to insist on the continuation of a right, claim, immunity or on the continued observance of a rule.

The Random House Dictionary of the English Language (the Unabridged Version) defines surrender to mean yielding something to the possession or power of another.

So I take the view that a surrender of secured rights did not take place either as enjoined by statute or by operation of law.

It is often said that a mortgage is a bundle of contractual rights that a lender and borrower write into their covenant and priority of claims is often justified by referring to the notion of freedom of contract. Every creditor dealing with a limited liability company has, in theory, the freedom to stipulate that the right to insist on repayment of his debt be supported by security over the company's assets. In fact it is argued that a creditor who failed to arrange security took the risk of being 'trumped' on corporate insolvency by a secured creditor-see David Milman, "Priority rights on corporate insolvency" in *Current Issues in Insolvency Law* (London: Stevens, 1991). Perhaps the best example of this theory at work comes from a case which is well known to company lawyers throughout the English-speaking world, namely the seminal case of *Salomon v. A. Salomon & Co Ltd* (1892) AC 22. The essence of the dispute in this case was whether the controller of a 'one-man company' could lend money to it and take security over its assets in return, thereby ensuring priority for himself over the unsecured creditors of the company. Both Vaughan Williams, J. (at first instance) and the Court of Appeal rejected such a possibility. A powerfully constituted House of Lords took the opposite view. Lord Macnaghten typified their attitude when he declared:-

"Any member of the company, acting in good faith, is as much entitled to take and hold the company's debentures as any outside creditor. Every creditor is entitled to get and to hold the best security the law allows him to take".

So a secured creditor obtains a proprietary right in the asset of the company in liquidation. This position cannot be gainsaid. If there is a rule permitting debtors to encumber their assets by private agreement, the same device can be utilised to surrender the proprietary right. There is no contractual surrender of this proprietary right in this case and I would turn to Fidelis Oditah's illuminating article "*Assets and the treatment of claims in winding up*" (1992) 108 Law Quarterly Review to quote him:-

“...To say that the creditor entitled to assert the proprietary right is entitled to priority is only another way of saying that, the extent of his claim, the property is not an asset available for distribution among unsecured creditors. An unsecured creditor is merely owed an obligation; at no point in time, both before and after winding-up, does he have a claim in any particular asset of the debtor. This distinction between proprietary and personal claims is at the heart of insolvency law.”

So it boils down to the nitty-gritty of insolvency law. What is due to the NDB has to stand outside the pool marshalled and collected and if the sum of Rs.39,671,000/- is the proceeds of sale of the property mortgaged to the NDB, it is not available for distribution under Section 347 or for unsecured creditors. In fact Section 365 (2) of the Companies Act, No.07 of 2007 alluding to preferential claims enacts the following:-

Without limiting paragraph 7(b) of the Ninth Schedule, the term “assets” in subsection (1) shall not include assets subject to a charge unless-

- a) the charge is surrendered or taken to be surrendered or redeemed under section 358; or
- b) the charge was, when created, a floating charge in respect of those assets.

So when another District Judge made order on 20th June 2002 that priority must be given to the NDB, it was indeed a correct order that rectified a *per incuriam* order made on 24th November 2000 inasmuch as it directed the liquidator to act under Section 347 of the Companies Act No.17 of 1982.

No doubt though this appeal, with leave having been granted by consent, is for the purpose of setting aside the order dated 16th January 2004 marked H dismissing the Petitioner's petition in the District Court, the Petition had indeed been filed to set aside the order dated 20th June 2002 which had accorded priority to NDB's claims.

In view of my holding that there was no surrender of the secured rights on the part of the NDB and its security, which was sold pursuant to the winding up and it is available to recoup its lending, I would proceed to dismiss the appeal. The related application CALA 265/2002 would accordingly stand dismissed.

I must place on record my appreciation of both Mr. Kanag-Isvaran, P.C. and Romesh de Silva, P.C. for the adroit and eloquent manner in which they presented their arguments in order to elucidate their respective cases.

JUDGE OF THE COURT OF APPEAL